# Prosecution of Fraud and Civil RICO Claims in the Involuntary Insurance Market

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## I. Introduction

As a result of the intense competition in the trucking industry and the difficulty of verifying the representations on all of the applications for insurance, the incidence of fraud in the involuntary insurance market (also known as the commercial automobile assigned risk market) has been a serious problem. Unlike the voluntary market, where commercial insurers can reject an applicant for insurance after reviewing financial and operating information, insurers in the assigned risk market are required to extend insurance coverage based on information provided in a standard-form application so long as the applicant meets eligibility requirements. This automatic coverage coupled with federal regulations mandating insurance coverage for all trucking vehicles, regardless of whether they are listed on an insurance policy, facilitates the ability of an applicant to misrepresent the scope and extent of coverage.

This article provides an overview of how to identify fraud and prosecute civil claims to recover the true earned premium under commercial motor carrier liability insurance policies. Although the focus is on assigned risk plans in Pennsylvania[1] and New Jersey,[2] most of the issues apply equally to other state plans and to the voluntary market as well.

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1. Pennsylvania Assigned Risk Plan (Pennsylvania Plan).
2. New Jersey Automobile Insurance Plan (New Jersey Plan).

After briefly describing the framework of the assigned risk plans and federal regulations applicable to commercial motor carriers (truckers), this article identifies the most frequent misrepresentations occurring in the market and provides specific discovery methods tailored to proving the misrepresentations. This article concludes with an analysis of how the Racketeer Influenced and Corrupt Organizations Act (ARICO) can be used to prosecute trucker fraud claims.[3]

## II. Federal Regulation of Insurance

All truckers must comply with federal financial responsibility requirements, which may be met through the purchase of liability insurance.[4] The federal government imposes three key requirements:

The truckers' insurance coverage must be the primary insurance applicable to the truckers' operations;

All vehicles in the fleet must be covered by the insurance policy whether or not they have been reported to the insurer and regardless of whether the vehicles are leased or owned; and

Notification to the regulatory agencies is required whenever insurance coverage is canceled or not renewed.[5]

The overriding purpose behind these requirements is to protect the innocent motoring public and all other parties affected by the truckers' operations.[6] Proof of the insurer's compliance with these requirements is made by filing a Certificate of Insurance, either Form B.M.C. 91 or B.M.C. 91X, with the federal government.[7] When an insurer issues a Certificate of Insurance to the government, Form MCS-90 must also be endorsed to the insurance policy.[8] Form MCS-90, the terms of which are dictated by the government, provides that the insurer agrees to pay, within the limits of liability described herein, any final judgment recovered against the insured for public liability resulting from negligence in the operation, maintenance or use of motor vehicles . . . *regardless of*

3. 18 U.S.C. § 1961-1968 (1994).

4. *See, e.g.*, 49 U.S.C. § 13906 (Supp. V 1999); 49 U.S.C. § 31139 (1994); 49 C.F.R. § 387.7 (2000) (Financial Responsibility Required); 49 C.F.R. § 387.9 (2000) (Financial Responsibility, Minimum Levels); 49 C.F.R. § 387.301 (2000) (Surety Bond, Certificate of Insurance, or Other Securities). In 1980 and 1982, the Federal government enacted the Motor Carrier Act and the Bus Regulatory Reform Act, respectively, which required that certain commercial insureds carry liability limits of up to $5,000,000. 49 U.S.C. § 31139(b) (1994); 49 C.F.R. § 387.9 (2000).

5. *See* 49 U.S.C. § 13906(e) (Supp. V 1999); 49 C.F.R. § 387.7(a), (b)(1) (2000); 49 C.F.R. § 387.15 (2000); 49 C.F.R. § 387.301(a) (2000); 49 C.F.R. § 313 (2000). *See also* 49 U.S.C. § 14102(a)(4) (Supp. V 1999) (Leased motor vehicles treated as if the motor vehicles were owned by the motor carrier.).

6. 49 U.S.C. § 13101(a)(1)(B) (Supp. V 1999); *id.* § 13906(a)(2) (Supp. V 1999).

7. 49 C.F.R. § 387.311(a) (2000); *id.* § 387.313(a)(3) (2000).

8. 49 C.F.R. § 387.15 (2000); *id.* § 387.7(d)(1) (2000).

*whether or not each vehicle is specifically described in the policy and whether or not such negligence occurs on any route or in any territory authorized to be served by the insured or elsewhere.*[9] As a result of those forms, all of the trucker's vehicles are insured regardless of whether they have been disclosed to the trucker's insurance carrier.

## III. Assigned Risk Plans

Commercial insurance policies generally are issued by insurers who voluntarily agree to provide insurance coverage, often in a highly competitive marketplace. For various reasons, some truckers are unable to obtain the requisite insurance from an insurer on a voluntary basis. To respond to this situation, "assigned risk" plans or similar mechanisms have been created in most states that distribute the risks associated with these applicants under a proportional scheme to all insurers doing business in the state.

The plans or other mechanisms establish their own set of rules known as Commercial Automobile Insurance Procedures (ACAIP) and assign trucker applicants in the assigned risk market to certain participating insurers known as "servicing carriers." The CAIP establish the rights and responsibilities of the insurer, insured and insurance broker (also known as a producer). The CAIP defines the eligibility of applicants and producers, plan administration and procedures, assignment of applicants to specific insurers, standards of insurance coverage, and the source of applicable rules and premium rates for insurance coverage. Before applying to either the Pennsylvania Plan or the New Jersey Plan, a trucker must have tried and failed to obtain insurance in the voluntary market in the sixty days prior to the date of the application.

Underwriting in the assigned risk plans differs in two significant respects from the voluntary market. The underwriter has neither the discretion to decline the coverage requested nor authority to modify the premiums beyond those specifically authorized for involuntary business applicants. As a result, the servicing carrier must accept risks it might decline in the voluntary market, and its ability to assure sufficient premium income to cover losses is more circumscribed.

## IV. The Insurance Application and Premium Rating

The CAIP rules are applied initially by insurance producers, who obtain information from the trucker necessary to complete the application and then calculate the estimated premium based on CAIP rules. The application seeks information to identify the risk and determine the pre-

9. 49 C.F.R. § 387.15 (2000).

mium, including the applicant's ownership of vehicles, garage location, cost of hiring leased vehicles, loss history, and radius of operation. The producer assists the prospective insuree in the completion of the application, the submission of it to the plan, and in the subsequent correspondence concerning the prospective insuree's operations. A properly completed application should provide the same information and result in the same premium regardless of the identity of the insurance producer who completes the application or the servicing carrier who issues the policy.

The servicing carrier specifically relies on the representations in the application when issuing a liability policy. As a result, the applications to the Pennsylvania and New Jersey Plans specifically require both the applicant and the producer to give certifications concerning the information in the application. Applicants to both Plans must certify that "all statements contained in this application are true." Applicants in the New Jersey Plan further certify that the statements [in the application] are offered as an inducement to the Servicing Carrier to issue the policy for which I am applying. Producers in both Plans must certify that they read the Plan manual, "explained the provisions (of the Plan) to the applicant, and have included in this application all required information given to me by the applicant." Producers in the New Jersey Plan also must certify that they understand that intentional misstatement of information may subject [the producers] to penalties as provided by law. Similarly, the Pennsylvania Plan has a general Anti-Fraud Statement on the application—applicable to both producer and trucker—stating that [a]ny person who knowingly and with intent to defraud any insurance company or other person files an application for insurance or statement of claim containing any materially false information or conceals for the purpose of misleading, information concerning any fact material thereto commits a fraudulent insurance act, which is a crime and subjects such person to criminal and civil penalties. In proving fraud claims based on misrepresentations in the insurance applications, counsel should rely on execution of those certifications as evidence of specific intent to defraud, materiality of the misrepresentations, and reasonable reliance by the servicing carrier on the misrepresentations.

Basically, there are three methods by which premium is calculated based on the information on an application: (1) gross receipts, (2) specified auto, and (3) cost of hire. Although gross receipts, if used, would be the sole method for calculating premium, truckers may be rated, and typically are rated, using a combination of specified autos and cost of hire. As its name implies, gross receipts rating calculates premium based on a formula using a trucker's gross receipts. A trucker generally must have

an established operating history for a period of years to qualify for rating under this method.

Specified auto rating is the most common method of insuring vehicles. The number of owned vehicles is used as the measure of the level of exposure to liability, and the insurer assigns a separate premium for each owned or long-term leased vehicle. As to long-term leased vehicles, each Plan specifies the length of time necessary for a vehicle to be considered long-term leased (*e.g.*, six months in the New Jersey Plan and one year under the Pennsylvania Plan), and long-term leased vehicles are viewed the same as owned vehicles for premium purposes because of the comparable amount of control the trucker has over the vehicles. After policy inception, vehicles are added to the policy as they enter a trucker's fleet and deleted from the policy when they leave the fleet.

Cost of hire rating is a rating method for developing premium for vehicles leased on a short-term basis (as defined by Plan rules). Like gross receipts rating, cost of hire does not use the number of vehicles as a measure of exposure. As a surrogate for the number of vehicles in operation, cost of hire rating uses the expense involved in leasing the hired autos as the measure of exposure. Unlike gross receipts rating, which is intended to develop premiums approximately equivalent to the specified car premiums, the cost of hire rating rules are intended to develop premiums higher than specified auto premiums. The higher premium is intended to reflect the additional exposure resulting from the insuree's lack of control over the maintenance of short-term hired vehicles and (if the vehicle is hired with a driver) the insuree's lack of control over the driver.

## V. Potential Misrepresentaions on an Application

There are five key questions on the application that are typically the subject of fraud claims: (1) the location of the trucker's headquarters; (2) the number of vehicles owned and long-term leased; (3) the cost of hiring vehicles on short-term leases; (4) the radius of trucking operations; and, (5) the trucker's loss history. Responses to these questions constitute material representations since each has a significant effect on the premium charged to a trucker.[10]

### A. Principal Garage

First, the trucker's headquarters (also known as the principal garage location) determines the assigned risk plan to which the trucker must apply. For example, if the trucker is headquartered in Pennsylvania, the

10. Included in the Addendum to this article is a non-exclusive list of indicators, both from the application as well as the trucker's conduct during the policy period that can be used to assist in identifying potentially fraudulent conduct.

trucker must apply to the Pennsylvania Plan. Similarly, if headquartered in New Jersey, the trucker must apply to the New Jersey Plan. For truckers with multi-state operations, they must apply to the state where its operating headquarters are located. "Operating headquarters" is defined as "the chief or usual place of business."

There are at least two reasons why a trucker may misrepresent its state of principal garaging. First, another state's assigned risk plan may be less expensive than that where the trucker is actually located. For example, all things being equal, rates under the New Jersey Plan are less expensive than the Pennsylvania Plan. Second, the assigned risk plan where a trucker is located may have canceled its insurance because of non-payment of the insurance premium or some other reason. Under CAIP rules, if a trucker fails to pay premiums, it is ineligible for insurance through the Plan until the trucker cures the non-payment. To avoid this bar, the trucker may, for example, obtain a post office box or establish a mail drop (*i.e.*, rent a small amount of space and a phone line) in another state and list that state as its principal garage or headquarters.

To verify the actual garaging location, counsel should check the applicant's articles of incorporation, tax returns, federal or state regulatory filings, vehicle registrations, equipment leases, bills of lading, and addresses on prior insurance policies. A representative of the insurance carrier or a private investigator also should physically visit the alleged headquarters to verify the trucker's actual garaging at the location on the application.

### B. Owned and Long-Term Leased Vehicles

A trucker may misrepresent the number of vehicles it owns and long-term leases it holds. A trucker has an incentive to underreport vehicles for two reasons. First, the premium increases with each vehicle added to the policy. Second, the insurance regulations provide that all vehicles operating under a trucker's motor carrier authority have insurance. Thus, vehicles are covered regardless of whether they are specifically identified on the application. If a vehicle is in an accident but was not listed on the application, it is therefore covered by insurance if operating under the insured's motor carrier number.[11]

This misrepresentation can occur by a trucker understating the num-

11. In that circumstance the insurer may have a claim back against the trucker for indemnification of any losses the insurer had to pay under the policy if information concerning that vehicle were fraudulently concealed. *See* 49 C.F.R. § 387.15 (2000) (MCS-90 endorsement specifically provides that the insured agrees to reimburse the company for any payment made by the company on account of any accident, claim, or suit involving a breach of the terms of the policy, and for any payment that the company would not have been obligated to make under the provisions of the policy except for the agreement contained in this endorsement.).

ber of vehicles or by establishing an affiliated, captive corporation whose sole purpose is to own the vehicles and then "lease" them to the insured under highly favorable terms. In the latter scenario, the captive corporation does not obtain separate insurance for the fleet, leases the vehicles only to the affiliated trucker, and gets the benefit of the affiliated trucker's liability insurance.[12] If the leases continuously rollover (either by their own terms or as a matter of course), they are effectively long-term leases, and the vehicles should be scheduled onto the policy. Because there normally is no interpretation or judgment in identifying owned or long-term leased vehicles, this is the easiest and perhaps, in terms of evidentiary value, the most persuasive source of fraud to identify.

Counsel can obtain a rough estimate of how many vehicles a trucker operates by using the rule of thumb in the industry that each tractor (power unit) in full-time use should generate approximately $100,000 in revenue.[13] Thus, transportation revenue divided by $100,000 should approximate the number of tractors in operation, which can be compared to the number specified on the application and endorsed during the policy period.

Documents relevant to identifying the true number of vehicles include: equipment lists; vehicle schedules attached to physical damage (PD) insurance applications and policies,[14] depreciation schedules, equipment leases, driver lists, audits by the insurer, applications to and policies issued by other liability carriers, and forms filed with federal and state governments for fuel and highway use taxes.

### C. Cost of Hire

Third, a trucker may misrepresent its cost of hire, which is defined as the total cost of hiring vehicles a trucker does not own. In the absence of specific language to the contrary in the rating rule, all costs of hiring a vehicle, including the driver's wages, must be used. The cost of hire premium is expressed as a dollar amount per $100 of revenue, which then is

12. 49 U.S.C. § 14102(a)(3) (Supp. V 1999) (leased vehicles operating under a trucker's motor carrier authority are covered by the trucker's insurance). 49 C.F.R. § 387.15 (2000) (the applications specifically ask for the applicants to identify all affiliated companies at least in part to identify any such arrangements).

13. To be conservative, counsel may want to use $125,000, which is the estimate used by some truckers.

14. A trucker needs both liability insurance, which covers personal injury claims, and property damage insurance, which covers damage to the vehicle itself. Vehicles normally are scheduled on property damage insurance policies, so these provide an excellent source of information on vehicles in operation. In a case involving affiliated companies engaging in sweetheart leasing, counsel may find that the named insured on the property damage policy is the insured on the liability policy and not the affiliated company that technically owns the vehicles.

multiplied by total revenue.[15]

An applicant can misrepresent cost of hire either by misrepresenting the total amount of hired car costs or by including only its out-of-pocket costs for the leased vehicle rather than all costs incurred in hiring the vehicle, including fuel and tolls. Counsel should closely examine the expenses in the trucker's financial statements to determine the true cost of hire. Those expenses may be included in accounts with names such as purchased transportation, owner-operators, vehicle expense, leasing costs, or general and administrative.

Cost of hire also may be misrepresented if the insured pays below market rents for the hire of vehicles, which may occur when the leasing company is an affiliate of the insured trucker. The below-market lease payments reduce the number used to calculate premium appropriate to the exposure under the policy. This utilization of less than fair market value leases is equivalent to hiding vehicles from the insurer.

Although cost of hire encompasses all costs associated with operating leased vehicles whether or not paid by the trucker (lessee), some truckers and producers may claim that they did not know what their cost of hire would be for the coming year and simply gave their best guess, or may dispute the expenses properly included in calculating cost of hire. Fraud claims involving understated cost of hire tend to be more difficult to prove unless there is evidence of sweetheart leasing or of a prior history of consistent costs for hiring leased vehicles over a multi-year period and then a dramatic departure in the insurance application.

Documents relevant to identifying the true cost of hire include: the hired vehicle expense that is included in tax returns and financial statements, general ledgers and check registers, Form 1099s, vehicle leases, driver lists, and any regulatory filings that set forth the trucker's expenses.

### D. Radius of Operations

Fourth, a trucker may misrepresent its radius of operations, which is where the vehicles regularly operate on a straight-line basis. There are three different radii: local radii (0 to 50 miles); intermediate radii (51 to 200 miles); and long or zone radii (more than 200 miles). Intermediate generally is the most expensive radius, followed by local and then long distance. When vehicles operate in long distance, the trucker must iden-

15. That dollar amount is the Average Specified Car Rate and is based on the premium associated with vehicles listed on the application (which are rated using the specified auto rate discussed above). The lower the Average Specified Car Rate, the lower the cost of hire premium will be. A trucker or producer may attempt to fraudulently manipulate the Average Specified Car Rate by listing on the application only vehicles with lower premium (e.g., light trucks rather than heavy trucks).

tify the zone (such as eastern or southeastern) in which its vehicles operate. Some zones, such as those in more heavily traveled areas like the Baltimore-Washington zone, are more expensive. False insurance applications typically list long distance as the only radius of operations for all vehicles.

For truckers whose vehicles do not always follow regular routes, there may be some judgment involved in what constitutes "regular operation" in a particular radius or zone, and this may be a more difficult basis for a fraud claim. Consequently, counsel needs to gather as much evidence as possible concerning each vehicle's operations. Vehicle logs and bills of lading, although voluminous, will identify exactly where each vehicle traveled. There is nothing in the CAIP rules that precludes the use of an audit of the bills of lading to determine radius, but any audit should evaluate every bill of lading for each vehicle for a sufficient period of time so that all trips on each day are captured. This should avoid defense arguments that additional trips were made that were not considered or that each vehicle was not separately evaluated. Deposition testimony by principals of the trucker, the dispatcher and the drivers concerning where the vehicles regularly operate is also an effective way to prove the radius of operations.

Other documents also assist in identifying the radius. Some physical damage applications require the trucker to identify each vehicle's radius of operations. In addition, regulatory filings may describe where the insured intends to operate. The trucker may need to file a fuel tax report in states where it operates, and those reports identify the total miles traveled in that state, which provides some insight into operations. Another method is to analyze accidents to determine where they occurred in relation to the principal garage location. Counsel further can obtain through interrogatories a list of the trucker's largest clients (in terms of revenue) and addresses and use a software program (such as Automap) or website (such as Mapquest.Com) to determine with reasonable accuracy the distance between the insured's garage and the client's location.

### E. Loss History

Finally, a trucker may misrepresent its loss history because an insurer can surcharge the policy for accidents when the trucker was at fault. Depending on the dollar value of the claim paid, each accident is assigned a certain number of points. The points are added, and there are a maximum number of points assessed against each vehicle. A trucker with a significant loss history will be subject to huge surcharges that may make the cost of insurance prohibitive.

Other than failing to report or understating loss history, a trucker

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may incorporate under a new name or transfer the business to a family member to mask the loss history. The insurer should run motor vehicle reports on each of the scheduled drivers and vehicles and identify the officers of the corporation to see if they were associated with a previous insurer.

Loss information is relatively easy to locate. Insurance companies maintain loss runs showing claims paid under the policy, and loss runs should be obtained from any previous insurer within the preceding three-year period. (The insurance application requests the identity of the previous insurer.) In addition, once the insured provides a list of its drivers, an insurer can obtain a motor vehicle report ("MVR") for each of the drivers from the relevant state's Department of Motor Vehicles that will identify each accident reported to the police in which the insuree was involved. Although the MVR does not identify whether the driver was at fault, the insuree has the burden of proving that its driver was not at fault. Finally, an insuree may have a safety department that keeps track of the accidents in which its vehicles and drivers are involved, and interrogatories should be able to obtain the information.

## VI. Discovery and Investigation

As with every fraud claim, a plaintiff proves the fraud with both direct and circumstantial evidence. There are a number of sources the insurer can use to determine the true scope and extent of a trucker's operations.

### A. Document Request to Trucker

Depending on the issues in the case, the insurer should serve a document request on the trucker seeking the following categories of documents, as appropriate, covering a time period from the present to five years before the inception of the insurance policy:

—Operating information: equipment lists (tractors, trucks, trailers, etc.); vehicle leases, lease-purchase agreements, the bills of lading for shipments under a trucker's motor carrier authority, dispatch records, trip reports, mileage reports and driver daily logs for all shipments under the trucker's motor carrier authority or another carrier's authority for owned and leased vehicles;

—Financial information: financial statements, balance sheets, income statements, general ledgers, sales journals, disbursement journals (both cash and check), and check registers, financing agreements for purchased vehicles, depreciation schedules, Forms W-2 and 1099 showing wages of all operators of owned and leased vehicles, invoices for all shipments under the trucker's motor carrier authority reflecting gross amount of

billings by month, federal and state income tax returns with supporting schedules, fuel tax filings, vehicle use tax filings;

—Loss information: accident reports and related documents for vehicles operating under the trucker's motor carrier authority, motor vehicle reports (MVRs) on all drivers who have hauled freight under the trucker's motor carrier authority, loss runs prepared by the trucker's insurer or safety department;

—Insurance information: the trucker's insurance file, including correspondence with its insurance producer, prior insurance applications and policies for both liability and physical damage insurance, certificates of insurance issued to agents, shippers or any other entity or person;

—Regulatory filings by the trucker at the federal and state levels, including articles of incorporation.

### B. Interrogatories

Because of their tendency to draw objections and evasive answers, interrogatories should be fairly specific and focus mostly on identification of witnesses and documents. Counsel should serve interrogatories asking the defendants to identify:

—The trucker's officers, stockholders, dispatchers, safety manager, drivers, insurance producer, bookkeeper, and accountant;

—The liability insurance carriers and physical damage carriers for the five years preceding the application;

—The vehicles operated during the policy period and in the year preceding the application, including whether the vehicle was owned or leased (and if leased, from whom);

—All documents showing leased vehicles and the expenses associated with operating those vehicles;

—The number of accidents in the three-year period preceding the policy and the driver involved in each accident;

—The routes where the trucker's vehicles regularly operated;

—The terminals operated by the trucker;

—The trucker's twenty largest clients, including the revenue associated with each.

### C. Subpoenas

The insurer should subpoena documents from the following:

—The trucker's insurance producer. Truckers generally communicate with their insurers through a producer, and the producer is responsible for requesting information from the trucker and submitting that information to the insurer. The producer thus will have documentation

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concerning the trucker's operations, including vehicle lists, equipment leases, certificates of insurance issued to equipment lessors, and file memoranda concerning conversations with the trucker. If the producer has worked for the trucker over a period of time, the producer will have historical information about prior insurance policies, such as applications, endorsements showing scheduled vehicles or hired vehicle costs, loss runs, and audit reports. This information is especially useful when a trucker previously sought insurance in the voluntary market, where the insurer seeks and receives substantial operating information before agreeing to issue a policy. This historical insurance information may disclose such things as significant loss history or increased premium costs, which explain why a trucker may have submitted a false application to the involuntary market.

If the producer is not a party, subpoenaing the producer's files also may demonstrate that the producer is at fault and provide another potential source of recovery, especially if the producer carries errors and omissions ("E&O") insurance that can satisfy a judgment or settlement. The producer may have failed to request appropriate information from the trucker or may have failed to submit information the producer in fact received. Another possibility is that the trucker and producer conspired together to understate the true exposure on the policy, with the producer receiving, for example, a percentage of the insurance savings. Because E&O policies normally exclude coverage for fraudulent conduct, counsel should include a negligence theory against the producer or encourage the trucker to assert a third-party claim on that basis.

—The trucker's accountant. The accountant likely has a number of documents that assist in determining whether the trucker misrepresented the information on the application. For example, the accountant may have, among other things: (1) equipment lists identifying tractors and trailers that he or she used to calculate depreciation; (2) specific and general ledgers identifying revenue and expenses relevant to calculating cost of hire and estimating the number of vehicles used by the trucker; (3) tax returns signed by the trucker's principals verifying the amount of revenue and expenses; (4) Form 1099s that identify the compensation paid to independent contractors, which is relevant to cost of hire; (5) articles of incorporation, by-laws and correspondence relevant to the trucker's principal garage; (6) state fuel tax reports, heavy vehicle use tax and other state tax reports, which are relevant to number of vehicles and radius of operation; (7) equipment agreements relating to vehicles purchased and leased; and, (8) information relating to loss history.

—Governmental entities regulating truckers, such as a department of transportation or a public utility commission. The insurer should ask an interrogatory requesting identification of all filings made by the trucker

with governmental entities from the present time to five years preceding the inception of the insurance policy.

### D. Depositions

Depending on the litigation budget, there are many deposition targets available. Before deposing the principals of the trucker, counsel should consider deposing lower-level individuals involved in the day-to-day operations of the trucker. Truckers use dispatchers to schedule and monitor the trucks on the road, and the dispatchers typically know the number of trucks in operation, the number of owned and leased vehicles, routes traveled, number of accidents, significant customers, and the names of drivers. Truckers also frequently have safety managers who are involved with loss control for the truckers by training drivers and maintaining information on drivers, vehicles and accidents. Many large truckers have in-house financial personnel who can testify concerning revenues and expenses, number of vehicles, and vehicle leasing costs. If the trucker has entered a large number of leases, counsel should depose the individual who signed the leases on behalf of the trucker.

An excellent source of information, which frequently is overlooked in litigation, are the drivers. A trucker must identify drivers on the insurance application, and those drivers can provide extremely useful information concerning the trucker's overall scope of operations, including garage location, radius of operation (*i.e.*, regularly traveled routes), and number of vehicles. For a trucker with multiple terminals, a driver can identify where the terminals are located and the approximate number of vehicles at each terminal. If the driver is an owner-operator, he can provide the lease rates and a copy of the lease, as well information on radius of operations. In cases where affiliated corporations or mail drops are used, the driver typically knows the name of the true beneficiary of the insurance and the principal garage and thus provides compelling testimony in support of the fraudulent scheme. For example, we have had cases where the drivers listed on the application were unfamiliar with the trucking company named as the insured on the application; did not drive the vehicle assigned to them on the application; and had never been to (or heard of) the address shown as the principal garage location. The drivers in fact drove for the co-defendant affiliated trucking company and always believed their services were provided for that company, which was named on the bills of lading as the company providing the trucking service.

For the reasons set forth above, counsel also should consider deposing the trucker's accountant and insurance producer.

### E. Experts

Like any complex case, counsel likely will need expert witnesses to explain and prove the fraudulent scheme. Counsel should consider three types of witnesses. First, counsel should consider retaining an insurance expert, such as a producer experienced in submitting applications to assigned risk plans, to testify concerning the information sought by the application, the materiality of that information to the premium, and whether the trucker misrepresented material information on the application. Although an in-house underwriter can provide the first two categories concerning the underwriting of the file, it is the expert's ability to testify regarding misrepresentations on the application that gives his or her testimony the most significance. The expert also can confirm that the insurer properly underwrote the file and assessed premium.

Second, counsel should consider retaining an accountant who can express an opinion concerning the trucker's true scope and extent of operations after evaluating all the information counsel has generated in discovery about the trucker's operations. Although an in-house underwriter will have gathered some information during the course of underwriting the file and investigating the suspicion of fraud, the underwriter will not have first-hand knowledge of much of the material discovered in litigation. The accountant, however, can analyze and present a coherent picture of the trucker's operations which will be used both for liability purposes in proving that the information on the application did not reflect the true operations and for damages in showing what the premium should be based on the true operations.

Third, if the case involves significant leasing activity, and it is believed that the leases do not reflect market terms and provisions, counsel should consider retaining a trucking expert, such as a manager from Penske Truck Leasing or Rollins Leasing Corporation, to review the leases and compare them to market leases to show that the trucker did not follow market leasing practices and that the lease rates were below market rates. The trucking expert can explain how the leases, although perhaps containing some of the basic terms used in market leases, ultimately structure the leasing costs in a way to significantly reduce the lease rates that the trucker should pay, causing the rates to be significantly below market rates.

## VII. Fraud Claims versus RICO Claims

Depending on the number of truckers and insurance policies and the amount of damages involved, counsel should consider whether to include

RICO claims in addition to fraud.[16] While providing significant benefits such as treble damages and attorneys' fees, RICO claims also tend to increase both the cost and complexity of litigation and thus should be carefully considered before they are asserted.

If there is only one trucker and a single insurance policy, counsel likely should pursue only fraud and breach of contract claims to keep the case as simple as possible, with a request for punitive damages as well. Counsel then needs only to match up the representations in the insurance application with the trucker's true operations, allowing for a more streamlined presentation and reducing the likelihood of extensive briefing of RICO issues and confusion of the jury at trial with RICO concepts.

Conversely, if there are multiple truckers (or one trucker using affiliated companies to execute a scheme to misrepresent operations) and multiple insurance policies, RICO claims are an attractive means to combine all parties and policies in one litigation, particularly if the potential defendants have the means to satisfy a judgment that would include treble damages and attorneys' fees.

Of the claims available under RICO, Section 1962(c) is the one most suitable for redressing trucking fraud because it addresses the operation of an existing business—trucking—through criminal activity, which here is fraud.[17] Section 1962(c) makes it unlawful for any person employed by or associated with an enterprise to conduct or participate, directly or indirectly, in the conduct of the enterprise's affairs through a pattern of racketeering activity. 18 U.S.C. §1962(c). Set forth below are considerations in alleging a RICO enterprise and a pattern of racketeering activity based on fraudulent representations in insurance applications.

### A. The Enterprise

There are various alternatives in selecting the RICO enterprise, which may be any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity.[18] Counsel may plead an association-in-fact enterprise consisting of the affiliated trucking companies involved in each scheme and/or their principals. In addition, the trucking company applying for insurance may itself be the enterprise, although counsel must be-

16. Counsel also would assert breach of contract claims against the insured-truckers for failing to pay the true earned premium under their respective insurance policies, as well as unjust enrichment claims against the individual defendants and affiliated truckers who were not named insureds under the policies.

17. In contrast, Section 1962(a) pertains to the acquisition of legitimate businesses through criminally obtained money, while Section 1962(b) focuses on maintaining or acquiring businesses through criminal acts.

18. 18 U.S.C. § 1961(4) (1994).

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ware of the enterprise-person rule, which requires that the enterprise be distinct from the defendant-person.[19] Alternatively, if the producer is involved in the fraudulent scheme, the producer's company can be the enterprise either by itself or in an association-in-fact enterprise with the trucker. Finally, the insurance carrier may be the enterprise, although this enterprise may be more suitable for claims in the voluntary market where the insurer is known at the time the application for insurance is submitted.[20] In identifying the enterprise, counsel should keep in mind that the enterprise can be lawful or unlawful, culpable or non-culpable.[21]

In identifying the defendant persons who are employed by or associated with the enterprise, counsel must identify individuals who participated in the operation or management of the enterprise.[22] Although ARICO liability is not limited to those with primary responsibility for the enterprise's affairs, . . . some part in directing the enterprise's affairs is required.[23] Where a defendant merely conducts its own affairs, there can be no liability.[24] Counsel thus should consider naming the principals of the insured trucker, the principals of any affiliates involved in the scheme,[25] the parties involved in any fraudulent leasing activities,[26] and the individuals involved with obtaining insurance, including the individual who signed the insurance application.[27] Establishing RICO liability will

19. *See Jaguar Cars, Inc. v. Royal Oaks Motor Car Co.*, 46 F.3d 258, 262-63 (3d Cir. 1995); *Glessner v. Kenney*, 952 F.2d 702, 710 (3d Cir. 1991); *Brittingham v. Mobil Corp.*, 943 F.2d 297, 300 (3d Cir. 1991); *Hirsch v. Enright Refining Co.*, 751 F.2d 628, 633 (3d Cir. 1984).

20. *See Aetna Casualty Surety Co. v. P&B Autobody*, 43 F.3d 1546, 1559 (1st Cir. 1994) (plaintiff insurer was enterprise: [b]y acting with purpose to cause Aetna to make payments on false claims[,] . . . [the defendants'] activities caused Aetna employees having authority to do so to direct that other employees make payments Aetna otherwise would not have made).

21. *Rose v. Bartle*, 871 F.2d 331 (3d Cir. 1989).

22. *Reves v. Ernst & Young*, 507 U.S. 170, 183 (1993); *Jaguar Cars, Inc. v. Royal Oaks Motor Car Co.*, 46 F.3d 258, 265-66 (3d Cir. 1995).

23. *Reves*, 507 U.S. at 179.

24. *Id.* at 185 (aliability depends on showing that the defendants conducted or participated in the conduct of the *enterprise's* affairs, not just their *own* affairs).

25. *See 131 Main Street Assoc. v. Mango*, 897 F. Supp. 1507, 1526-27 (S.D.N.Y. 1995) (individual participated in RICO enterprise by permitting his corporation to be used to conduct the racketeering activity); *American Arbitration Ass'n, Inc. v. DeFonseca*, No. 93 CIV.2424 (CSH), 1996 WL 363128, at *5 (S.D.N.Y. June 28, 1996) (individual faced RICO liability for his role in form[ing] corporations to accept fraudulent checks and corporate accounts in which to deposit them; that he and [another defendant] exerted joint control over these accounts; and that together they distributed a percentage of the proceeds to [another defendant]).

26. *See Town of Kearny v. Hudson Meadows Urban Renewal*, 829 F.2d 1263, 1269 (3d Cir. 1987) (execution of lease had racketeering consequences: A factfinder could find [racketeering] injury to [plaintiff's] business or property from the execution of the . . . lease alone).

27. *Cf. MCM Partners v. Andrews Bartlett & Assoc.*, 62 F.3d 967, 979 (7th Cir. 1995) (Even if [defendants] may have been reluctant participants in a scheme devised by upper management, they still knowingly implemented management's decisions, thereby enabling the enterprise to adhere to its goal.); *United States v. Gabrielle*, 63 F.3d 61, 68 (1st Cir. 1995) (even employees not

be very fact-intensive, and counsel must consistently seek facts demonstrating a defendant-person's operation or management of the enterprise, which is more difficult than simply showing participation in the scheme to defraud.

### B. Pattern of Racketeering Activity

In order to establish a pattern of racketeering activity, counsel must establish a relationship among the predicate acts, which most likely will involve mail or wire fraud, and a threat that they will continue.[28] Predicate acts are related, and thus part of a pattern, if they have the same or similar purposes, results, participants, victims, or methods of commission, or otherwise are interrelated by distinguishing characteristics and are not isolated events.[29] As to the threat of the predicate acts continuing, counsel may allege a closed period of repeated conduct, or past conduct that by its nature projects into the future with a threat of repetition.[30] The pattern of racketeering activity revolves around the submission of fraudulent insurance applications and the issuance of insurance policies so that a trucking company can obtain liability insurance at a fraction of its true cost. It is an open-ended scheme because the defendants submitted the fraudulent application in the regular course of the trucker's business, and the insurance will remain in place at reduced cost unless the insurer discovers the misrepresentations.[31] Conduct occurring during the policy to conceal the trucker's true operations, such as delaying or obstructing attempts by the insurer to audit the trucker or otherwise gain information about the trucker's operations, provide further predicate acts and proof of pattern, including the threat that fraudulent conduct will continue. Although each application and policy period may constitute a distinct scheme, all applications by a trucker ultimately are part of the same pattern because of the common purpose, results, participants, and method of commission. Counsel should look for the same types of misrepresentations appearing on each fraudulent application or for substantially similar leasing schemes among affiliated entities.

To establish a basis for the predicate acts of wire or mail fraud, counsel must allege that the defendants acted either pursuant to a scheme or artifice to defraud or acted by means of false or fraudulent pretenses,

engaged in directing the operations of the RICO enterprise are criminally liable if they are plainly integral to carrying it out).

28. *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 239 (1989).

29. *Id.* at 240.

30. *Id.* at 242.

31. Open-ended continuity is established by demonstrating that the commission of the predicate acts is a regular way of conducting defendant's ongoing legitimate business. *H.J., Inc.*, 492 U.S. at 243.

representations or promises and that the United States mail or interstate wire communications were utilized to transmit matter integral to the scheme.[32] The predicate acts primarily will involve mail fraud, such as the trucker's sending the fraudulent application, premium checks, or loss claims through the United States mail.[33] Each mailing from a trucker to an insurer will be a predicate act, as would those documents sent by an insurer to a trucker, such as the policy or requests for information. There also may be a basis for asserting wire fraud based on telephone conversations or facsimiles between a trucker and an insurer, which could involve attempts by a trucker to mislead an insurer about the true scope and extent of operations or to obstruct an audit attempt.[34] Counsel should analyze all communications between trucker, producer and insurer to ensure that there are at least two (and preferably numerous) predicate acts in a ten-year period.[35]

### C. Hypothetical Scheme To Defraud

Assume that Penn Trucking has a principal garage location in Pennsylvania, operates 100 tractors, regularly incurs annual costs of $1 million for short-term leasing of additional tractors, operates primarily in the intermediate radius of operations, and had 20 surchargeable accidents in the three years preceding the application. Owen Owner is the owner of Penn Trucking and is actively involved in the day-to-day trucking operations. Paul President is the president of Penn Trucking, and along with Owner participates both in running the company and in obtaining liability insurance. Penn Trucking uses an insurance producer named Peter Producer of ABC Insurance Agency (ABC), which has represented Penn Trucking for years and has intimate knowledge of Penn Trucking's operations from first-hand inspection of the operations, conversations with

32. *United States v. Frankel*, 721 F.2d 917, 921 (3d Cir. 1983). *See also Schmuck v. United States*, 489 U.S. 705, 715 (1989).

33. 18 U.S.C. § 1341 (1994). To establish mail fraud, counsel must prove the following elements: (1) the defendants engaged in a scheme to defraud; (2) the defendants or someone associated with the scheme used the mails for the scheme; and (3) the use of the mails was for the purpose of effectuating the scheme. *See, e.g., Prudential Ins. Co. Of America v. U.S. Gypsum Co.*, 828 F. Supp. 287, 295 (D.N.J. 1993) (citing *Armco Indust. Credit Corp. v. SLT Warehouse Co.*, 782 F.2d 475, 481-82 (5th Cir. 1986)). The use of the mails need not be an essential element of the fraudulent scheme. *Tabas v. Tabas*, 47 F.3d 1280, 1295 (3d Cir. 1995).

34. 18 U.S.C. § 1343 (1994). The elements of the wire fraud statute are identical to the mail fraud statute except that the defendant must cause the use of interstate wire communications rather than the mails. *United States v. Lemire*, 720 F.2d 1327, 1334 n.6 (D.C. Cir. 1984), *cert. denied*, 467 U.S. 1226 (1984); *United States v. Perlstein*, 576 F.2d 531, 534 (3d Cir. 1978) (culpable participation by the defendant is required) *United States v. Klein*, 515 F.2d 751, 754 (3d Cir. 1975) (the requisite *mens rea* of the defendant is specific intent to defraud).

35. 18 U.S.C. § 1961(5) (1994).

Owner and President, and vehicle lists and other documents Producer received.

In anticipation of applying for insurance to the Pennsylvania Plan, Producer recommends that Penn Trucking establish Affiliated Trucking to own the trucks and then lease them back to Penn Trucking using below-market leases. Owner and President would have the same roles with Affiliated Trucking as they have with Penn Trucking, and Affiliated Trucking would be captive to Penn Trucking. All of Affiliated Trucking's vehicles would be leased to Penn Trucking; Affiliated Trucking would not lease vehicles to third parties. The leases would purport to be short-term (*e.g.*, monthly) and would automatically renew. The lease costs are intentionally structured in such a way that the leasing costs are minimized. The intent behind the leases is to avoid disclosing vehicles on the insurance application and to minimize cost of hire in the event there is an audit. ABC would receive a percentage of the savings in the cost of insurance through the Pennsylvania Plan rather than through the voluntary market.

Although Penn Trucking was able to obtain insurance in the voluntary market, Producer, Owner and President decide to apply to the Pennsylvania Plan based on the increasingly expensive cost of the insurance premiums, which were elevated due to accidents involving Penn Trucking's vehicles. Producer completes the application for Penn Trucking after discussions with Owner and President, and President signs the application, which Producer mails to the Pennsylvania Plan. According to the application, Penn Trucking owns and/or long-term leases 15 tractors, has cost of hire of $100,000, no loss history, and a long-distance radius of operations. The Plan assigns the application to a servicing carrier, which issues a policy as a result of the completed application by a Pennsylvania trucker and the inclusion of a deposit check in the appropriate amount. During the time the policy is in effect, Penn Trucking mailed checks for premium (calculated based on the representations in the application) to the insurer, which resulted in significant savings compared to the premium in the voluntary market that was based on the trucker's true operations.

Within the first two months of the policy, ABC mails the insurer loss notices for fifteen (15) separate accidents, five of which involved leased vehicles that did not appear on the application. The underwriter responsible for the file learns from publicly available information that the trucker has gross revenues in excess of $10 million. The underwriter schedules an audit to determine the true exposure, and contacts President and Producer, each of whom has telephone calls with, and send faxes to, the underwriter, including a copy of the below-market lease to prove that the vehicles are short-term leased from a third-party. President and Pro-

ducer seek to mislead the underwriter about the trucker's operations and to postpone the audit. The audit eventually occurs due to the insurer's persistence, and the true scope of operations is discovered. The insurer issues endorsements for the exposure and an invoice with a significantly increased premium. Penn Trucking fails to pay the premium when due, and the policy is canceled by the insurer.

After receiving the notice of cancellation from the insurer, Owner and President (in consultation with Producer) form NJ Trucking, which is a Pennsylvania company that claims to be located at a truck stop in New Jersey, where NJ Trucking has a post office box and a telephone. NJ Trucking, though, is run by the same individuals as Penn Trucking and uses the same vehicles and drivers, who operate from Penn Trucking's principal garage in Pennsylvania. NJ Trucking mails an application to the New Jersey Plan, showing ten tractors, cost of hire of $50,000, no accidents, and a long-distance radius of operations. NJ Trucking claims to be a new company with no prior history. President signed the application, which was completed and mailed by Producer. The application seeks insurance coverage beginning the day after the Penn Trucking policy canceled (although there is no reference to Penn Trucking). NJ Trucking leased vehicles from Affiliated Trucking under the same form lease that Penn Trucking used, and NJ Trucking's bills of lading include Penn Trucking's name, which had an established reputation in the industry. Penn Trucking thus continued its operations under NJ Trucking's insurance. After the New Jersey Plan assigned the application to a servicing carrier, the servicing carrier schedules an audit, which uncovers the relationship between Penn Trucking and NJ Trucking and the true scope of trucking operations.

Under those facts, counsel can assert RICO claims in addition to fraud claims, even if a different insurer was assigned the application to the New Jersey Plan. Penn Trucking and NJ Trucking each could be the enterprise, or together they could constitute an association-in-fact enterprise. Another alternative is to have ABC as the enterprise or part of an association-in-fact enterprise with the two trucking companies. Regardless of which of these enterprises is selected, Al Owner, Paul President, and Peter Producer are defendant persons employed by or associated with that enterprise. Because of the enterprise-person rule, the trucking companies would not be defendants under a RICO claim to the extent each alone was the enterprise. However, to the extent each is part of an association-in-fact enterprise, they could be defendant persons.[36]

36. *See, e.g., Perlberger v. Perlberger*, No. CIV.A. 97-4105, 1999 WL 79303 at *1 (E.D. Pa. Feb. 12, 1999) (A complete overlap between the defendant persons and the members of an association-in-fact enterprise does not defeat the distinctiveness requirement.), citing *Shearin v.*

The pattern of racketeering activity involves the fraudulent insurance applications to the Pennsylvania and New Jersey Plans, which were designed to obtain reduced insurance premiums using misrepresented operating information (*e.g.*, owned vehicles, cost of hire, radius of operations, and loss history) and the leasing scheme. The predicate acts are mail fraud based on the fraudulent insurance applications, premium checks, and loss notices being mailed as part of obtaining and maintaining the insurance, and wire fraud based on the telephone calls and facsimiles. The pattern is open-ended, as evidenced by the fact that the applications were submitted in the regular course of business, there was no disclosure of true operations and in fact were attempts to deceive the insurer, and the defendants submitted another application to a different plan after their misrepresentations to the Pennsylvania Plan were discovered.

## VIII. Conclusion

Trucking fraud is a serious problem in the insurance industry. The potential schemes to defraud are virtually limitless, and counsel should scrutinize the applications and the trucker's conduct to identify similarities among insurance applications to determine whether there is a basis for asserting racketeering claims. With a focused approach to pleading claims and conducting discovery, counsel will successfully prosecute both fraud and RICO claims.

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*E.F. Hutton Group, Inc.*, 885 F.2d 1162, 1165-66 (3d Cir. 1989) (three corporate defendants, alleged to be persons under RICO, also together form an association-in-fact).

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## ADDENDUM

## *POTENTIAL FRAUD INDICATORS FOR COMMERCIAL TRUCKING APPLICATIONS AND POLICIES*

### Policy Application Factors

* Use of a trade name, doing business as or name of the subsidiaries, which may obscure the identity of the true named insured.

* A trucker whose primary address is a post office box, suite number, room number or whose address differs from state incorporation records.

* Many truckers with the same address, especially if a post office box only.

* Trucker has moved or changed address since policy inception.

* Trucker adds a large number of vehicles after policy inception.

* Indications that the trucker has changed address frequently.

* Applicant address is same as producer or does not match address listed on the deposit check.

* Listing less than five vehicles and requesting state operating rights for all states.

* Indications that trucker is a new venture or has no previous insurance history yet has an older ICC number. ICC numbers issued beginning in 1992 are about 240000.

* Establishing a storefront location in a state with low rates while physical plants and/or operations actually take place in other states with higher rates.

### Ownership Information Factors

* A change in ownership which diverts the ownership of a company to other family members without effectively changing the control of the company.

* Several changes in name or ownership within the last three to five years.

* A leasing company with its true parent as the only client.

### Claim Information Factors

* A minimum or low premium policy which early in policy period begins to generate many claims.

* A pattern where losses have considerably exceeded the premium, especially if the number of claims is greater than the number of vehicles would allow.

* Claim experience from a wider geographic area than one would expect from a few vehicles.

* A policy which remains "loss free" for a time and then suddenly begins to generate a large number of losses. This could occur when closely affiliated corporations with substantially the same ownership have two or more concurrent automobile policies.

* Claims for non-owned vehicles when the application or policy did not request or identify non-owned vehicles and/or non-owned vehicle coverage.

* Insured driver states his/her employer is other than that listed on claim form.

* Insured driver disputes information supplied by employer/named insured on first report of loss.

* Trucker refuses to cooperate during claim investigation.

* Inability to contact either the trucker or driver at principal location.

**Premium Audit Factors**

* An insistence by the agent or insured that the audit be conducted off-site.

* Refusal to allow audits or attempts to delay the audit procedures.

* Audit records provided are altered, incomplete, or incorrect.

* Business name and/or logo are not present at location.

* Location visited is the same address previously visited for a different risk.

**NOTE: The existence of a single indicator or a combination of indicators is not conclusive proof that a fraud has been committed. However, the presence of indicators may suggest that the representations on the application warrant further investigation.**