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INSURANCE IS THE great protector of the standard of living of the American middle class. A good job provides the means to acquire a home, a car, a college education for the children, and a comfortable retirement, and insurance secures those things against the uncertainties of life. Houses will burn, but homeowners insurance furnishes funds to rebuild. Cars will crash, but auto insurance pays medical bills and repair costs and guards against potentially massive liability to other people who are injured. Illness, injury, and death will occur, but health insurance, disability insurance, and life insurance remove the burden of cost and replace the lost earnings of the breadwinner.

Insurance has come a long way in five thousand years, from the time when Babylonian merchants found investors who agreed to accept the risk of cargo lost at sea in return for a payment, a transaction that would develop into marine insurance.¹ Today insurance in the United States is a trillion-dollar industry, with 2,700 property/casualty insurance companies collecting \$440 billion in premiums and paying \$250 billion in claims each year. (Property/casualty insurance mostly protects against property damage and liability to others; “personal lines property/casualty” is largely auto and homeowners insurance, the subjects of this book.) State Farm, the industry’s giant, has forty-two million policies in force and processes over twelve million claims each year.

Insurance is the great protector of the standard of living of the American middle class, but only when it works. Purchasing an insurance policy



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is less like buying a product and more like receiving a promise. In return for the policyholder's payment of a premium, the insurance company promises to accept the risks of financial loss that the policyholder otherwise could not bear. As a formal matter the promise to indemnify the insured against loss is embodied in the policy document, often fifty pages of eight-point type that is seldom read and less often understood, but the real promise is to provide security against loss. Long before the GEICO gecko promised to save you 15 percent or more on car insurance, the iconic slogans of insurance company advertising expressed that real promise: "Like a good neighbor, State Farm is there." "You're in good hands with Allstate."

Insurance doesn't work when the insurance company fails to honor the terms of the policy and its promise of security through the strategy that has become known as "delay, deny, defend." The company delays payment of a claim, denies all or part of a valid claim, or aggressively defends litigation the policyholder is forced to bring to get what he is rightfully owed. When insurance doesn't work, the consequences are more severe than when any other kind of company fails to keep its promise. If a homeowner hires someone to paint his house and the painter never shows up, the homeowner can take his money and hire someone else. If the insurance company refuses to pay a claim, it is too late to go elsewhere for another policy; no company will write a policy that will pay for fire damage that has already occurred.

Insurance didn't work for Kim Zilisch, who was in an accident that killed her fiancé and permanently injured her. After she filed a claim with State Farm, her insurance company, the response was to delay. State Farm's claims adjuster knew her injuries were permanent yet waited four months for a copy of a doctor's report he knew didn't exist. The adjuster then concluded without sufficient evidence that Zilisch's injuries were not that serious, waited another four months to make an offer to settle her claim, then changed the offer without regard to the facts. A year after her claim was filed Zilisch was awarded \$387,500 by an arbitration panel, at which point State Farm finally paid the policy limit of \$100,000.²

Insurance didn't work for Terry Buttery. When his home was burglarized he called the police and his insurance company, Hamilton Mutual.



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Buttery completed the claims forms he was given within twenty-four hours but that was only the beginning. Even though he supplied three more statements, receipts for stolen items, repair estimates, and five years worth of tax returns, and gave testimony to Hamilton under oath four separate times, Hamilton still did not pay. So Buttery sued and won. But Hamilton delayed payment even after Buttery's judgment was upheld by the Kentucky Supreme Court, hoping that his precarious financial position would force him to settle for less than he was owed.³

Delay, deny, defend violates the rules for handling claims that are recognized by every company, taught to adjusters, and embodied in law. Within the vast bureaucracy of insurance companies, actuaries assess risks, underwriters price policies and evaluate prospective policyholders, and agents market policies. The claims department's only job is to pay what is owed, no more but no less. A classic text used to train adjusters, James Markham's *The Claims Environment*, states the principle: "The essential function of a claim department is to fulfill the insurance company's promise, as set forth in the insurance policy. . . . The claim function should ensure the prompt, fair, and efficient delivery of this promise."⁴

Beginning in the 1990s, many major insurance companies reconsidered this understanding of the claims process. The insight was simple. An insurance company's greatest expense is what it pays out in claims. If it pays out less in claims, it keeps more in profits. Therefore, the claims department became a profit center rather than the place that kept the company's promise.

A major step in this shift occurred when Allstate and other companies hired the megaconsulting firm McKinsey & Company to develop new strategies for handling claims. McKinsey saw claims as a "zero-sum game," with the policyholder and the company competing for the same dollars. No longer would each claim be treated on its merits. Instead, computer systems would be put in place to set the amounts policyholders would be offered, claimants would be deterred from hiring lawyers to help with their claims, and settlements would be offered on a take-it-or-litigate basis. If Allstate moved from "Good Hands" to "Boxing Gloves," as McKinsey described it, policyholders would either take a lowball



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offer from the good hands people or face the boxing gloves of extended litigation.

How widespread is delay, deny, defend? How often is it that insurance doesn't work? There are two answers: too widespread and too often, and no one knows.

Too widespread and too often. As the new claim strategies have been implemented there have been an increasing number of cases in which companies have delayed payment, denied valid claims, and unnecessarily defended litigation. Minor auto accidents have become the source of major litigation as companies routinely and systematically deny claims. Homeowners can no longer be assured of receiving enough from their insurance companies to rebuild their homes and their lives. When mass disasters strike, things get even worse. After Hurricane Katrina struck in 2005 policyholders who believed they were treated unfairly by their insurance companies complained to the Louisiana Department of Insurance at the rate of twenty thousand a month during the first six months after the storm. Thousands of policyholders sued their insurance companies; more than 6,600 suits were filed in federal court in New Orleans alone, and many cases are still pending.

Nor is delay, deny, defend restricted to auto and homeowners insurance. All insurance companies have an incentive to chisel their customers in order to increase profits. Unum, the largest seller of disability and long-term care insurance in the United States, became notorious for failing to pay what it owed to sick or injured workers. Numerous courts castigated the company for unscrupulous tactics, nonsensical legal arguments, and lack of objectivity amounting to bad faith in denying claims. Employees who were especially aggressive in denying claims were recognized with the company's "Hungry Vulture Award." Under a settlement with insurance regulators in all the states, Unum was forced to review claims denied between 1997 and 2004, and it reversed its decisions in 42 percent of the cases, paying out \$676 million in additional benefits. Almost everyone who has health insurance has a story about an arbitrary or incomprehensible denial of a claim. In 2009 New York attorney general Andrew Cuomo concluded that the databases used by insurance companies to calculate the "reasonable and customary" fees



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they would pay for out-of-network treatment were part of a scheme to defraud consumers by systematically lowballing the fees. UnitedHealth, Aetna, Guardian, and other companies agreed to stop using the faulty databases and contribute to the creation of a new independent database. The story of delay, deny, defend by property/casualty companies is part of the failure of insurance as a whole.

No one knows how widespread delay, deny, defend is because part of this story is the failure of state insurance regulators to police insurance companies' conduct. Insurance is the most heavily regulated industry in the United States. Every state has an insurance commissioner who licenses companies and agents, sets financial standards, requires regular reports, and examines the operations of companies. Most of the regulatory effort is devoted to making sure insurance companies have the resources to honor their promise to pay claims, and that effort works well; when insurance giant AIG collapsed in September 2008, its financial products division was a shambles, but regulators reported that its property/casualty insurance company subsidiaries were sound. Making sure companies actually do honor their promise has received much less attention. Insurance commissioners generally do not even collect, analyze, and publish comprehensive figures on the payment and denial of claims.

Consumers certainly do not know how widespread delay, deny, defend is for the industry as a whole or for individual companies. Consumers have little to go on when making one of their most important purchases—auto and homeowners insurance—to secure their standard of living. The average American homeowner pays \$804 each year for homeowners insurance, about what she might pay for a new television set. Yet someone buying a television has many more sources of information about the product's performance and reliability than does the purchaser of homeowners insurance. *Consumer Reports* tests TVs in its labs and surveys hundreds of thousands of its subscribers so a shopper can learn that a Sony TV has better picture quality than a Westinghouse and is about three times less likely to need a repair, but the insurance shopper has little accurate information on whether Allstate or State Farm is more likely to pay a claim. And information is even more important when



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buying insurance; if a TV is unreliable it can be repaired or replaced, and the owner is at worst out the price of the set, but if an insurance company fails to pay a claim after a loss occurs, the consumer is out of luck.

The story of delay, deny, defend is easy to understand but hard to discover and document. It is easy to understand that insurance companies make more money when they pay less out in claims, and as with other industries, from chain restaurants to Internet sales, they have become more systematic about the ways in which they make money in recent decades. But while insurance companies like to shape the public's perception of them through advertising, they are notoriously unwilling to disclose information about their internal workings, especially information that shows they do not always deliver on their promises. Companies spend a great deal of money on advertising that they will fulfill their promise to provide security for their policyholders, but they also spend a great deal of money on lawyers to mask the times when that security fails.

News articles, trade journals, industry groups, academic studies, and an increasing number of Web sites and blogs cover insurance companies and their claim practices. But this book depends on three special kinds of sources that insurance companies go to great length to keep under wraps or discredit. The first are insider accounts provided by former insurance company employees who have become whistleblowers. The second is information revealed in litigation against insurance companies. And the third is the documentary evidence of the redesign of claim practices to increase profits at the expense of policyholders and victims. Much of the evidence in this book is about well-known companies, State Farm and Allstate in particular, but it is not an attack on them; they are just the largest players in the industry and the companies whose involvement with McKinsey & Company in the transformation of claims is the best documented.

Traditionally, claims adjusters were taught to follow a simple maxim: "We pay what we owe." The adjuster's job, to determine what the claimant was entitled to under the insurance policy, carried independence to exercise judgment and an obligation to assist policyholders in their time of need. As the claims department became a profit center, and delay, deny, defend increased, the adjuster's job changed, diminishing the obligation



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to the claimant in favor of an increased obligation to the company's bottom line. For many adjusters the change was disheartening. Robert Dietz, a fifteen-year veteran of Farmers Insurance, described the shift: "My vast experience in evaluating claims was replaced by values generated by a computer. More often than not, these values were not representative of what I had experienced as fair and reasonable."⁵

Many adjusters adapted to the new system and kept their jobs or were replaced by "claims representatives"—the customer-friendly term now preferred by the industry—who were trained in the new normal. Some, like Dietz, left their employers and revealed what was happening. The companies' response has been, predictably, to try to silence or discredit the whistleblowers. Dietz became an expert consultant on claim practices, and Farmers sued to obtain a gag order to prevent him from sharing his knowledge with lawyers representing policyholders. (Farmers eventually abandoned the attempt to silence Dietz.)⁶ Other former employees have faced similar attempts to restrict them, but former insurance adjusters have become important sources for information about claim practices.

Usually, when an insurance company delays, denies, or underpays a claim that is the end of the story. The claimant might not understand that he has been shortchanged, or he may not believe that there is anything he can do about it, or he may just want to get on with his life. In some cases, however, the claimant sees that he has been wronged and believes that it is worthwhile to get a lawyer and fight for what he is entitled to. In the course of those cases, attorneys have discovered a great deal of information about insurance company behavior in the individual cases being litigated and about their general claims practices. Documents produced in discovery, testimony at trial, and reported judicial opinions provide major sources of information about how insurance companies organize and conduct their business and how it affects their claimants. Because litigation often drags on it can take years for this information to come to light, and when it does, the companies disingenuously attack it as outdated.

This evidence is seldom produced willingly; on the contrary, insurance companies expend considerable effort and lawyer time to limit the information produced and to keep what is produced out of the hands of



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those who should know about it. In numerous cases they have quibbled, equivocated, concealed, and sometimes even defied the legal processes that aim to produce an informed adjudication of disputed cases. When company executives and claims supervisors are deposed, they are often unresponsive or difficult; an Oklahoma trial judge described State Farm's witnesses as "obstructionist" when holding the company in contempt for discovery abuse in 2007.⁷ In a Nevada case in 2002, State Farm tried to block a policyholder's lawyers from introducing documents that the company argued were confidential—though they came from the public records of the Washoe County court clerk's office.⁸

Even when a plaintiff's lawyer discovers damaging evidence about claims practices the company has a simple way to prevent it from ever becoming public: settle the case. In any case in which the plaintiff's lawyer discovers evidence that would be damaging in future cases, the company may conclude that it makes long-term sense to settle the case, on the condition that the plaintiff's lawyer agree to keep confidential any discovery material. The attorney is forced to agree because he must accept a settlement that is favorable to his client, even if it injures future claimants and the public at large by keeping the bad practices secret.

In a case that is not settled the company can still apply to the court for a protective order under which the plaintiff's lawyer can use the evidence in the current litigation but not reveal it to anyone else; in particular, he cannot give the evidence to a lawyer representing a policyholder in another suit against the company in which it might be used to prove that the company consistently violates fair claims practices. If the court grants the protective order, as unfortunately happens too often, it is harder and more expensive for the policyholder in the second case to prove what may already have been established in the earlier one.

Allstate went to especially great lengths in its attempt to prevent the release of the PowerPoint slides, notes, and training manuals prepared by McKinsey & Company when it was hired to redesign Allstate's claims processing in the 1990s. For critics of the industry, the McKinsey documents are the smoking gun that describes in detail how the claims process shifted from customer service to profit center. Allstate in turn contends



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the documents demonstrate its effort to make sure that each claim is promptly and fairly evaluated on its own merits.

The documents were the subject of a seven-year odyssey through the courts that began in an ordinary lawsuit. Santa Fe, New Mexico, lawyer David J. Berardinelli, who would become Allstate's principal antagonist over the McKinsey documents, represented José and Olivia Pincheira in a suit against the company and its agents for bad faith denial of an insurance claim. After considerable procedural wrangling, Allstate gave Berardinelli a copy of the slides with an overlay that prevented them from being photocopied. Following two years of more motions and appeals, the appellate court upheld the trial judge's order to Allstate to produce the documents, and Berardinelli returned the overlaid slides and requested a legible copy. The company refused to give him one, essentially asking to be held in contempt of court so it could further challenge the trial judge's order on appeal.

Lawyers in other cases sought to have Allstate disclose the documents, and it continued to resist, with varying degrees of success. (One Kentucky judge responded to Allstate's trade secrets claim by concluding that "the material sought does not rise to the level of the Colonel's secret recipe.") Because McKinsey had also consulted with State Farm, plaintiffs' lawyers sought similar documents in actions against that company too. The most remarkable case turned out to be a suit brought in Missouri by Dale Deer, who had been injured in an auto accident by Allstate-insured Paul Aldridge. The company was ordered to produce the McKinsey documents and, when it refused, Judge Michael Manners held the company in contempt and fined it \$25,000 per day beginning on September 4, 2007. Despite accruing fines eventually totaling \$2.4 million, Allstate continued to refuse.

The denouement of the saga came in Florida. On October 16, 2007, Florida insurance commissioner Kevin McCarty exercised his regulatory authority to direct Allstate to produce the McKinsey documents. When Allstate refused McCarty suspended Allstate from selling new insurance policies in the state. When the courts upheld McCarty's authority, on April 4, 2008, Allstate immediately posted on its Web site 150,000 pages of the McKinsey documents that it long had argued were confidential, trade secrets and essential to its business.¹⁰



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The point of view in this book is proconsumer but it is not anti-insurance. Insurance is essential to our economic security. But if insurance is to maintain its role as the great protector of the standard of living of the American middle class, prompt and fair claim handling has to be the rule. This book explores why that doesn't always happen, and why it is even less likely to happen today than fifteen or twenty years ago.

