An excerpt from
Insult to Injury: Insurance, Fraud, and the Big Business of Bad Faith
by Ray Bourhis

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Chapter One

FALSE PROFITS

The woman seated before me had pain and sadness etched deeply into her face. Her eyes were dark and hollow; her gray-brown hair tired and stiff. The corners of her mouth were fixed in a dry frown. She had the look of a frightened, skittish animal, betrayed and immensely fragile. She appeared on the verge of lunging for the door, poised to make a run for it before uttering a word. Watching her as she fidgeted with the papers on her lap, struggling to maintain her composure, I felt an air of uneasy tension settling in between us.

A few years earlier, Joan Hangarter had everything going for her. She had a successful chiropractic practice; two great kids; a nice house in upscale and comfortable Novato in Marin County, California; a late-model car; and a relationship she saw as solid and lasting. Then one day in 1997, while she was performing a difficult lumbar manipulation on a patient, Joan felt a sudden ripping pain in her right forearm. The pain radiated up the arm to the base of her neck. She thought her condition would improve, but instead it worsened. Months later, following extensive testing, her doctors told her that her injuries were permanent and that she would no longer be able to perform the demanding maneuvers required in her work. She was devastated.

Joan may have made some bad decisions and lousy investments over the years, but there was one thing she had done that she believed would carry her through. Years before she had given in to a "won't take no" insurance saleswoman. "She was very insistent," Joan recalled. "She explained that the policy she was trying to sell me would keep a roof over my head if anything should ever happen that prevented me from continuing in my career.

"'You've studied and built your practice for years,' she told me. 'You have responsibilities. A mortgage. Big monthly expenses. Unexpected things happen in life. What would you do? Retrain? Start all over? Empty out your retirement account? Take some menial job for a fraction of what you're now earning?'

"She knew I was about to become a mother. How could I not protect my baby?"

Joan bought an "own-occupation" disability policy from the Paul Revere Life Insurance Company and, for almost a decade, dutifully paid the $3,000-a-year premium. Following her accident and diagnosis, Paul Revere investigated her claim, reviewed her medical records, and evaluated her condition. It concluded that she was disabled and began paying the monthly benefits.

Paul Revere continued to pay until after the company was swallowed up by its chief competitor, Provident. Suddenly, Joan's benefits were cut off.

I listened to her describe the downhill plunge of her life: how her injuries had prevented her from treating her patients; how she had been forced to sell her practice; how, following the termination of her benefits, she had lost almost everything; how her car had been repossessed and she and her children had been evicted from their home and driven into bankruptcy and onto welfare. I saw a defeated person, a woman who appeared to have little reason to live. But when I asked about her children, Joan's demeanor changed. She transformed into a proud mother, talking about Elana and Anton, their personalities, their hobbies, their school activities.

After talking to her about her history with Provident and about what had happened to her, I knew Joan had a good case. Unfortunately, good cases don't always go the plaintiff's way. I wasn't about to give this woman who had been kicked so hard any inflated hopes.

"If you sue this company," I said, "if you take them on, they will try to crush you any way they can. They have billions of dollars. They will spend whatever it takes to fight you. They will try to destroy you and your case."

I watched her carefully to see if my words were sinking in.

"They will attack you personally. They will call you a fake. They will say you made stupid mistakes and choices in your life and that

you are trying to blame them for your problems. They will go after your former employees."

I wasn't making any of this up or exaggerating in the slightest. I had seen this company use just such tactics with other clients we had represented against it.

"They will send investigators to film your every move. They will take your deposition for days at a time. They will subpoena your tax records. They will accuse you of insurance fraud – "

"These are bad people," she interrupted. "They are *really* bad." I heard an intense firmness in her voice as she took responsibility for her mistakes. "I've made some big mistakes," she said, "but I'm disabled. I can't *be* a chiropractor anymore. They know that's true. They were wrong in cutting me off. If they hadn't done that, we wouldn't have been ruined. We wouldn't have been thrown out of our home. We wouldn't be living on food stamps."

"Yesterday," she said, her eyes welling up, "my son, Anton, was looking at some old photos from the good days. He turned to me and asked, 'Mommy, will we ever be normal again?'"

"Mr. Bourhis," Joan said, now sounding more determined than defeated, "I don't care what they do to me. They can't be allowed to get away with this."

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THE CONCEPT OF INSURANCE IS NOTHING NEW. IT DATES BACK TO THE maritime industries of ancient China and Babylonia. The Chinese had a system to lessen the loss of cargo in the treacherous Yangtze River. A group of ship owners threw money into a pot (the birth of premiums) to cover the loss of goods on a single boat.

The Babylonians developed an interesting variation, called "bottomry contracts." Ship owners negotiated loans on their vessels. If the ships didn't make it back to port, the debt was wiped clean. Insuring, in one form or another, against maritime loss carried through to the Greeks, Romans, and Byzantines.

A catastrophic occurrence in London in 1666 made it abundantly apparent that a new type of insurance was needed – for fire. The Great

Fire of London raged for four days, destroying more than thirteen thousand buildings and leveling 436 acres. An enterprising gentleman named Nicholas Barbon promptly started a business to protect against future fire loss.

One hundred years later, the always-enterprising Benjamin Franklin founded one of the first fire insurance companies in the United States, the Philadelphia Contributorship, which is still in existence today.

Variations and nuances progressed through the centuries. Otto Bismarck instituted a social insurance in Germany as an end run against socialism. Its basic tenet was that for the good of all society, the individual must be protected. (Bismarck's creation worked so well that despite the upheavals following the world wars, Germany's national health insurance never stopped functioning.) In the late nineteenth century, disability insurance in its more modern guise made an appearance. With the rise of unions, workers demanded that they no longer be treated as commodities to be used and tossed away. Since employees gave up part of their lives making widgets and what-have-yous, they wanted more than a salary. They wanted peace of mind.

That's what disability insurance is all about. Whereas car insurance protects something tangible, disability insurance is a protection for what might happen – there might come a time that you are no longer able to work because of an injury or illness. Since profits could be made in selling this type of protection, naturally the private sector rushed in.

Insurance companies don't make the real money on premiums. The big returns come from their investments. The 1980s were a decade of double-digit interest rates and bond returns. Companies that earned their profits by accumulating and investing cash could expand and grow exponentially. There was no better business for this than insurance. And with its high premiums, long-term policies, low marketing costs, and limited risk, there was no better insurance line for this than disability. This was the time to rake it in, the time to corner the market. All you had to do was come up with a seductive benefits package, price premiums aggressively, hire swarms of hungry sales agents, put them on high commission schedules, and stand back. The premium dollars would fly in, the cash would be thrown

into the bond market, and profits would soar. If the competition didn't match you, step for step, you would own them before they could walk out the door. The weak and the tentative would fall to the side, and the resolute, the daring, would take over. It was the same old deal. The meek might inherit the earth, but before long, the bold would have it all back and would be disinheriting them.

In 1983, there were dozens of disability insurers in the business but only three heavyweights: Provident Life and Accident Insurance Company of Chattanooga, Tennessee; the Paul Revere Life Insurance Company of Worcester, Massachusetts; and Unum Life Insurance Company of America of Portland, Maine. Whether through loose lips, competitive surveillance, or coincidental stupidity, all three companies came up with similar plans.

Between 1983 and 1989, Provident, Paul Revere, and Unum had nearly a hundred thousand agents plowing the fields from Maine to California and throughout Canada. They were all selling "own-occupation" (own-occ) individual disability insurance. These policies held the enticing promise of payment should the insured become unable to perform the duties of his or her "own occupation."

The pitches were almost identical:

> Buy ours; it's noncancelable.
>
> No, buy ours; the premiums can never be raised.
>
> No, buy ours; it will pay benefits for life, not just to age sixty-five.
>
> Wait; we'll throw in annual cost-of-living adjustments to cover inflation.

Each company played on fear. The promotional material contained shocking statistics on the number of people seriously injured every year (see exhibit 2). This was accompanied by dire warnings about what could happen to someone who can no longer work. Auto accidents, sports injuries, illnesses, diseases – the litany of potential calamities went on and on.

"Don't think it can't happen to you," the sales agents warned. "That's what everybody thinks. Then it happens. And your life is ruined – along with the lives of all of those who are depending on you." But if you buy this policy, it will protect you if you are ever unable to perform your specific job. Your *specific* occupation."

Policy after policy was sold.

Happy projections came into the boardrooms. Double-digit interest rates – so good for insurance companies, so bad for mortgage seekers – would continue into the foreseeable future. Premiums were priced accordingly and *could not be raised*.

Of course, claims would be made on these policies – people would be injured or would develop covered illnesses – but claims payments would be far surpassed by the fat investment revenues.

Profits were just sitting there, waiting to be plucked, like juicy, fat little plums in a vast, glorious orchard that stretched from sea to shining sea – plums worth billions of dollars. As long as the interest rate projections that formed the basis for all of this continued to be correct, the profits would fly along as expected. You would need an army of counters just to keep tabs on the increasing profits.

The problem was the projections were wrong.

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A COPY OF THE MEMO RESTED ON THE POLISHED MAHOGANY COFFEE table next to a confidential analysis of the problem. Not only had the double-digit rates of the 1980s failed to hold up into the 1990s, but they had plummeted to half their 1980s levels. And as the rate predictions went out the window, so too did the claims/investment-profits formula that had provided the basis for the 1980s pricing calculations – calculations that had been used to price every own-occupation policy sold between 1983 and 1989.

Short-term claims – sprains and pains with small payouts and speedy recoveries – were not the problem. It was the high-benefit, long-term claims, claims that would have to be paid year after year, that suddenly posed the threat.

Because Provident had been the most aggressive in its attempts to corner the disability market, it was now facing the greatest exposure for losses. It knew the number of own-occ policies it had sold. It knew the size of the long-term disability benefits that were in place. It knew the extent and duration of the existing claims being paid. It knew the estimates of future claims that would be filed over the lives of the policies in force. It knew the terms of the insurance contracts it had

written. It knew it could not make interest rates go up. It knew it was in trouble.

In 1993, Provident was forced to take a $423 million charge, a loss of almost half a billion dollars caused by having to increase the company's reserves in order to pay existing and projected claims (see exhibit 3). This, undoubtedly, was just the beginning. If interest rates remained low, losses would continue to grow, which would have a very substantial effect on profits and, worse, on stock prices.

It was amazing, really, the kinds of blunders high-powered corporate executives with degrees from prestigious business schools were capable of making. These Wonder Boys, handpicked by the Provident board, had screwed up like rank amateurs.

But it wasn't just the senior management. Too many board members were out of touch. And while they were playing golf, attending charity socials, and checking on their portfolios, the barn was burning.

How the interest-rate projections could have been so far off the mark was a mystery. But they were. Why the leadership had thought it was a great idea to sell policies for which premiums could not be raised was equally mysterious. But they did.

Now these own-occ policies were going to cause shareholders a huge, expensive headache. The more shares one held, the bigger the headache. And this company had some very big shareholders. The situation had all the makings of an ugly, severe, and very real problem.

The Provident board did what such boards always do in these situations – it brought in a new CEO.

Enter J. Harold Chandler. To many, Chandler was an odd choice – *very* odd. But whatever had gone on behind closed doors stayed there, and the choice was made.

This isn't to say that Chandler's academic credentials weren't impressive. He had graduated Phi Beta Kappa in 1971 from Wofford College, a small, fairly selective institution in Spartanburg, South Carolina. He earned an MBA from the University of South Carolina and went through the advanced management program at Harvard.

In his early forties, Chandler projected an aura of competence. And while detractors found him aloof, detached, and somewhat arrogant, he packaged himself as an aw-shucks, regular kind of guy. It made little difference. CEOs aren't hired for their common touch. Boards want to turn over the reins to someone who can deliver.

In the case of Provident, the board was looking for someone who could get the company back on the profit-making track. Yet some real head shaking occurred over Chandler's appointment. Beyond owning his own policies, there was little evidence that the man knew anything about insurance. He was, of all things, a banker. He had spent more than twenty years with the Citizens & Southern Corporation, which became NationsBank Corporation, rising to become president of its Mid-Atlantic Banking Group.

Despite his lack of experience in the insurance industry, the handful of powerful individual and institutional stockholders whose shares in the company were worth hundreds of millions of dollars – the investors who really controlled things – anointed Chandler to lead Provident to "Moneyland." To provide him with a powerful incentive to accomplish this goal quickly, in addition to his fat salary the shareholder bigwigs gave Chandler options to purchase hundreds of thousands of shares of Provident stock at the price of $30 per share. The only catch was that the options would expire in five years. If the stock price rose substantially and rapidly, Chandler's personal take would be in the multimillions of dollars. If, on the other hand, the price stayed flat or went down, his options would be worthless.

Such an arrangement is not uncommon in corporate America. Many argue that awarding stock options is a legitimate way to attract – and keep – top talent. If an executive has stock options and the share price is rising, he or she will be less likely to jump to a competitor. Dot-coms in the 1990s were especially prone to using options as an incentive. How else were they to lure people away from established firms such as Intel or Microsoft?

Also, some argue that the option carrot is useful in getting management to try all that much harder to increase profits and push the stock price skyward. The good of the company becomes the very good of the executive.

But options have their critics, not the least of whom is Federal Reserve Board Chairman Alan Greenspan, who would blame what he called the "infectious greed" of the 1990s partially on stock options. "The... spread of shareholding and options among business managers," Greenspan said in 2002 after the Enron debacle, "perversely created incentives to artificially inflate reported earnings in order to keep stock prices high and rising. The incentives they created

overcame the good judgment of too many corporate managers." Greenspan could well have added that the problem was a lack of effective countervailing disincentives to serve as financial deterrents against profitable fraudulent activities.

In the case of Enron, top management hid problems in the company through creative accounting in order to exercise options before the stock price plummeted. Twenty-nine insiders walked away with $1.1 billion (with CEO Ken Lay's share being $104 million).

Chandler took over as CEO of Provident within weeks of the company's taking its $423 million charge. So what if he didn't know anything about insurance regulations? Perhaps so much the better.

What Chandler *did* know was what was really important. As a banker, he knew how to count.

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ACROSS THE COUNTRY, JOAN HANGARTER WAS COMPLETELY UNAWARE OF the situation in Chattanooga. Even if she had noticed an announcement of Chandler's ascendancy, it would have made no impression on her. She had, after all, purchased her policy from Paul Revere. In any case, she had other things to think about.

Joan started the 1990s doing well. Her kids were wonderful. Her fiancé, Bruce Wexler, was ambitious and filled with ideas. At the height of the Internet boom, when people were scrambling for ways to exploit the potential of the World Wide Web, Wexler was working on a start-up company that would sell music over the Net while protecting the artists' copyrights. His technology could also be used for Webcasts and online concerts. It was a heady time, filled with ahead-of-the-curve, moneymaking possibilities. Joan was right there at Wexler's side. But more importantly, she had her practice.

Health conscious, she looked more like a fitness instructor than a chiropractor. So unless you knew her background, chiropractic would have seemed an unlikely career for her to choose. When she entered the field in the 1980s, it was still viewed as a step off the mainstream by some. After all, the practitioners weren't *real* doctors, not *medical* doctors like Dr. Welby and Dr. Kildare. They didn't even solve problems by prescribing pills.

Chiropractors believe that many varieties of ill health stem from the spine being misaligned, that roadblocks in the spinal highway keep nerve impulses from reaching their destinations. By manipulating the spine at specific locations, chiropractors can solve or at least ameliorate specific health problems.

Though modern chiropractic began only a century ago, records exist of manipulations being performed as far back as 2560 BC. The legitimacy of the profession received a big boost in 1944 when veterans were allowed to use GI Bill of Rights grants for chiropractic training. In 1972, Congress okayed Medicare payments for chiropractic treatment. Thirty years later, members of the armed forces and veterans were accorded benefits, as well.

It is estimated today that twenty to twenty-five million people entrust their bodies to approximately sixty-five thousand chiropractors in the United States. But as late as 1997, most of those practitioners were men – 84 percent versus 16 percent women.

Despite all this, there was little question of Joan entering the profession. Naysayers of chiropractic could naysay all they wanted. Joan knew its healing power firsthand. At thirteen, she was diagnosed with scoliosis, curvature of the spine. The traditional treatment was wearing a brace for more than sixteen hours a day until the spine straightened or surgery. The latter was recommended for Joan. Her father opted for a third option. He took her to a chiropractor, who treated her for two years. As a result, no operation was necessary.

The profession also appealed to her because she loved helping people, so working as a waitress, Joan put herself through chiropractic school. After passing the state boards, she borrowed $10,000 to start her business and began the long, hard task of building her practice. Working from 6 a.m. to 7 p.m. daily, Joan built a solid referral network from the ground up, one step at a time. She was loved and respected by her many patients – who ranged from children with sports injuries to adults with back problems. Her easy smile and confident proficiency impressed both those she treated and the numerous medical doctors and other professionals who steadily sent their patients to her.

Beyond enjoying the feeling of success that came from the solid growth of Solano Chiropractic, Joan was truly fulfilled by the work she was doing. She was treating people who were in pain, as she had

been as a child, and she was making them well. Little else could have provided her with the satisfaction she was getting from what she was doing.

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ON FIRST ANALYSIS, PROVIDENT AND CHANDLER WERE FACED WITH a seemingly unsolvable conundrum. On one hand, there was nothing the company could do about low interest rates, while on the other, it was receiving more and more long-term claims every day.

Whether Chandler was truly ignorant of them or not, there are certain rules governing the insurance industry. One is the implied promise of good faith and fair dealing. This means that an insurance provider cannot unfairly deny a policyholder the peace of mind that he or she pays for when buying a policy.

It is illegal for an insurance company to unreasonably delay, terminate, or reject a valid claim. Investigations of a claim must be full, fair, and objective. The company's financial interests must never, ever be put above those of the policyholder. The insurer may never conceal benefits – which wouldn't be hard considering that most policies read as if they were written in random Chinese. Any ambiguities in coverage must be read in favor of the claimant. All of this means the company has to pay up honestly on *legitimate* claims.

The "legitimate" part is what Provident decided to use to its advantage. After all, the insurer got to decide what a "legitimate" claim was. If the claimant disagreed, he or she could just sue the multibillion dollar company with its battery of in-house lawyers and army of high-priced outside counsel.

Not long after Chandler's arrival, Ralph Mohney was tapped to take over Provident's entire claims department. Mohney's background was in accounting and tax. Despite being put in charge of the department, Mohney had never handled a single insurance claim in his life. But he, like Chandler, was a numbers cruncher.

Outside consultants were hired, the situation was analyzed, strategy sessions were conducted, and the problem was examined from

every angle. Through it all, one fact was certain. There were two sides of the equation – interest rates and claims. No matter what, one side was in granite – Provident could do absolutely nothing about the low interest rates. The other side, the claims side, was another matter entirely. It was there that changes could be made – bold, aggressive changes.

Starting in 1994 a number of "initiatives" would be instituted by Chandler and Mohney – initiatives that would put in place new procedures for dealing with claims *and* claimants. These initiatives would change the direction, the very philosophy, of the company. (See exhibit 4, for example.)

As a result of the profitability of these initiatives, by 1997 Provident was able to consume its former rival, Paul Revere. By 1999 it would gobble up Unum, as well. Through it all, Chandler, Mohney, and their "philosophy" would endure. Endure and thrive.

Under Provident's new corporate philosophy, the claims department began aggressively searching for reasons *not* to pay claims. Methods would be developed. Strategies would be deployed. Obstructions would be raised, delays instituted, and medical determinations challenged.

This was much to the misfortune of Joan Hangarter and many others who found their lives destroyed and themselves falling down the rabbit hole.