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December 14, 2007

SEC Settles Option Backdating Case with Former UnitedHealth CEO for $468 Million

On December 6, 2007, the Securities and Exchange Commission ("SEC") announced a $468 million settlement in an options backdating case against William W. McGuire, M.D., the former CEO and Chairman of UnitedHealth Group Inc.[1] This is the first time Section 304 of the Sarbanes-Oxley Act ("SOX")[2] has been used to deprive a corporate executive of his stock sale profits and bonuses earned while his company was misleading investors.

I. BACKGROUND

Section 304 (otherwise known as the "clawback" provision) of SOX states that CEOs and CFOs of companies that have to restate earnings due to financial misconduct must disgorge bonuses and incentive compensation that they received from their companies.[3] More specifically, the clawback provision requires these executives to return to their companies bonus compensation they received in the twelve months following the original issuance of the later-restated financials and any profits realized from the sale of securities during the same twelve month period.

In recent years, courts have addressed the clawback provision, holding that Section 304 is solely limited to SEC enforcement actions. It does not provide a private right of action for shareholders to file a derivative suit.[4] Although Section 304 was enacted in 2002, the McGuire settlement is the first time the SEC has invoked the provision. This settlement indicates a desire by the SEC to establish standards to hold executives accountable for illegally backdating stock options.

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1 *Former United Health Group CEO/Chairman Settles Stock Options Backdating Case for $468 Million: Settlement is Largest to Date in an Options Backdating Case*, SEC Litigation Release No. 20387 (Dec. 6, 2007) ("SEC Litigation Release").

2 15 U.S.C. § 7201 (2002).

3 15 U.S.C. § 7243.

4 *See, e.g., In re Bisys Group Inc. Deriv. Action*, 396 F. Supp. 2d. 463 (S.D.N.Y. 2005); *Neer* v. *Pelino*, 389 F. Supp. 2d. 648 (E.D. Pa. 2005).

II. FACTS OF THE MCGUIRE SETTLEMENT[5]

This settlement resulted from an options backdating[6] case brought by the SEC against William W. McGuire, M.D., the former CEO and Chairman of UnitedHealth Group Inc. In the Complaint, the SEC alleged that, over a twelve year period, McGuire "looked back over a window of time and picked grant dates for UnitedHealth options that coincided with dates of historically low quarterly closing prices for the company's common stock, resulting in grants of in-the-money options."[7] This practice, therefore, increased the value of the options. Moreover, McGuire signed and approved backdated documents that falsely indicated that the options had actually been granted on these earlier dates when the stock price was at or near these low points. As a result of these inaccurate documents, the company understated compensation expenses for stock options. In addition, these inaccurate documents were routinely provided to the company's external auditors in connection with their audits and reviews of the company's financial statements.

The Complaint further alleged that McGuire received more that 44 million split-adjusted options, most of which were backdated. Of those backdated options, more than 11 million were exercised for an in-the-money gain of more than $6 million. In addition, according to the SEC's Complaint, McGuire received nearly $5 million in incentive-based cash compensation in 2005 and 2006 which was tied to earnings per share targets that the company would not have achieved had the financial statements been prepared in the proper manner.

On December 6, 2007, McGuire, without admitting or denying the SEC's charges, agreed to the settlement. According to its terms, "McGuire will (i) disgorge ill-gotten gains of $10,997,596 with $1,697,492 in prejudgment interest, (ii) pay a $7 million civil penalty, and (iii) pursuant to Section 304 of the Sarbanes-Oxley Act, reimburse United Health for all incentive- and equity-based compensation he received from 2003 through 2006, totaling approximately $448 million in cash bonuses, profits from the exercise and sale of UnitedHealth stock, and unexercised UnitedHealth options." This is the largest settlement in an options backdating case.

III. SIGNIFICANCE OF SETTLEMENT

The UnitedHealth stock options backdating scandal provided the first occasion for the implementation of the clawback provision under Section 304 of SOX. With an increasing number of companies that have disclosed internal or federal probes of option backdating,[8] McGuire's settlement

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5 The following facts were taken from the SEC Litigation Release.

6 Options backdating "generally refers to the granting of an option as of a date earlier than the date on which board or com mittee action is taken, often as of a date on which the company's stock price was lower than the price on the date of grant." Michael Gold, *Stock Option Backdating- What Boards Should Consider*, 9151 PLI 499, 501 (Nov. 2006).

7 "The option was "in-the-money" whenever the trading price of UnitedHealth's common stock exceeded the option's strike-price." Complaint, *SEC* v. *McGuire*, No. 07-CV-4779, ¶ 11 (D. Minn. Dec. 6, 2007).

8 Michael Gold, *Stock Option Backdating- What Boards Should Consider*, 9151 PLI 499, 501 (Nov. 2006).

could significantly impact both pending and future option backdating cases. This is particularly true in situations where the company has been forced to restate earnings and where executives have personally gained from option backdating. This blockbuster settlement is clear evidence of the SEC's willingness to pursue corporate executives who abuse their positions and to seek the return of undeserved compensation through different avenues.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Charles A. Gilman at (212) 701-3403 or cgilman@cahill.com; Jon Mark at (212) 701-3100; or jmark@cahill.com or John Schuster at (212) 701-3323 or jschuster@cahill.com.