

# INSURANCE LITIGATION™

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*Reporter*

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**Book Review: Ron Shelp with Al Ehrbar, *FALLEN GIANT: THE AMAZING STORY OF HANK GREENBERG AND THE HISTORY OF AIG*  
New York: John Wiley & Sons, Inc. (2006) 228pp. \$24.95.**

by Michael Sean Quinn, Ph.D., J.D., C.P.C.U. Etc.  
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Austin, TX

The authors of this book say that “Greenberg was the most powerful businessman in the world[.]” They also say that Cornelius Vander Starr “was unquestionably one of the 20th century’s great entrepreneurs.” Starr, of course, founded the predecessors of the American Insurance Group (“AIG), grew it to approximately 100 companies, and helped bring the giant who has now failed to power. Maurice Raymond (“Hank”) Greenberg took AIG from a “Group” worth approximately \$100 million to a “Group” which consisted of hundreds of companies, is worth billions of dollars, and is the world’s largest insurance company. Greenberg accomplished this during the 37 year period he was AIG’s CEO. When the board of directors he himself handpicked kicked him out in 2005, he had been running AIG longer than the CEO of any other major U.S. corporation. (Greenberg got his nickname from “Hammerin’ Hank Greenberg, a Depression-era and Post WWII slugger for and hero of the Detroit Tigers.”<sup>1</sup>)

AIG’s predecessor companies started in China in 1919. Starr hadn’t gone to college, but he had studied law with a lawyer in San Francisco and was licensed in California. The original company was Asiatic Insurance Underwriters (“AIU”); it was really an insurance brokerage house, selling policies of various insurers in China. Over the years, AIU grew all over China, as well as some other companies. Starr moved back to the United States in 1939 when the Japanese overran China. He spread into a variety of other countries, including Europe and South America. During the Second World War, he and his company worked closely with American intelligence. Apparent-

ly the German Nazis used insurance agencies and insurance companies to launder money and store it overseas.

Greenberg has been—and probably still is—an extraordinary and dynamic character. As a general rule, say the authors, “insurance is inherently recondite and dull[.]” It had neither of these characteristics insofar as Greenberg runs the show. “He was an archetypal autocrat, one who knew every detail of the company’s operations and, incredible as it seems, persisted in trying to micromanage the business even as it grew to nearly \$100 billion in annual revenues.” Greenberg was frequently sarcastic and given to occasional tirade. “Over the decades, Greenberg worked indefatigably to be recognized as the smartest, canniest, and most successful insurance executive in the world, the brilliant exception to what normally is a numbingly mundane business.”

For many years, AIG had the reputation of being difficult to deal with. It apparently did this in three ways. First, it specialized in coverages which lots of insurance companies did not want to issue. For example, it issued a variety of coverages in foreign countries. In addition, it insured business executives against being kidnapped; it insured companies when they needed to pay ransom (or something like it); and it insured some securities against wild changes in value, e.g., caused by foreign inflation. Because many insurers were (and are) unwilling to do this, Greenberg was able to charge some very high premiums. Its second approach was “to pay as few claims as possible.” To that end, AIG has always had a notoriously tough claims department that has been

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1. Strangely Bush’s new Secretary of the Treasury has been called “Hammerin’ Hank” by the editors of the current issue of FORTUNE magazine. See its cover. See also Nina Easton and Andy Serwer, *Hammerin’ Hank: An Exclusive Interview*, 154.11 FORTUNE 140 (November 27, 2006) Greenberg and Paulson share at least one characteristic besides the same nickname. They both have gone and go to China a lot. Paulson says in FORTUNE that he has probably been 70 times.

(and still is) famous for finding reasons to send policyholders away empty handed. The company was so tough, in fact, that some portfolio managers joked that they loved to buy AIG stock, because they would never consider buying an AIG policy. Third, Greenberg utilized creative forms of incentive compensation. Often these incentives involved AIG stock itself, or—to put the matter more precisely—they involved receiving interest in trusts which owned AIG stock.

One of the really helpful parts of this book is to give a sense of just how international AIG really is and has been. Over the years, it has dealt with governments and regulators in more than a hundred countries around the globe. Its middle initial, of course, stands for “International,” and there is truth to this: “AIG’s roots are broad.”

It is also quite possible that AIG’s “notoriously tough claims department” and its theory of claims handling is (or at least has been) inconsistent with a fundamental normative truth about insurance. The purpose of insurance services is to cushion against risk and therefore help those in trouble. It is *not* the purpose of insurance to make more trouble for those who are already in trouble, unless it is necessary. Thus, Shelp is mistaken when he says this: “There is nothing wrong with [AIG’s claims] approach ... provided that it isn’t carried to such lengths that it drives business away. Management’s first and foremost obligation is to make as much money for its shareholders as it can. The only real obligation to policyholders is to honor the contract.” This isn’t quite right. The last sentence should read this way: “Its only real obligation to policyholders is to fully honor the contract in a timely and prompt manner.” Of course, promptness, timeliness, and the full recognition of claims together tend to cost more than the Greenberg approach. Interestingly, over the last decade or so, AIG has retreated significantly from its earlier, aggressive, lengthy, prolonged, and complex adjustment process. This is much to its credit, and if it currently continues to have a poor claims reputation, it is now undeserved. I have repeatedly seen AIG adjusters go out of their way to look for coverage, rather than looking for way out of coverage.

One thing Shelp is certainly right about. “Hank Greenberg was forced out of a great, one of a kind company—a company with a dramatic and unusual history, [a company with] very different management

practices, an innovative offering of products, traditions unlike those in other businesses, and an extraordinary system of computation.” He also had very interesting internal memory and an interesting corporate culture. Part of this is attributable to its international flavor and its commitment to growing insurance in the developing world. Insurance in many already developed countries often appears to be “inherently dull from the outside (and [it] generally is)[.]” This is not true about AIG on a world-wide basis. It “reinvented insurance in [less developed] countries. As a consequence of Greenberg’s leadership, AIG has become “the world’s largest insurance company, the first reverse U.S. multinational, company founded abroad by Americans that comes to the United States only later in its corporate life, and [which is] the owner of numerous other businesses[,] such as International Lease Finance Corporation, the world’s largest airline leasing company.”

The book contains a number of interesting stories regarding the development of AIG. As indicated, Starr moved to New York in 1939, and many of his people followed, while a fair fraction of his business for China was buried there in someone’s backyard. After the war was over, AIG was short of money. Starr quickly got the company in shape. There was a flotilla of large boats—twenty or so in all—sitting in the Shanghai harbor waiting to take people home. Nobody would insure the boats, until someone asked Starr. He had them checked carefully for safety; he watched them nervously until they reached their destinations; but the premium he charged was \$1 million per boat. “If just one of the fleet had sunk, Starr would have been out of business. All told, he made about \$20 million on this one transaction. Insuring this fleet gave Starr his first really significant capital.” No doubt, much of this capital was utilized in the United States. AIG had been acquiring insurance companies since the 1930’s. However, during much of the second half of the 20<sup>th</sup> century, nearly half of AIG’s operations were overseas, and that accounted for as much as 40% of the company’s business. After WWII, AIG even moved into Japan.

Another interesting feature of AIG was the extent to which lawyers were utilized. Starr himself had legal training. Greenberg, who grew up mostly on a farm in upstate New York, took an undergraduate degree from the University of Miami, then took his law degree from New York Law School. (Greenberg was awarded

a Bronze Star in WWII, and served again in the Korean War, where he rose to the rank of Captain.) Interestingly, a great many senior people at AIG were trained as lawyers. In addition, AIG used first class outside counsel, perhaps the most famous of whom was Thomas “Tommy the Cork” Corcoran, a heavy-hitting Washington lawyer. One of the most interesting smatterings here and there throughout this book is a list of the lawyers employed by or used by AIG and/or Greenberg. Many are from famous New York law firms. Greenberg’s personal counsel in his controversies with AIG is David Boies,<sup>2</sup> and one of his lawyers in his controversies with Spitzer is Robert Morvillo, who represented Martha Stewart, long ago. (Speaking of lists, several pages at the end of the book are entitled “The Cast of Characters,” and it is extremely helpful in keeping track of everyone. Following that is an extremely helpful chronology entitled “AIG Timeline.”)

One of the most interesting parts of the book, considered as relatively superficial business history (which is often very helpful prose),<sup>3</sup> concerns the “war” between or among various AIG executives to determine who succeeds Starr. As he aged, Starr’s life became less satisfying. His late marriage failed. His interests in art, architecture, and opera faded. He couldn’t seem to give up meaningless micromanagement. In any case, Greenberg came to AIG from Continental Casualty, where he was a rising star. The senior executive of that company, handed Greenberg over, as it were, to AIG because he determined that “a Jew could never become president of Continental Casualty.” Greenberg had previously worked on accident and health insurance, and that’s where he began at AIG. He very quickly made this a booming part of AIG’s business.

In 1963, the then probable successor to Starr, William Youngman, tried to “assassinate” Greenberg as a future leader. There was a meeting of several senior executives involving American Home Assurance Company. It was AIG’s primary domestic company, and it was losing up to \$1 million a year. The “so-called find-a-solution meeting turned into a gripe

session.” Several participants in the meeting whined and complained, said the business wasn’t as good as the international business, and recommended that it be sold. “Greenberg, exasperated, and out of patience, interrupted and said ‘If you weren’t all such god-damned fools, we could do something with American Home. None of you understands the basics of insurance.’ [¶] Youngman saw his chance to set up Hank for failure. ‘Since you think you are so damned smart,’ he said, ‘you are today officially the president of American Home. It better not be losing money next month like it is today. The meeting is adjourned.’”

This regrettable action spelled Youngman’s doom as a rising star, and guaranteed that of Greenberg, as things turned out, even if Greenberg had carried on tactlessly—which he certainly did. The latter immediately got rid of the insurance agents who sold business for American Home and immediately converted American Home into a brokerage company. (The agents could formally commit American Home to business. The brokerage could not. Apparently the agents were picking some real bad coverages.) Greenberg also immediately began focusing on “larger industrial and commercial risks, [and] this was the heart of the change.” He also created an internal reinsurance business. Within two years, American Home’s losses were turned into profits.

The fall of Greenberg began in 2004, when Spitzer decided to prosecute Marsh-Mac for bid-rigging. Eventually, at least 17 executives, including four from AIG, have pled guilty and are going, if they have not already gone, to jail. Spitzer’s investigation of AIG and Greenberg expended over time. He picked up various investigations conducted by others, and they grew from bid-rigging to problems of “finite risk” insurance. (Shelp does not explain this concept very well. This does not distinguish him from most of the insurance press. It is enough to say, for the purposes of this review, that finite risk insurance coverage is really a loan disguised as insurance, so that it can be made to increase assets rather than increase liability.)

As Spitzer’s investigation grew broader and

2. For background on Boies see Karen Donovan, *v. GOLIATH: THE TRIAL OF DAVID BOIS* (2005) and David Boies, *COURTING JUSTICE: FROM NY YANKEES v. MAJOR LEAGUE BASEBALL TO BUSH V. GORE—1997-2000* (2004), the latter of which is probably the first volume of a multi-volume autobiography.

3. Scholarly business history can easily have characteristics analogous to those Shelp attributes to the insurance business.

deeper, the number of senior insurance executives decided to take the Fifth Amendment when questioned. The AIG Board of Directors, which was his creation, asked him what he intended to do; he indicated that he would indeed “take the Fifth;” as a consequence, he was removed from office in the spring of 2005. (One wonders if this was the real reason or if board members feared “Spitzerian Aggression.” After all, people have a right to rely upon the Fifth Amendment.)

Over time, Spitzer’s inquiry grew more complex, much deeper, and quite broader. He became interested in how AIG used several of its subs as ways to enrich its senior executives. For the last couple of years, outrageous compensation of senior executives has been under considerable review in various places, including the financial and insurance press. In addition, AIG partly or wholly owned several reinsurers, significantly, AIG had (at least probably), “repeatedly misled regulators about the nature of its relationship with [various of] the ... entities it owned.” They had common characteristics, and here is Shelp’s list:

They were created by AIG

- AIG found the investors and drafted all documents relating to the initial capitalization.
- They were under-capitalized.
- They had passive investors backed by AIG or its affiliates.
- The management and administrative functions of each were performed by the same AIG affiliate.
- Officers of the three offshore entities had numerous relationships with AIG and with each other.

Most insurance investigators would regard this mixture of common characteristics as suggestive of both danger and crookedness. These problems were made worse by the way in which AIG accounted for

its reserves. Shortly after Greenberg was kicked out, AIG’s books were changed in what appear to be dramatic manners involving large sums.

After Greenberg left AIG, there has been one problem after another between the person and the entity. There have been squabbles over who really owned various pieces of Chinese art. There have been struggles over whether various Starr companies could pursue insurance brokerage for other insurance companies—in other words, whether Starr companies could return to that with which they started—and what else they can do. Many have seek the full page ads of Starr companies in papers like the NEW YORK TIMES, the WALL STREET JOURNAL, and BUSINESS INSURANCE.<sup>4</sup> In addition, although Greenberg’s reputation has been injured significantly, “very few people are as resilient as Hank Greenberg—or as fortunate.” Moreover, he has been left in possession of a “triumvirate of prestige, power, and money.” Greenberg has also been active in international politics, to some degree on behalf of China. His views and argument have been carried on the editorial pages of very prestigious daily publications.

Perhaps the most interesting lawsuit of the several which have commenced is a lawsuit AIG brought against Starr International Company (“SICO”), which owned 311 million shares of AIG, “which it claimed was committed to compensating AIG employees to outstanding contributions to the company’s growth.” Over a good part of the second half of the 20<sup>th</sup> century, a large number of senior employees at AIG received annual bonuses from not only AIG but from SICO as well. In effect, AIG sued SICO for utilizing the AIG stock to its own benefit and for failing to remain committed to AIG executives. In the suit, “AIG alleged that the intent was to give these shares away until they were depleted, which it is estimated could be hundreds of years.”<sup>5</sup> Probably, AIG was bringing this lawsuit in order to hang onto its senior employees friendly to Greenberg. “Basically, the AIG versus SICO lawsuit alleged that the latter’s plan was to use the AIG shares for its own purposes and hence that it had breached a contract with AIG when then current AIG

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4. As striking as these ads are, it is not certain that each of them is perfect. There is one on p. 6 of BUSINESS INSURANCE for July 10, 2006 which identifies four (4) specialist companies. At the top the ad is entitled ‘STARR POWER.’ In the middle one of the specialist companies is entitled ‘Starr Aviation.’ At the bottom the same company is called ‘Starr Aviation.’ One would think that this kind of spelling error would be caught by somebody. (I am not the person, of course, given the number of proofing errors which have appeared in my stuff over the years.)

executives were removed from the SICO board.” AIG “asked for a declaratory judgment keeping the shares for employees, a reinstatement of AIG executives to constitute the majority of the SICO board, and the creation of a constructive trust on behalf of AIG for the shares.”

SICO filed its own counterclaim. The focus of the lawsuit shifted. The lawsuit had started out with SICO seeking the recovery of artwork. It followed up with AIG pursuing the stock and stock regulation. With its counterclaim to AIG counterclaim, SICO was seeking to retain ownership and control of \$20 billion in AIG shares. “Life or death for SICO and very important for AIG.”

SICO was owned by Greenberg and other shareholders, “each of whom had basically 10% control of the company but no equity interest.” At one point, common stock was controlled by a Bermuda foundation, but by the time these lawsuits were filed, the shares were owned by the Starr International Charitable Trust, which is based in Ireland. According to Shelp, this pattern is probably nothing more than the surface of things. True ownership is treated by the company and the people involved as highly confidential.

Interestingly, SICO has argued that AIG has undercut its own position by its past behavior. If AIG has a property interest in the stock possessed by SICO in AIG, AIG would have to change its books and records; it would have to “include such shares as a contra-equity count on its consolidated balance sheet.” Since it has not done so, it has thereby refuted its own position.

Shelp states that he has reviewed this case with knowledgeable lawyers, and at least one of them believes that “AIG ha[s] handled the SICO lawsuit badly[.]” The same lawyer has told Shelp that “he thought Greenberg would win and be cleared of all charges, although he probably would have to pay a fine. [¶] So the battle continues and will likely continue for some time.” Whatever happens, there will likely be an appeal. This is a long case with

complex issues. It is not exactly insurance litigation. It is more like litigation involving insurers and the securities of insurers. Shelp, a non-lawyer, thinks that—as a legal matter—the stock belongs to SICO. At the same time, since Greenberg was head of both companies, there was actually some kind of unity between the two of them. “One has to wonder[.] if Greenberg had not been at SICO when he retired from AIG, what would have happened?” Shelp’s bet is that somehow or another, the companies would have remained united, at least in some sense.

“It doesn’t seem fair,” however, Shelp says, “that SICO suddenly has \$20 billion to do with as it likes[,] when that clearly was not the original intent. Yet, on the other hand, why should AIG have \$20 billion handed over after it cancelled participation by its own employees in the SICO compensation plan?” Shelp thinks that “an appealing compromise” would be for SICO to give AIG a bunch of the stock which AIG could then use as a compensation plan and then SICO should keep the rest for itself. “Clearly,” says Shelp, “my idea of a compromise will never happen. The swords are drawn in the sand and the intensity of feeling is too high.”<sup>6</sup>

There may be some sort of a business ethics problem surrounding the AIG-SICO-Etc. relationships. People who were AIG executives worked not only for AIG but also for companies named “Starr” when it did business with AIG. In some sense, these executives were being paid by all three of them. Is there any chance that these executives were not discharging the fiduciary duties they owed to each of their employees?

According to Shelp, he is asking four fundamental questions. They are these:

- Why did Greenberg get in trouble and fiddle with such insignificant numbers in the AIG earnings as he did? What on earth was he thinking about? Why would he do such a thing, since, in comparison to larger numbers generated day after day by AIG, the finite

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5. “[O]nly 4% of the AIG shares owned by SICO have been distributed to AIG employees, and [SICO] has never agreed to use any portion of its AIG shares for future compensation of AIG employees. SICO does pledge that all the shares set aside for employees until now will be paid. [SICO] also argues that the bonus payments [it] used to pay participants in the compensation plan were cancelled in about 1992, without objection from AIG.”

6. As a reviewer, I must confess that I wonder if Shelp is not trying to help out by making a suggestion that will be read by many of those involved and appreciated by some.

insurance funds and finite reinsurance funds were tiny?

- Why did Greenberg's group of hand-picked directors throw him out?
- Why did Spitzer so zealously go after Greenberg?
- How did the corporate culture of AIG contribute to his downfall?

In the end, Shelp thinks that there are some pretty straight forward explanations for some of these questions. Here they are:

- Greenberg did his finite risk insurance and reinsurance arrangements because he had a habit of running all parts of the company. In other words, Greenberg had not grown out of micromanagement. "Greenberg's success [in] overriding regulators around the world became a habit. He kept ahead of economic changes, insurance needs in society, political changes." In other words, Greenberg was fooling around. It was as if he didn't have anything better to do, and he liked playing the game.
- Greenberg got kicked out of AIG because he was going to take the Fifth Amendment in a very public context. (I wonder!)
- Shelp says that he doesn't really know why Spitzer went after Greenberg. Here are Quinn's speculative cynical-answers. First, Spitzer is and has at all times been running for higher office. Showing off high nerve is politically valuable. Second, Greenberg is not well loved outside his immediate circle, and perhaps not even there. Lots of people are

suspicious of the insurance industry and hence its famous leaders. Besides, it is well known that Greenberg's two sons left AIG because he was difficult to work for and with. Third, Spitzer loves to clash. Fourth, he loves conflict.<sup>7</sup>

- "[T]he corporate culture Greenberg created clearly contributed to his downfall. Simply stated, it became essential to make your numbers and even though in this case[,] it was not increased earnings but increased reserves, it was still part of making sure AIG was well perceived on Wall Street."

Still, according to Shelp, this whole thing will not come to a good end. "The sad and ironic conclusion is that even if Greenberg wins the civil suit, avoids criminal prosecution, wins the SICO-AIG case, and maintains his control of the Starr Foundation, [etc.,] he will never get back the one thing he most wants: his reputation. He has been tainted by the many months of high-visibility accusations, and that taint cannot be completely removed."

One wonders if Shelp is right about this. Greenberg's reputation was already blemished by the "tough claims department" he set up. However, this has—to a considerable extent—been corrected and improved. If Hank can give up his total dedication to embracing the joke from inside AIG that the company's acronym stood for "All Is Greenberg," he might have productive years ahead of him at the head of some 10 or so. Interestingly, he is inquiring about buying the LOS ANGELES TRIBUNE; one of Shelp's theses is that Starr and Greenberg are really quite alike. For many years, Starr owned newspapers in China. Greenberg might be a hell of a publisher.<sup>8</sup>

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7. Even with himself. Consider the following two articles on the first two pages of the FINANCIAL TIMES for Monday, November 27, 2006. The front page article begins with this headline: "Spitzer hits out at any roll-back of reforms." The article itself begins with the following text: "Eliot Spitzer, New York's governor-elect, has hit out at efforts by figures in the Bush administration and business to roll back corporate accountability reforms imposed in the wake of financial scandals, such as Enron [i.e., Sarbanes-Oxley]." On the next page, there is another article about Spitzer, and it begins with this headline: NY governor Spitzer plans to be a friend of business." Interestingly both of these articles are by Brooke Masters and based on interviews with Spitzer. Ms. Masters is the author of a recent book on Spitzer, SPOILING FOR A FIGHT: RISE OF ELIOT SPITZER (2006). It covered his conflict with AIG and Greenberg at some length.

8. The present ending of Greenberg's career, if that's what it really is, remains one of Andrew Mellon's prosecution after FDR came to office. Mellon was acquitted; he created the National Gallery; and lots of stuff was and is named after his family and him. There was a bank by that name; it is Carnegie-Mellon University, and the best fellowships in the graduate school at the University of Pittsburgh were named for him. See David Cannadine, MELLON: AN AMERICAN LIFE (2006)