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Chief Executive at Health Insurer Is Forced Out in Options Inquiry

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Dr. William W. McGuire, a medical entrepreneur who built the UnitedHealth Group into a colossus in its field, was forced to resign from the company yesterday and to give up a portion of the \$1.1 billion he holds in harshly criticized stock options.

UnitedHealth, one of the nation's two largest health insurers, also dismissed its general counsel and a member of its board in what amounted to a sweeping overhaul of its governance practices and leadership ranks. The options that Dr. McGuire had been granted over the years have led to criminal and civil investigations and public disapproval.

Dr. McGuire's Pay



Chris Greenberg/Bloomberg News

TOTAL BASE SALARY	\$19,649,039
BONUSES	36,681,077
PAYOUTS	9,284,000
OPTION EXERCISE GAINS	457,051,736
TOTAL PAY (1992-2005)	522,665,852

Sources: Equilar; S.E.C. filings

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In a sweeping report released yesterday that was highly critical of management, a law firm hired by UnitedHealth to investigate the timing of stock options concluded that the company was riddled with poor controls and conflicts of interest. The report, which the company posted on its Web site, found that UnitedHealth had backdated options to maximize employees' compensation.

The company said yesterday that the disputed options would be repriced from the lowest share price for the years in question to the highest prices, scaling back the earnings of Dr. McGuire and others. The company did not say precisely how much its executives would give up.

The developments are the most dramatic to date since federal regulators started looking into the widespread practice of backdating stock options. More than 100 companies have come under scrutiny over the unlikely coincidence of stock options being granted again and again to senior

executives on dates when the company's share price was low, a tactic that guaranteed the maximum profit when the options were turned into cash.

Executives at several companies have already been forced to resign, and at UnitedHealth Group, it was announced that five other directors would be forced out over the next three years.

At UnitedHealth, there was significant evidence that options were backdated for employees at all levels of the company between 1994 and 2002. But among the most substantial and egregious, according to the law firm's report, were those awarded to Dr. McGuire, the company's longtime chairman and chief executive. Of the 12 options grants issued to Dr. McGuire, three just happened to be priced at the stock's lowest price that year.

The Justice Department, the Minnesota Attorney General's office, the Securities and Exchange Commission and the [Internal Revenue Service](#) are all investigating UnitedHealth's options practices.

Most of the companies implicated in backdating controversies so far are Silicon Valley start-ups or firms with technology roots, where options with favorable dates were considered a recruitment tool in the dot-com boom. UnitedHealth, which has a market capitalization of \$66 billion, is one of the few large blue-chip companies to stumble over the issue, and its problems underscore how prevalent the practice has been. Scrutiny over backdating also comes at a time of increasingly loud criticism of excesses of executive pay.

At UnitedHealth, even the man named to replace Dr. McGuire as chief executive has been a beneficiary of backdated options: Stephen J. Hemsley, who has been Dr. McGuire's top lieutenant, will lose a sizable portion of his options, the company said.

"Mr. Hemsley has voluntarily agreed to reprice all options awarded through 2002 to the annual high share price for each year, and to take any other appropriate action to eliminate any possible financial benefit from options-related issues," UnitedHealth said. Other senior UnitedHealth executives, including Dr. McGuire and the resigning general counsel, David J. Lubben, will take similar actions, the company said.

In a lengthy and somewhat contrite statement after a board meeting yesterday, UnitedHealth announced that it would take a series of steps recommended by an outside law firm, Wilmer Cutler Pickering Hale & Dorr, which had been hired by a special committee of UnitedHealth directors. The seven-month investigation led to a showdown that ended late yesterday after Dr. McGuire and the UnitedHealth board was presented with the findings.

In their report, investigators from Wilmer Cutler found that “most of the 29 stock grants” that accounted for nearly 450 million stock options that the company awarded between 1994 and 2002 “were likely backdated.”

The report also found that a grant of one million stock options to Dr. McGuire and 500,000 options awarded to Mr. Hemsley in connection with their 1999 employment contract were probably backdated. But the company’s outside investigators appeared to clear Mr. Hemsley, finding that he “had little or no role in the negotiation of, or the process leading up to, the option award” related to the contract.

Investigators, moreover, painted a picture of “inadequate” internal controls and a senior management team that failed to set an appropriate tone at the top. But the report attempted to clear the directors on the compensation committee of any legal wrongdoing. “The directors were entitled to presume that matters brought before them for action were procedurally proper and consistent with applicable legal and accounting standards,” the report concludes.

The report also said that the financial relationships between Dr. McGuire and the board member who resigned yesterday, William G. Spears, who headed the board’s compensation committee when Dr. McGuire’s employment agreement was negotiated in 1999, “created a conflict of interest.” Mr. Spears served as a trustee for two trusts for Dr. McGuire’s children and managed as much as \$55 million of Dr. McGuire’s money. He also managed millions of dollars managed for Mr. Hemsley.

Acting on the law firm’s recommendations, the board said it would replace, within three years, all of the directors on its compensation committee who had approved the improper options. The company also said it would create new senior executive posts to oversee ethics and compensation.

Dr. McGuire, an internist and lung specialist, will not leave empty-handed: he will still take home hundreds of millions of dollars from stock options. Over his 18 years at UnitedHealth, he banked more than a half billion dollars.

UnitedHealth said last night that it was still negotiating whether he would receive a \$5.1 million a year pension, which is called for in his employment contract.

Dr. McGuire is by far the best known, most powerful and most richly compensated business leader to be toppled by challenges to pay packages that were inflated by stock options based on favorable, low purchase dates. Options are typically granted at the current market price of the stock, to avoid adverse tax and accounting consequences.

Options-dating issues led to the resignation from the [Apple Computer](#) board two weeks ago of Fred D. Anderson of a former chief financial officer of Apple, but the

company said that [Steven P. Jobs](#), chief executive of Apple, had not benefited from improper equity awards.

The United Health board faced formidable challenges at its meeting yesterday. Dr. McGuire is a superstar executive with one of the best track records in American business, and losing him could undermine the confidence of Wall Street investors. The statement released by UnitedHealth, which is based in Minneapolis, pointed out that under Dr. McGuire's leadership, the company's stock price had risen by almost 8,500 percent.

But not acting posed considerable legal and financial risks for the company and the directors themselves. For some compensation committee members who remain on the board, ousting Dr. McGuire over stock option improprieties might mean implicating themselves.

Wall Street analysts said investors, who have driven down United's stock price by more than 20 percent this year, are likely to be jolted by the departure of the widely admired Dr. McGuire but may be reassured by the promotion of Mr. Hemsley, "the guy who makes things happen" at the company, said Sheryl Skolnick, a health care analyst at the CRT Capital Group.

The uproar over backdating erupted at a time when dozens of companies were forced to restate earnings to reflect option awards, under new accounting rules. UnitedHealth said in May that restating could cut as much as \$286 million from profits for 2003, 2004 and last year.

The Justice Department has brought charges against officers at two companies — [Brocade Communications](#) and [Comverse Technology](#) — over options backdating, and with dozens of cases under review, more charges could be on the way.

Boards, meanwhile, have forced out more than two-dozen executives, including five in the past week. And scores of companies are rushing to restate their results in time for this quarter's earnings, so they do not face legal and financial exposure for additional delays.

In an apparent effort to get ahead of the official investigators, in March, a special committee of UnitedHealth's independent directors began examining the 45,000 separate stock option grants made to company employees. The following month, the committee hired William R. McLucas, a former S.E.C. enforcement director, and his team of investigators, Wilmer Cutler Pickering Hale & Dorr, to lead the review.

There are also questions about the an unusual clause woven into Dr. McGuire's 1999 employment contract that allowed him to choose the grant date of his stock options by providing "oral notification" to the human resources or compensation committee chair. While there is nothing illegal about such a provision,

compensation specialists say the practice could lead to abuse. The clause was eliminated last year.

Most analysts have continued to recommend the stock during its slide, but Matthew Borsch, who follows UnitedHealth at [Goldman Sachs](#), predicted that United's share price "will fall further now with the certainty of Dr. McGuire's departure."

Ms. Skolnick or CRT Capital Group had other concerns. She said the changes announced yesterday were "good" but added that "the scary thing" was the possibility that past stock-dating practices may still lead to costly penalties. "I worry that something bad must have happened," she said.