

SPECIAL LITIGATION COMMITTEE RECOMMENDATION HELD TO BE UNREVIEWABLE

by David W. Larson, Esq., RPLU

In March of 2006, the *Wall Street Journal* reported that executives at various U.S. corporations, among them UnitedHealth Group, a Minnesota Corporation (“UnitedHealth”) received stock options on dates that coincided with a very low price on the date the option was granted, and that those options appeared to have been backdated.¹ The UnitedHealth options were identified as being primarily granted to Dr. William McGuire, CEO and chairman of the board and Chief Operating Officer Stephen Hemsley. The unexercised stock options granted to these two were valued at 2.3 billion dollars as of the end of 2005.² The litigation that followed demonstrated the full array of the tools available to minority shareholders in derivative actions, and established new legal principles for Minnesota Courts.

THE SHAREHOLDER LITIGATION

Shortly after the publication of the *Wall Street Journal* article, a number of actions were brought against McGuire and other UnitedHealth executives, including (1) eleven federal shareholder derivative suits (consolidated on July 6th), (2) federal securities class actions under the Private Securities Litigation Reform Act (“PSLRA litigation”), and (3) two state derivative suits under Minnesota law (consolidated on July 20th). The state derivative suits were brought in Minnesota state district court. The federal derivative litigation and PSLRA litigation were brought in the United States District Court for the District of Minnesota. The Securities Exchange Commission brought its own action against McGuire.

THE INITIAL REACTION OF THE UNITEDHEALTH BOARD TO THE WALL STREET JOURNAL ARTICLE

On April 4, 2006, UnitedHealth’s Board of Directors created a Special Committee composed of three disinterested Directors (Messrs. Richard Burke, James Johnson and Douglas Leatherdale) to lead an independent review of the Company’s option grant practices over the period from

1994 through 2006. The Special Committee engaged the law firm of Wilmer Cutler Pickering Hale and Dorr LLP (“WilmerHale”) as its counsel. The lead partner in the review was William R. McLucas, former Director of Enforcement of the United States Securities and Exchange Commission. Over the next five months, WilmerHale examined four million corporate documents, and interviewed individuals consisting of 80 current and former UnitedHealth employees, present and former Directors, and former auditors. They examined 29 option grants made by the Company from 1994 through 2006. These grants accounted for approximately 85 percent of the total number of options issued by UnitedHealth during that twelve-year period.

On October 15, 2006, UnitedHealth’s Board of Directors accepted the Wilmer-Hale Report, in which WilmerHale concluded: “The measurement dates used by the Company for most of the option grants issued to Section 16 Officers and non-section 16 employees under review were incorrect, and many of the option grants were likely backdated.”³

Also on October 15, the Board announced a complete restructuring of its organization, executive and board compensation, and the resignation of a number of officers and employees, including CEO William McGuire.

THE ROLE OF A SPECIAL LITIGATION COMMITTEE

A shareholder derivative suit is a common law creation that permits a shareholder to seek restitution for wrongs done to the corporation. A derivative suit actually belongs to the corporation, but the shareholders bring the action where the corporation has failed to take action for itself. Both Minnesota⁴ and Delaware⁵ law require that when an injury is to the corporation and only indirectly harms the shareholder, the claim based on that injury



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can only be pursued as a derivative claim. While shareholder derivative actions provide concerned shareholders a check against abuses committed by the directors or corporate executives, they also provide disruptive shareholders an opportunity to abuse the legal system and cause unjustified disruption and expense to the corporation.

In both Minnesota⁶ and Delaware⁷ a board of directors may create a special litigation committee consisting of one or more independent directors or other independent persons to consider legal rights or remedies of the corporation and whether those rights and remedies should be pursued through litigation or otherwise. Because of the independence of the special litigation committee, and through that committee, a corporation may dismiss or settle a derivative suit despite a conflict of interest on the part of some or all directors, and despite the wishes of the shareholders who may have initiated the action.

On July 19, 2006, UnitedHealth’s board passed a resolution creating a two-member Special Litigation Committee (“SLC”) under Minnesota Law.⁸ The two members appointed to the SLC were former justices of the Minnesota Supreme Court.

On November 29, 2006, the Federal Court, Chief Judge James Rosenbaum, entered an Order restraining the release of property that was the subject of the suit and claimed by Dr. McGuire. Later, the restraining order was extended with the agreement of all parties pending the report of UnitedHealth Group’s Special Litigation Committee.

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THE SPECIAL LITIGATION COMMITTEE'S INVESTIGATION

Over a period of fifteen months, the SLC conducted an investigation into a wide range of issues relating to the Company's historical stock option granting practices, and into thirty-two specific grants made during the period from 1994 to 2005. It examined each of the named defendants' roles in those practices and in connection with specific grants. The SLC members' personal involvement in the investigatory process was extensive. Each member personally reviewed thousands of source documents and interviewed fifty witnesses. Upon completion of the investigatory phase, the SLC considered the claims against each defendant and whether the pursuit of those claims would be in the best interests of the Company in light of all the facts and circumstances.⁹

THE SPECIAL LITIGATION COMMITTEE'S REPORT

While its investigation was ongoing, the SLC agreed to participate in the mediation along with other parties. Numerous mediation sessions were held with the assistance of former United States District Court Judge Layn R. Phillips, an independent mediator.¹⁰ On December 5, 2007, as a direct result of the mediation, the SLC, Plaintiffs, and certain Defendants agreed to settle the lawsuits.

The SLC issued its 75 page report the next day, on December 6, 2007.¹¹ In the report the SLC set forth the legal standards and defenses applicable to each derivative claim. Citing the "ongoing federal securities fraud actions involving similar allegations," however, the SLC declined to provide any detailed factual basis for its conclusions.¹² In the end, the SLC determined that a number of the claims "may have merit" and recommended a settlement of both state and federal shareholder derivative

suits. Premised upon that settlement, the federal shareholder derivative plaintiffs joined the defendants in asking the Federal Court to lift its injunction and release stock options and other property in excess of the proposed settlement sums to Dr. McGuire. One party, the California Public Employees' Retirement System, opposed lifting the injunction, claiming release of the funds will jeopardize its ability to collect a judgment should it prevail in the PSLRA litigation.¹³

THE REACTION OF THE FEDERAL DISTRICT COURT

The Federal Court was clearly troubled by the Special Litigation Committee's proposed settlement which permitted Dr. McGuire to retain substantial sums. The Court commented that an alert Board of Directors might not agree that Dr. McGuire was entitled to "pelf approaching \$800,000,000."

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Words such as “huge,” “fantastic,” “astounding,” “staggering,” or “astronomical,” do not describe \$1 billion. Such a sum can only be thought of as “transcendent,” or in terms of the gross national product of smaller members of the United Nations.¹⁴

* * *

The Special Litigation Committee has apparently made a business judgment favoring settling the Board’s and UHG’s possible claims against its former officers on terms outlined in its report. But its lack of any findings leaves no tracks showing why or how its business judgment can be considered reasonable. Its business judgment may close the inquiry, leaving a Court mute, and charged only with the ministerial duty to sign off on the deal and dismiss the derivative suit. Or there may be other alternatives. Ultimately, the Court asks whether Minnesota law makes an SLC an impenetrable “black box,” whose decisions and evaluative processes are immune from review in a shareholders’ derivative suit. Put another way, does the business judgment rule foreclose any action, beyond the Court’s rubber stamping an SLC’s decision?¹⁵

Following available provisions of Minnesota Statutes, Chief Judge Rosenbaum “certified”¹⁶ to the Minnesota Supreme Court the question of his ability to review the business judgment of the SLC.

THE RULING OF THE MINNESOTA SUPREME COURT

Courts nationwide have developed two lines of analysis when considering the deference due to the finding of a Special Litigation Committee. The New York rule holds an SLC’s decision essentially unreviewable. *Auerbach v. Bennett*, 47 N.Y.2d 619, 419 N.Y.S.2d 920, 393 N.E.2d 994, 996 (N.Y.1979). The Delaware rule allows limited review of an SLC’s business judgments. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788 (Del.1981)

The Minnesota Supreme Court formulated the certified question posed by Chief Judge Rosenbaum as follows:

To what extent does the business judgment rule as recognized in Minnesota

law require a court, in deciding whether to approve a proposed settlement of a shareholder derivative action, to defer to the decision of a Special Litigation Committee duly constituted under Minn.Stat. § 302A.241, subd. 1 (2006) that the derivative action should be settled on specific terms?¹⁷

The Minnesota Supreme Court issued its decision on August 14, 2008.¹⁸ The Supreme Court adopted New York’s *Auerbach*¹⁹ rule for determining whether it is appropriate to defer to an SLC.²⁰ The Supreme Court explained that the *Auerbach* court “forbade any inquiry into ‘which factors were considered by [the SLC] or the relative weight accorded them in reaching that substantive decision.’”²¹ The Supreme Court elaborated by stating that, under the *Auerbach* rule, “the substantive aspects of a decision to terminate a shareholders’ derivative action against defendant corporate directors made by a committee of disinterested directors appointed by the corporation’s board of directors are beyond judicial inquiry.”²²

In adopting the New York rule, the Minnesota Court analyzed and rejected the standards for review set forth in the Delaware case of *Zapata Corp. v. Maldonado*.²³ Under the Delaware process, a court reviewing an SLC report, after an initial review of the independence and good faith of the SLC, “may proceed, in its discretion,” to a second step, in which the court “applies its own independent business judgment.”²⁴

THE AFTERMATH OF THE MINNESOTA SUPREME COURT’S HOLDING

Based on the ruling of the Minnesota Supreme Court, on December 24, 2008, the Federal District Court and the State court issued a joint order preliminarily accepting the settlement reached by the parties and the Special Litigation Committee.²⁵ The order authorized notifying the shareholders of the settlement, and set a final hearing for February 13, 2009. Attached to the order was the approved notice of the proposed settlement to be distributed to shareholders.²⁶

There were no objections to the settlement itself at the February hearing. There were, however, objections to the application for fees for the plaintiff’s counsel in the amount


of \$47 million in fees and expense reimbursement of \$803,591.78.²⁷

On July 1, 2009, an order was filed approving the settlement, and awarding reduced fees of \$29.2 million and \$514,591 in litigation expense reimbursement. To reach that number, the court found that 10.6 million dollars in fees were appropriately incurred, and applied a multiplier of 2.75.²⁸ A notice of appeal was filed in the 8th Circuit on September 4, 2009, on the attorneys’ fee issue, and the initial brief was filed on January 19, 2010.

THE SPECIAL LITIGATION COMMITTEE CAN SERVE A USEFUL FUNCTION

Derivative litigation creates a high exposure for officers, directors, corporations and insurers. The risks are substantial. Even the best of intentioned board of directors faces potential catastrophic losses when thrown into a court system, particularly a state court system, where the judges may have no commercial or business background, and the jurors do not have a clue. The special litigation committee process has the ability to divert potentially disastrous litigation into the hands of professionals who understand the insured’s business and can devote the time and resources to fashion a solution to the shareholder problem, or, if the claim is meritless, dispose of it without trial.

Special Litigation Committees are controversial. Commentators and courts have criticized the Special Litigation Committee process as having an inherent pro-management bias.²⁹ In *Zapata*, the Delaware Supreme Court noted a structural bias in special litigation committees, where members of the special litigation committee may be sympathetic to corporate directors, thinking that “there but for the grace of God go I.”³⁰

Nonetheless, the Special Litigation Committee is the best available mechanism for limiting the risk of runaway meritless derivative litigation. The same mechanism provides an avenue for pursuing legitimate shareholder claims in an effective manner without destroying the corporation. 

Footnotes for this article can be found on page 7.

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Rene Syler, well known television personality, served as anchor on CBS “The Early Show” from 2002 to 2006. During her tenure she conducted high profile interviews including First Lady Laura Bush, General Colin Powell and numerous celebrities. She is currently an author, blogger and continues to make guest appearances on networks such as CNN and HLN. She travels and speaks following her latest book, “Good Enough Mother.” Ms. Syler is also an ambassador for the Susan G. Komen for the Cure, and was awarded the prestigious Gracie Allen award for her television series on breast cancer.

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FOOTNOTES for Special Litigation Article from Page 5

1. Charles Forelle & James Bandler, *The Perfect Payday*, Wall St. J., Mar. 18, 2006.
2. UnitedHealth Proxy Statement on Schedule 14A, filed April 7, 2006, p. 16.
3. www.unitedhealthgroup.com/assets/shared/Wilmer_Hale_Report.pdf.
4. *Wessin v. Archives Corp.*, 592 N.W.2d 460, 464 (Minn. 1999).
5. *Tooley v. Donaldson, Lufkin & Jemette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004).
6. Minn.Stat. Ann. § 302A.241, Subd. 1.
7. *Maldonado v. Flynn*, 413 A.2d 1251 (Del.Ch.1980).
8. Minn.Stat. § 302A.241, subd. 1 (2006).
9. *Report of the Special Litigation Committee*, Case 06-cv-01216-JMR-FLN Document 298, page 32.
10. *Id.* p. 39.
11. *Report of the Special Litigation Committee*, Case 06-cv-01216-

- JMR-FLN Document 298 and 299.
12. *Report of the Special Litigation Committee*, Case 06-cv-01216-JMR-FLN Document 298 p 19.
13. *In re Unitedhealth Group Inc.*, 754 N.W.2d 544, 549 (Minn., 2008).
14. *In re Unitedhealth Group Incorporated Shareholder Derivative Litigation*, 2007 WL 4571127 *3 (D.Minn.)
15. *Id.* at *7.
16. A question may be certified to the Minnesota Supreme Court for decision “if the answer may be determinative of an issue in pending litigation in the certifying court and there is no controlling appellate decision, constitutional provision, or statute of this state” Minn.Stat. § 480.065 subd. 3 (2006).
17. *In re Unitedhealth Group Inc.*, 754 N.W.2d 544, 549 (Minn., 2008).
18. *In re Unitedhealth Group Inc.*, 754 N.W.2d 544 (Minn., 2008).
19. *Auerbach v. Bennett*, 47 N.Y.2d 619, 419 N.Y.S.2d 920, 393 N.E.2d 994 (1979).

20. *In re Unitedhealth Group Inc.*, 754 N.W.2d 544, 559 (Minn., 2008).
21. *Id.*
22. *Id.*
23. *Zapata Corp. v. Maldonado* 430 A.2d 779, 787 (Del.1981).
24. *In re Unitedhealth Group Inc.*, 754 N.W.2d 544, 556 (Minn., 2008).
25. *In re: Unitedhealth Group Incorporated Shareholder Derivative Litigation*, 591 F.Supp.2d 1023 (Dec 24th 2008).
26. *Id.* at 1032.
27. Order of July 1, 2009, Case 06-cv-01216-JMR-FLN Document 409, Page 11.
28. *Id.* at 13.
29. See Daniel S. Kleinberger and Imanta Bergmanis, *Direct v Derivative* 22 William Mitchell Law Review 1204, 1235-1236 (1996).
30. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 787 (Del. 1981).