

Financial

AIG's Other Reputation; Some Customers Say the Insurance Giant Is Too Reluctant to Pay Up

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When his pickup truck developed engine trouble a few years ago, Anthony A. **Stankus** filed a claim under an auto warranty he had bought from a unit of insurance giant American International Group Inc.

Soon the Phoenix consultant got his answer: Claim denied.

Most policyholders would have left it at that. But **Stankus** sued -- and won a rare look at the internal claims-handling practices at the world's largest insurance company.

As it turns out, **AIG** was losing more than \$210 million on auto-warranty claims, provoking the ire of the company's longtime chairman and chief executive, Maurice R. "Hank" Greenberg, according to court documents. As a result, in mid-1999, a newly installed team at **AIG's** auto-warranty division began to reject thousands of claims -- including half of the claims that its own contractor, a claims-handling company, recommended be paid, according to court papers. **Stankus's** claim was among them.

Any modification to a car could be used as a reason to reject, Richard John Jr., a former senior vice president of the claims-handling company, Mechanical Breakdown Administrators Inc. of Scottsdale, Ariz., testified -- even installing manufacturer-approved new tires or, in **Stankus's** case, a trailer hitch. When John protested, he said an **AIG** official told him, " 'We are losing X number of million dollars a year on these programs, and we've got to do something.' "

AIG has declined to discuss individual lawsuits. But Charles R. Schader, **AIG's** senior vice president for claims, said the company never denies claims to boost profitability. He said that -- allowing for an occasional mistake -- **AIG** pays legitimate claims promptly and gets few complaints.

"If we didn't pay claims, including the large ones, we'd be out of business," Schader said.

These days **AIG** is on the defensive. New York Attorney General Eliot L. Spitzer has accused the New York insurance behemoth, Greenberg and another top former official of engaging in a "pattern of fraud" against investors and regulators since at least the 1980s,

concocting sham transactions to falsely boost reserves, hiding control of offshore insurance companies, disguising underwriting losses as investment losses and more.

Federal prosecutors, meanwhile, are probing whether **AIG** and other insurers misused a specialized financial product that makes public companies' books look better -- all to fool investors.

But the loudest complaints about **AIG** over the years have come not from investors but from **AIG** customers. Consumer advocates, former customers and their lawyers gripe that **AIG** has routinely flouted its obligations under state insurance laws to pay legitimate claims promptly and has abused the legal system in fights with customers who sue.

Metro-Goldwyn-Mayer Studios Inc., for instance, accused an **AIG** unit of "pulling the rug" out from under a policy to defend the studio against lawsuits on the eve of a critical trial over ownership of the James Bond movie franchise. The two sides settled at the end of 2002 after a California state court judge found that the **AIG** unit had wrongfully dropped the coverage.

Eugene R. Anderson, a New York policyholders' lawyer and longtime **AIG** nemesis, says the company's business strategy is simple: "Just say no."

Surprisingly little information is available about claims-handling in the \$1.3 trillion property and casualty insurance industry. Under a patchwork system of state regulation, companies are not required to disclose how frequently they deny claims, the reasons for doing so or how often they are sued by customers for failing to pay legitimate claims promptly.

Certainly, **AIG** isn't the only target of insurance industry critics, who say problems in claims handling are increasing generally. They point to cases in which courts have found that insurers committed systemic claims-handling abuses or used improper legal tactics to grind down customers who sue.

Last year, the U.S. Court of Appeals for the 9th Circuit in San Francisco upheld a federal magistrate who wrote that UnumProvident Corp. had implemented a "company-wide scheme to terminate expensive disability claims to increase profits." The trial judge in the case, U.S. Magistrate Judge James Larson, in a 2002 ruling cited evidence that, beginning in the mid-1990s, the Chattanooga, Tenn., benefits insurer convened "roundtable" meetings, usually held after hours, to target expensive claims for termination, with each executive bringing a "Top 10" list based on the size of the payout.

The judge found that the company impeded Joan Hangarter, a Marin County, Calif., chiropractor, in the pursuit of her claims through, among other things, a document-shredding program. The ruling upheld \$5 million in punitive damages awarded to her.

A UnumProvident spokeswoman said the company strongly disagrees with the courts' ruling and denies wrongfully turning down the claim, as well as the existence of improper

"roundtable" meetings, a shredding program or systemic problems, generally. She pointed to an examination report on the company's claims-handling practices overseen by the insurance commissioners of Massachusetts, Maine and Tennessee that found only "areas of concern," but no violations of law or claims regulations.

Also last year, the California Supreme Court upheld an \$8.5 million award, including \$5 million in punitive damages, against Allstate Insurance Co., finding that the Northbrook, Ill., company "exploited its knowledge" of a couple's "perilous financial condition" to drag out a homeowner's claim and force a settlement. The court said the trial turned up evidence that Allstate's offer of \$7,000 for the house's contents -- the couple had claimed \$45,000 -- "conformed to a standard amount it used to minimize its payouts in similar cases."

An Allstate spokesman said the company was "disappointed" with that verdict. "We're focused on delivering a superior customer experience," he said, adding that the company is obligated to investigate some claims to keep costs down for other policyholders.

Robert Hartwig, chief economist for the Insurance Information Institute, a Washington trade group, strongly disagrees that disputes between insureds and insurers are growing and says the industry is no more at odds with customers than are other industries. Hartwig said U.S. insurers sometimes fight policyholders because an increasingly sophisticated plaintiffs' bar has worked to broaden coverage of asbestos, mold, pollution and other liabilities in ways never contemplated by insurers. Unforeseen liabilities -- and lenient claims handling -- have sunk dozens of insurers in recent years, including Kemper, Reliance and other familiar names, industry defenders say.

But **AIG** has long stood out. Five times as large as its nearest competitor, it is also the industry's most successful and influential company. **AIG** shares have returned a stunning 4,800 percent over the past three decades, far better than its peers and five times better than the Dow Jones industrial average. Its many innovations -- from new products to claims handling -- have been widely imitated, insurance brokers and competitors say.

The company's unique and admittedly hard-nosed culture is a legacy of Greenberg, who took over as chief executive in 1967 and was famous for stressing discipline in underwriting -- the ability to collect more in premiums than is paid in claims -- while other insurers relied on investments. "If you don't make a profit in your basic business, which is underwriting, you won't make a profit for very long," Greenberg said in a 1992 Crain's Business Insurance article.

Unlike the rest of the industry, **AIG** has turned an underwriting profit nearly every year during the past 25 years and in 2003 posted its best-ever performance, paying out only 92.43 cents in claims and expenses for every \$1 in premiums, far below the industry average of 99.6, the industry's lowest mark in years.

Greenberg recently resigned under pressure from state and federal probes of the company's accounting practices. A spokesman for Greenberg's lawyers declined to comment.

AIG officials point out that the company's underwriting record has come from its lower operating expenses, not claims, which, they note, are sometimes near or even above industry averages.

Litigation over the years has offered glimpses into the company's tightfisted culture. In a 2001 affidavit, a former claims supervisor in **AIG**'s San Francisco office alleged in an employment case that beginning in 1983 or 1984, **AIG** adopted what employees called a "slow-pay" system for claims.

Robert Cook, a supervisor from 1978 to 1985, said that under an **AIG** "check-retention policy," checks owed insureds, vendors and others were simply locked in a safe until payees complained. Cook said **AIG** created an internal form to keep track of complaints. Even then, Cook said, he had to cajole the regional manager, Robert C. Davidson, with special "buzzwords" to convey the urgency of the complaint.

Other slow-pay techniques, Cook said: using second-class mail, writing checks for West Coast claimants on East Coast banks and making executives rewrite reports "again and again for no reason." Cook died in 2003. The employment case was settled. Davidson, in a brief interview, said the policy "came from New York, and all we did was implement it, even though we didn't appreciate it." He declined to comment further.

In part, **AIG**'s reputation comes from its massive size and its unique business model -- taking on the most complex risks in the most far-flung parts of the globe. It insures theme parks, liquor makers, contractors in Iraq, industrial companies with big pollution exposure, even executives at risk of kidnapping.

Schader says **AIG**'s reputation of being tough on policyholders' claims is unwarranted. He says **AIG** over the years has bulked up its claims-handling expertise and now has fewer disputes with customers, not more, and that only a handful -- far less than one-tenth of 1 percent -- of the 800,000 claims now pending against the company involve actual bad-faith suits brought by customers.

And the number of policyholder lawsuits against the company is dwarfed, **AIG** says, by thousands of examples of exceptional claims-handling service it performs. In one instance, when an iron beam fell from a crane at a Sacramento construction site three years ago, seriously injuring a worker, the crane's owner, Maxim Crane Works LP, turned to **AIG**, which last year paid out \$12.5 million under an excess-casualty policy. "They wrote the check and were very good about it," said Ron Marmo, a vice president with the Bridgeville, Pa., crane-rental company.

Claims that do end in litigation, though, are often hard-fought. **AIG**'s policyholders routinely wage years-long court fights to learn how the insurer handled similar claims

and to obtain seemingly mundane claims documents, such as company training manuals for claims handlers.

This spring a federal judge in Indianapolis issued a rare sanctions order against an **AIG** unit for unfairly blocking discovery in a case brought by a manufacturer whose environmental claim was denied. U.S. District Judge Richard Young wrote that the insurer's lawyers made "unwarranted" objections and gave instructions not to answer 539 times during the 284-page deposition of an **AIG** unit executive.

Most of **AIG's** squabbles with customers are settled and the terms kept secret. That also happened two years ago when RSR Corp., a Dallas smelting company, settled an environmental claim with an **AIG** unit and other insurers. "It took 13 years," says William Brewer, a Dallas lawyer for RSR. "They're shameless."

But in 2000, a case did go to trial, and a federal court jury in Hartford awarded corporate giant United Technologies Inc. \$16 million in punitive damages, later reduced to \$13 million, against an **AIG** unit, finding it had handled another environmental claim in bad faith.

In a decision upholding the award, U.S. District Judge Janet Bond Arterton wrote that the **AIG** unit had "shunted" UTC's claims into "limbo," a "netherworld of non-processing," and simply didn't respond for years, asking for more and more information while it "investigated" the claim. When UTC finally sued for an answer, the claim was denied.

The "obvious" motive was to hold onto the money as long as possible, she wrote. "Delay . . . would naturally result in defendant's retaining control over huge sums with the resulting investment-profit benefit," she wrote.

AIG's Schader points out, "We have 10,000 people handling claims. Are there cases where people go over the line? People make mistakes." He added, "It's our objective to have very, very few of those."

Staff researcher Richard Drezen contributed to this report.