

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

**RESPONSE BRIEF OF DAVID J. LUBBEN
ON CERTIFIED QUESTION**

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ARGUMENT

The opening briefs of several parties advocate a modification of the Minnesota business judgment rule, based either on inapplicable procedural rules or foreign cases. Despite these arguments, the Court need not and should not look to federal cases interpreting federal procedural rules, procedural rules governing the resolution of class-action lawsuits, or other states' varying interpretations of the business judgment rule. The answer to the certified question is clear: The business judgment rule as developed under Minnesota law requires courts to defer to an SLC's decision if the SLC "acted in good faith and was sufficiently independent from the board of directors to dispassionately review the derivative lawsuit." *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 888 (Minn. 2003). There is no occasion or need for a different answer.

I. THE CERTIFIED QUESTION INQUIRES ABOUT THE BUSINESS JUDGMENT RULE, NOT STATE OR FEDERAL PROCEDURAL RULES

The federal district court certified a narrow question regarding the degree of deference that Minnesota courts afford to SLC's and their decisions. As reformulated by this Court, the question asks nothing about federal or state procedural rules. Several parties have advocated for an answer to the certified question that confounds the purposes behind different procedural rules and the business judgment rule. Their positions are untenable and should be rejected.

Nothing in the text of Minn. R. Civ. P. 23.09 or Fed. R. Civ. P. 23.1 indicates that any particular substantive review is mandated in approving a settlement of derivative litigation. Rule 23.09 states only that "[t]he [derivative] action shall not be dismissed or

compromised without the approval of the court” The Rule’s federal counterpart likewise contains no provision regarding the substantive review of an SLC’s decision to settle derivative litigation. Rule 23.1(c) simply states: “A derivative action may be settled, voluntarily dismissed, or compromised only with the court’s approval.” Both rules of procedure contemplate approval by the court, but the substantive basis for judicial review under either procedural rule is determined by Minnesota law, specifically the business judgment rule this Court defined in *Janssen*. 662 N.W.2d at 888.

In *Burks v. Lasker*, 441 U.S. 471, 478 (1979), a case that addressed the power of disinterested directors to terminate derivative litigation under the Investment Advisors Act¹, the United States Supreme Court acknowledged that even where federal rights are at stake, if resolution of the issue involves matters of corporate law, state law controls: “As we have said in the past, the first place one must look to determine the powers of corporate directors is in the relevant State’s corporation law. . . . Corporations are creatures of state law, and it is state law which is the font of corporate directors’ powers.” (Citations omitted); *see also Santa Fe Indus. Inc. v. Green*, 430 U.S. 462, 479 (1977); *Cort v. Ash*, 422 U.S. 66, 84 (1975) (confirming that state law governs the internal affairs of the corporation).

Twelve years later, in *Kamen v. Kemper Fin. Servs. Inc.*, 500 U.S. 90, 96 (1991), the Supreme Court held that state corporation law would determine whether a derivative

¹ *Burks* addressed Rule 23.1 in a footnote, noting that it was inapplicable because the matter was before the court on an involuntary settlement by the court, which fell outside the scope of Rule 23.1. 441 U.S. at 485 n.16.

plaintiff met the demand requirement under Rule 23.1. The analysis of Rule 23.1 and state corporate law in *Kamen* is instructive in answering the certified question.

The Court first clarified the role of Rule 23.1 in derivative lawsuits. “Rule 23.1 clearly *contemplates* both the demand requirement and the possibility that demand may be excused, it does not *create* a demand requirement of any particular dimension.” *Id.* at 96 (emphasis in original). Rule 23.1 is a procedural rule, and under the Rules Enabling Act, 28 U.S.C. § 2072(b), such a rule cannot ‘abridge, enlarge or modify any substantive right.’ *Id.* See also *Kanter v. Barella*, 489 F.3d 170 (3d Cir. 2007) (holding that federal courts hearing shareholders’ derivative actions involving state law claims apply the federal procedural requirement of particularized pleading, but apply state substantive law to determine whether the facts demonstrate demand would have been futile and can be excused), and *Rosenfeld v. Schwitzer Corp.*, 251 F. Supp. 758 (S.D.N.Y. 1966) (holding that in diversity suits, the applicable state substantive law must be used to determine whether plaintiffs are shareholders within the meaning of Rule 23.1).

In *Kamen*, after the Court made it clear that Rule 23.1 was procedural, it turned to the demand requirement and held that the requirement was substantive and that it was governed by state law. *Kamen*, 500 U.S. at 97 (citing *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 543-44 and n.2 (1984) (Stevens, J., concurring); *Hanna v. Plumer*, 380 U.S. 460, 477 (1965) (Harlan, J., concurring)).

Moreover, federal procedural rules may not dictate the substance of state law. “[N]o reading of [Rule 23] can ignore the [Rules Enabling] Act’s mandate that ‘rules of procedure “shall not abridge, enlarge or modify any substantive right [under state

law].””” *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 848 (1999). Federal courts thus cannot invoke Rule 23.1 to create rights that do not otherwise exist under state law. The *Erie* Doctrine and the Rules Enabling Act prohibit altering or expanding state substantive law in that fashion. *See Guaranty Trust Co. v. York*, 326 U.S. 99, 108-09 (1945) (district court sitting in diversity is “only another court of the state” and may not “substantially affect the enforcement of a right as given by the State”).

Under Minnesota state law, Rule 23.09 is also procedural, not substantive. *See Vista Fund v. Garis*, 277 N.W.2d 19, 27 (Minn. 1979) (addressing the predecessor of Rule 23.09 as a procedural rule, not a substantive rule); *Meagher v. Kavli*, 251 Minn. 477, 488, 88 N.W.2d 871, 878-80 (1958) (stating that “substantive law is that part of law which creates, defines, and regulates rights”).

Rule 23.1 and Rule 23.09 have no impact on the substance of the business judgment rule.² Those procedural rules simply require courts to approve settlements of derivative litigation without providing any indication of the standard of review that courts are to employ. The applicable standard is found in the state’s substantive corporate law, and in this case, that standard is the business judgment rule articulated in *Janssen*.

II. CLASS-ACTION AND DERIVATIVE SUITS ARE FUNDAMENTALLY DIFFERENT; RULE 23.05 IS NOT HELPFUL TO ANSWER THE CERTIFIED QUESTION

Some parties assert that the Court should be persuaded to employ a standard of review specifically provided for by rule in class-action settlements. That position

² The Minnesota Rule is particularly inapposite to defendants, such as Lubben, who are not named in the state court litigation.

confounds the role of the SLC and the role of the courts in making decisions about derivative litigation.

The SLC is an independent body formed to analyze the merits of continuing, dismissing, or settling derivative litigation—the SLC is not the corporation and the SLC is not the shareholders. It is a separate and autonomous committee whose existence is authorized by statute. *See* Minn. Stat. § 302A.471, subd. 1. In derivative litigation, the SLC balances the legal, ethical, commercial, public relations, and other relevant factors to determine whether to pursue, dismiss, or settle the litigation. *See Janssen*, 662 N.W.2d at 882. To the extent the shareholders proposing the litigation seek to challenge the SLC’s decision, the matter goes before the courts, but only for review on narrow grounds. The merits of the SLC’s decision are not subjected to *de novo* review, but to review under the deferential business judgment rule. *Janssen*, 662 N.W.2d at 888. This is so because by the time that a derivative settlement is before the court, the SLC has already determined that a certain disposition would be in the best interest of the corporation. *See Vista Fund*, 277 N.W.2d at 22 n.4 (derivative actions permit shareholders to bring suit “on behalf of the *corporation* to enforce a *corporate right*,” not the rights of individual shareholders) (emphasis added). Class-action settlements are much different.

Class-actions involve groups of plaintiffs who band together to enforce a common right. *Cf. Vista Fund*, 277 N.W.2d at 22 n.4 (derivative suits enforce corporate rights). The named plaintiffs undertake the task of developing a case and negotiating a settlement on behalf of the entire class. Unlike derivative actions, class actions are purely creations of Rule 23, which governs their availability, conduct and resolution. Each step along the

way is subject to court review and control. *See, e.g.*, Minn. R. Civ. P. 23.01, 23.02, and 23.03 (governing when a class action may be maintained and certified). Review of any proposed class action settlement does not go before an independent committee like an SLC. Instead, a court conducts the first review of any settlement with an eye toward the settlement's fairness, reasonableness, and appropriateness for all class members, not just the named plaintiffs. Minn. R. Civ. P. 23.05.

An SLC-approved settlement and a class-action settlement thus come to court in significantly different postures. SLC-approved settlements have already been vetted by the independent and statutorily created SLC; class-action settlements have not been reviewed by any independent body. The distinction between settlements in shareholder derivative actions and class-action lawsuits is a principled basis for different standards of judicial review.³

In addition, the recent amendment to Rule 23.05 counsels against importing class-action settlement principles into a court's approval of an SLC's business judgment to settle a derivative lawsuit because Rule 23.09 was not similarly amended. Rule 23.05 was amended in 2006 to expressly include a "fair, reasonable, and adequate" standard for

³ Not only is Rule 23.05 inapplicable by its very terms and not invoked by the certified question, but cases cited by other parties asserting the class-action settlement standard are inapposite. *See e.g., Cohn v. Nelson*, 375 F. Supp. 2d 844 (E.D. Mo. 2005) (considering settlement without any mention of an SLC's decision); *In re Cendant Corp.*, 232 F. Supp. 2d 327 (D.N.J. 2002) (relying on cases that did not involve SLC decisions to settle derivative litigation as authority to apply the class-settlement rules); *In re Xcel Energy, Inc.*, 364 F. Supp. 2d 980 (D. Minn. 2005) (addressing only attorneys fees); *In re PEMSTAR, Inc.*, No. A05-2225, 2006 WL 2530388 (Minn. Ct. App. Sept. 5, 2006) (addressing standing to object to settlement without deciding standard for reviewing settlement).

review of class-settlement proposals. The PSLRA Plaintiffs acknowledge the amendment, but gloss over the fact that Rule 23.09 was not changed then or in the ensuing years. Any reliance on Rule 23.05 is negated by the fact that this Court, acting on the recommendation of the Rules Committee, amended Rule 23.05, but did not similarly amend Rule 23.09 to mandate review of a derivative settlement for its fairness, reasonableness, and its adequacy to the corporation.

If the SLC acted independently and with good faith, then its decision is afforded deference. *Janssen*, 662 N.W.2d at 882. Interpreting purely procedural rules to require a more exacting standard of review makes no sense. The Court developed the business judgment rule in *Janssen* as a rule of substantive law, and should continue to consider it as such.

III. THIS COURT REJECTED THE SECOND STEP OF ZAPATA IN JANSSEN, AND LEFT THE BUSINESS JUDGMENT WITH CORPORATE BOARDS AND SLCS

Advocates for a more expansive rule than *Janssen* also rely upon the Delaware Supreme Court's decision in *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981) to support their position. But in *Janssen*, this Court rejected the premise underlying the *Zapata* rule when it recognized that corporations or SLCs are better positioned than the courts to exercise business judgment. This case presents no reason to change that conclusion.

In *Zapata*, the court created a two-part analysis: (1) “[f]irst, the [c]ourt should inquire into the independence and good faith of the committee,” and (2) “the [c]ourt

should determine, applying its own independent business judgment, whether the motion [to dismiss derivative litigation] should be granted.” *Id.* at 788-89.

The premise underlying the second step of the business judgment rule created by the Delaware court in *Zapata* was that although the “substantive judgment whether a particular lawsuit should be maintained requires a balance of many factors ethical, commercial, promotional, public relations, employee relations, fiscal as well as legal . . . such factors are not ‘beyond the judicial reach.’” *Id.* at 788. Essentially, the Delaware court authorized the substitution of the business judgment of the court for the business judgment of the SLC. *Id.* at 787.

But while the Delaware court’s two-part analysis clearly invades the independent business judgment of an SLC, *Janssen* opted to allow corporate boards and their committees to make business judgments. 662 N.W.2d at 882. This Court determined that “courts are ill-equipped to judge the wisdom of business ventures and have been reticent to replace a well-meaning decision by a corporate board with their own.” *Id.* (citing *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979)). It is the board or the SLC—not the court—that is most “familiar with the appropriate weight to attribute to each factor [legal, ethical, commercial, promotional, public relations, fiscal, etc.] given the company’s product and history.” *Id.* at 883 (citing *Auerbach* for the factors, which were also cited in *Zapata*).

While under *Zapata*, consideration of business factors is within the purview of the court, which may supplant an SLC’s business judgment with its own views, this Court determined that the consideration and balance of those factors was a matter best left to

corporate directors or SLCs. *Id.* And although other parties' advocate that *Auerbach* and *Janssen* do not go far enough and that *Zapata* should be adopted by this Court, the Court has already stated its position on the second step of the *Zapata* analysis, which is to leave the balancing of the ethical, legal, economic, public relations, fiscal, and commercial decisions with the body best suited to balancing those factors: disinterested corporate directors and SLCs.

The rule adopted in *Janssen* does not mean that courts will simply rubber-stamp the decision of the board or an SLC under the business judgment rule. Indeed, in *Jansen* the Court specifically rejected the SLC decision because it lacked independence and good faith. The process was scrutinized, but the Court recognized that business judgments are best left with businesses. *Id.* at 882-83. Nothing about this case presents any reason to deviate from *Janssen* and adopt a *Zapata*-type analysis, or any other formulation of the business judgment rule.

IV. SETTLEMENTS SHOULD RECEIVE PARTICULAR DEFERENCE

The decision of a special litigation committee to settle litigation as opposed to seeking dismissal should not change the standard applied by a court reviewing the decision. *See* Lubben Opening Br. at 8-10. *See also* *Carlton Inves. v. TLC Beatrice Int'l Holdings, Inc.*, No. Civ. A. 13950, 1997 WL 305829, at *2 (Del. Ch. May 30, 1997) (applying Delaware law and analyzing proposed settlement under *Zapata*); *In re Oracle Sec. Litig.*, 829 F. Supp. 1176, 1187 (N.D. Cal. 1993) (same); *see also* *Kaplan v. Wyatt*, 499 A.2d 1184, 1189 n.1 (Del. 1985) (court dismissed argument that there is a significant distinction between a motion to dismiss potentially resulting in termination of suit and a

post-demand determination by the board of directors which permits the suit to proceed, holding that “[t]his distinction is irrelevant to the director’s ability to make an independent business judgment”).

As noted in Lubben’s opening brief, if any distinction at all is to be drawn between reviewing a determination to settle as opposed to a decision to seek dismissal, it is a distinction that favors an even more restrictive role for the courts in evaluating the decision of a special litigation committee to settle. In jurisdictions that follow *Auerbach*, settlements are particularly favored because shareholder derivative litigation is “notoriously difficult and unpredictable.” *Schimmel v. Goldman*, 57 F.R.D. 481, 487 (S.D.N.Y. 1973). See also *In re Cendant Corp.*, 232 F. Supp. 2d at 336 (D.N.J. 2002) (“The [special litigation committee] has determined that this Settlement Agreement is in the company’s best interest. The [committee’s] adoption of the settlement is significant because it avoids the [committee’s] potential dismissal of the case.”).⁴

A decision to settle litigation on particular terms involves even greater discretion and judgment on the part of the special litigation committee than does a decision to simply end litigation. The SLC must not only evaluate the costs to the corporation of continued pursuit of the litigation, but must also evaluate the prospects of recovering more—or less—than the amount of a proposed settlement. Cf. *Carlton Invs.*, 1997 WL 305829, at *11 (“The whole point of recognizing the board’s authority and responsibility

⁴ Even in cases applying the inapposite class-action settlement standard, such as *In re Cendant* and *Cohn*, courts recognize that deference should be afforded to decisions to settle litigation. See *Cohn*, 375 F. Supp. 2d at 854 (applying Delaware law and opining that “where . . . the parties have negotiated at arm’s-length and in good faith, and plaintiffs have obtained a valuable benefit, the settlement should be approved”).

in [the settlement-negotiation] context is to allow the board's judgment *concerning what is in the long-run best interest of the corporation* to be acted upon.") (emphasis in original).

The *Carlton* court expressed its frustration with the *Zapata* two-part analysis and highlighted a significant concern resulting from *Zapata*'s premise that a court should second-guess a special litigation committee's decision that a settlement is in the best interest of the corporation:

The idea suggested in *Zapata* that the court may—for reasons of public policy—require the board to continue a litigation even though an independent committee determines in good faith and on appropriate information that a proposed settlement is advantageous to the corporation, is difficult to understand. It is fair to ask, on what basis may a court legitimately impose the cost and risk of litigation on a party in order to achieve *only a perceived public benefit*? In other contexts the constitution explicitly protects against such exactions (*i.e.*, takings clause of U.S. Constitution).

Carlton Invs., 1997 WL 305829, at *2 n.4, *21 (emphasis in original) (also stating that “[a]s to the conceptually difficult second step of the *Zapata* technique, it is difficult to rationalize in principle . . .”).

The second part of the *Zapata* is unnecessary in connection with a court's review of settlements. There is no reason to adopt such a rule as Minnesota law, or to require courts and litigants to engage in unnecessary and wasteful litigation about the merits of a special litigation committee's settlement decision.

CONCLUSION

The certified question is a narrow one, and the answer is similarly narrow: under the business judgment rule in Minnesota, if an SLC acts independently and in good faith, its decision about whether to dismiss, pursue, or settle derivative litigation is afforded deference. *Janssen*, 662 N.W.2d at 882. That rule does the job that it is supposed to do; an SLC is not a rubber-stamp for the board of directors, but when the SLC acts in good faith and independently then there is no reason to substitute the court's business judgment for the SLC's judgment.

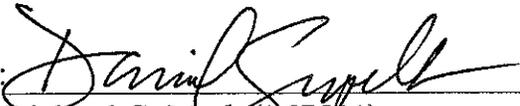
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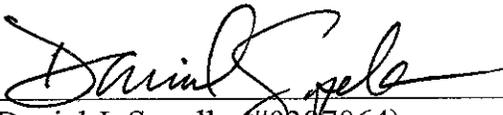
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CERTIFICATE OF COMPLIANCE

The undersigned counsel for David J. Lubben, certifies that this brief complies with the requirements of Minn. R. App, P. 132.01 in that it is printed in 13-point, proportionately spaced typeface utilizing Microsoft Word Word 2003 and contains 3,194 words, including headings, footnotes and quotations.

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