

No. A08-114

STATE OF MINNESOTA
IN SUPREME COURT

In re UnitedHealth Group Incorporated Shareholder Derivative Litigation

and

In re UnitedHealth Group Incorporated PSLRA Litigation

**OPENING BRIEF OF THE MEMBERS OF THE BOARD OF DIRECTORS
OF
UNITEDHEALTH GROUP INCORPORATED**

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REPRESENTATION STATEMENT

This brief is submitted on behalf of those defendants in the pending federal derivative litigation who were the members of the Board of Directors of UnitedHealth Group Incorporated at the time the special litigation committee was created by the Board: Stephen J. Hemsley, William C. Ballard, Jr., Richard T. Burke, James A. Johnson, Thomas H. Kean, Douglas W. Leatherdale, Mary O. Munding, Ph.D., Robert L. Ryan, Donna E. Shalala, M.D., and Gail R. Wilensky, Ph.D.*

Certain current and former officers of UnitedHealth Group Incorporated, including Arnold H. Kaplan, David P. Koppe, Thomas P. McDonough, Jeannine M. Rivet, Robert J. Sheehy, R. Channing Wheeler, and Travers H. Wills, are also defendants in the federal derivative actions. While their views on the answer to the certified question are consistent with those of the members of the Board, the members of the Board have the most direct interest in the issues before this Court, and this brief is accordingly submitted only on their behalf.**

* William W. McGuire, M.D., William G. Spears, former Board members who stepped down from the Board on October 15, 2006, and David Lubben are also defendants and are represented separately.

** Although the certified question directly relates only to the federal derivative actions, the federal district court's certification order also is entered in the pending federal securities action brought under the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4, in which Patrick J. Erlandson, William A. Munsell, Tracy L. Bahl, and Lois E. Quam are also defendants. This brief is not submitted on their behalf. UnitedHealth Group Incorporated is a defendant in the federal securities action and is the beneficiary of the settlement referenced herein.

TABLE OF CONTENTS

REPRESENTATION STATEMENT	i
TABLE OF CONTENTS	ii
TABLE OF AUTHORITIES	iii
STATEMENT OF ISSUES.....	1
STATEMENT OF THE CASE	2
STATEMENT OF FACTS.....	3
A. United and Its Board of Directors.....	3
B. <i>The Wall Street Journal</i> Article Regarding Stock Options and the Subsequent Derivative Lawsuits	4
C. United’s Board Responds to the Issues Raised in <i>The Wall Street Journal</i> Article	4
D. United’s Board Creates the SLC to Respond to Claims Raised by the Derivative Plaintiffs.....	5
E. The Report of the SLC.....	6
F. Certification of the Question Presented to this Court.....	7
INTRODUCTION AND SUMMARY OF THE ARGUMENT.....	8
ARGUMENT	10
A. Fundamental Principles Of Corporate Law Support Application Of The Business Judgment Rule To, And Limited Judicial Review Of, The Determinations Of Special Litigation Committees	10
B. As this Court Established in <i>Janssen</i> , The Business Judgment Rule Applies To The Determinations Of Special Litigation Committees, Limiting Judicial Review To The Independence And Good Faith Of The Committee ..	13
C. The Principles of <i>Janssen</i> Require Similar Deference to the Settlement Determinations of Special Litigation Committees	20
D. Deference to the Settlement Decisions of Special Litigation Committees is in Accord With The Authority Conferred By Minnesota Statute	21
E. The Path Chosen By This Court in <i>Janssen</i> Reflects the Better Rule.....	23
CONCLUSION.....	27

TABLE OF AUTHORITIES

	Page(s)
CASES	
<i>Arent v. Distribution Sciences, Inc.</i> , 975 F.2d 1370 (8th Cir. 1992)	11
<i>Atkins v. Hibernia Corp.</i> , 182 F.3d 320 (5th Cir. 1999)	24
<i>Auerbach v. Bennett</i> , 47 N.Y.2d 619 (1979)	23, 24, 25, 26
<i>Black v. NuAire, Inc.</i> , 426 N.W.2d 203 (Minn. Ct. App. 1988)	14
<i>Drilling v. Berman</i> , 589 N.W.2d 503 (Minn. Ct. App. 1999)	1, 15, 16, 17
<i>Finley v. Superior Court</i> , 80 Cal. App. 4th 1152 (Cal. Ct. App. 2000)	24
<i>Hirsch v. Jones Intercable, Inc.</i> , 984 P.2d 629 (Colo. 1999)	24
<i>Janssen v. Best & Flanagan</i> , 662 N.W.2d 876 (Minn. 2003)	passim
<i>Kaplan v. Wyatt</i> , 484 A.2d 501 (Del. Ch. 1984)	25
<i>Karmen v. Kemper Fin. Servs., Inc.</i> , 500 U.S. 90 (1991)	11
<i>Miller v. Bargaheiser</i> , 591 N.E.2d 1339 (Ohio Ct. App. 1990)	24
<i>Roberts v. Alabama Power Co.</i> , 404 So.2d 629 (Ala. 1981)	24
<i>Singer v. Allied Factors, Inc.</i> , 13 N.W.2d 378 (Minn. 1944)	10

<i>Skoglund v. Brady</i> , 541 N.W.2d 17 (Minn. Ct. App. 1995).....	16
<i>United Copper Securities Co. v. Amalgamated Copper Co.</i> , 244 U.S. 261 (1917).....	12
<i>Wessin v. Archives Corp.</i> , 592 N.W.2d 460 (Minn. 1999)	11
<i>Zapata Corp. v. Maldonado</i> , 430 A.2d 779 (Del. 1981).....	24, 25, 26
STATUTES AND RULES OF PROCEDURE	
Del. Code Ann. Title 8 § 141(c).....	25, 26
Minn. R. Civ. P. 23.09.....	11, 21
Minn. Stat. § 302A.201	11
Minn. Stat. § 302A.241	passim
Minn. Stat. § 302A.243 (1988)	14, 16
Minn. Stat. § 302A.251	13
Minn. Stat. § 302A.425	10
Minn. Stat. § 302A.431	11
Minn. Stat. § 302A.433	11

STATEMENT OF ISSUES

In its Order filed February 1, 2008, this Court accepted a certified question from the United States District Court for the District of Minnesota and reformulated the question 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?

Most Apposite Authority:

Minn. Stat. § 302A.241, subd. 1 (2006)

Janssen v. Best & Flanagan, 662 N.W.2d 876 (Minn. 2003)

Drilling v. Berman, 589 N.W.2d 503 (Minn. Ct. App. 1999)

STATEMENT OF THE CASE

As more fully described in the Statement of Facts below, various shareholder derivative lawsuits were filed in the United States District Court for the District of Minnesota beginning in late March of 2006. The cases were eventually consolidated under the caption *In re UnitedHealth Group Inc. Shareholder Derivative Litigation*, Master File No. 06-1216 JMR/FLN. In response, the Board of Directors of UnitedHealth Group Incorporated (“United”) appointed a Special Litigation Committee (“SLC”) to investigate and act on the claims asserted in the derivative action. After acknowledging the deference afforded a special litigation committee under Minnesota law, the federal district court granted a partial stay of the derivative lawsuit, pending the report of the SLC. (A.1-5).

Beginning in April of 2006, shareholder derivative suits were also filed in Hennepin County District Court and eventually consolidated under the caption *In re UnitedHealth Group Inc. Derivative Litigation*, File No. 27 CV-06-8085. These state court derivative actions are pending before the Honorable George F. McGunnigle, and also have been stayed in part pending the report of the SLC. (A.6-29).

The SLC’s report was issued on December 6, 2007. (A.193-302). Among other things, the report announced a substantial settlement that would result in the recovery by United of hundreds of millions of dollars. All of the parties to the derivative action agreed to the terms of the settlement, including the corporation (the plaintiff in a derivative action), the derivative plaintiffs (who ostensibly stood in the shoes of the corporation), the defendants, and the SLC. (A.303-335). The derivative plaintiffs and

Dr. McGuire thereafter jointly moved the court to dissolve a preliminary injunction as a step in concluding settlement of the derivative action. The lead plaintiff (the California Public Employees' Retirement System) in the accompanying federal securities class action, captioned *In re UnitedHealth Group Inc. PSLRA Litigation*, Civ. Action No. 06-1691 JMR/FLN, opposed the motion. No party to the derivative action or the *PSLRA* action requested that a question be certified to this Court, and the federal court did not ask the parties' view on the matter. On December 26, 2007, the federal court issued an order, maintaining the injunction until it received the answer to the question which it certified to this Court in an order dated January 2, 2008. This Court accepted the question, as reformulated, in its Order filed February 1, 2008, and ordered briefing thereon.

STATEMENT OF FACTS

A. United and Its Board of Directors

United is a diversified health care company incorporated in the State of Minnesota and headquartered in Minnetonka. Lead Plaintiffs' Amended and Consolidated Verified Derivative and Class Action Complaint ("Compl.") at ¶ 31 (A.42).

Stephen J. Hemsley, William C. Ballard, Jr., Richard T. Burke, James A. Johnson, Thomas H. Kean, Douglas W. Leatherdale, Mary O. Mundinger, Ph.D., Robert L. Ryan, Donna E. Shalala, M.D., and Gail R. Wilensky, Ph.D., were Board members at the time of the creation of the SLC, as were William W. McGuire, M.D. and William G. Spears. Eight of those Board members were "independent" under the rules of the New York Stock Exchange and had no other material relationship with the Company. (A.185). The

Complaint in the federal derivative lawsuit seeks a recovery for the corporation and names all of the Board members listed above as “Director Defendants.” Compl. at ¶¶ 33-66 (A.42-53). The Complaint also names several current and former officers of United as “Officer Defendants,” including Dr. McGuire, Mr. Hemsley, Arnold H. Kaplan, David P. Koppe, David J. Lubben, Thomas P. McDonough, Jeannine M. Rivet, Robert J. Sheehy, R. Channing Wheeler, and Travers H. Wills. Compl. at ¶¶ 67-75 (A.53-55).

B. *The Wall Street Journal* Article Regarding Stock Options and the Subsequent Derivative Lawsuits

On Saturday, March 18, 2006, *The Wall Street Journal* published an article reporting that executives at certain public companies had received options on dates which coincided with a low point in the price of the companies’ stock. *See* Compl. at ¶ 5 (A.32-33). United and its Chairman and CEO, Dr. McGuire, were included in the article. *Id.*

Thereafter, several United stockholders filed derivative lawsuits on behalf of the corporation, generally alleging that United’s Board breached its fiduciary duties by granting stock options to United’s management which were “back-dated,” or by allowing management to “back-date” such grants, so that the exercise price for the options coincided with a low or the lowest price for United’s stock in a particular time period. *See, e.g., id.* at ¶ 7 (A.33-34).

C. United’s Board Responds to the Issues Raised in *The Wall Street Journal* Article

United’s Board promptly responded to the issues raised in *The Wall Street Journal* article, and appointed a committee comprised of independent directors to review the Company’s current and past stock option grant practices (“Independent Committee”).

(A.186). The Independent Committee retained William R. McLucas, the former Director of Enforcement of the U.S. Securities and Exchange Commission and a partner in the law firm Wilmer Cutler Pickering Hale and Dorr LLP (“WilmerHale”), as independent counsel to assist in the review. (A.187-88). Mr. McLucas and his team were “given full authority and access to conduct a comprehensive review with no restrictions.” (A.188).

The Independent Committee, with the assistance of its independent counsel, completed its review and, on October 15, 2006, United made its report (the “WilmerHale Report”) publicly available. Concurrent with the release of the WilmerHale Report, United’s Board announced that Dr. McGuire was stepping down as Chairman of the Board and as a Director, and that Mr. Spears had resigned. (A.189-92). In addition, certain senior executives, including Dr. McGuire, voluntarily agreed to reprice all options awarded to them through 2002. *Id.*

D. United’s Board Creates the SLC to Respond to Claims Raised by the Derivative Plaintiffs

On April 18, 2006, a shareholder made a demand, based on the same issues as raised in the Complaint, that the Board pursue certain remedies arising out of the Company’s stock options practices. (A.282-83). In response to the demand and the various derivative lawsuits filed by United shareholders against United and its directors and officers, and explicitly acting “pursuant to Section 302A.241 of the Minnesota Statutes,” the Board created a Special Litigation Committee by resolution on June 26, 2006. (A.278-81). The Board conferred on the SLC the “complete power and authority to investigate” all of the claims raised in the derivative actions and shareholder demand

and the power to “analyze the legal rights or remedies of the Company and determine whether those rights or remedies should be pursued.” (A.279). United’s Board further provided that “[t]he SLC is in no way limited solely to a review of the Independent Committee’s review and has the express power to conduct any additional investigation or analysis it deems appropriate,” and gave the SLC full authority to retain independent legal counsel and financial advisors to advise and assist its work. (A.279-80).

The members of the SLC are former Minnesota Supreme Court Chief Justice Kathleen Blatz and former Minnesota Supreme Court Justice Edward Stringer. (A.211-13). As set forth in their Report, the members of the SLC confirmed their independence from the Company and the individual defendants in the derivative actions. (A.213). The SLC retained independent counsel, the law firms of Kelly & Berens, P.A. and Munger, Tolles & Olson, LLP, to assist in its review. (A.213-16). The SLC also retained a law professor, forensic accountants, and an economist. (A.216-18).

E. The Report of the SLC

The SLC conducted an extensive fifteen month investigation. In the course of that investigation the SLC studied a wide range of issues, including thirty-two specific stock option grants made from 1994 to 2005. (A.228-35). The SLC examined the role of each of the defendants named in the derivative suits, reviewed thousands of source documents, and conducted fifty witness interviews. *Id.* The SLC met with the professor whose statistical studies were cited in *The Wall Street Journal* article, interviewed current and former United employees, officers and directors, and met with counsel for the various parties to obtain their perspectives. *Id.* When the SLC determined it would be in the best

interests of United to attempt to resolve certain claims by settlement, it encouraged the retention of a former federal judge to mediate those efforts. *Id.*

On December 6, 2007 the SLC issued its 75-page report. In sum, the SLC determined that it was in “the best interest of the Company” for certain claims asserted in the derivative actions to be dismissed as a result of settlements and that certain claims should be dismissed because “it is in the best interests of the Company not to pursue the claims.” (A.270). The SLC took note of the “substantial” package of remedial actions by certain defendants that would result in a recovery of \$992.7 million in intrinsic value to the Company. (A.270-71). Agreements memorializing the settlements were entered into between the Company, the SLC and certain individual defendants, as well as with the derivative plaintiffs. (A.303-35).

F. Certification of the Question Presented to this Court

On December 7, 2007, counsel for the derivative plaintiffs and Dr. McGuire jointly moved the federal district court to dissolve a stipulated injunction that prohibited Dr. McGuire from exercising options during the pendency of the SLC review. Although not a party to the federal derivative actions, the lead plaintiff in the accompanying federal securities action opposed the injunction’s dissolution.

In ruling on that motion, the federal court noted that “all information available to the Court suggests the SLC was properly constituted under Minnesota law,” and that the SLC was made up of “persons of unquestioned integrity and probity.” (A.338). It also noted that “[t]he Court has not yet been asked to approve the SLC’s proposed settlement.” (A.346). In order to aid its decision on the dissolution of the injunction

being sought, however, and because it recognized that the standard of “review of an SLC’s business judgment . . . is a matter of public policy,” it “opt[ed] to ask Minnesota’s highest court to define the policy Minnesota’s legislature has enacted into law.” (A.347). This certification followed.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

The business judgment rule is a fundamental principle under Minnesota law. When a board of directors makes business judgments, generally courts are not in the business of reviewing the reasonableness of those judgments. Such judgments, which include decisions to expand the business, or change strategic direction, or pursue legal claims, are given deference under the business judgment rule. In particular with respect to whether to pursue legal claims, this Court has previously recognized in *Janssen v. Best & Flanagan*, 662 N.W.2d 876 (Minn. 2003), that a decision by a corporation through a duly authorized special litigation committee to pursue or not to pursue derivative claims is generally protected by the business judgment rule so long as the special litigation committee was independent and acted in good faith. The question of whether a special litigation committee may *settle* claims and be given the same deference is novel, but the answer is a logical extension of *Janssen* and is contemplated by Minn. Stat. § 302A.241. If deference is given to a special litigation committee’s decision to sue or not sue, it is natural to extend the same deference to a decision not to pursue a lawsuit where settlements have been reached.

In *Janssen*, the Court recognized that “[b]ecause of the business judgment rule . . . not all shareholders’ derivative suits proceed on their merits.” *Id.* at 882-883. The

Janssen Court recognized that the business judgment rule allows boards and their committees to make business decisions, and concluded that “[i]f the board properly delegates its authority to act to the special litigation committee, the court will extend deference to the committee’s decision under the business judgment rule.” *Id.* at 884. The standard for whether a special litigation committee is entitled to the benefit of deference consistent with the business judgment rule is whether the special litigation committee “conducted [its] investigation with sufficient independence and good faith to deserve the deference of the business judgment rule.” *Id.* at 888.

Following *Janssen*, the deference due a special litigation committee’s decision to settle – the question certified here – follows inexorably: the authority to decide not to sue at all includes within it the authority to decide not to sue if the putative defendants are willing to take certain actions or make certain payments to the corporation. A court’s role in reviewing that decision is important, but limited: if the special litigation committee has acted in good faith and with sufficient independence (as outlined in *Janssen*), its business decision to settle must be respected. That is part of the legislative decision to give special litigation committees the power not only “to *consider* legal rights or remedies of the corporation” but also to determine “*whether* those rights and *remedies should be pursued*.” Minn. Stat. § 302A.241, subd. 1 (emphasis added).

Although the Board has delegated its normal power to sue and to settle on behalf of the corporation to the SLC here, the Board of Directors of United has a very significant interest in this Court’s answer to the certified question. As discussed below, the Board has a duty to all the shareholders of the corporation, not merely to those who

want it to sue. To fulfill that duty here, the Board created the SLC, as Minnesota law empowered it to do, and it must defer to that Committee's decision regarding the matter delegated to it; by legislative command, the Board cannot "control" or even "direct" that decision. Minn. Stat. § 302A.241, subd. 1. It would contradict the purpose of Minnesota's special litigation committee statute if a corporation's regular board, and through it the shareholders who chose it, must defer to such a committee's decision, while a court, acting on its own or at the behest of only a few of the shareholders, need not. This Court in *Janssen* has already assured both boards and shareholders that Minnesota law does contemplate the appropriate deference by courts to such business judgments, and the Board here urges the Court to confirm that under Minnesota law such deference includes a special litigation committee's business judgment as to settlements of derivative claims.

ARGUMENT

A. Fundamental Principles Of Corporate Law Support Application Of The Business Judgment Rule To, And Limited Judicial Review Of, The Determinations Of Special Litigation Committees

A corporation is an entity separate and distinct from its shareholders. 1 William Mead Fletcher, *Fletcher Cyc. Corp.* § 25.10 (2007); see *Singer v. Allied Factors, Inc.*, 13 N.W.2d 378, 380 (Minn. 1944). Among the benefits of this business form is that individual shareholders ordinarily cannot be held liable for the acts of the corporation. See Minn. Stat. § 302A.425. Among its consequences is that the corporation, as a separate entity, must decide its own fate and act on its own rights. Shareholders may have the power to vote for the board of directors, and may through proxy solicitations and

related mechanisms make proposals for board consideration or demand that a shareholders' meeting be held, but they do not otherwise make decisions for the corporation in lieu of the board. *See* Minn. Stat. §§ 302A.431, 302A.433. If they did, the corporation would not be a separate entity; it would be more like a partnership, presumably with partnership-like liability for its shareholders as well.

A corporation is also a creature of the state. Accordingly, the legislature sets the requirements for and limitations on how a corporation must operate. *See generally* Minn. Stat. § 302A. Among the requirements are those that make the corporation's board of directors responsible for directing the affairs of the corporation. Minn. Stat. § 302A.201, subd. 1. Among the limitations are that individual shareholders, or even groups thereof, cannot themselves assert a right (such as a potential cause of action) that is the right of the corporate entity. *See Wessin v. Archives Corp.*, 592 N.W.2d 460, 464 (Minn. 1999); *Arent v. Distribution Sciences, Inc.*, 975 F.2d 1370, 1372 (8th Cir. 1992) (applying Minnesota law).

As a check on the power of boards, however, shareholders can, within limits, seek permission to assert a corporate right if the corporation has failed to do so. *See* Minn. R. Civ. P. 23.09. Among those limits are a requirement of proof that a demand has been made on the board to assert the corporate right at issue, *see, e.g., Wessin*, 592 N.W.2d at 464, and a general deference to the business decision of the board concerning the assertion of that corporate right, if certain standards have been met. *See, e.g., Karmen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 95 (1991) (describing the extraordinary remedy of a shareholder derivative action in which an individual shareholder may bring a lawsuit

“to enforce a *corporate* cause of action against officers, directors and third parties”) (internal quotation marks omitted) (emphasis in the original). That deference is, of course, known as the business judgment rule.

The business judgment rule is a common law standard of judicial review that is designed to protect the wide latitude conferred on a board of directors in handling the corporation’s affairs. 3A William Mead Fletcher, *Fletcher Cyc. Corp.* § 1036 (2007). In the context of the decision whether or not to sue, Justice Brandeis succinctly articulated the rule as follows:

Whether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of management and is left to the discretion of the directors, in the absence of instruction by vote of the stockholders. Courts seldom interfere to control such discretion *intra vires* the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment[.]

United Copper Securities Co. v. Amalgamated Copper Co., 244 U.S. 261, 263-64 (1917).

The application of the business judgment rule to the decision whether or not to sue is important not just to the corporation as an entity, but to the other shareholders who are not part of the group suing to assert a corporate right instead of the board. Those other shareholders invested in the corporate form, with its attendant benefits and consequences. Shareholders would not typically expect that any one group of shareholders could direct corporate affairs outside of the corporate form. They also would not expect that the judicial branch would direct the business affairs of the corporation by deciding whether a corporation should pursue legal claims in the first

instance, or what sort of a remedy a corporation should accept in consideration for deciding not to further pursue claims that belong to the corporation. The state does not normally get to decide whether private actors should or should not assert their own private rights.

The corporation (and hence the board) has a duty to act in accord with the interests of *all* the shareholders, *see, e.g.*, Minn. Stat. § 302A.251, subd. 1, not just the ones who want it to sue. To preserve that role when the board's own interest may reasonably be questioned as being a self-interest apart from that of the corporation, and thus to preserve, to the extent possible, the corporate form in which the shareholders invested, the state has explicitly provided the board with a way to keep the corporate form and yet make a decision apart from the board: the appointment of a special litigation committee of the board "to consider legal rights or remedies of the corporation and whether those rights and remedies should be pursued." Minn. Stat. § 302A.241, subd. 1.

B. As this Court Established in *Janssen*, The Business Judgment Rule Applies To The Determinations Of Special Litigation Committees, Limiting Judicial Review To The Independence And Good Faith Of The Committee

Prior to 1981, the power of a board of directors to delegate aspects of the management of the business and affairs of the corporation to committees was not explicit, except in relation to an executive committee of the board, and "the power of committees was vague." *See* Minn. Stat. Ann. § 302A.241, Reporter's Notes – 1981. In 1981, § 302A.241 explicitly gave boards the power to "parcel out the management of the corporation to one or more committees," *id.*, and a separate section dealt explicitly with the topic of special litigation committees:

Unless prohibited by the articles or bylaws, the board may establish a committee composed of two or more disinterested directors or other disinterested persons to determine whether it is in the best interests of the corporation to pursue a particular legal right or remedy of the corporation and whether to cause the dismissal or discontinuance of a particular proceeding that seeks to assert a right or remedy on behalf of the corporation. For purposes of this section, a director or other person is “disinterested” if the director or other person is not the owner of more than one percent of the outstanding shares of, or a present or former officer, employee, or agent of, the corporation or of a related corporation and has not been made or threatened to be made a party to the proceeding in question. The committee, once established, is not subject to the direction or control of, or termination by, the board. A vacancy on the committee may be filled by a majority vote of the remaining members. The good faith determinations of the committee are binding upon the corporation and its directors, officers, and shareholders. The committee terminates when it issues a written report of its determinations to the board.

Minn. Stat. § 302A.243 (1988). The Minnesota Court of Appeals construed this section as “preclud[ing] our courts from reviewing the merits of a recommendation to dismiss a shareholder’s derivative action when that recommendation is made by a disinterested committee conducting its investigation in good faith.” *Black v. NuAire, Inc.*, 426 N.W.2d 203, 209-10 (Minn. Ct. App. 1988).

In 1989, the legislature repealed the language it had used in Minn. Stat. § 302A.243, and replaced it with new provisions inserted into the general committee forming power found in Minn. Stat. § 302A.241. As later recounted by the Court of Appeals:

The legislature took that action in recognition that Minnesota was one of the few states with legislation governing judicial review of special litigation committees. *Hearing on S.F. No.*

190 Before the Senate Comm. on the Judiciary (Apr. 11, 1989) (statement of Sen. Luther). The repeal represented “a commitment to let the caselaw develop,” *id.*, and a desire to give our courts flexibility. *Hearing on S.F. No. 190 Before the Senate Comm. on the Judiciary, Civil Law Division* (Mar. 17, 1989) (statement of Sen. Luther).

Drilling v. Berman, 589 N.W.2d 503, 506 (Minn. Ct. App. 1999).

Whatever the exact nature of the judicial flexibility intended, the legislature did not merely leave everything up to the judiciary. First, it took the unusual step of explicitly stating its intent regarding any implication to be drawn from the fact of its repeal of the previous language:

Notwithstanding any contrary provision of Minnesota Statutes, chapter 645, the repeal of Minnesota Statutes, section 302A.243, does not imply that the legislature has accepted or rejected the substance of the repealed section but must be interpreted in the same manner as if section 302A.243 had not be [sic] enacted.

1989 Minn. Laws ch. 172, § 12 (A.350). Next, in § 302A.241, the legislature explicitly provided for the formation of special litigation committees, for them to have certain powers, and for them to be exempt from the control and direction of the regular board:

A resolution approved by the affirmative vote of a majority of the board may establish committees *having the authority of the board in the management of the business of the corporation* only to the extent provided in the resolution. *Committees may include 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.* Committees *other than special litigation committees . . .* are subject at all times to the direction and control of the board.

Minn. Stat. § 302A.241, subd. 1 (emphasis added).

In its first opportunity to consider what standard of review should be applied to special litigation committee decisions under the new section, the Court of Appeals concluded that the standard of review adopted in *Black* was not affected by the repeal. See *Skoglund v. Brady*, 541 N.W.2d 17, 21 (Minn. Ct. App. 1995). The court noted that the legislature had specifically advised in its repealer that the repeal was not intended to suggest that the legislature was rejecting the content of Section 302A.243, but rather was intended to enable the courts to develop case law in this area. *Id.* at 20. The court held, therefore, that the district court in the case before it had properly refrained from conducting a “substantive review” of the special litigation committee’s recommendation and was correct to limit its review to “determining whether the special litigation committee was independent and conducted its review in good faith.” *Id.* at 21.

In *Drilling v. Berman*, the Court of Appeals again confirmed that the judicial review of a special litigation committee’s decision is limited to the committee’s independence and good faith. 589 N.W.2d at 507. In *Drilling*, a group of shareholders brought a derivative suit on behalf of Grand Casinos, alleging that members of the corporation’s executive staff had breached their fiduciary duties by, among other things, “misappropriating and misusing material, nonpublic corporate information to profit personally through insider trading, and [] exposing [the corporation] to liability for violations of . . . securities laws.” *Id.* at 505. In response to the suit, Grand Casinos created a special litigation committee. *Id.* The committee, after reviewing numerous documents but offering no written analysis, recommended that none of the claims be

pursued. *Id.* at 506. Based upon the committee’s recommendation, the district court dismissed the suit. *Id.*

The Court of Appeals, noting that this was not an issue of first impression, stated that its review was strictly limited to “whether the committee was independent and conducted its investigation in good faith.” *Id.* at 507. Citing *Skoglund* and *Black*, the court added that it had adopted a more “deferential” approach to the application of the business judgment rule, which precludes the court from “inquir[ing] as to which factors were considered by [the special litigation committee] or the relative weight accorded them in reaching [the committee’s] substantive decision.” *Id.* at 509. The *Drilling* court explained that it adopted this deferential standard because “courts are ill-equipped to evaluate business judgments while corporate directors [are] peculiarly qualified to discharge that responsibility.” *Id.* at 507 (internal quotation marks omitted). Applying this standard, the court concluded that the committee was independent and had conducted its investigation in good faith, and affirmed the district court’s dismissal of the action. *Id.* at 511.

Against the above backdrop, this Court decided *Janssen*. The questions directly at issue were “(1) whether the Minnesota Nonprofit Corporations Act prohibits a nonprofit corporations’ board of directors from establishing an independent committee *with authority to make decisions about derivative lawsuits*; and (2) whether Murnane, as special counsel [*i.e.*, as a special litigation committee], *displayed sufficient independence and good faith to be entitled to the deference of the business judgment rule.*” *Janssen*, 662 N.W.2d at 881 (emphasis added).

The Court began by stating that “[t]o resolve this case we must strike a balance between two competing interests in the judicial review of corporate decisions.” *Id.* As the Court described those interests: “On the one hand, courts recognize the authority of corporate directors and want corporations to control their own destiny. . . . On the other hand, courts provide a critical mechanism to hold directors accountable for their decisions by allowing shareholder derivative suits.” *Id.* at 881-82 (citations omitted). It then recognized that “[c]ourts have attempted to balance these two competing concerns by establishing a ‘business judgment rule’ that grants a degree of deference to the decision of corporate directors.” *Id.* at 882.

The Court recognized that, “[b]ecause of the business judgment rule . . . not all shareholders’ derivative suits proceed on their merits,” *id.* at 882-83, and that “courts apply the business judgment rule when evaluating the decision by a board of directors whether to join or quash a derivative suit belonging to the corporation,” *id.* at 883. The Court first articulated “the principles by which we apply the business judgment rule to a for-profit corporate board’s decision whether to join a derivative lawsuit,” and only then “consider[ed] whether to grant similar deference to nonprofit boards of directors.” *Id.* In the course of so doing, the Court also decided the rule for special litigation committees: “If the board properly delegates its authority to act to the special litigation committee, the court will extend deference to the committee’s decision under the business judgment rule.” *Id.* at 884. The Court also set the standard for whether or not a special litigation committee gets the benefit of the minimal review of the business judgment rule: “[w]e consider whether Murnane [the single member of the special litigation committee in that

case] conducted his investigation with sufficient independence and good faith to deserve the deference of the business judgment rule.” *Id.* at 888. Applying that standard, the Court concluded that, under the facts of the case before it, Murnane’s investigation “lacked the independence and good faith necessary to merit deference from this court.” *Id.* at 889.¹

The federal district court sought the guidance of this Court because *Janssen* “explicitly declined to ‘adopt a particular version of the business judgment rule for use with Minnesota nonprofit organizations today.’” (A.347) (quoting *Janssen*, 662 N.W.2d at 888 n.5). Indeed, the Court in *Janssen* did question whether a “more exacting standard” might be more appropriate for nonprofits, as described in footnote 5:

We do not adopt a particular version of the business judgment rule for use with Minnesota nonprofit organizations today. Because we hold that Murnane’s investigation failed the most minimal version of a business judgment rule, requiring that a litigation committee act in good faith, with independence, we need not reach the question of whether a more exacting standard of judicial review may be appropriate for nonprofit corporations than in the case of for-profit corporations. The members of nonprofits are not akin to diversified shareholders-any risk sustained by them cannot necessarily be spread among their other investments. Nor can they necessarily protect themselves by taking their assets elsewhere.

662 N.W.2d at 888 n.5. The uncertainty of whether a “more exacting standard” might be appropriate for a nonprofit, however, has no bearing here because the *Janssen* Court had

¹ The Court also concluded that defects in the grant of authority to Murnane could not be remedied by a second grant of additional authority, and a second investigation, after the results of the initial investigation had been challenged. 662 N.W.2d at 889-890.

no doubt about the standard applied to for-profit special litigation committees, namely “good faith” and “independence.” *Id.* at 888. *Janssen* thus made clear both “the principles by which we apply the business judgment rule to a for-profit corporate board’s decision whether to join a derivative lawsuit,” *id.* at 883, and the standard of “minimum judicial review” that applies to the decisions of a for-profit board’s special litigation committee. In order to decide how those principles and that standard applied in the nonprofit context, it had to first decide what they were in the for-profit context. Thus, the Court’s rulings were not mere *dicta* but were necessary to its ultimate decision.

C. The Principles of *Janssen* Require Similar Deference to the Settlement Determinations of Special Litigation Committees

Following *Janssen*, the question certified by the federal district court and reformulated by this Court fairly answers itself. As *Janssen* itself noted: “*The key element is that the board delegates to a committee of disinterested persons the board’s power to control the litigation. . . . A mere advisory role of the special litigation committee fails to bestow a sufficient legitimacy to warrant deference to the committee’s decision by the court.*” 662 N.W.2d at 884 (emphasis added). The requisite “power to control the litigation” necessarily includes the power to decide when and under what terms litigation should end, *i.e.*, when, in the exercise of business judgment, corporate resources should not be further spent on litigation, particularly if certain goals can be achieved by settlement. Moreover, “[c]ourts are not well-equipped to scrutinize the decisions of a corporation; judges should not be . . . thrust between dissatisfied

shareholders and profit-seeking boards.” *Id.* at 883. Indeed “[i]f the board properly delegates its authority to act [the “key element” of which is the “power to control the litigation”] to the special litigation committee, the court will extend deference to the committee’s decision under the business judgment rule.” *Id.* at 884.²

D. Deference to the Settlement Decisions of Special Litigation Committees is in Accord With The Authority Conferred By Minnesota Statute

This conclusion – that the decision of properly appointed special litigation committees, if arrived at in good faith and with sufficient independence, must be followed with regard to settlement decisions – is also in accord with the legislature’s decision to authorize special litigation committees in the first place. The statute explicitly allows an SLC to have the power not only “to consider legal rights or remedies of the corporation,” but also “whether those rights and remedies *should be pursued.*” Minn. Stat. § 302A.241, subd. 1 (emphasis added). Indeed, the legislature’s provision for special litigation committees only makes sense if that conclusion is reached.

First, if special litigation committee decisions were not accorded the deference of the courts, there would be little point in providing for such committees even to exist. The

² The provision for court approval found in Minn. R. Civ. P. 23.09 must be read in light of the above, because that rule requires approval but does not itself provide a standard to be applied. The standard for that approval thus depends on what is being reviewed: If the business judgment of a special litigation committee to settle is being reviewed, the court reviews for good faith and independence, and defers to the decision of the special litigation committee if it does not find those qualities lacking. If it does find them lacking, and accordingly the derivative action is allowed to proceed, it may be that a more searching review, perhaps akin to that required for approval of a class action settlement, may be appropriate. That latter question, however, is not before the Court today.

mere provision of a mechanism by which the board may preserve the normal corporate form of governance by appointing a special litigation committee itself demonstrates an intent to have the decisions of that committee be given judicial deference. Any other conclusion would mean that the legislature created a mechanism that lacked a purpose because if courts always reviewed the reasonableness of a special litigation committee's business judgment, special litigation committees would become redundant.

Second, the legislature has in fact removed any need to guess at the proper interpretation of its provision for special litigation committees. Under the two-prong power conferred by Minnesota's statutory scheme, the legislature has allowed the delegation of more than the power to investigate; investigative power is the power "to consider legal rights and remedies of the corporation" (the first prong). The second prong, the power "to consider . . . whether those rights and remedies should be pursued," is conferred in addition to the investigative power, and is more than that; it is in fact the power to control pursuit of those corporate rights. Indeed, the legislature was even more specific than that, explicitly granting such committees not just the power to decide whether corporate "rights" should be pursued – *e.g.*, whether a cause of action asserting those rights should or should not be filed – but also "whether . . . *remedies* should be pursued" – *i.e.*, to decide on the appropriate remedy to accept for breach of those rights. In the words of this Court in *Janssen* noted above, delegation of the "power to control the litigation" – to control "whether . . . rights and remedies should be pursued" – is the "key element" of the legislative scheme. Minn. Stat. § 302A.241, subd. 1.

E. The Path Chosen By This Court in *Janssen* Reflects the Better Rule

Courts in other jurisdictions have also concluded that special litigation committees of for-profit boards are entitled to substantial deference. For example, in *Auerbach v. Bennett*, 47 N.Y.2d 619 (1979), a case repeatedly cited in *Janssen*, a shareholder brought a derivative action, claiming that the corporation's directors and accountants had breached their fiduciary duties in connection with certain questionable foreign payments. *Id.* at 625. The board thereafter created a special litigation committee, consisting of three directors who had joined the board after the challenged transactions, and delegated to the committee all of the authority of the board to determine whether to pursue the derivative claims. *Id.* The special litigation committee, after investigation, determined that maintenance of the derivative action was not in the best interest of the corporation. *Id.* at 626.

The New York Court of Appeals affirmed summary judgment in favor of the corporation on the basis of the committee's decision, holding that courts must defer to the recommendations of the special litigation committee and limit their review to the committee's independence and the adequacy of its investigation into the issues raised in the complaint. In doing so, the Court reasoned that the committee's substantive decision was protected from judicial scrutiny by the business judgment rule:

The . . . substantive decision falls squarely within the embrace of the business judgment doctrine, involving as it did the weighing and balancing of legal, ethical, commercial, promotional, public relations, fiscal and other factors familiar to the resolution of many if not most corporate problems. To this extent the conclusion reached by the special litigation committee is outside the scope of our review. Thus, the

courts cannot inquire as to which factors were considered by that committee or the relative weight accorded them in reaching the substantive decision. . . . To permit judicial probing of such issues would be to emasculate the business judgment doctrine as applied to the actions and determinations of the special litigation committee.

Id. at 633-34. Courts in other jurisdictions have also followed the *Auerbach* approach. *See Atkins v. Hibernia Corp.*, 182 F.3d 320, 325 (5th Cir. 1999) (predicting that the Louisiana Supreme Court would “follow the majority of jurisdictions” and adopt the *Auerbach* approach); *Finley v. Superior Court*, 80 Cal. App. 4th 1152, 1162 (Cal. Ct. App. 2000) (adopting the *Auerbach* approach); *Hirsch v. Jones Intercable, Inc.*, 984 P.2d 629, 637-38 (Colo. 1999) (same); *Miller v. Bargaheiser*, 591 N.E.2d 1339, 1342 (Ohio Ct. App. 1990) (applying the “traditional view” that a court should not independently assess the merits of a derivative action); *Roberts v. Alabama Power Co.*, 404 So.2d 629, 632 (Ala 1981) (limiting the court’s review to the good faith and independence of the committee).

As noted by the federal court here, the Delaware Supreme Court chose a different route in *Zapata Corp. v. Maldonado*, 430 A.2d 779, 787-89 (Del. 1981). While, *Zapata* adopted the *Auerbach* court’s analysis, it added a second, discretionary step in which the court applies its own business judgment to the committee’s recommendation. The primary rationale offered for the two-step approach is that judicial scrutiny of the merits of a business decision not to prosecute a derivative claim minimizes the possibility that the result will have been affected by “structural bias.” The *Zapata* court felt that courts “must be mindful that directors are passing judgment on fellow directors in the same

corporation and fellow directors, in this instance, who designated them to serve both as directors and as committee members.” *Id.* at 787. It added the second step in order to “strik[e] the balance between legitimate corporate claims as expressed in a derivative shareholder suit and a corporation’s best interests as expressed by an independent investigating committee.” *Id.* at 789.³

There are several reasons why this Court should not follow *Zapata*. First, *Zapata* was decided 22 years before *Janssen* and had this Court concluded that the *Zapata* approach, as opposed to that of *Auerbach*, represented the approach most consistent with Minnesota corporate law, it could and would have done so.

Second, the Minnesota legislature has directly addressed the “structural bias” referred to in *Zapata* by creating a mechanism that allows the board to appoint independent and disinterested persons who are not current members of the board. Minn. Stat. § 302A.241. Under Delaware law a committee of the board must consist of board members. *See* Del. Code Ann. tit. 8 § 141(c). Moreover, the review for independence and good faith is to uncover the existence of circumstances that would preclude application of the business judgment rule. *See Auerbach*, 47 N.Y.2d at 631. This is not a perfunctory task. The court must look into the procedures employed and determine whether they were adequate or whether they were so inadequate as to suggest bad faith on the part of the committee members. “Proof . . . that the investigation has been so restricted in scope, so shallow in execution, or otherwise so pro forma or halfhearted as to

³ As noted by one Delaware Court, *Zapata* “has the pragmatic effect of setting up a form of litigation within litigation.” *Kaplan v. Wyatt*, 484 A.2d 501, 511 (Del. Ch. 1984).

constitute a pretext or sham, consistent with the principles underlying the application of the business judgment doctrine, would raise questions of good faith or conceivably fraud which would never be shielded by that doctrine.” *Id.* at 634-35. Indeed, *Janssen* itself – which in addition to establishing the standard of judicial review held that the investigation in that case had not met the standard – proves that judicial review for good faith and sufficient independence “has teeth,” and is effective.

Third, in Delaware, where *Zapata* was decided, special litigation committees are not specifically provided for by the legislature; Delaware law only provides for the establishment of committees in general. *See* Del. Code Ann. tit. 8, § 141(c). Special litigation committees are Delaware common law creations resulting from courts interpreting that general grant, and are accordingly more subject to judicial delineation of their powers and limitations. *See, e.g., Zapata*, 430 A.2d at 785 (construing Del. Code Ann. tit. 8, § 141(c)). That fact alone distinguishes the *Zapata* rule and militates against its adoption here.

Finally, and most importantly, for this Court now to overrule the foundations of *Janssen* and follow the *Zapata* path would be inconsistent with legislatively established principles of Minnesota corporate law. As noted above, the Minnesota legislature has affirmatively provided for the creation of special litigation committees, and has explicitly delineated their allowed powers. That has the necessary consequence of judicial deference, once good faith and sufficient independence have been found.

CONCLUSION

For all the foregoing reasons, this Court should reaffirm the principles established in *Janssen*. In answer to the certified question, this Court should state that “minimal judicial review” is the appropriate standard for review of the settlement determinations of a special litigation committee duly formed pursuant to the provisions of and powers provided for in Minn. Stat. § 302A.241, subd. 1. In accord with that standard, if a court determines that the special litigation committee conducted its investigation and made its settlement determination with good faith and sufficient independence, the court must then defer to its business judgment as to the settlement terms.

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**CERTIFICATE OF COMPLIANCE
WITH MINNESOTA RULE OF CIVIL APPELLATE
PROCEDURE 132.01, SUBD. 3**

The undersigned hereby certifies, pursuant to Minnesota Rule of Civil Appellate Procedure 132.01, Subd. 3(a)(1), that this brief (exclusive of the table of contents, the table of authorities, any addendum, and any certificates of counsel), contains 7,643 words, as ascertained by using the word count feature of the Microsoft® Word 2000 word-processing software used to prepare the brief, and conforms to the typeface and type style requirements of the Rules by being in 13-point Times New Roman format.

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