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Dispute roils 22-year State Mutual-Hanover marriage

O'Brien vs. O'Brien

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It's been 22 years since State Mutual Life Assurance Co. bought a majority stake in then-floundering Hanover Insurance Co. of New York and moved the sinking property and casualty insurer to Worcester.

During the intervening decades, Hanover prospered under the arrangement. And the two companies operated side-by-side on State Mutual's 40-acre campus on Lincoln Street, where they employ more than 2,500 people.

But that amicable union appears to be rupturing.

Last month, in what one insider says was the first non-unanimous board vote in years, Hanover's 12 directors deadlocked over a State Mutual proposal to add five more State Mutual directors to the Hanover board. The failed proposal would have given the life insurer more power over Hanover operations.

HIT STALEMATE

The board also hit a stalemate on a Hanover proposal to set up a special directors' committee to review any stock sale or purchase proposals involving Hanover and State Mutual.

Days later, Hanover's president recommended to directors that the company be sold entirely to a third party. That recommendation, called "almost irresponsible" by State Mutual's top officer, is on the table for a Hanover board meeting scheduled for Tuesday. An alternative proposal for a special transaction committee also is on the agenda.

And last week, State Mutual took steps toward calling a special stockholders' meeting next month at which it will seek to remove some Hanover directors.

Because it was widely believed that State Mutual controlled the Hanover board by a 7-to-5 margin, the directors' stalemate last month surprised analysts.

TAKEN BACK

Also taken back by the tie vote was State Mutual's top officer, who serves as chairman of the Hanover board. Even more surprising, he said, is the force of Hanover's resistance to the State Mutual proposal. Part of that resistance includes the recent hiring as advisers of the heavy-hitting Skadden, Arps, Slate, Meagher and Flom law firm. The New York- and Washington-based practice is one of two top-ranked corporate takeover legal firms in the country.

"I'm surprised by the reaction to this ... It's kind of a tempest in a teapot ... this is not a takeover ... like BTR and Norton Co.," John F. O'Brien, president, chief executive officer and a director at State Mutual, said during an animated interview in his office last week.

But William J. O'Brien, president of Hanover, thinks differently. In a letter to Hanover directors after the split vote, he said he believes State Mutual's drive to win more seats on the board is part of a wider plan to eventually gain full ownership of the company. That would be financially detrimental to both the minority shareholders and Hanover, O'Brien says.

Observers suggest that the two O'Briens are on a collision course over management of Hanover — State Mutual's single largest investment. The men, who are unrelated despite their common surnames, appear to be leading opposing sides in the growing rift.

ATHLETICALLY TRIM

Tall and athletically trim, John O'Brien, 48, has been president and chief executive officer of State Mutual for two years. A graduate of both Harvard and its business school, he came to the company after rising to second-in-command at Fidelity Management & Research Co. in Boston.

He is "bottom-line, financially oriented" and has gone over State Mutual's expenses "with a microscope" during the past two years, according to one source familiar with both companies. The financial inspection led to the scrapping of some longtime State Mutual perks — like a shuttle service between the company's main building and nearby conference center. More important, some departments and jobs also were eliminated.

At 59 years of age, William O'Brien has been president of Hanover for 12 years. White-haired and introspective, he earned a bachelor's degree from Jesuit-run Fordham University and sometimes quotes the Bible and great thinkers in his business speeches. He keeps a company philosopher on staff and recently distributed to Hanover managers copies of Pope John Paul II's encyclical on capitalism and the role of the worker.

Described by some as a "people person," he has written that he believes "the first purpose of a corporation is to serve people." He is fiercely protective of the employee-centered corporate culture he helped craft at Hanover. The distinctive management approach — based on merit, openness and localness — has gained widespread attention and was featured in "The Fifth Discipline," a book on business organizations by Massachusetts Institute of Technology professor Peter M. Senge.

DIFFERENT OUTLOOKS

While John O'Brien has more of a what-have-you-done-for-me-lately view of business operations, William O'Brien favors a longer-range outlook on results, according to one observer.

All of which does not mean that Hanover's O'Brien is not a keen financial manager. As one former employee put it: "Bill is bottom-line oriented, too. But he believes the culture will take care of the bottom line."

So confident is he in Hanover's assiduously developed culture that he credits it for playing a key role in the company's financial turnaround over the past 20 years.

And preservation of that culture is a major motivation for William O'Brien's strenuous opposition to State Mutual's either taking over or exerting more control over Hanover.

"Most mergers don't work except for investment bankers and acquirers. Many fail because of clashes in culture which have dire consequences for individuals and negative consequences for financial results," O'Brien said during an interview in his office, which overlooks the nearby State Mutual building.

WANTS APPRECIATION

That is a point he hopes to impress on company directors in trying to convince them to sell Hanover to "an owner who appreciates us."

State Mutual's O'Brien is less convinced of the link between Hanover's corporate culture and its financial results.

"Sometimes you can spend so much time defining style, it can get in the way of managing the company," John O'Brien said from his wood-paneled office atop State Mutual's five-story headquarters building.

He suggests that Hanover's O'Brien is guilty of "old-fashioned management entrenchment" by so vigorously working against State Mutual's bid to gain more representation on the Hanover board.

But William O'Brien dismissed that theory. Bucking the wishes of the company's majority stockholder puts his job at great risk, he said.

SANK THE PROPOSAL

It was State Mutual's refusal to say what it planned to do with the increased board power — if and when it gets it — coupled with concern over lawsuits by disgruntled minority stockholders that sank the proposal in the directors' vote, William O'Brien said.

John O'Brien said State Mutual could not define its precise intentions to Hanover board members because it has none right now — except to exercise more control over its investment in Hanover.

He asserted that as a 57 percent shareholder, State Mutual has the right to pull more strings at Hanover. State Mutual chose to try and exercise that right at this time because of its displeasure with Hanover's recent financial performance, he said.

To illustrate his point, John O'Brien displayed a five-year comparison of Hanover's stock price performance with that of the property and casualty industry as a whole. According to that measure, Hanover's stock price declined 5.2 percent over the past five years while stock prices for the entire industry rose 39.9 percent.

EARNINGS HAVE SUFFERED

Hanover earnings also have suffered of late. The company earned $53.2 million in 1990, down from $82.8 million in 1989 and $119.9 million in 1988. For the first nine months of this year, net income was $33 million, off from $37.1 million for the same period in 1990.

Nonetheless, William O'Brien maintains that State Mutual's recent move to wield more control over its subsidiary violates a long-standing "responsible freedom" pact developed under previous State Mutual management. The unwritten agreement allowed Hanover to operate with little or no interference from its majority stockholder over the years, he said.

He also points out that State Mutual's original $35 million investment in Hanover is worth more than $450 million at today's stock price.

"We've been an extraordinarily remunerative investment for State Mutual," he said.

IN TOP HALF

William O'Brien doesn't deny that Hanover's recent financial results haven't been outstanding. But, using combined ratio as a standard, the company still ranks in the top half of the industry and expects to return to the top quarter soon, he said. A few years ago, the company's combined ratio put it near the top of the industry.

Combined ratio is a measure of profitabilty for insurance companies. It is based on the difference between dollars paid out in claims and expenses and dollars taken in in premiums.

Hanover and some analysts blame the diminished results in recent years largely on a down cycle plaguing the entire property and casualty industry.

"Mostly, I'd say it's been a difficult business environment. I think that's primarily why returns are poor in the last two years. But if you look at a longer-term chart, management has done an admirable job," said Matt Greenberg of New York-based Greenhaven Associates, an investment firm which holds a large chunk of Hanover stock.

TRACK TOWARD EARNINGS

Greenberg also believes Hanover has made some strategic decisions in the past 12 months that put it on a track toward improved earnings. A key change is "slowing down the business," or policy sales, during this period of competitive pricing, he said.

Greenberg praised William O'Brien's management skills. "He's always impressed us as a good leader. It's not clear to me what the problem is here," he said of the State Mutual/Hanover flare-up.

Some suggest that Hanover's time has just come in John O'Brien's scrutiny of State Mutual operations. Others say the current interest in Hanover is the result of State Mutual's own capital needs.

Right now, the Hanover investment, as valued on State Mutual's books, accounts for more than 70 percent of State Mutual's capital reserves. But under an accounting rule change proposed by the National Association of Insurance Commissioners, life insurers may no longer be able to use such subsidiaries in calculating their reserves and solvency.

WOULD NEED CAPITAL

Passage of that rule would leave State Mutual in great need of capital, analysts say. One way to get it is to sell its 57 percent share of Hanover. Another is to buy Hanover and sell off its subsidiary companies - such as Michigan-based Citizens Insurance Co. and Beacon Insurance Co. of Ohio.

Experts also say that State Mutual has other, more immediate capital needs that could be resolved by the sale of Hanover subsidiaries.

But all of that is unrelated to State Mutual's current desire to hold more sway over Hanover operations, John O'Brien maintains.

"Right now this has more to do with Hanover's performance ... It may be some things need to be done differently ... these are the kinds of issues we want to get at," he said.