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INSURANCE OBSERVER

Nationwide to Pay $160 Million for Lawsuit

The Allied Mutual Rip-off

When Nationwide Mutual acquired Allied Mutual in 1998, it inherited a liability induced by David Schiff—a class-action and derivative-action lawsuit (*Rieff v. Evans*) against Allied, its chairman and CEO John Evans, and certain directors and officers who oversaw the siphoning of Allied Mutual's assets into its publicly-traded affiliate, Allied Group, which was also run by Evans.

Nationwide has now agreed to settle this lawsuit by paying $135 million to Allied Mutual's policyholders and $28.5 million to their lawyers. Although the lawsuit against Allied made some important law about the rights of policyholders, sadly, the settlement falls short of a great victory. Had the plaintiffs gone to trial and won (the facts were in their favor), the judgment might have exceeded $1 billion. But there would have been appeals, and given that the case has already taken eight years, seven appeals to the Iowa Supreme Court, and involved the production of hundreds of thousands of documents, it's not surprising that—with no end in sight—both sides would want to settle.

The proposed settlement, which must be approved by the Polk County, Iowa District Court, will bring to a close a saga that began with the stripping of Allied Mutual by its directors twenty years ago. Left unresolved is the legal issue of whether it is wrong for a mutual insurance company's directors to strip a mutual for their own benefit by engaging in numerous related-party transactions, complicated asset shuffles, and unfair transactions.

John Evans, Chairman & CEO of Allied Mutual

In 1996, David Schiff decided to spend some time traveling the back roads of Iowa and visiting insurance companies. At that time, Schiff was disheartened by the avarice and amorality he had observed in New York, and believed that in the American heartland he would find old-fashioned virtues and corn-fed honesty. Instead, he stumbled into the biggest racket the insurance industry has ever seen: the mutual-insurance industry's attempt to separate policyholders from hundreds of billions of dollars. (For more on the subject of mutuals, demutualization, and mutual holding companies, see every issue of *Schiff's* from October 1997 through the end 1999.)

Allied Mutual and its affiliate, Allied Group, were just two of the more than 100 Iowa companies that Schiff looked at. He no longer recalls why the Allied companies piqued his interest so much that he would spend a year and a half of his life on them, but they were the largest property-casualty companies in Iowa.

The Allied Mutual story is about how a mutual's officers and directors treated the mutual as if it belonged to them rather than to its policyholders. Beginning in 1985, Allied Mutual's directors and officers oversaw the transference of assets, premiums, and employees from Allied Mutual to its subsidiary, Allied Group. Over the next eight years, the two companies—which had interlocking boards of directors and the same executive officers—would engage in pooling changes, stock swaps, and complicated asset shuffles. Virtually every one of these transactions would prove to be beneficial to Allied Group (and to Evans and Allied's employees) and detrimental to Allied Mutual. For example, sixty-four percent of the premiums written by Allied Mutual would eventually be transferred to Allied Group—for no money. Since Allied was a profitable underwriter, this was a windfall for Allied Group.

The mastermind behind this asset shifting and expense jiggering was a little man with large glasses, white hair, and a bald pate named John Evans. Allied Mutual was founded by his grandfather, and John took over in 1964 at the age thirty-six after the death of his father. By the 1980s, as Evans approached the traditional retirement age, he found himself in comfortable financial position—but not really wealthy. He had divorced and remarried, and was developing expensive habits. He liked traveling by private jet and helicopter, and eventually bought two houses in California, in Palm Springs and Pebble Beach.

In 1985, Evans began the asset shuffling that would enrich Allied Group (and Evans) and emasculate Allied Mutual. He took Allied Group public at an extremely low valuation and was granted a stack of options. He transferred premiums from Allied Mutual to Allied Group. He transferred expenses from Allied Group to Allied Mutual. He had Allied Group charge fees to Allied Mutual. He had Allied Mutual sell assets to Allied Group at ridiculously low prices. He had Allied Group sell assets to Allied Mutual at high prices. He arranged for Allied Mutual to lend money to Allied Group on favorable terms. He rigged it so that even though Allied Group and Allied Mutual each had shares of an identical book of business, Allied Mutual's combined ratio was much higher than Allied Group's. He transferred all of Allied Mutual's employees to Allied Group (for no payment) then arranged for Allied Group to charge Allied Mutual excessive fees for their services. He set up a leveraged ESOP for Allied Group's employees and arranged for it to buy newly-issued Allied Group shares for about half their intrinsic value, thereby diminishing the value of the majority interest that Allied Mutual owned in Allied Group.

Some of Evans' crafty dealings were papered over by spurious "fairness opinions," including one from Conning & Company which may well be the most unsupportable fairness opinion of all time.

Irreconcilable conflicts of interest were a hallmark of Evans' handiwork. Because he was chairman and CEO of Allied Mutual *and* Allied Group, he was on both sides of all transactions. Because he had received a pile of stock options in Allied Group, he would *personally* profit if Allied Group got the best of Allied Mutual in their various dealings, which it did. What are the odds that Allied Group and Allied Mutual would engage in a dozen major transactions and that they would all be home runs for Allied Group and strikeouts for Allied Mutual?

After Schiff uncovered some of the seamy dealings between Allied Mutual and Allied Group, he spent about six months researching the company in great detail. Eventually, he decided that he wouldn't just write an article exposing what was going on; he would *do* something about it. He decided to run for Allied Mutual's board of directors, seize control, kick out the avaricious Evans and his cronies, unwind all the abusive transactions, and make restitution to Allied Mutual's policyholders. (Schiff would waive any compensation for his efforts.)

As Schiff was formulating his plan, he looked for someone else who was keenly interested in mutual insurance companies, preferably a lawyer, who could advise him. He eventually came across Jason Adkins, a consumer advocate then at the Center for Insurance Research, which he had also founded. Schiff's first conversation with Adkins, in the summer of 1997, was memorable. He briefly outlined what had gone on at Allied and told Adkins about his plan to take over the company via a proxy fight. Adkins sized up Schiff as a kook (perhaps he was right), and got off the phone quickly. "Send me your article when it comes out," he said.

In September 1997, Schiff, by then a nominee for Allied Mutual's board, published his article and ran a large ad in the *Des Moines Register* in which he called for Allied Mutual to distribute $385 million to its policyholders and encouraged policyholders to contact him. (One respondent was Mary Rieff, a longtime Allied Mutual policyholder. A couple of months later, Schiff introduced her to Adkins—who had by that time become his good friend and fellow traveler in the battle against abusive demutualizations—and Rieff became the plaintiff in *Rieff v. Evans*, the class-action and derivative-action lawsuit against Allied Mutual.)

On September 30, *The Wall Street Journal* ran an article by Leslie Scism about Schiff's exposé and proxy fight on page one of its "C" section. It was accompanied by a picture of Schiff, of whom Allied's president, Douglas Andersen, said, "He's a writer from New York. What does he know?"

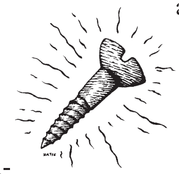
In the ensuing months, the Allied Mutual affair would receive considerable media coverage, and the Iowa insurance commissioner, Terri Vaughan, would reluctantly open an investigation. Soon, Allied would begin calling Schiff "a well-financed corporate raider." It would also attempt to prevent him from running for Allied Mutual's board, and, when those attempts failed, go to court to prevent a fair election. Allied Mutual also rigged the election by *giving* each of Allied Group's 1,600 employees a nominal policy so that they could vote.

On December 31, 1997, just before the statute of limitations ran out, Adkins filed *Rieff v. Evans* in the Polk County, Iowa court. The lawsuit, which followed the lines of *Schiff's* article, claimed that beginning in 1985 and continuing through February 18, 1993, the individual defendants and Allied Group caused Allied Mutual to enter into a series of transactions that improperly transferred substantial assets and business opportunities from Allied Mutual to Allied Group, and that the defendants and Allied Group benefited from these transactions. The lawsuit also claimed that the effect of these transactions was the *de facto* demutualization of Allied Mutual.

Allied Mutual remained under attack in 1998. Schiff was attempting to take control of the company, Adkins was pressing the lawsuit, and the Iowa insurance department was trying to figure out how a billion dollars of value had moved from Allied Mutual to Allied Group without the department realizing what was happening. The issue of corporate governance at mutual insurance companies had become the hot topic of the year. (America's large mutual life insurers were attempting to form mutual insurance holding companies so that they wouldn't have to give hundreds of billions of dollars of value to their owners—the policyholders.) Unbeknownst to the public, Allied was under even greater pressure—Nationwide Mutual wanted to take over Allied Group and Allied Mutual. In May, after being rebuffed by Evans, Nationwide went public with a hostile takeover offer for Allied Group and a concomitant proposal to merge Allied Mutual into Nationwide. Allied opposed the offer, but the price—more than fifty-percent higher than the previous close—made it difficult to turn down—without being sued by shareholders. Nationwide also sued Allied, accusing it of various improprieties.

Nationwide and Allied quickly resolved their differences, and, as part of the agreement, Nationwide agreed to provide Evans and his cronies with a broad indemnification. That indemnification will now cost Nationwide more than $160 million.

John Evans and the other Allied defendants denied the claims in the lawsuit, and, as part of the settlement, assert that "all of the contested transactions were for the benefit of Allied Mutual and its policyholders and caused no harm to them." We believe that *Schiff's* has shown, in its numerous articles about Allied, that the contested transactions were *not* for the benefit of Allied Mutual.



On August 16, the first advertisements about the settlement will appear in *USA Today*, *The Des Moines Register*, and other newspapers. All Allied Mutual policyholders who had policies on February 18, 1993 are eligible for compensation under the settlement. (Allied estimates that there are 300,000 such policyholders.)

Former Allied Mutual policyholders have already received a "Notice & Claim Form" which they must submit to receive their part of the $135 million settlement. (If you know anyone who had an Allied Mutual policy, make sure to tell them about the settlement.)

The amount of money that a policyholder receives will depend on how much he paid in premiums for the three years preceding February 18, 1993. It will also depend on the number of policyholders who submit claims. (If 100,000 policyholders submit claims, the average payment will be $1,350.)

Before the settlement can be ratified, a fairness hearing must take place. It will be held on October 7, 2005 at 9:00 a.m. in the courtroom of the Honorable Donna Paulsen at the District Court for Polk County, 500 Mulberry Street, Room 304, Des Moines, Iowa.

The following firms are the plaintiffs' class counsel: Adkins, Kelston & Zavez, P.C.; Barrack Rodos & Bacine; Lane & Waterman LLP; and Brady & O'Shea, P.C. More information about the settlement can be found at www.Alliedmutualsettlement.com.

After the settlement is paid, Allied Mutual's policyholders will have received $245 million ($110 million from a dividend when Nationwide acquired Allied and $135 million from the settlement). While this is a significant sum—and one that never would have been paid had Schiff and Adkins not gotten involved—it is still something of a disappointment. In 1985, Allied Mutual owned all of its own assets and 100% of Allied Group. Thirteen years later, after Evans' manipulations, most of Allied Mutual's assets had been transferred to Allied Group, and Allied Mutual owned virtually none of Allied Group. Allied Mutual got nothing from Allied Group's $1.6 billion takeover by Nationwide.

The $135 million settlement goes only a small way towards making Allied Mutual's policyholders whole. Of course, the policyholders wouldn't have lost out if *any* regulator had been on the ball. But none were. No regulator in any state objected to any of Allied's poisonous transactions and asset shuffles. And, to the best of our knowledge, no regulator did anything about the transactions once *Schiff's* made them public. That's a sorry comment on the state of insurance regulation.

In 1997, we called John Evans to interview him about the various asset shuffles. He responded with disdain. "What are you?" he asked. "Some kind of historian?" He then got off the phone.

While we were doing our research, one thing that stood out but that we didn't write about was how many people despised Evans. He'd had a bitter divorce battle with his ex-wife, two of his kids were estranged from him, Allied employees hated him, and agents felt he had screwed them. He was described as "junkyard dog mean." We were told that he was stingy and didn't have many friends.

Given that Evans masterminded a ripoff that left him rich and Allied Mutual's policyholders poor, it would be nice to imagine that he has paid a heavy price for his actions. But that may be wishful thinking. As someone who has known him for fifty years told us, "He fucked a million little policyholders and never had a bad night's sleep." ■

The following pages contain a brief chronology of events for Allied Mutual, and an index for all articles we published about Allied.

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A Brief Allied Mutual Chronolgy

1974

Allied Mutual forms wholly-owned subsidiary Allied Group. John Evans is chairman and CEO of both companies.

1985

Allied Group goes public, raising $16.8 million at a price approximating book value. Allied Mutual's ownership decreases to 79%.

Allied Group has no employees; Allied Mutual's 1,000 employees provide all services and administer the Allied pool of premiums.

John Evans granted options for 234,516 shares.

1986

Allied Group forms Western Heritage Insurance Co., which doesn't cede business to the Allied pool even though it markets through a "readily available distribution system—Allied Mutual agents.

1987

Allied Group forms Allied Group Information Systems and begins charging Allied Mutual fees for data-processing services. Allied Group increases its shares of the Allied pool of premiums to 41%.

Allied Group's SEC filings says that its "continued profitability is largely dependant upon the continued successful operations of Allied Mutual, which provides facilities, employees and all services required to conduct the business of the Company on a cost-allocated basis." All the officers of Allied Group are officers of Allied Mutual, and two-thirds of Allied Group's directors are directors of Allied Mutual.

1988

Evans receives 10-year options to purchase Allied Group stock for 44¢ per share. (Book value is $6.38 per share.) Other employees receive similar options. Allied Group directors (many of whom serve on Allied Mutual's board), are offered Allied Group stock options.

Allied Group borrows $7.8 million from Allied Mutual.

1990

Big restructuring plan. Allied Group sells its subsidiary, Allied Life, to Allied Mutual for a 17% premium to book value in exchange for its own shares at an 18% discount to book value. "Management believes that the future long-term profitability of property-casualty operations will be greater than the profitability of life-insurance operations," Allied Group admits. (By 1997, Allied Life is worth $50 million and Allied Group's repurchased shares are worth $273 million.)

Allied Group's percentage of the Allied pool is raised to 53%. "[Increasing the pool] gave us all the advantages of an acquisition without any of the drawbacks," Allied Group admits.

All Allied Mutual employees are transferred to Allied Group for no payment.

Allied Group's ESOP borrow $35 million from Allied Group to buy newly issued Allied Group convertible preferred stock at a bargain-basement price, thereby diluting Allied Mutual's interest. Allied Mutual's ownership of Allied Group is reduced from 78% to 40%. Allied Group's employees own 37%.

1992

Allied Group's share of the Allied pool increases to 60%.

Allied Group issues $52 million of 6.75% nonconvertible preferred stock in exchange for 4,111,250 shares of Allied Group owned by Allied Mutual. Allied Group later refers to the preferred stock as "a source of low-cost capital." By 1998, the preferred stock is still worth $52 million but the shares Allied Mutual parted with are worth almost $300 million.

1993

Allied Group's share of the Allied pool increases to 64%.

Allied Group replaces Allied Mutual as the pool administrator. Breaks tradition and begins charging Allied Mutual a fee. Evans calls this "an opportunity to flow every dollar of savings straight to [Allied Group's] bottom line." As a result, Allied Group earns $21.4 million from underwriting over the next four years while Allied Mutual loses $63 million.

Under Evans' direction, Allied Mutual sells the last of its Allied Group common stock. "The sale of the mutual's shares served all stockholders by increasing the float without diluting earnings or book value."

1994

Allied Group repurchases shares at higher price than Allied Mutual got for selling its shares. Allied Group's stock quintuples in next four years.

Between 1985 and 1993, under Evans' direction, Allied Mutual sold all of its interest in Allied Group. (Most of the sales were to Allied Group.) Allied Mutual received $24 million in cash, $52 million of preferred stock, and a life-insurance company worth about $50 million. Grand total: $126 million. In 1998, Allied Group will be sold to Nationwide for $1.6 billion, providing a windfall for Evans and Allied Group employees, who own more than 30% of the company.

1997

September: *Schiff's Insurance Observer* publishes 15,000-word exposé of Allied Mutual and Evans. David Schiff announces his candidacy for Allied Mutual's board and a proxy fight to gain control of Allied Mutual. He intends to boot out the board and make restitution to policyholders. Schiff waives any remuneration.

Iowa Insurance Department, run by commissioner Terri Vaughan, reluctantly begins investigation into Allied Mutual.

Vaughan orders Allied Mutual to provide mechanism for Schiff to mail proxies to policyholders. Allied Mutual goes to court and gets the order stayed. Vaughan, under pressure from the insurance industry, lets the matter drop.

December 31, 1997: Jason Adkins and the Center for Insurance Research bring a class-action and derivative-action lawsuit (based on *Schiff's* article) against Evans, Allied Mutual, and its directors and officers.

1998

May: Nationwide Mutual makes hostile takeover offer for Allied Group and Allied Mutual. Allied opposes offer, but after its officers and directors are indemnified by Nationwide, accepts.

Nationwide acquires Allied Group for $1.6 billion. Allied Mutual merged into Nationwide Mutual. Its policyholders receive a $110-million dividend.

2005

Nationwide agrees to settle lawsuit and pay Allied Mutual policyholders $135 million.

John Evans remains at large. *continued*

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continued