



## UnitedHealth Option-Granting Board Holds \$230 Million in Stock

Aug. 10 (Bloomberg) -- UnitedHealth Group Inc. Chairman William McGuire sparked outrage among some stockholders over his \$1.8 billion in potential stock-option gains. Turns out, the board of directors that granted those options got a share of the wealth, too.

UnitedHealth's 10 non-executive directors held \$230 million in stock as of March 21, according to the health insurer's most recent proxy. Director Richard Burke, who joined the board in 1977, had \$169 million in shares, while Douglas Leatherdale owned \$47 million. The directors, including former New Jersey Governor Thomas Kean and former Fannie Mae chief executive officer James Johnson, held more than 3.1 million stock options, whose underlying value is about \$175 million.

"You have to ask yourself, are these people paying attention to the mission of the corporation, or are they being distracted by the amount they're getting themselves?" says Minnesota Attorney General Mike Hatch, who is investigating Minnetonka-based UnitedHealth along with federal authorities.

More than 90 companies are under investigation by federal prosecutors, regulators or independent board committees over alleged efforts to inflate stock-option grants by backdating them to times when stock prices were at lows. Five former executives at two companies -- including the ex-CEOs at Comverse Technology Inc. and Brocade Communications Systems Inc. -- face criminal charges. Scrutiny is extending to boards of directors because they approve stock-option awards. Several have been targeted by shareholder lawsuits.

### Report Delayed

UnitedHealth yesterday said it delayed its second-quarter earnings report while it determines whether it will have to restate results because of inappropriate options accounting. A board committee is reviewing 45,000 separate option grants made to 15,000 people over 13 years, the company said in a statement.

The UnitedHealth board's role in granting options and setting executive compensation has come under fire from big stakeholders. The California Public Employees' Retirement System, the largest U.S. public pension fund, wrote in an April 25 letter to the company that the board's own stock options create "a climate which threatens directors' ability to objectively determine appropriate executive pay." Calpers holds 5.9 million shares in UnitedHealth, the No. 2 U.S. health insurer.

Each UnitedHealth director makes at least \$400,000 a year, counting pay and exercisable options, according to Jesse Fried, a professor at the law school of the University of California at Berkeley. The Corporate Library, a Portland, Maine-based governance group, says UnitedHealth had the eighth-best-compensated board in the nation in 2004, with total compensation of \$5.4 million.

### 50-Fold Growth

Says Fried: "What is the cost of standing up and saying, 'We think the CEO should go, or we think the CEO should not be paid as much, or we think the CEO should not be able to backdate his options?'"

McGuire said it would be "inappropriate" to comment until the board of directors completes its independent investigation. None of the directors would comment, with some referring questions to company spokesman Mark Lindsay.

Lindsay says the board has taken steps to reduce directors' compensation, as well as that of top executives. He says the growth in the value of options held by McGuire was a result of his success in

expanding the company in his 15 years at the helm, during which the share price rose more than 7,000 percent.

McGuire, 58, has overseen a 50-fold growth in the company's customer base as health-plan enrollment has grown to more than 70 million, from 1.4 million in 1991, the year he also became chief executive officer. Last year's sales were \$45 billion, compared with \$847 million in 1991, and profit climbed to \$3.3 billion in 2005 from \$74.8 million in 1991.

Pre-Eminent Business'

UnitedHealth has gone from a company in 1990 with a troubled business model, uncertain future and \$600 million in revenue to a pre-eminent business with a projected \$72 billion in revenue this year," says Lindsay.

During the 12-year period ended Dec. 31, 2005, McGuire redeemed stock options with gains of \$333 million and had unexercised profits of \$1.8 billion, according to filings with the Securities and Exchange Commission. UnitedHealth President Stephen Hemsley, 54, had \$663 million in exercisable options and another \$82 million in options that can't be used yet, according to the April 7 proxy.

Lowest Points

The timing of McGuire's option grants is under investigation because it coincided with the lowest points of the company's share price for three years, raising questions about whether the dates were set retroactively. A low price on the grant date would boost the potential profit to the holder.

The company said in May it might have to restate earnings for three previous years by as much as \$286 million. UnitedHealth said yesterday it was trying to determine the correct accounting treatment for its past options grants. Charges would be "significant" under one method and "not material" under the other, it said.

UnitedHealth, which began its internal probe in April, yesterday said it hoped to complete that investigation in the third quarter. The company was subpoenaed on May 17 by the Justice Department, and the Internal Revenue Service requested documents related to executive compensation. Shareholders have filed a dozen lawsuits, some alleging that the board's own compensation compromised its independence. On July 27, Moody's Investors Service lowered UnitedHealth's bond rating, citing uncertainties from the probes.

UnitedHealth's stock has fallen 21 percent this year. The shares were at \$48.98 at the close of New York Stock Exchange composite trading yesterday.

The options held by the company's directors have probably ballooned in value because of the 836 percent surge in the share price between Jan. 1, 2000, and Dec. 31, 2005. Still, it's impossible to calculate their value without knowing the dates they were issued and their strike prices.

Cash and Options

The outside directors are paid in a combination of cash and options grants. According to the April 7 proxy, they get an annual cash retainer of \$30,000, plus payments for each board and committee meeting attended. They also get an initial one-time option to buy 58,000 shares, plus quarterly options to buy 8,000 shares, or 32,000 options a year for each year they serve.

The initial grants are exercisable over three years, while the quarterly grants can be exercised immediately. The price of the initial options is set by the closing price of UnitedHealth stock on the day the director is elected, which is at the annual meeting. The price of the quarterly options is set by the closing price of UnitedHealth shares the first business day after the quarter ends, the proxy says.

Veteran Members

The lengthy service of some UnitedHealth directors allowed them to amass options. Seven of the 10 outside directors joined the board in 1993 or earlier, including Burke, 62, the longest-serving member.

After the revelations in April about McGuire's options, the board revised its own pay policies on May 1,

reducing its compensation by 40 percent. That came on top of a 20 percent reduction in the number of options they could get after the shares were split, in May of last year.

The board also discontinued equity grants to McGuire and other executives, capped supplemental retirement benefits for the executives, eliminated perks like life-insurance premium payments and set the annual meeting as the grant date for all options for existing employees.

As of March 21, the three members of the compensation committee -- Johnson, 62, the chairman, Mary Munding, 68, dean of Columbia University's school of nursing, and William Spears, 67 -- held a total of more than 1.1 million options, the company's proxy shows. Spears also held \$3.7 million in stock and Munding held \$1.8 million.

\$62 Million

While the shares underlying the options held by all three were valued at \$62 million, the options would be worth less, since in order to obtain the shares they would have to pay the strike price, set by the market on the day the shares were granted. The difference would be their net gain.

For the most part, the strike price would be well below the current share price, because UnitedHealth shares have soared in value.

The proxy doesn't disclose how many options the directors may have previously converted to shares and then sold. That would enlarge the amount of money they got for their board service.

Johnson, who joined UnitedHealth's compensation committee in 2003, serves on the boards of five other companies listed on the Standard & Poor's 500, including Goldman Sachs Group Inc. and Target Corp. The vice chairman of Washington-based merchant bank Perseus LLC, he's on six board compensation committees and is chairman of five.

That's more than any other board member in the U.S., according to Equilar Inc., a San Mateo, California-based proxy-research firm. Former 9/11 commission Co-Chairman Kean, 70, who formerly served as chairman of UnitedHealth's compensation panel, is a member of four compensation committees of S&P 500 companies.

Missing a Crisis

"Being on a board is relatively predictable until you get into a crisis," says Sheryl Skolnick, a stock analyst with CRT Capital Group LLC, in Stamford, Connecticut. "When you're on five or six boards, you may not pick up the problem before it becomes a crisis."

UnitedHealth's non-executive board members serve on 27 boards among them, while compensation committee members serve on 11 boards, according to Institutional Shareholder Services, a Rockville, Maryland-based proxy-advisory company. A study by the firm found that 67 percent of directors sit on only one major company board, and that fewer than 2 percent of the 9,808 board members covered in its study sit on more than four boards.

Handing Over Reins

"This is the no-show board of all time in terms of the job they did in overseeing compensation," says Patrick McGurn, executive vice president of Institutional Shareholder. "They handed the reins over to management and played the roles of cheerleader."

Critics cite one board policy: McGuire was formerly allowed to pick his own option-grant dates. His Oct. 13, 1999, employment contract says: "The annual options shall be granted on such date or dates as executive requests by oral notification to the chair of the compensation and human resources committee."

He received \$8 million in cash and bonuses in 2005, more than three times the median pay of CEOs at 12 peer group companies," according to Institutional Shareholder Services. His 2005 option award of \$37 million was more than four times the awards at the peer group companies chosen by ISS.

Three of the grants he got between 1994 and 2005 were made with a strike, or exercise, price equal to

the lowest closing market price of the year, according to a review by Bloomberg.

``There wasn't proper oversight by the compensation committee," says Shirley Westcott, the managing director for policy at Proxy Governance, an investor advisory service based in Vienna, Virginia. ``They didn't understand that the kind of grant timing they had in McGuire's employment contract was inappropriate."

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