

**Ex-insurance executive sentenced** *Patterson gets 12 ½ years; convicted of role in fraud that ruined malpractice insurers* by Allen Cooper, Times Dispatch Staff Writer (June 29, 2005)

The former president of Reciprocal of America was sentenced yesterday to 12½ years in prison for insurance and mail fraud.

Kenneth R. Patterson's role in the frauds contributed to the 2003 collapse of companies that were once the primary medical and legal malpractice insurers in Virginia.

Patterson, 56, had pleaded guilty in February to charges of mail fraud and conspiracy to commit insurance fraud.

Carolyn B. Hudgins, 52, formerly executive vice president of the Richmond-based insurance group, pleaded guilty at the same time to conspiracy to commit insurance fraud. U.S. District Judge James R. Spencer sentenced her to five years in prison yesterday.

It is unlikely, however, that they will serve the full terms.

Assistant U.S. Attorney David T. Maguire asked Spencer to allow Patterson and Hudgins to remain free until Oct. 11.

"He's cooperating with the government, and we need access to him," Maguire told Spencer when the judge suggested a July date to start serving the sentence. Under federal law, prosecutors may, and often do, ask for sentence reductions based on the cooperation of defendants.

The cooperation of Pat-

terson and Hudgins "has led to disclosure of some very seedy things in the insurance and reinsurance industries," Maguire told Spencer.

Those disclosures have implicated executives at General Re Corp., a major international reinsurance company owned by the holding company of stock market guru Warren Buffett, and American International Group, one of the world's largest insurers.

Two former senior executives at General Re pleaded guilty this month to fraud related to alleged machinations between that company and AIG designed to make AIG's finances appear to be better than they were.

As opposed to Reciprocal, though, General Re and AIG remain in business.

Maguire said the most recent estimate of claims from health-care facilities, physicians and lawyers insured by Reciprocal of America and related companies may exceed \$400 million.

Formed in 1976 when Virginia hospitals and physicians were having trouble getting medical-malpractice insurance, the company also provided liability and worker's compensation coverage for health facilities. It created related companies, Doctors Insurance Reciprocal and American National Lawyers Insurance Recipro-

cal, to protect doctors and lawyers.

The companies ran into financial difficulty when they attempted to expand into such states as Alabama, Mississippi and Arizona, which have a history of large malpractice awards.

The insurers provided coverage for more than 7,000 professionals when Insurance Commissioner Alfred W. Gross placed them into receivership. Authorities said the companies insured more than 40,000 individuals and entities nationwide.

Court documents allege that First Virginia Reinsurance, a Bermuda-based reinsurance company created by Reciprocal of America, was short of the money it needed in a trust account to avoid the scrutiny of state regulators.

At the same, the parent company had barely the amount of surplus it needed to avoid regulators. To get around the problems, the parent company reported a \$10 million payment to the trust account as the prepayment of a premium, which falsely converted a reduction of its surplus to an asset.

The documents also allege that Patterson created the impression that the company's assets were larger than they



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were by ordering an arbitrary reduction in the amount of reserves allocated to resolve filed cases.

Attorneys for the defendants contended, and Maguire did not dispute, that their motivation was to salvage the company and that they did not benefit personally from the frauds.

But the defense attorneys also acknowledged that the loss might have been much less if regulators had been aware of the financial problems and intervened earlier.

The fraud allegations are among many other instances of accounting irregularities alleged in a civil lawsuit filed against many individuals and entities related to Reciprocal of America in November 2003 by Virginia's insurance commissioner.

A key allegation in the civil case is that General Re made a series of secret deals with Reciprocal of America and First Virginia Reinsurance that concealed the precarious financial condition of the companies from state insurance regulators.

That case has been consolidated in Memphis, Tenn., with another civil action. Pretrial motions have been filed but proceedings have been delayed by the criminal proceedings and by difficulty in coordinating the many claims.