OutFront

Ace in the Hole

Bernard Condon, 08.11.03

Hank Greenberg, betrayed by a protégé who quit to run a big AIG rival, may be about to get even.

Maurice (Hank) Greenberg, the prickly patriarch of insurer American International Group, has had a thorn in his side for years: a former protégé named Brian Duperreault. Duperreault worked for Greenberg for 21 years, rising to run AIG's vast foreign operations before defecting in 1994 to run rival Ace Ltd.

Since then Greenberg's ex-lieutenant has poached half a dozen key AIG (nyse: AIG - news - people) executives. The unkindest cut came in November 2001: Duperreault hired the 78-year-old Greenberg's younger son, Evan Greenberg. Evan, 46, was once Hank's heir apparent at AIG; he is now Ace's president. At a briefing for analysts a few years ago, AIG's chief dismissed Ace thusly: "Is that a bandage or something?" He knows all too well what Ace is:his fastest-growing big U.S. rival. Its net premiums rose 27% (to $8.1 billion) last year, compared with 14% for the U.S. property and casualty industry as a whole.

But Hank Greenberg may yet get even, via an arcane legal struggle he launched eight years ago. In state superior court in San Francisco, AIG essentially accuses Ace and a predecessor company of trying to dodge billions of dollars in asbestos claims by moving thousands of insurance policies out of its Insurance Co. of North America subsidiary into a tiny, underfunded rump company called Century Indemnity. AIG calls this "a shell game."

Adding to the intrigue: Just as Ace was buying INA and other properties from Cigna in 1999, almost $2 billion of assets was diverted from INA to another unit included in the deal, regulatory documents show. That could put those assets out of reach of policyholders should Century Indemnity go broke--a distinct possibility.

Greenberg argues that Ace's INA should take the hit--and California policyholders should be able to tap it for money--if the tiny Century falters. If the court concurs, Century policyholders in other states may sue for the same fallback. Ace insists it is insulated from any fallout and that, in a collapse, the asbestos policyholders legally are on their own.

AIG says Greenberg is motivated by "principle," not malice. Insurers shouldn't be allowed to abandon policyholders they suddenly deem too costly. Ultimately, AIG says, big insurers would have to cover the losses if too many wobbly, walled-off subsidiaries ended up in default. AIG also notes that it had been fighting for this principle long before Ace bought INA.

But note that Greenberg is pressing his case at a vulnerable time for Ace. Mounting claims at the asbestos unit, Century, forced Ace to increase reserves by $2.2 billion last December. That consumed 90% of a rainy-day fund. Moreover, in three years the amount of money owed to Ace by other insurers has grown 60% to $14 billion--an alarming 3.5 times Ace's tangible equity; the comparable ratio at AIG is 0.5. This raises the specter of what might happen to Ace if the insurers can't or won't pay up.

The dispute began in 1995, when INA, a Philadelphia insurer then owned by Cigna, asked Pennsylvania state regulators to let it carve out a new, legally separate company and load it with INA's yawning claims for asbestos and environmental damage. By shedding that business INA hoped to land a better credit rating. Greenberg protested to regulators, who nonetheless granted the INA split-off. Greenberg moved his fight to the Pennsylvania Supreme Court, which in July 1999 ruled that regulators had followed "correct procedures." Interestingly, the court said INA policyholders, who hadn't yet bothered to complain, could sue over the move.

Spurned in Pennsylvania, Greenberg in late 1999 took his fight to California, where a company can sue even if it hasn't been harmed, so long as it can show it is trying to protect the public. In a suit filed in San Francisco AIG argued that state law required INA to get California policyholder consent to the split-up. In May 2000 Greenberg lost yet again. The trial court ruled that AIG had no ground on which to sue and that AIG's claim of a risk to policyholders was "speculative."

But in July 2001 the California Court of Appeal overruled that decision and sent AIG's plaint back to San Francisco. The appeals court also said notices sent by INA to policyholders informing them of the split "implied that nothing of consequence had occurred" and thus were "likely to deceive," which could be argued to constitute "fraud." Strong words.

In March of this year AIG asked the trial court for a summary judgment to essentially make INA liable if Century can't pay. Its filing describes an embarrassing e-mail at INA recommending that customer notices be worded to "make this entire thing seem like a nonevent." The notices eventually mailed out said that Century Indemnity would now be "handling" and "managing" claims, avoiding the word "insuring."

Ace responds that the wording was at worst an attempt to "avoid confusing" policyholders, not to mislead them. In any case, Ace says policyholders, not AIG, should be the ones bringing the matter to court. It says AIG has an ulterior motive: to raise doubts about INA's "viability" with regulators and rating agencies, potentially "jeopardizing" the very policyholders AIG claims to defend.

Arguments began July 17. No matter which side wins, an appeal is likely.

It is unclear whether AIG lawyers also may seize on a second line of attack--the diversion of $1.7 billion in assets from INA. In 1999 Ace acquired Cigna's property and casualty insurance business, including INA and related units. Regulatory filings show that before the deal closed, in July 1999, Cigna shifted the $1.7 billion out of INA, leaving it with just 18% of its former assets. Most of that money ended up at a sibling, now named Ace American Insurance, which isn't as directly at risk for the pending asbestos claims. "There's no obvious reason for the move of assets, and it looks questionable in hindsight," says Alice Schroeder, an advisory director at Morgan Stanley. Ace declines to comment on this asset shuffle.