Presentation to the United States Senate Governmental Affairs Committee

Report of the Special Counsel
ULLICO Stock Purchase and Repurchase Programs
and Global Crossing Investment

Governor James R. Thompson
Chairman, Winston & Strawn

June 19, 2003

Special Counsel Mandate

- In early 2002, the press criticized ULLICO's stock purchase offer and repurchase programs as favoring directors and officers over the Company's other shareholders
- In response, on April 29, 2002, ULLICO's Board retained Governor James R. Thompson, Chairman of Winston & Strawn, as Special Counsel to investigate and make recommendations to the Board:
  - Regarding the circumstances underlying ULLICO's issuance and repurchase of its own stock since 1997,
  - Actions of ULLICO concerning the initial public offering of Global Crossing, Inc., and
  - Such other matters as he may deem appropriate

Facts

Background

- **1925 – Union Labor Life Insurance Company formed, and Capital Stock price fixed at $25 per share (investors limited to unions and their members)**
- **1987 – ULLICO formed**
- **1987-1992 – ULLICO paid 10% stock dividends and 9% cash dividends (most years)**
- **1992 – The Board issued convertible preferred certificates that paid an 8% cash dividend plus a 4% conversion fee (union pension funds become authorized shareholders)**
- **1992-1997 – Preferred certificates converted to Class A Stock (voting) or Class B Stock (non-voting)**

ULLICO STOCK PRICE HISTORICALLY FIXED AT $25 PER SHARE, BUT STOCK PAID HIGH DIVIDENDS

1997 Stock Repurchase Program

- **Main purpose: "To provide liquidity to our larger shareholders" (Georgine)**
- **Key Terms:**
  - **"Book value" stock price set once a year in May based on prior December 31 audited financials**
  - **10,000 share proration threshold**
  - **Repurchase $180 million over 11 years**
  - **Repurchase $30 million in 1997, $15 million each year thereafter**
  - **Class A and B Stock only (no Capital Stock)**

STOCK REPURCHASE PROGRAM REPLACED FIXED STOCK PRICE

“Book Value”

Book value = Stockholders Equity ÷ Outstanding Shares

- **“Stockholders Equity” is reflected in year-end audited financial statements**
- **“Outstanding Shares” includes all Capital Stock, Class A Stock and Class B Stock**

BOOK VALUE STOCK PRICE IS SET ONLY ONCE A YEAR

10,000 Share Proration Threshold

If tender offer is oversubscribed:

- **Shareholders holding 10,000 shares or more prorated**
- **Shareholders holding under 10,000 shares not prorated if 100% tendered**

Rationale for 10,000 Share Threshold

- **Tax – Avoid ordinary income treatment of distributions (unions and pension funds are tax exempt)**
- **Administrative – Eliminate small shareholders (mainly individuals, such as directors/officers)**

ONLY INDIVIDUAL SHAREHOLDERS BENEFITED FROM TAX RATIONALE FOR 10,000 SHARE THRESHOLD

Global Crossing Investment

- **Executive Committee approved \$7.6 million investment in Nautilus LLC on February 14, 1997**
- **Global Crossing (formerly Nautilus LLC) went public in August 1998**
- **To date, ULLICO's pre-tax Global Crossing gains total about \$486 million, reflecting almost a 64-fold return on its investment**

GLOBAL CROSSING INVESTMENT WAS EXTRAORDINARILY SUCCESSFUL

Impact of Global Crossing Success on Stockholders Equity

- **Global Crossing investment constituted an increasingly large portion of Stockholders Equity beginning in 1998**
- **By December 31, 1999, ULLICO's realized and unrealized Global Crossing gains constituted about 85% of total Stockholders Equity**

GLOBAL CROSSING GAINS MATERIALLY IMPACTED "BOOK VALUE" STOCK PRICE

Impact of Global Crossing Success on Stock Repurchase Program

- **ULLICO's "book value" stock price increased significantly but lagged behind Global Crossing's market price**
- **The increased ULLICO "book value" stock price resulted in increased proration**
- **Insiders benefited from 10,000 share proration threshold**

INSIDERS DISPROPORTIONATELY BENEFITED FROM GLOBAL CROSSING GAINS

Stock Repurchase Program Timeline

Date Program Approved	Amount of Program	Stock Price	Proration: Percent of Tendered Shares Redeemed	Dividend
May 1997	$30 million	$27.06	35.8%	2%
May 1998	$15 million	$28.70	100%	2%
May 1999	$15 million	$53.94	91.9%	--
May 2000	$240 million (abandoned)	$146.04	N/A	--
Nov. 2000	$30 million	$146.04	2.2%	--
May 2001	$15 million	$74.87	2.7%	--
May 2002	$15 million (abandoned)	$46.58	N/A	--

Global Incentive Program

- **Before Global Crossing's IPO, Compensation Committee approved four-year bonus plan for senior officers driven by Global Crossing gains**
- **By 2001, five officers received about $5.67 million pursuant to this program**

EXECUTIVES WERE COMPENSATED FOR EXTRAORDINARY GLOBAL CROSSING SUCCESS

Stock Offers to Directors/Officers

Chairman Georgine offered stock to directors and senior officers without holding period restrictions

- **July 29, 1998 – 2,000 shares at $28.70**
- **October 13, 1998 – 2,000 shares at $28.70**
- **December 17, 1999 – 4,000 shares at $53.94**

DIRECTORS/OFFICERS <u>ONLY</u> WERE GIVEN OPPORTUNITIES TO PURCHASE ULLICO STOCK AFTER GLOBAL CROSSING IPO

Stock Offers – Georgine's Stated Purpose

- **"[M]anagement and the board of directors should have their interests in line with the stockholders."**
- **"And the officers and directors in conducting their everyday business should have the interests of the stockholders foremost in their minds."**

Stock Offers – Compensation?

- **Offers "approved" by Compensation Committee despite lack of authority to do so**
- **Offers in anticipation of increased ULLICO stock price due to Global Crossing success**
- **December 17, 1999 offer approved in May but made just before year-end, when Global Crossing stock was high**
- **No resale restrictions on stock sales**
- **In 2002, outside auditors reversed position to conclude that offers were compensation – not enough "investment risk"**

STOCK OFFERS HAD EFFECT OF COMPENSATING DIRECTORS AND OFFICERS

Deferred Compensation Program

- **Approved in July 1998 to allow Georgine and other senior executives to defer up to 25% of base salary and up to 100% of bonuses**
- **Plan allowed tracking stock investments in ULLICO stock**
- **Executives deferred substantial portion of income to ULLICO stock in 1998 and 1999 at lower stock prices**
- **Executives shifted amounts allocated to ULLICO stock account at $146.04 per share in 2000 and 2001**
- **Between 1999 and 2001, Georgine made approximately $4 million; three other senior officers made between $320,000 and $605,000 each**

Discretionary Stock Repurchase Program

- The Chairman repurchased shares outside of the formal program
- The program was historically used for retiring directors/officers and estates
- Georgine: "We do not advertise this [discretionary program] and we do not encourage it"

ORIGINAL PURPOSE OF THE DISCRETIONARY PROGRAM WAS LIMITED

May 11, 2000 Board Meeting

- $146.04 stock price adopted, practically a three-fold increase from the 1999 stock price of $53.94
- "Extraordinary" program to repurchase up to 20% of outstanding stock (conditioned on Global Crossing stock rising to $43 per share)
- Shareholders holding fewer than 100 shares had to have all of their shares repurchased
- Board received financial fairness opinion from Credit Suisse First Boston

Summer and Fall of 2000

- **Global Crossing stock price continues to drop while ULLICO stock price remained at $146.04 per share**
- **ULLICO repurchases approximately $4.6 million of stock from insiders in Summer under discretionary program**
- **“Extraordinary” repurchase program trigger price not met**
- **ULLICO devises replacement program in Fall**

November 3, 2000 Board Meeting

- "Extraordinary" repurchase program abandoned
- $30 million replacement program at $146.04
- Terms of the plan and high stock price made extreme proration inevitable
- Under-10,000 shareholders exempt from proration (20 directors eligible)
- Discretionary repurchase program purportedly ratified, including prior repurchases
- Program was not contingent on Global Crossing price trading in particular range

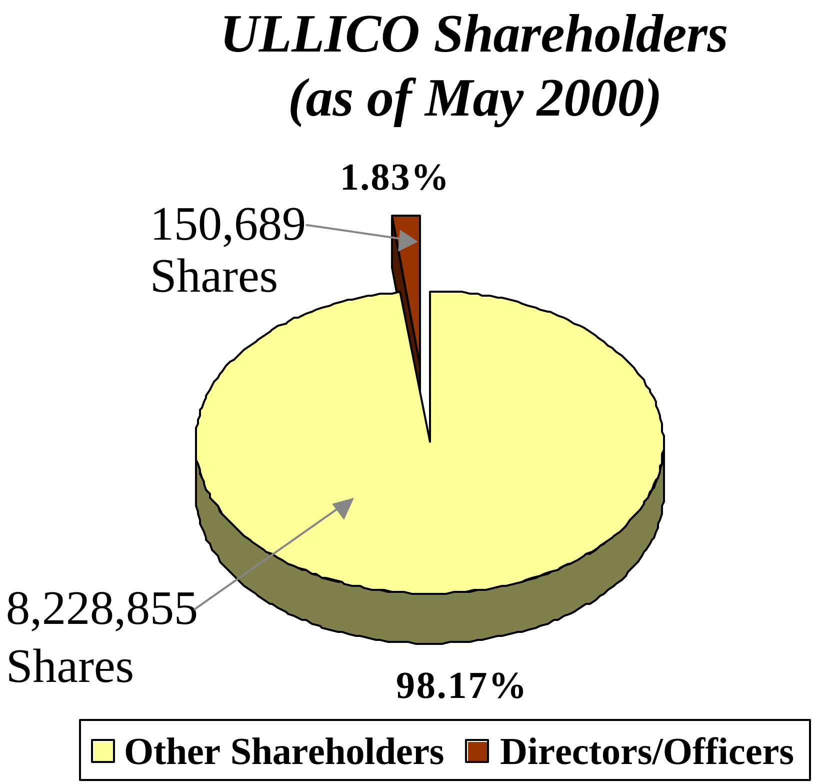
Tender Offer Documents for Replacement Program

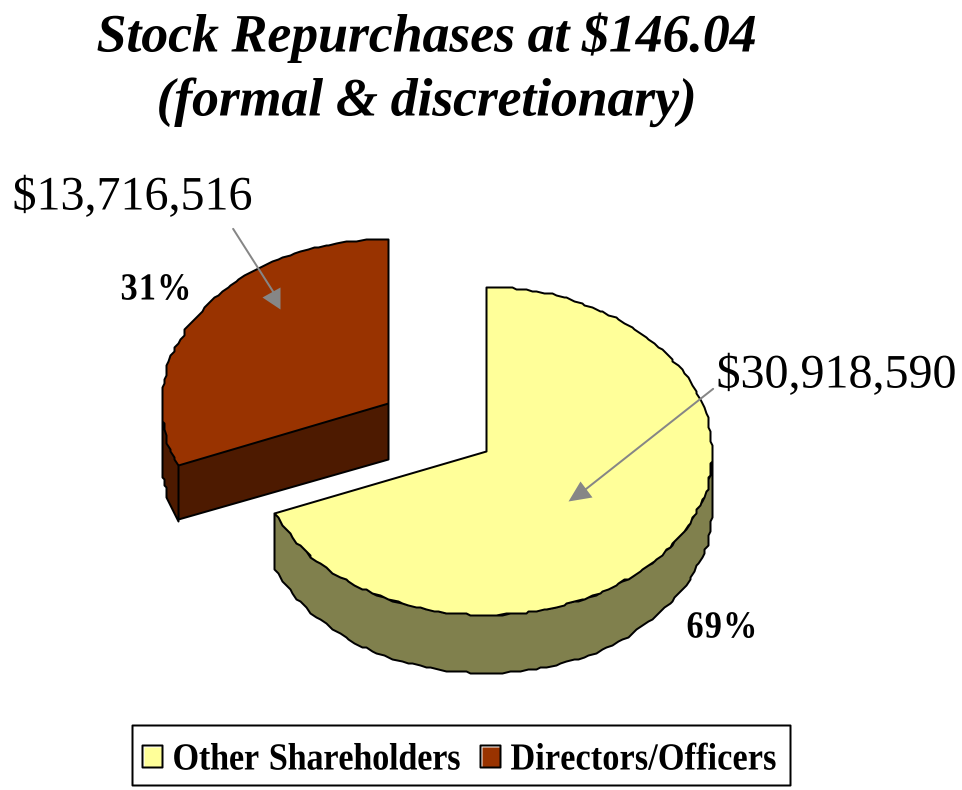
- **“The Company has not been advised that any of its directors and executive officers presently intend to tender any Shares personally owned by them pursuant to the Offer.”**
- **The Company believes ULLICO stock to be an “excellent investment opportunity for investors seeking long-term growth of capital.”**
- **No disclosure of discretionary repurchases from directors and officers**
- **No clear disclosure of impact of proration provisions and benefit to directors and officers**
- **No clear discussion of the fact that ULLICO’s “book value” stock price lagged behind Global Crossing’s market price**

Proration in 2000
Stock Repurchase Program

- Stock worth more than $1 billion tendered by shareholders holding 10,000 shares or more (offering capped at $30 million)
- Shareholders holding 10,000 or more shares could redeem only 2.2% of shares tendered
- Under-10,000 shareholders could redeem up to 100% of shares tendered
- No director or officer was prorated

Total Stock Repurchases at $146.04





DIRECTORS/OFFICERS DISPROPORTIONATELY BENEFITED

Terms of Georgine's Stock Purchase & Credit Agreement

- Effective as of December 30, 1999, ULLICO and Georgine entered into a Stock Purchase and Credit Agreement
- ULLICO loaned Georgine $2.2 million to purchase 40,000 shares of Class A Stock at $53.94 per share
- Loan is forgiven ratably over five years contingent on Georgine's continued employment as Chairman, President and CEO
- By May 2000, when the ULLICO stock price was reset to $146.04 per share, the 40,000 share bonus was worth $5,841,600

Issues Concerning Georgine's Stock Purchase & Credit Agreement

- The Board approved neither the stock issuance nor the loan
- The Compensation Committee lacks authority to issue stock
- The Compensation Committee arguably lacked the authority to make the loan to Georgine

Georgine's Put Options

- Stock Purchase & Credit Agreement allowed Georgine to sell a portion of the shares he received under the 40,000 share bonus back to ULLICO each year
- In Fall of 2000, Compensation Committee approved an addendum to Georgine's Employment Agreement allowing him to sell back to ULLICO other shares he held at any time without restriction
- This addendum was approved after Georgine had already sold non-bonus shares back to ULLICO in the Summer of 2000 at $146.04 per share

Executive Compensation (Pre-Tax) *

	1996 (salary, def. comp. + bonuses)	1997 (salary, def. comp. + bonuses)	1998 (salary, def. comp. + bonuses)	1999 (salary, def. comp. + bonuses)	2000 (salary, def. comp., bonuses and stock profit)	2001 (salary, def. comp., bonuses and stock profit)
Robert A. Georgine	**$900,000**	**$650,000**	**$1,627,273**	**$1,946,346**	**$5,356,961**	**$3,383,184**
Michael R. Steed	**$309,000**	**$445,167**	**$1,192,273**	**$1,158,525**	**N/A**	**N/A**
John K. Grelle	**$200,000**	**$300,700**	**$652,727**	**$658,201**	**$1,856,316**	**$1,188,714**
James W. Luce	**$262,500**	**$338,600**	**$652,727**	**$649,961**	**$1,826,098**	**$978,630**
Joseph A. Carabillo	**$187,250**	**$260,700**	**$537,727**	**$532,128**	**$1,239,451**	**$954,339**

* Does not include compensation under certain company retirement plans or the value of a split-dollar life insurance policy covering Georgine

Law

Governing Law - Overview

- Maryland fiduciary duty laws
- Federal securities laws
- State securities laws
- Criminal laws

Directors' Fiduciary Duties

Under Maryland statutory law, directors must act in the best interests of their company:

- **Directors must act with due care**
- **Directors must act in good faith**

Business Judgment Rule

- ***Directors*** **are presumed to have acted in accordance with their fiduciary duties**
- **It is unclear whether *officers* are entitled to this presumption under Maryland law**

Federal Securities Laws

- **Section 10(b) of Exchange Act and SEC Rule 10b-5 prohibit fraudulent schemes, untrue statements of material fact and material omissions concerning sale of securities**
- **Section 14(e) of Exchange Act prohibits untrue statements of material fact and material omissions in tender offers**
- **Civil securities violations must be committed with severe recklessness**

State Securities Laws

- State “Blue Sky” laws prohibit inaccurate or misleading tender offer disclosures
- Many states apply negligence standard

Criminal vs. Civil Liability

- **Prosecutors must demonstrate beyond a reasonable doubt that the defendant acted with a specific intent to defraud**
- **Civil plaintiffs, in contrast, may base a claim on allegations of severe recklessness or negligence**

Other Areas of Law Outside of Special Counsel Mandate

- **Special Counsel mandate limited to actions taken by directors and officers, on behalf of ULLICO, in connection with stock offer and repurchase programs**
- **ERISA or LMRDA obligations of directors, because of their union or pension fund positions, not within Special Counsel mandate**

Analysis

Fiduciary Duty Analysis: Stock Purchase Offers

- Business purpose of stock offers was unclear – stated objective of aligning interests with stockholders not achieved
- Approval of stock offers involved an excessive and perhaps impermissible delegation of authority by the Board (to the Compensation Committee or Georgine)
- Georgine may have exceeded general authority to issue stock by issuing stock to insiders
- Terms and timing of stock offers minimized, if not eliminated, investment risk
- Stock offers had effect of compensating directors and officers through inappropriate method

Fiduciary Duty Analysis: Stock Repurchase Programs

- **No meaningful basis for 10,000 share threshold in formal repurchase program**
- **Excessive delegation to Georgine to administer discretionary program, which was used in 2000 beyond historical practice**
- **Board ratified the discretionary program without complete disclosure of material information regarding discretionary repurchases**

Fiduciary Duty Analysis: Stock Repurchase Programs (Cont.)

- **Programs resulted in self-interested transactions that disproportionately benefited insiders at expense of larger shareholders (despite stated purpose of formal program to provide liquidity to larger shareholders)**
- **Details and effects of 2000 repurchase programs not adequately considered by the Board or disclosed to shareholders**

Fiduciary Duty Analysis: Stock Repurchase Programs (Cont.)

- **Serious questions exist regarding whether directors and officers who participated in repurchase programs acted both (1) in good faith, and (2) with due care and thus in a manner that they reasonably believed was in the best interests of ULLICO**
- **It cannot be said with a reasonable degree of certainty that the business judgment rule would protect those directors and officers who took advantage of these programs**

Fiduciary Duty Analysis: Role of Counsel

- **No outside counsel or professional was specifically asked to evaluate fiduciary duty issues**
- **Fiduciary duty issues here involve business, not legal, decisions**
- **Any advice given by in-house counsel was neither independent nor objective**

DIRECTORS/OFFICERS DO NOT HAVE A STRONG RELIANCE ON COUNSEL DEFENSE

Securities Laws: Disclosure Issues

- **Two of the three stock offers were not disclosed in disclosure documents**
- **2000 discretionary repurchases were not disclosed in disclosure documents**
- **2000 disclosure documents characterized ULLICO stock as an "excellent investment opportunity" when insiders were cashing out**
- **2000 disclosure documents implied that directors and officers did not intend to participate in the program**

Securities Laws: Fraud Issues

- **Senior management recommended, and the Board approved, a 10,000 share threshold that disproportionately favored directors and officers**
- **Senior management and certain directors participated in the stock offer and discretionary repurchase programs that were not fully disclosed to the shareholders**

Securities Laws: Possible Defenses

- **No severe recklessness**
- **Causation and reliance elements not satisfied**
- **Directors' individual stock holdings at year-end were disclosed in proxy statements**
- **Advice of counsel (but may not be a defense under certain state securities laws)**

Legal Conclusions

- There is a lack of evidence of criminal intent
- There is a compelling argument that directors and certain officers who benefited from the stock programs at issue breached their respective fiduciary duties
- There is limited exposure under the federal securities laws
- There is potential exposure under certain state securities laws

Special Counsel Report Recommendations

Directors’ and Carabillo’s Profits from Stock Purchased in 1998 and 1999

To remedy fiduciary duty breaches, directors, as well as Chief Legal Officer Carabillo, should return profits from ULLICO stock purchased in 1998 and 1999 – approximately $5.6 million

Georgine's Stock Purchase and Credit Agreement

- 24,000 (out of 40,000) shares already released from stock pledge
- 8,000 of these shares sold at $146.04
- $865,000 remains outstanding under the note
- Company should determine whether agreement should be rescinded, and profits on 8,000 shares (approximately $736,000) returned because:
  - Compensation Committee not authorized to issue stock; unclear whether it was authorized to enter into loan agreement
  - Agreement never approved by the Board

Georgine Profits From Capital and Class A Preferred Stock

- **The Company should determine whether these $592,000 of profits should be returned or the transactions rescinded because:**
  - **Board never approved put options**
  - **Doubtful that Board delegated authority to Compensation Committee to approve put options**
  - **Repurchases under discretionary program would have involved clear conflict of interest**
  - **Repurchases were made in February 2001 at $146.04, after decline in book value was obvious**

Other Directors' Profits From Capital Stock

- **Company should determine whether directors Casstevens ($39,943), Gentleman ($132,780), McNulty ($185,796) and West ($151,300) should return profits from sale of Capital Stock at $146.04 per share**

Argument against return of profits

- **Investment risk over long period of time**
- **Ineligible to participate in formal program**
- **1997 and 1998 letters to shareholders indicated that Capital Stock could be repurchased upon request**

Other Directors' Profits From Capital Stock (Cont.)

Argument for return of profits

- Duty of disclosure
- Took advantage of discretionary repurchase program under scrutiny
- Repurchases did not satisfy traditional discretionary repurchase program criteria
- Two directors sold shares well after it was apparent that $146.04 stock price would decline significantly

Other Directors' Profits From Class A Preferred Stock

- Company should determine whether to seek the return of most profits received by directors Bernard and Casstevens from Class A Preferred repurchases be disgorged or rescind the transactions
  - Most repurchases occurred through discretionary program without satisfying traditional criteria for repurchase
  - November 2000 ratification of these repurchases was either ineffective or fiduciary duty breach
  - Directors who repurchased shares under formal program inappropriately benefited from 10,000 share threshold to extent that more than 2.2% of tendered shares were repurchased
  - Bernard ($1,002,839 of profits less 2.2% equals $980,777) and Casstevens ($166,604 of profits less 2.2% equals $162,939)

Profits of Officers Grelle and Luce

- Company should determine whether to seek a return of profits from stock transactions involving Grelle ($837,760) and Luce ($789,299)
- Neither were directors and neither, based upon present evidence, were significantly involved in the creation of the programs at issue
- However, they did profit from stock offers, repurchase programs, the deferred compensation plan, and other matters in controversy

Other Remedial Recommendations

We also suggest that the Special Committee

- **Set conditions for future stock sales by insiders**
- **Revisit ULLICO’s stock price valuation practices**

Principal Corporate Governance Recommendations

- **Develop comprehensive corporate governance guidelines**
- **Develop a code of business conduct and ethics**

Corporate Governance Guidelines

The corporate governance guidelines should address, at a minimum, the following topics:

- **Director qualification standards**
- **Director responsibilities**
- **Director and officer compensation**
- **Director orientation and continuing education**
- **Director performance evaluations**

Code of Business Conduct and Ethics

The code of business conduct and ethics should be administered by a Chief Compliance Officer and address, at a minimum, the following topics:

- **Conflicts of interest**
- **Corporate opportunities**
- **Confidentiality**
- **Compliance with laws, rules and regulations**
- **Reporting on illegal or unethical behavior**

Additional Corporate Governance Recommendations

- **Set clear written standards for limited repurchases under “discretionary” program**
- **Provide director training**
- **Require review and disclosure by Corporate Governance Committee of insider transactions**
- **Reduce the Board’s size (create advisory group)**
- **Require majority of Board—and all members of Audit, Compensation, Nominating and Corporate Governance Committees—to be “independent”**

Additional Corporate Governance Recommendations (Cont.)

Disqualifying Director Relationships

- **Current or former employee**
- **Employee of company auditor**
- **Interlocking compensation committee directorships**
- **Other material relationships**
  - **Exempt ordinary course relationships**
  - **Identify those relationships/transactions that are material and/or involve significant management discretion**
  - **Develop process for disinterested board approval of related-party transactions**

Additional Corporate Governance Recommendations (Cont.)

Improved Written
Disclosure to Shareholders

- **Disclose independence standards and exceptions**
- **Disclose director relationships, potential conflicts of interest and related-party transactions**
- **Disclose executive compensation of all types**

Additional Corporate Governance Recommendations (Cont.)

- Increase frequency of Board meetings
- Require “independent” directors to determine and rotate committee assignments
- Prohibit broad delegations
- Require regular committee reports to the Board
- Authorize committees to engage advisors
- Remove inactive directors
- Require at least one “financial expert” on the Audit Committee
- Consider barring insider loans

End