

**Governance Committee  
Agenda  
Mansfield Service Office  
Tappan Building  
November 16, 2007  
Small Training Room, Level 2  
9:00 am – 11:00 am**

**Call to Order**

Alison Falls, Chair

**Roll Call**

Mike Sourek, Scribe

**Approve Minutes of October 24 meeting**

Alison Falls

**New Business/Action Items**

1. Review and Approval of Governance Committee Charter  
Alison Falls
2. Review and Approval of Board Committee Charters
3. Fiduciary Responsibility Memo/Discussion of Caremark  
Ron O'Keefe, Hahn, Loeser and Parks

**Discussion Items\***

1. Oversight of rule review process  
Marsha P. Ryan/James Barnes
2. Board process for input from stakeholders
3. Board approval of motions  
John Williams
4. Calendar
  - Future Calendar Topics

\* Not all discussion items have materials included.

Adjourn

**Next Meeting: January 2008**

Proposed Calendar  
Governance Committee  
November 16, 2007

December: no meeting

**2008**

January: Review draft of Board Governance Guidelines

February: no meeting

March/April: Coordination of Administrator's review

May/June: Board self-assessment  
Committee membership/Committee Chair recommendations

July/August: Orientation/Continuing Education program

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# OHIO ADMINISTRATIVE CODE

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	CHAPTER 4121-1 NOTICE; MEETINGS	4121-15-07	Representatives' responsibility relative to employees' code of ethics
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4121-1-02	Notice of public meetings	4121-15-09	Prohibition against unnecessary claim file possession
4121-1-03	Non-adjudicatory meetings of the industrial commission	4121-15-10	Standards of conduct for adjudicators
	CHAPTER 4121-2 STANDARDS OF PRACTICE FOR ATTORNEYS, AGENTS, AND REPRESENTATIVES OF CLAIMANTS OR EMPLOYERS		CHAPTER 4121-17 PAYMENTS TO HEALTH CARE PROVIDERS
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4121-3-01	Office locations and office hours		CHAPTER 4121-18 APPEAL
4121-3-09	Conduct of hearings before the commission and its staff and district hearing officers	4121-18-10	Appeal of administrative decisions of the division
4121-3-10	Awards		CHAPTER 4123-1 NOTICE PROCEDURE
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COURT OF CHANCERY OF DELAWARE, NEW CASTLE  
IN RE CAREMARK INTERNATIONAL INC. DERIVATIVE LITIGATION  
CONSOLIDATED CIVIL ACTION NO. 13670  
698 A.2d 959

August 16, 1996, DATE SUBMITTED  
September 25, 1996, DATE DECIDED

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**JUDGES:** ALLEN, CHANCELLOR

**OPINIONBY:** ALLEN

**OPINION:** MEMORANDUM OPINION

ALLEN, CHANCELLOR

Pending is a motion pursuant to Chancery Rule 23.1 to approve as fair and reasonable a proposed settlement of a consolidated derivative action on behalf of Caremark International, Inc. ("Caremark"). The suit involves claims that the members of Caremark's board of directors (the "Board") breached their fiduciary duty of care to Caremark in connection with alleged violations by Caremark employees of federal and state laws and regulations applicable to health care providers. As a result of the alleged violations, Caremark was subject to an extensive four year investigation by the United States Department of Health and Human Services and the Department of Justice. In 1994 Caremark was charged in an indictment with multiple felonies. It thereafter entered into a number of agreements with the Department of Justice and others. Those agreements included a plea agreement in which Caremark pleaded guilty to a single felony of mail fraud and agreed to pay civil and criminal fines. Subsequently, Caremark agreed to make reimbursements to various private and public parties. In all, the payments that Caremark has been required to make total approximately \$ 250 million.

This suit was filed in 1994, purporting to seek on behalf of the company recovery of these losses from the individual defendants who constitute the board of directors of Caremark. n1 The parties now propose that it be settled and, after notice to Caremark shareholders, a hearing on the fairness of the proposal was held on August 16, 1996.

-----Footnotes-----

n1 Thirteen of the Directors have been members of the Board since November 30, 1992. Nancy Brinker joined the Board in October 1993.

-----End Footnotes-----

A motion of this type requires the court to assess the strengths and weaknesses of the claims asserted in light of the discovery record and to evaluate the fairness and adequacy of the consideration offered to the corporation in exchange for the release of all claims made or arising from the facts alleged. The ultimate issue then is whether the proposed settlement appears to be fair to the corporation and its absent shareholders. In this effort the court does not determine contested facts, but evaluates the claims and defenses on the discovery record to achieve a sense of the relative strengths of the parties' positions. *Polk v. Good*, Del.Supr., 507 A.2d 531, 536 (1986). In doing this, in most instances, the court is constrained by the absence of a truly adversarial process, since inevitably both sides support the settlement and legally assisted objectors are rare. Thus, the facts stated hereafter represent the court's effort to understand the context of the motion from the discovery record, but do not deserve the respect that judicial findings after trial are customarily accorded.

Legally, evaluation of the central claim made entails consideration of the legal standard governing a board of directors' obligation to supervise or monitor corporate performance. For the reasons set forth below I conclude, in light of the discovery record, that there is a very low probability that it would be determined that the directors of Caremark breached any duty to appropriately monitor and supervise the enterprise. Indeed the record tends to show an active consideration by Caremark management and its Board of the Caremark structures and programs that ultimately led to the company's indictment and to the large financial losses incurred in the settlement of those claims. It does not tend to show knowing or intentional violation of law. Neither the fact that the Board, although advised by lawyers and accountants, did not accurately predict the severe consequences to the company that would ultimately follow from the deployment by the company of the strategies and practices that ultimately led to this liability, nor the scale of the liability, gives rise to an inference of breach of any duty imposed by corporation law upon the directors of Caremark.

### *I. BACKGROUND*

For these purposes I regard the following facts, suggested by the discovery record,

as material. Caremark, a Delaware corporation with its headquarters in Northbrook, Illinois, was created in November 1992 when it was spun-off from Baxter International, Inc. ("Baxter") and became a publicly held company listed on the New York Stock Exchange. The business practices that created the problem pre-dated the spin-off. During the relevant period Caremark was involved in two main health care business segments, providing patient care and managed care services. As part of its patient care business, which accounted for the majority of Caremark's revenues, Caremark provided alternative site health care services, including infusion therapy, growth hormone therapy, HIV/AIDS-related treatments and hemophilia therapy. Caremark's managed care services included prescription drug programs and the operation of multi-specialty group practices.

#### *A. Events Prior to the Government Investigation*

A substantial part of the revenues generated by Caremark's businesses is derived from third party payments, insurers, and Medicare and Medicaid reimbursement programs. The latter source of payments are subject to the terms of the Anti-Referral Payments Law ("ARPL") which prohibits health care providers from paying any form of remuneration to induce the referral of Medicare or Medicaid patients. From its inception, Caremark entered into a variety of agreements with hospitals, physicians, and health care providers for advice and services, as well as distribution agreements with drug manufacturers, as had its predecessor prior to 1992. Specifically, Caremark did have a practice of entering into contracts for services (e.g., consultation agreements and research grants) with physicians at least some of whom prescribed or recommended services or products that Caremark provided to Medicare recipients and other patients. Such contracts were not prohibited by the ARPL but they obviously raised a possibility of unlawful "kickbacks."

As early as 1989, Caremark's predecessor issued an internal "Guide to Contractual Relationships" ("Guide") to govern its employees in entering into contracts with physicians and hospitals. The Guide tended to be reviewed annually by lawyers and updated. Each version of the Guide stated as Caremark's and its predecessor's policy that no payments would be made in exchange for or to induce patient referrals. But what one might deem a prohibited *quid pro quo* was not always clear. Due to a scarcity of court decisions interpreting the ARPL, however, Caremark repeatedly publicly stated that there was uncertainty concerning Caremark's interpretation of the law.

To clarify the scope of the ARPL, the United States Department of Health and Human Services ("HHS") issued "safe harbor" regulations in July 1991 stating conditions under which financial relationships between health care service providers and patient referral sources, such as physicians, would not violate the ARPL. Caremark contends that the narrowly drawn regulations gave limited guidance as to the legality of many of the agreements used by Caremark that did not fall within the safe-harbor. Caremark's predecessor, however, amended many of its standard forms of agreement with health care providers and revised the Guide in an apparent

attempt to comply with the new regulations.

*B. Government Investigation and Related Litigation*

In August 1991, the HHS Office of the Inspector General ("OIG") initiated an investigation of Caremark's predecessor. Caremark's predecessor was served with a subpoena requiring the production of documents, including contracts between Caremark's predecessor and physicians (Quality Service Agreements ("QSAs")). Under the QSAs, Caremark's predecessor appears to have paid physicians fees for monitoring patients under Caremark's predecessor's care, including Medicare and Medicaid recipients. Sometimes apparently those monitoring patients were referring physicians, which raised ARPL concerns.

In March 1992, the Department of Justice ("DOJ") joined the OIG investigation and separate investigations were commenced by several additional federal and state agencies. n2

-----Footnotes-----

n2 In addition to investigating whether Caremark's financial relationships with health care providers were intended to induce patient referrals, inquiries were made concerning Caremark's billing practices, activities which might lead to excessive and medically unnecessary treatments for patients, potentially improper waivers of patient co-payment obligations, and the adequacy of records kept at Caremark pharmacies.

-----End Footnotes-----

*C. Caremark's Response to the Investigation*

During the relevant period, Caremark had approximately 7,000 employees and ninety branch operations. It had a decentralized management structure. By May 1991, however, Caremark asserts that it had begun making attempts to centralize its management structure in order to increase supervision over its branch operations.

The first action taken by management, as a result of the initiation of the OIG investigation, was an announcement that as of October 1, 1991, Caremark's predecessor would no longer pay management fees to physicians for services to Medicare and Medicaid patients. Despite this decision, Caremark asserts that its management, pursuant to advice, did not believe that such payments were illegal under the existing laws and regulations.

During this period, Caremark's Board took several additional steps consistent with an effort to assure compliance with company policies concerning the ARPL and the contractual forms in the Guide. In April 1992, Caremark published a fourth revised version of its Guide apparently designed to assure that its agreements either complied with the ARPL and regulations or excluded Medicare and Medicaid patients

altogether. In addition, in September 1992, Caremark instituted a policy requiring its regional officers, Zone Presidents, to approve each contractual relationship entered into by Caremark with a physician.

Although there is evidence that inside and outside counsel had advised Caremark's directors that their contracts were in accord with the law, Caremark recognized that some uncertainty respecting the correct interpretation of the law existed. In its 1992 annual report, Caremark disclosed the ongoing government investigations, acknowledged that if penalties were imposed on the company they could have a material adverse effect on Caremark's business, and stated that no assurance could be given that its interpretation of the ARPL would prevail if challenged.

Throughout the period of the government investigations, Caremark had an internal audit plan designed to assure compliance with business and ethics policies. In addition, Caremark employed Price Waterhouse as its outside auditor. On February 8, 1993, the Ethics Committee of Caremark's Board received and reviewed an outside auditors report by Price Waterhouse which concluded that there were no material weaknesses in Caremark's control structure. n3 Despite the positive findings of Price Waterhouse, however, on April 20, 1993, the Audit & Ethics Committee adopted a new internal audit charter requiring a comprehensive review of compliance policies and the compilation of an employee ethics handbook concerning such policies. n4

-----Footnotes-----

n3 At that time, Price Waterhouse viewed the outcome of the OIG Investigation as uncertain. After further audits, however, on February 7, 1995, Price Waterhouse informed the Audit & Ethics Committee that it had not become aware of any irregularities or illegal acts in relation to the OIG investigation.

n4 Price Waterhouse worked in conjunction with the Internal Audit Department.

-----End Footnotes-----

The Board appears to have been informed about this project and other efforts to assure compliance with the law. For example, Caremark's management reported to the Board that Caremark's sales force was receiving an ongoing education regarding the ARPL and the proper use of Caremark's form contracts which had been approved by in-house counsel. On July 27, 1993, the new ethics manual, expressly prohibiting payments in exchange for referrals and requiring employees to report all illegal conduct to a toll free confidential ethics hotline, was approved and allegedly disseminated. n5 The record suggests that Caremark continued these policies in subsequent years, causing employees to be given revised versions of the ethics manual and requiring them to participate in training sessions concerning compliance with the law.

-----Footnotes-----

n5 Prior to the distribution of the new ethics manual, on March 12, 1993, Caremark's president had sent a letter to all senior, district, and branch managers restating Caremark's policies that no physician be paid for referrals, that the standard contract forms in the Guide were not to be modified, and that deviation from such policies would result in the immediate termination of employment.

-----End Footnotes-----

During 1993, Caremark took several additional steps which appear to have been aimed at increasing management supervision. These steps included new policies requiring local branch managers to secure home office approval for all disbursements under agreements with health care providers and to certify compliance with the ethics program. In addition, the chief financial officer was appointed to serve as Caremark's compliance officer. In 1994, a fifth revised Guide was published.

#### *D. Federal Indictments Against Caremark and Officers*

On August 4, 1994, a federal grand jury in Minnesota issued a 47 page indictment charging Caremark, two of its officers (not the firm's chief officer), an individual who had been a sales employee of Genentech, Inc., and David R. Brown, a physician practicing in Minneapolis, with violating the ARPL over a lengthy period. According to the indictment, over \$ 1.1 million had been paid to Brown to induce him to distribute Protropin, a human growth hormone drug marketed by Caremark. n6 The substantial payments involved started, according to the allegations of the indictment, in 1986 and continued through 1993. Some payments were "in the guise of research grants", Ind. P20, and others were "consulting agreements", Ind. P19. The indictment charged, for example, that Dr. Brown performed virtually none of the consulting functions described in his 1991 agreement with Caremark, but was nevertheless neither required to return the money he had received nor precluded from receiving future funding from Caremark. In addition the indictment charged that Brown received from Caremark payments of staff and office expenses, including telephone answering services and fax rental expenses.

-----Footnotes-----

n6 In addition to prescribing Protropin, Dr. Brown had been receiving research grants from Caremark as well as payments for services under a consulting agreement for several years before and after the investigation. According to an undated document from an unknown source, Dr. Brown and six other researchers had been providing patient referrals to Caremark valued at \$ 6.55 for each \$ 1 of research money they received.

-----End Footnotes-----

In reaction to the Minnesota Indictment and the subsequent filing of this and other derivative actions in 1994, the Board met and was informed by management that the investigation had resulted in an indictment; Caremark denied any wrongdoing relating to the indictment and believed that the OIG investigation would have a favorable outcome. Management reiterated the grounds for its view that the contracts were in compliance with law.

Subsequently, five stockholder derivative actions were filed in this court and consolidated into this action. The original complaint, dated August 5, 1994, alleged, in relevant part, that Caremark's directors breached their duty of care by failing adequately to supervise the conduct of Caremark employees, or institute corrective measures, thereby exposing Caremark to fines and liability. n7

-----Footnotes-----

n7 Caremark moved to dismiss this complaint on September 14, 1994. Prior to that motion, another stockholder derivative action had been filed in the United States District Court for the Northern District of Illinois, complaining of similar misconduct on the part of Caremark, its Directors, and three employees, as well as several other claims including RICO violations. *Brumberg v. Mieszala*, No. 94 C 4798 (N.D. Ill.). The federal court entered a stay of all proceedings pending resolution of this case.

-----End Footnotes-----

On September 21, 1994, a federal grand jury in Columbus, Ohio issued another indictment alleging that an Ohio physician had defrauded the Medicare program by requesting and receiving \$ 134,600 in exchange for referrals of patients whose medical costs were in part reimbursed by Medicare in violation of the ARPL. Although unidentified at that time, Caremark was the health care provider who allegedly made such payments. The indictment also charged that the physician, Elliot Neufeld, D.O., was provided with the services of a registered nurse to work in his office at the expense of the infusion company, in addition to free office equipment.

An October 28, 1994 amended complaint in this action added allegations concerning the Ohio indictment as well as new allegations of over billing and inappropriate referral payments in connection with an action brought in Atlanta, *Booth v. Rankin*. Following a newspaper article report that federal investigators were expanding their inquiry to look at Caremark's referral practices in Michigan as well as allegations of fraudulent billing of insurers, a second amended complaint was filed in this action. The third, and final, amended complaint was filed on April 11, 1995, adding allegations that the federal indictments had caused Caremark to incur significant legal fees and forced it to sell its home infusion business at a loss. n8

-----Footnotes-----

n8 On January 29, 1995, Caremark entered into a definitive agreement to sell its

home infusion business to Coram Health Care Company for approximately \$ 310 million. Baxter purchased the home infusion business in 1987 for \$ 586 million.

-----End Footnotes-----

After each complaint was filed, defendants filed a motion to dismiss. According to defendants, if a settlement had not been reached in this action, the case would have been dismissed on two grounds. First, they contend that the complaints fail to allege particularized facts sufficient to excuse the demand requirement under Delaware Chancery Court Rule 23.1. Second, defendants assert that plaintiffs had failed to state a cause of action due to the fact that Caremark's charter eliminates directors' personal liability for money damages, to the extent permitted by law.

### *Settlement Negotiations*

In September, following the announcement of the Ohio indictment, Caremark publicly announced that as of January 1, 1995, it would terminate all remaining financial relationships with physicians in its home infusion, hemophilia, and growth hormone lines of business. n9 In addition, Caremark asserts that it extended its restrictive policies to all of its contractual relationships with physicians, rather than just those involving Medicare and Medicaid patients, and terminated its research grant program which had always involved some recipients who referred patients to Caremark.

-----Footnotes-----

n9 On June 1, 1993, Caremark had stopped entering into new contractual agreements in those business segments.

-----End Footnotes-----

Caremark began settlement negotiations with federal and state government entities in May 1995. In return for a guilty plea to a single count of mail fraud by the corporation, the payment of a criminal fine, the payment of substantial civil damages, and cooperation with further federal investigations on matters relating to the OIG investigation, the government entities agreed to negotiate a settlement that would permit Caremark to continue participating in Medicare and Medicaid programs. On June 15, 1995, the Board approved a settlement ("Government Settlement Agreement") with the DOJ, OIG, U.S. Veterans Administration, U.S. Federal Employee Health Benefits Program, federal Civilian Health and Medical Program of the Uniformed Services, and related state agencies in all fifty states and the District of Columbia. n10 No senior officers or directors were charged with wrongdoing in the Government Settlement Agreement or in any of the prior indictments. In fact, as part of the sentencing in the Ohio action on June 19, 1995, the United States stipulated that *no senior executive of Caremark participated in, condoned, or was willfully ignorant of wrongdoing in connection with the home infusion business practices.* n11

-----Footnotes-----

n10 The agreement, covering allegations since 1986, required a Caremark subsidiary to enter a guilty plea to two counts of mail fraud, and required Caremark to pay \$ 29 million in criminal fines, \$ 129.9 million relating to civil claims concerning payment practices, \$ 3.5 million for alleged violations of the Controlled Substances Act, and \$ 2 million, in the form of a donation, to a grant program set up by the Ryan White Comprehensive AIDS Resources Emergency Act. Caremark also agreed to enter into a compliance agreement with the HHS.

n11 On July 25, 1995, another shareholder derivative complaint was filed against Caremark and seven of its Directors, asserting allegations related to the Minnesota indictment and the terms of the Government Settlement Agreement. *Lenzen v. Piccolo*, No. 95 CH 7118 (Circuit Court of Cook County, Illinois).

-----End Footnotes-----

The federal settlement included certain provisions in a "Corporate Integrity Agreement" designed to enhance future compliance with law. The parties have not discussed this agreement, except to say that the negotiated provisions of the settlement of this claim are not redundant of those in that agreement.

Settlement negotiations between the parties in this action commenced in May 1995 as well, based upon a letter proposal of the plaintiffs, dated May 16, 1995. n12 These negotiations resulted in a memorandum of understanding ("MOU"), dated June 7, 1995, and the execution of the Stipulation and Agreement of Compromise and Settlement on June 28, 1995, which is the subject of this action. n13 The MOU, approved by the Board on June 15, 1995, required the Board to adopt several resolutions, discussed below, and to create a new compliance committee. The Compliance and Ethics Committee has been reporting to the Board in accord with its newly specified duties.

-----Footnotes-----

n12 No government entities were involved in these separate, but concurrent negotiations.

n13 Plaintiff's initial proposal had both a monetary component, requiring Caremark's director-officers to relinquish stock options, and a remedial component, requiring management to adopt and implement several compliance related measures. The monetary component was subsequently eliminated.

-----End Footnotes-----

After negotiating these settlements, Caremark learned in December 1995 that

several private insurance company payors ("Private Payors") believed that Caremark was liable for damages to them for allegedly improper business practices related to those at issue in the OIG investigation. As a result of intensive negotiations with the Private Payors and the Board's extensive consideration of the alternatives for dealing with such claims, the Board approved a \$ 98.5 million settlement agreement with the Private Payors on March 18, 1996. In its public disclosure statement, Caremark asserted that the settlement did not involve current business practices and contained an express denial of any wrongdoing by Caremark. After further discovery in this action, the plaintiffs decided to continue seeking approval of the proposed settlement agreement.

#### *F. The Proposed Settlement of this Litigation*

In relevant part the terms upon which these claims asserted are proposed to be settled are as follows: 1. That Caremark, undertakes that it and its employees, and agents not pay any form of compensation to a third party in exchange for the referral of a patient to a Caremark facility or service or the prescription of drugs marketed or distributed by Caremark for which reimbursement may be sought from Medicare, Medicaid, or a similar state reimbursement program;

2. That Caremark, undertakes for itself and its employees, and agents not to pay to or split fees with physicians, joint ventures, any business combination in which Caremark maintains a direct financial interest, or other health care providers with whom Caremark has a financial relationship or interest, in exchange for the referral of a patient to a Caremark facility or service or the prescription of drugs marketed or distributed by Caremark for which reimbursement may be sought from Medicare, Medicaid, or a similar state reimbursement program;

3. That the full Board shall discuss all relevant material changes in government health care regulations and their effect on relationships with health care providers on a semi-annual basis;

4. That Caremark's officers will remove all personnel from health care facilities or hospitals who have been placed in such facility for the purpose of providing remuneration in exchange for a patient referral for which reimbursement may be sought from Medicare, Medicaid, or a similar state reimbursement program;

5. That every patient will receive written disclosure of any financial relationship between Caremark and the health care professional or provider who made the referral;

6. That the Board will establish a Compliance and Ethics Committee of four directors, two of which will be non-management directors, to meet at least four times a year to effectuate these policies and monitor business segment compliance with the ARPL, and to report to the Board semi-annually concerning compliance by each business segment; and

7. That corporate officers responsible for business segments shall serve as compliance officers who must report semi-annually to the Compliance and Ethics Committee and, with the assistance of outside counsel, review existing contracts and get advanced approval of any new contract forms.

*II. LEGAL PRINCIPLES*

*A. Principles Governing Settlements of Derivative Claims*

As noted at the outset of this opinion, this Court is now required to exercise an informed judgment whether the proposed settlement is fair and reasonable in the light of all relevant factors. *Polk v. Good*, Del.Supr., 507 A.2d 531 (1986). On an application of this kind, this Court attempts to protect the best interests of the corporation and its absent shareholders all of whom will be barred from future litigation on these claims if the settlement is approved. The parties proposing the settlement bear the burden of persuading the court that it is in fact fair and reasonable. *Fins v. Pearlman*, Del.Supr., 424 A.2d 305 (1980).

*B. Directors' Duties To Monitor Corporate Operations*

The complaint charges the director defendants with breach of their duty of attention or care in connection with the on-going operation of the corporation's business. The claim is that the directors allowed a situation to develop and continue which exposed the corporation to enormous legal liability and that in so doing they violated a duty to be active monitors of corporate performance. The complaint thus does not charge either director self-dealing or the more difficult loyalty-type problems arising from cases of suspect director motivation, such as entrenchment or sale of control contexts.<sup>n14</sup> The theory here advanced is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment. The good policy reasons why it is so difficult to charge directors with responsibility for corporate losses for an alleged breach of care, where there is no conflict of interest or no facts suggesting suspect motivation involved, were recently described in *Gagliardi v. TriFoods Int'l Inc.*, Del.Ch., 683 A.2d 1049 (1996) (1996 Del.Ch. LEXIS 87 at p.20).

-----Footnotes-----

n14 See *Weinberger v. UOP, Inc.*, Del.Supr., 457 A.2d 701, 711 (1983) (entire fairness test when financial conflict of interest involved); *Unitrin, Inc. v. American General Corp.*, Del.Supr., 651 A.2d 1361, 1372 (1995) (intermediate standard of review when "defensive" acts taken); *QVC Network, Inc. v. Paramount Communications, Inc.*, Del.Supr., 637 A.2d 34, 45 (1994) (intermediate test when corporate control transferred).

-----End Footnotes-----

1. Potential liability for directoral decisions: Director liability for a breach of the duty to

exercise appropriate attention may, in theory, arise in two distinct contexts. First, such liability may be said to follow *from a board decision* that results in a loss because that decision was ill advised or "negligent". Second, liability to the corporation for a loss may be said to arise from an *unconsidered failure of the board to act* in circumstances in which due attention would, arguably, have prevented the loss. See generally *Veasey & Seitz, The Business Judgment Rule in the Revised Model Act...63 TEXAS L. REV.* 1483 (1985). The first class of cases will typically be subject to review under the director-protective business judgment rule, assuming the decision made was the product of a *process* that was *either* deliberately considered in good faith or was otherwise rational. See *Aronson v. Lewis*, Del.Supr., 473 A.2d 805 (1984); *Gagliardi v. TriFoods Int'l Inc.*, Del.Ch. 683 A.2d 1049 (1996). What should be understood, but may not widely be understood by courts or commentators who are not often required to face such questions, n15 is that compliance with a director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith or rationality of the process employed. That is, whether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through "stupid" to "egregious" or "irrational", provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a *good faith* effort to advance corporate interests. To employ a different rule -- one that permitted an "objective" evaluation of the decision -- would expose directors to substantive second guessing by ill-equipped judges or juries, which would, in the long-run, be injurious to investor interests. n16 Thus, the business judgment rule is process oriented and informed by a deep respect for all *good faith* board decisions.

-----Footnotes-----

n15 See American Law Institute, Principles of Corporate Governance § 4.01(c) (to qualify for business judgment treatment a director must "rationally" believe that the decision is in the best interests of the corporation).

n16 The vocabulary of negligence while often employed, *e.g.*, *Aronson v. Lewis*, Del. Supr., 473 A.2d 805 (1984) is not well-suited to judicial review of board attentiveness, *see, e.g.*, *Joy v. North*, 692 F.2d 880, 885-6 (2d. Cir. 1982), especially if one attempts to look to the substance of the decision as any evidence of possible "negligence." Where review of board functioning is involved, courts leave behind as a relevant point of reference the decisions of the hypothetical "reasonable person", who typically supplies the test for negligence liability. It is doubtful that we want business men and women to be encouraged to make decisions as hypothetical persons of *ordinary* judgment and prudence might. The corporate form gets its utility in large part from its ability to allow diversified investors to accept greater investment risk. If those in charge of the corporation are to be adjudged personally liable for losses on the basis of a substantive judgment based upon what an persons of ordinary or average judgment and average risk assessment talent regard as "prudent" "sensible" or even "rational", such persons will have a strong incentive at the margin to authorize less risky

investment projects.

-----End Footnotes-----

Indeed, one wonders on what moral basis might shareholders attack a *good faith* business decision of a director as "unreasonable" or "irrational". Where a director *in fact exercises a good faith effort to be informed and to exercise appropriate judgment*, he or she should be deemed to satisfy fully the duty of attention. If the shareholders thought themselves entitled to some other quality of judgment than such a director produces in the good faith exercise of the powers of office, then the shareholders should have elected other directors. Judge Learned Hand made the point rather better than can I. In speaking of the passive director defendant Mr. Andrews in *Barnes v. Andrews*, Judge Hand said:

True, he was not very suited by experience for the job he had undertaken, but I cannot hold him on that account. After all it is the same corporation that chose him that now seeks to charge him....Directors are not specialists like lawyers or doctors....They are the general advisors of the business and if they faithfully give such ability as they have to their charge, it would not be lawful to hold them liable. Must a director guarantee that his judgment is good? Can a shareholder call him to account for deficiencies that their votes assured him did not disqualify him for his office? While he may not have been the Cromwell for that Civil War, Andrews did not engage to play any such role. n17

In this formulation Learned Hand correctly identifies, in my opinion, the core element of any corporate law duty of care inquiry: whether there was good faith effort to be informed and exercise judgment.

-----Footnotes-----

n17 208 App. Div. 856 (S.D.N.Y. 1924).

-----End Footnotes-----

2. Liability for failure to monitor: The second class of cases in which director liability for inattention is theoretically possible entail circumstances in which a loss eventuates not from a decision but, from unconsidered inaction. Most of the decisions that a corporation, acting through its human agents, makes are, of course, not the subject of director attention. Legally, the board itself will be required only to authorize the most significant corporate acts or transactions: mergers, changes in capital structure, fundamental changes in business, appointment and compensation of the CEO, etc. As the facts of this case graphically demonstrate, ordinary business decisions that are made by officers and employees deeper in the interior of the organization can, however, vitally affect the welfare of the corporation and its ability to achieve its various strategic and financial goals. If this case did not prove the point itself, recent business history would. Recall for example the displacement of senior management and much of the board of Salomon, Inc.; n18 the replacement of senior management of Kidder, Peabody following the discovery of large trading losses resulting from

phantom trades by a highly compensated trader; n19 or the extensive financial loss and reputational injury suffered by Prudential Insurance as a result its junior officers misrepresentations in connection with the distribution of limited partnership interests. n20 Financial and organizational disasters such as these raise the question, what is the board's responsibility with respect to the organization and monitoring of the enterprise to assure that the corporation functions within the law to achieve its purposes?

-----Footnotes-----

n18 See, e.g., *Rotten at the Core*, the Economist, August 17, 1991, at 69-70, *The Judgment of Salomon: An Anticlimax*, Bus. Week, June 1, 1992, at 106.

n19 See Terence P. Pare, *Jack Welch's Nightmare on Wall Street*, Fortune, Sept. 5, 1994, at 40-48.

n20 Michael Schroeder and Leah Nathans Spiro, *Is George Ball's Luck Running Out?*, Bus. Week, November 8, 1993, at 74-76; Joseph B. Treaster, *Prudential To Pay Policyholders \$ 410 Million*, New York Times, Sept 25, 1996, (at D-1).

-----End Footnotes-----

Modernly this question has been given special importance by an increasing tendency, especially under federal law, to employ the criminal law to assure corporate compliance with external legal requirements, including environmental, financial, employee and product safety as well as assorted other health and safety regulations. In 1991, pursuant to the Sentencing Reform Act of 1984, n21 the United States Sentencing Commission adopted Organizational Sentencing Guidelines which impact importantly on the prospective effect these criminal sanctions might have on business corporations. The Guidelines set forth a uniform sentencing structure for organizations to be sentenced for violation of federal criminal statutes and provide for penalties that equal or often massively exceed those previously imposed on corporations. n22 The Guidelines offer powerful incentives for corporations today to have in place compliance programs to detect violations of law, promptly to report violations to appropriate public officials when discovered, and to take prompt, voluntary remedial efforts.

-----Footnotes-----

n21 See Sentencing Reform Act of 1984, Pub.L. 98-473, Title II, § 212 (a)(2) (1984); 18 USCA §§ 3331-4120.

n22 See United States Sentencing Commission, Guidelines Manuel, Chapter 8 (U.S. Government Printing Office November 1994).

-----End Footnotes-----

In 1963, the Delaware Supreme Court in *Graham v. Allis-Chalmers Mfg. Co.*,<sup>n23</sup> addressed the question of potential liability of board members for losses experienced by the corporation as a result of the corporation having violated the anti-trust laws of the United States. There was no claim in that case that the directors knew about the behavior of subordinate employees of the corporation that had resulted in the liability. Rather, as in this case, the claim asserted was that the directors *ought to have known* of it and if they had known they would have been under a duty to bring the corporation into compliance with the law and thus save the corporation from the loss. The Delaware Supreme Court concluded that, under the facts as they appeared, there was no basis to find that the directors had breached a duty to be informed of the ongoing operations of the firm. In notably colorful terms, the court stated that "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists."<sup>n24</sup> The Court found that there were no grounds for suspicion in that case and, thus, concluded that the directors were blamelessly unaware of the conduct leading to the corporate liability.<sup>n25</sup>

-----Footnotes-----

n23 41 Del. Ch. 78, 188 A.2d 125 (1963).

n24 *Id.* 188 A.2d at 130.

n25 Recently, *the Graham* standard was applied by the Delaware Chancery in a case involving Baxter. *In Re Baxter International, Inc. Shareholders Litig.*, Del.Ch., 654 A.2d 1268, 1270 (1995).

-----End Footnotes-----

How does one generalize this holding today? Can it be said today that, absent some ground giving rise to suspicion of violation of law, that corporate directors have no duty to assure that a corporate information gathering and reporting systems exists which represents a good faith attempt to provide senior management and the Board with information respecting material acts, events or conditions within the corporation, including compliance with applicable statutes and regulations? I certainly do not believe so. I doubt that such a broad generalization of the *Graham* holding would have been accepted by the Supreme Court in 1963. The case can be more narrowly interpreted as standing for the proposition that, absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf. See 188 A.2d at 130-31.

A broader interpretation of *Graham v. Allis Chalmers* -- that it means that a corporate board has no responsibility to assure that appropriate information and reporting systems are established by management -- would not, in any event, be accepted by

the Delaware Supreme Court in 1996, in my opinion. In stating the basis for this view, I start with the recognition that in recent years the Delaware Supreme Court has made it clear -- especially in its jurisprudence concerning takeovers, from *Smith v. Van Gorkom* through *QVC v. Paramount Communications* <sup>n26</sup> -- the seriousness with which the corporation law views the role of the corporate board. Secondly, I note the elementary fact that relevant and timely information is an essential predicate for satisfaction of the board's supervisory and monitoring role under Section 141 of the Delaware General Corporation Law. Thirdly, I note the potential impact of the federal organizational sentencing guidelines on any business organization. Any rational person attempting in good faith to meet an organizational governance responsibility would be bound to take into account this development and the enhanced penalties and the opportunities for reduced sanctions that it offers.

-----Footnotes-----

<sup>n26</sup> *E.g.*, *Smith v. Van Gorkom*, Del.Supr., 488 A.2d 858 (1985); *Paramount Communications v. QVC Network*, Del. Supr., 637 A.2d 34 (1993).

-----End Footnotes-----

In light of these developments, it would, in my opinion, be a mistake to conclude that our Supreme Court's statement in *Graham* concerning "espionage" means that corporate boards may satisfy their obligation to be reasonably informed concerning the corporation, without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance.

Obviously the level of detail that is appropriate for such an information system is a question of business judgment. And obviously too, no rationally designed information and reporting system will remove the possibility that the corporation will violate laws or regulations, or that senior officers or directors may nevertheless sometimes be misled or otherwise fail reasonably to detect acts material to the corporation's compliance with the law. But it is important that the board exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility.

Thus, I am of the view that a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards <sup>n27</sup>. I now turn to an analysis of the claims asserted with this concept of the directors duty of care, as a duty satisfied in part by assurance of adequate information flows to the board, in mind.

-----Footnotes-----

n27 Any action seeking recover for losses would logically entail a judicial determination of proximate cause, since, for reasons that I take to be obvious, it could never be assumed that an adequate information system would be a system that would prevent all losses. I need not touch upon the burden allocation with respect to a proximate cause issue in such a suit. See *Cede & Co. v. Technicolor, Inc.*, Del.Supr., 636 A.2d 956 (1994); *Cinerama, Inc. v. Technicolor, Inc.*, Del.Ch., 663 A.2d 1134 (1994), *aff'd.*, Del.Supr., 663 A.2d 1156 (1995). Moreover, questions of waiver of liability under certificate provisions authorized by 8 Del.C. § 102(b)(7) may also be faced.

-----End Footnotes-----

### III ANALYSIS OF THIRD AMENDED COMPLAINT AND SETTLEMENT

#### A. *The Claims*

On balance, after reviewing an extensive record in this case, including numerous documents and three depositions, I conclude that this settlement is fair and reasonable. In light of the fact that the Caremark Board already has a functioning committee charged with overseeing corporate compliance, the changes in corporate practice that are presented as consideration for the settlement do not impress one as very significant. Nonetheless, that consideration appears fully adequate to support dismissal of the derivative claims of director fault asserted, because those claims find no substantial evidentiary support in the record and quite likely were susceptible to a motion to dismiss in all events. n28

-----Footnotes-----

n28 See *In Re Baxter International, Inc. Shareholders Litig.*, Del.Ch., 654 A.2d 1268, 1270 (1995). A claim in some respects similar to that here made was dismissed. The court relied, in part, on the fact that the Baxter certificate of incorporation contained a provision as authorized by Section 102(b)(7) of the Delaware General Corporation Law, waiving director liability for due care violations. *Id.* at 1270. That fact was thought to require pre-suit demand on the board in that case.

-----End Footnotes-----

In order to Show that the Caremark directors breached their duty of care by failing adequately to control Caremark's employees, plaintiffs would have to show either (1) that the directors knew or (2) should have known that violations of law were occurring and, in either event, (3) that the directors took no steps in a good faith effort to prevent or remedy that situation, and (4) that such failure proximately resulted in the losses complained of, although under *Cede & Co. v. Technicolor, Inc.*, Del.Supr., 636 A.2d 956 (1994) this last element may be thought to constitute an affirmative defense.

1. Knowing violation for statute: Concerning the possibility that the Caremark directors knew of violations of law, none of the documents submitted for review, nor any of the deposition transcripts appear to provide evidence of it. Certainly the Board understood that the company had entered into a variety of contracts with physicians, researchers, and health care providers and it was understood that some of these contracts were with persons who had prescribed treatments that Caremark participated in providing. The board was informed that the company's reimbursement for patient care was frequently from government funded sources and that such services were subject to the ARPL. But the Board appears to have been informed by experts that the company's practices while contestable, were lawful. There is no evidence that reliance on such reports was not reasonable. Thus, this case presents no occasion to apply a principle to the effect that knowingly causing the corporation to violate a criminal statute constitutes a breach of a director's fiduciary duty. See *Roth v. Robertson*, N.Y.Sup.Ct., 64 Misc. 343, 118 N.Y.S. 351 (1909); *Miller v. American Tel. & Tel Co.*, 507 F.2d 759 (3rd Cir. 1974). It is not clear that the Board knew the detail found, for example, in the indictments arising from the Company's payments. But, of course, the duty to act in good faith to be informed cannot be thought to require directors to possess detailed information about all aspects of the operation of the enterprise. Such a requirement would simply be inconsistent with the scale and scope of efficient organization size in this technological age.

2. Failure to monitor: Since it does appear that the Board was to some extent unaware of the activities that led to liability, I turn to a consideration of the other potential avenue to director liability that the pleadings take: director inattention or "negligence". Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation, as in *Graham* or in this case, in my opinion only a sustained or systematic failure of the board to exercise oversight -- such as an utter failure to attempt to assure a reasonable information and reporting system exists -- will establish the lack of good faith that is a necessary condition to liability. Such a test of liability -- lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight -- is quite high. But, a demanding test of liability in the oversight context is probably beneficial to corporate shareholders as a class, as it is in the board decision context, since it makes board service by qualified persons more likely, while continuing to act as a stimulus to *good faith performance of duty* by such directors.

Here the record supplies essentially no evidence that the director defendants were guilty of a sustained failure to exercise their oversight function. To the contrary, insofar as I am able to tell on this record, the corporation's information systems appear to have represented a good faith attempt to be informed of relevant facts. If the directors did not know the specifics of the activities that lead to the indictments, they cannot be faulted.

The liability that eventuated in this instance was huge. But the fact that it resulted from a violation of criminal law alone does not create a breach of fiduciary duty by directors.

The record at this stage does not support the conclusion that the defendants either lacked good faith in the exercise of their monitoring responsibilities or conscientiously permitted a known violation of law by the corporation to occur. The claims asserted against them must be viewed at this stage as extremely weak.

*B. The Consideration For Release of Claim*

The proposed settlement provides very modest benefits. Under the settlement agreement, plaintiffs have been given express assurances that Caremark will have a more centralized, active supervisory system in the future. Specifically, the settlement mandates duties to be performed by the newly named Compliance and Ethics Committee on an ongoing basis and increases the responsibility for monitoring compliance with the law at the lower levels of management. In adopting the resolutions required under the settlement, Care mark has further clarified its policies concerning the prohibition of providing remuneration for referrals. These appear to be positive consequences of the settlement of the claims brought by the plaintiffs, even if they are not highly significant. Nonetheless, given the weakness of the plaintiffs' claims the proposed settlement appears to be an adequate, reasonable, and beneficial outcome for all of the parties. Thus, the proposed settlement will be approved.

IV, ATTORNEYS' FEES

The various firms of lawyers involved for plaintiffs seek an award of \$ 1,025,000 in attorneys' fees and reimbursable expenses. n29 In awarding attorneys' fees, this Court considers an array of relevant factors. *E.g., In Re Beatrice Companies, Inc. Litigation*, 1986 Del. Ch. LEXIS 414, C.A. No. 8248, Allen, C. (Apr. 16, 1986). Such factors include, most importantly, the financial value of the benefit *that the lawyers work produced*; the strength of the claims (because substantial settlement value may sometimes be produced even though the litigation added little value -- i.e., perhaps any lawyer could have settled this claim for this substantial value or more); the amount of complexity of the legal services; the fee customarily charged for such services; and the contingent nature of the undertaking.

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n29 Of the total requested amount, approximately \$ 710,000 is designated as reimbursement for the number of hours spent by the attorneys on the case, calculated at their normal billing rate, and \$ 53,000 for out-of-pocket expenses.

-----End Footnotes-----

In this case no factor points to a substantial fee, other than the amount and sophistication of the lawyer services required. There is only a modest substantive benefit produced; in the particular circumstances of the government activity there was realistically a very slight contingency faced by the attorneys at the time they expended

time. The services rendered required a high degree of sophistication and expertise. I am told that at normal hourly billing rates approximately \$ 710,000 of time was expended by the attorneys.

In these circumstances, I conclude that an award of a fee determined by reference to the time expended at normal hourly rates plus a premium of 15% of that amount to reflect the limited degree of real contingency in the undertaking, is fair. Thus I will award a fee of \$ 816,000 plus \$ 53,000 of expenses advanced by counsel.

I am today entering an order consistent with the foregoing. n30

-----Footnotes-----

n30 The court has been informed by letter of counsel that after the fairness of the proposed settlement had been submitted to the court, Caremark was involved in a merger in which its stock was canceled and the holders of its stock became entitled to shares of stock of the acquiring corporation. No party to this suit, or the surviving corporation, has sought to dismiss this case thereafter on the basis that plaintiffs' have loss standing to sue. As plaintiffs continue to have an equity interest in the entity that owns the claims and more especially because no party has moved for any modification of the procedural setting of the matter submitted, I conclude that any merger that may have occurred is without effect on the decision of the motion or the judgment to be entered.

-----End Footnotes-----



# MEMORANDUM

## PRIVILEGED AND CONFIDENTIAL

### ATTORNEY/CLIENT COMMUNICATION

**DATE:** November 8, 2007  
**TO:** William J. Lhota, Chairman, Board of Directors, Ohio Bureau of Workers' Compensation  
**FROM:** F. Ronald O'Keefe, Esq., Hahn Loeser & Parks LLP  
**SUBJECT:** Overview - Fiduciary Duties of the Actuarial Committee; Ratings Recommendation

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Background: The Board of Directors (the "Board") of the Ohio Bureau of Workers' Compensation ("BWC") has approved a recommendation to consider reducing the maximum allowable group-rating discount. In order to implement this recommendation, the Board has referred this matter to the Actuarial Committee (the "Committee") for a complete review of the BWC group-rating program and recommendation to the Board regarding the program (the "Group-Rating Program Recommendation").

Purpose: The Governance Committee has requested that this memorandum be prepared to provide guidance to the Committee with respect to its fiduciary responsibilities as it undertakes to formulate its Group-Rating Program Recommendation.

Fiduciary Responsibilities: A fiduciary has been defined as "a person having a duty, created by his undertaking, to act *primarily for the benefit of another* in matters connected with his undertaking."<sup>1</sup> The monies paid into the worker's compensation fund "constitute a trust fund for the benefit of employers and employees."<sup>2</sup> The members of the BWC Board each have the duties of a trustee with respect to the workers' compensation fund. A trustee must exercise "such care and skill as a man of ordinary prudence would exercise in dealing with his own property" and that, if a "trustee has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill."<sup>3</sup> Accordingly, the members of the BWC Board are obligated by law to adhere to the highest standards of judgment and care when making decisions or taking actions that may affect the financial integrity and soundness of the workers' compensation fund.<sup>4</sup>

Executive Summary: All of the members of the Committee – Messrs. Bryan, Hummel and Matesich – are also members of the Board. Accordingly, the members of the Committee are Directors first and representatives of the constituencies that brought them to the Board second. It is important that the members of the Committee, in discharging the responsibility delegated to the Committee by the Board, separate themselves from whatever relationships they may have to

the constituencies that brought them to the Board and focus solely on their fiduciary responsibilities, as Board members, to the BWC and the fund administered by the BWC.

In order to properly discharge their responsibilities on the Committee, the members of the Committee should be informed of their fiduciary duties as Directors and, accordingly, should be guided by three primary considerations in formulating and presenting to the Board the Group-Rating Program Recommendation:

- The provisions of Ohio law that directly impact the Committee’s activities.
- The duty of loyalty to protect the workers’ compensation fund and to act in the interests of all the stakeholders of the BWC, taken as a whole.
- The duty of care owed to review the BWC group-rating program, considering all relevant information in the context of actuarial soundness and statutory requirements.

Discussion and Analysis:

1. Ohio Law.

- Ohio law requires the Administrator to “fix and maintain, with the advice and consent of the Board, for each class of occupation or industry, the lowest possible rates of premium consistent with the maintenance of a solvent state insurance fund and the creation and maintenance of a reasonable surplus.”<sup>5</sup>
- Ohio law requires the Administrator to develop “fixed and equitable rules controlling the rating system, which rules shall conserve to each risk the basic principles of workers’ compensation insurance.”<sup>6</sup>
- Ohio law provides that “the Administrator may grant discounts on premium rates for employers” who meet certain requirements.<sup>7</sup>
- The Committee was created under Ohio law to, among others, “review calculations on rate schedules and performance” prepared by the actuarial consultants to the Board.<sup>8</sup>
- The Committee has determined that actuarially sound rates are consistent with the requirements of Ohio law for workers’ compensation rates.<sup>9</sup>

2. Duty of Loyalty.

- In the context of the Group-Rating Program Recommendation, the duty of loyalty is observed by keeping the interests of the workers’ compensation fund and all the stakeholders of the BWC, taken as a whole, in the forefront. The Group-Rating Program Recommendation should be based on what is in the best interests of the

workers' compensation fund. In carrying out his responsibilities, each Committee member must separate himself from whatever relationships he may have to the constituency that brought him to the Board and focus solely on his fiduciary responsibilities as a Board member to the BWC and the fund administered by the BWC.

### 3. Duty of Care.

- The Committee would discharge its duty of care by doing what is reasonably prudent to review information relevant to the matter at hand and examine in sufficient detail, and with the aid of the appropriate resources, the material relevant factors with respect to the Group-Rating Program Recommendation.
- With respect to the Group-Rating Program Recommendation, the Committee should consider the various duties imposed by law on the Administrator, which include evaluating the factors considered in the rating process and considering what is fair and equitable to all Ohio employers while assuring the preservation of the solvency of the BWC fund.<sup>10</sup>
- Specific activities that could be undertaken by the Committee would be soliciting the views of stakeholders regarding the ratings process and reviewing, to the extent it is available, information with respect to the group rating procedures of other states with a similar workers' compensation system.
- The duty of care requires that the Committee make recommendations regarding the actuarial soundness of the group-rating program and the discount rates.
- The duty of care requires that the Committee devote an appropriate amount of time for assimilation and deliberation among the Committee members regarding the information obtained with respect to relevant factors in connection with formulating its Group-Rating Program Recommendation to the Board. The appropriate amount of time for deliberation, however, will have to be balanced against the need for prompt action with respect to the Group-Rating Program Recommendation.

Please advise if you require any further information or clarification with respect to the items addressed in this memorandum. The advice set forth herein is provided with respect to the specific purpose set forth above, and is intended solely for the use of the Board and its Committees.

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<sup>1</sup> Haluka v. Baker, 66 Ohio App. 308, 312 (1941) [Emphasis in original.]

<sup>2</sup> Ohio Revised Code Section 4123.30.

<sup>3</sup> Restatement (Second) of Trusts, Section 174 (1959).

<sup>4</sup> Ohio Attorney General Opinion No. 89-033 (1989).

<sup>5</sup> Ohio Revised Code Section 4123.34 [preamble].

<sup>6</sup> Ohio Revised Code Section 4123.34 (C).

<sup>7</sup> Ohio Revised Code Section 4123.34 (E).

<sup>8</sup> Ohio Revised Code Section 4121.129 (B).

<sup>9</sup> See page 11 of “Duties of the Administrator – Rules and Classifications,” undated text of Power Point slides prepared by BWC staff in connection with public hearings on rates.

<sup>10</sup> Ohio Revised Code Section 4123.29 (A)(2).

**OBWC Board of Directors  
Audit Committee Charter  
November 21, 2007**

**Purpose**

The Audit Committee has been established to assist the Board of Directors of the Ohio Bureau of Workers' Compensation in fulfilling its fiduciary oversight responsibilities through:

- oversight of the integrity of financial reporting process;
- compliance with legal and regulatory requirements;
- monitoring the design and effectiveness of the system of internal control;
- confirming external auditor's qualifications and independence; and
- reviewing performance of the internal audit function and independent auditors.

**Membership**

The Committee shall be composed of a minimum of three (3) members. One member shall be the appointed certified public accountant member of the board. The Board, by majority vote, shall appoint two additional members to serve on the Audit Committee and may appoint additional members, who are not Board members, as the Board determines necessary. Members of the Audit Committee serve at the pleasure of the board and the board, by majority vote, may remove any member except the member of the committee who is the certified public accountant member of the board.

Each committee member will be independent from management. The Chair is designated by the Board, based on the recommendation of the Board Chair. The Board Chair, while serving as an ex-officio member, shall not vote if his/her vote will create a tie vote.

The Committee Chair will be responsible for scheduling all meetings of the Committee and providing the Committee with a written agenda for each meeting. The Committee will have a staff liaison designated to assist it in carrying out its duties.

**Meetings**

The Audit Committee shall meet at least nine (9) times annually, or as frequently as needed and will provide activity reports to the Board of Directors. The Committee will invite members of management, external auditors, internal auditors and/or others to attend meetings and provide pertinent information, as necessary. Subject to open meeting laws, the Committee will hold executive sessions with external auditors, when deemed appropriate in the performance of their duties. A quorum shall consist of a majority of the Committee members. The Committee will have a staff liaison designated to help it carry out its duties.

## **Duties and responsibilities**

The Audit Committee shall have responsibility for the following:

1. Oversight of the integrity of the financial information reporting process:
  - a. Review with management and the external auditor significant financial reporting issues and judgments made in connection with the preparation of the financial statements.
  - b. Review with management and the external auditor the results of the audit.
2. Review all internal audit reports on regular basis.
3. Review results of each annual audit and management review; if problems exist, assess appropriate course of action to correct, and develop action plan. Monitor implementation of any action plans created to correct problems noted in annual audit.
4. Serving as the primary liaison for Bureau of Workers' Compensation Board of Directors and providing a forum for handling all matters related to audits, examinations, investigations or inquiries of the Auditor of State and other appropriate State or Federal agencies
5. Developing an oversight process to assess the adequacy and effectiveness of internal controls and provide the mechanisms for periodic assessment of system of internal controls on an ongoing basis.
6. Overseeing the assessment of internal administrative and accounting controls by both the external independent financial statement auditor and internal auditor.
7. Consult on the appointment and/or removal of the Chief of Internal Audit and have oversight on the work of the Internal Audit Division.
8. Ensuring the independence of the external auditor and approve all auditing, other attestations services and pre-approve non-audit services performed by the external auditor.
9. After every meeting, report to the Board of Directors of the Bureau of Workers' Compensation on all activities, findings and recommendations of the Committee.
10. Establishing policies and procedures to function effectively.
11. At least once every 10 years, have an independent auditor conduct a fiduciary performance audit of BWC's investment program, policies and procedures. Provide a copy of audit to the Auditor of State.
12. Recommend to the Board an accounting firm to perform the annual audit required under R.C. 4123.47. Recommend an auditing firm for the Board to use when conducting audits under R.C. 4121.125.
13. Retain and oversee consultants, experts, independent counsel, and accountants to advise the Committee on any of its responsibilities or assist in the conduct of an investigation.
14. Seek any information it requires from employees—all of whom are directed to cooperate with the Committee's requests, or the requests of internal or external parties working for the Committee. These parties include, but are not limited to internal auditors, all external auditors, consultants, investigators and any other specialists working for the Committee.
15. All Committee actions must be ratified or adopted by the Board of Directors of the Bureau of Workers' Compensation to be effective.
16. Coordinate with the other Board Committees on items of common interest.

17. At least annually, this charter must be reviewed by the Audit Committee and any proposed changes submitted to the Governance Committee and to the Board for approval.

Audit Committee Charter.doc

Draft 092607

Review & Approved 112107, Ken Haffey, Chair

**OBWC Board of Directors**  
**Investment Committee Charter**  
**November 21, 2007**

**Purpose**

The purpose of the Investment Committee is to ensure that the assets of the Ohio Bureau of Workers' Compensation (OBWC) are effectively managed in accordance with the laws of the State of Ohio, and the Ohio Bureau of Workers' Compensation Statement of Investment Policy and Guidelines. The Investment Committee:

- provides assistance to the Board of Directors in the review and oversight of the State Insurance Fund and each Ancillary Fund (collectively the Funds) assets; and is
- responsible for developing and monitoring the implementation of the BWC's investment policy.

**Membership**

The Committee shall be composed of a minimum of five (5) members. Two of the members shall be the members of the Board who serve as the investment and securities experts on the Board. The Board, by majority vote, shall appoint three additional members to serve on the Investment Committee and may appoint additional members, either from the Board or someone not on the Board. Each additional non-Board member appointed must have at least one of the following qualifications: a) experience managing another state's pension funds or workers' compensation funds; or b) expertise that the Board determines is needed to make investment decisions.

The Chair is designated by the Board, based on the recommendation of the Board Chair. The Board Chair is an ex-officio voting member of the committee, except that the chair shall not vote in the instance that his/her vote would create a tie vote.

Members of the Investment Committee serve at the pleasure of the Board and the Board, by majority vote, may remove any member except the members of the Committee who are the investment and securities expert members of the Board.

**Meetings**

The Investment Committee will meet at least nine (9) times annually; additional meetings may be scheduled as the Committee or its chairperson deem advisable. The Investment Committee is governed by the same rules regarding meetings, notice, quorum and voting requirements as are applicable to the Board. A quorum at any Investment Committee meeting will consist of a majority of the Committee members.

The Chair of the Committee will be responsible for establishing the agendas for the meetings of the Committee. An agenda, together with information/background materials, will be sent to members of the Committee prior to each meeting. Minutes for all meetings of the Committee will be prepared to document all actions to the Committee's discharge of its responsibilities. The Committee will have a staff liaison designated to help it carry out its duties.

## **Duties and Responsibilities**

The Investment Committee is charged with overseeing all investment-related matters and activities of the BWC. The Committee evaluates proposals requiring Board action and makes recommendations for consideration by the Board.

1. Develop and recommend the strategic asset allocation and investment policy for the Funds and submit to the Board for approval. The Committee will periodically review the investment policy in light of any changes in actuarial variables, market conditions, etc. and make recommendations for any changes, as appropriate to the Board for approval. Assist the Board to assure that the investment policy is reviewed and approved at least annually, published, and copies are made available to interested parties.
2. Evaluate and recommend an outside investment consultant to assist the Investment Committee in its duties. Submit a contract with the recommended investment consultant to the Board for approval.
3. Review the annual report on the investment performance of the funds and the value of each investment class and submit to the Board for approval. Once approved, this report must be submitted to the Governor, the president and Minority Leader of the Senate, and the Speaker and Minority Leader of the House of Representatives.
4. Recommend investment counsel to the Board for engagement.
5. Recommend to the Board for approval the criteria and procedures for the selection of the Investment Managers and General Partners. Approve the final selection, funding and termination of all Investment Managers and General Partners.
6. Monitor implementation of the investment policy by the Administrator and the Chief Investment Officer. Review performance of the Chief Investment Officer and any investment consultants retained by the BWC to assure compliance with the investment policy and effective management of the Funds.
7. Develop and recommend rules on due diligence standards for employees of BWC to follow when investing in each asset class. Develop and recommend policies and procedures to review and monitor the performance and value of each asset class. Submit these recommendations to the Board for approval.
8. Monitor and review the investment performance of the Funds on a quarterly basis to determine achievement of objectives and compliance with this investment policy.
9. Recommend prohibited investments, on a prospective basis, the Committee finds to be contrary to the investment objectives of the Funds and submit to the Board for approval.
10. Recommend the opening and closing of each investment class and submit to the Board for approval.
11. Report all activities/recommendations to the Board following each meeting of the Investment Committee.
12. The Investment Committee will coordinate with other Board committees on items of common interest.
13. At least annually, this charter must be reviewed by the Investment Committee and any proposed changes submitted to the Governance Committee and to the Board for approval.

InvestmentCommitteeCharter.doc  
Draft 092607  
Review & Approved 111607, Bob Smith, chairperson

**OBWC Board of Directors  
Actuarial Committee Charter  
November 21, 2007**

**Purpose**

The Actuarial Committee has been established to assist the Ohio Bureau of Workers' Compensation Committee Board of Directors in fulfilling their responsibilities through:

- monitoring the actuarial soundness and financial condition of the funds and reviewing rates, reserves and level of net assets
- oversight of the integrity of the actuarial audit process
- compliance with legal and regulatory requirements
- monitor the design and effectiveness of the actuarial studies
- confirm external actuarial consultants' qualifications and independence
- review performance of independent external actuarial work product

**Membership**

The Committee shall be composed of a minimum of five (5) members. The Board, by majority vote shall appoint four additional members. One member shall be the appointed actuary member of the Board. The Board may also appoint additional members who may or may not be on the Board. Members of the Actuarial Committee serve at the pleasure of the Board and the Board, by majority vote, may remove any member except the member of the committee who is the actuary member of the Board.

Each committee member will be independent from management. The Chair is designated by the Board, based on the recommendation of the Board Chair. The Board Chair is an ex-officio voting member of the committee, except that the chair shall not vote in the instance that his/her vote would create a tie vote.

The Committee Chair will be responsible for scheduling all meetings of the Committee and providing the Committee with a written agenda for each meeting. The Committee will have a staff liaison designated to assist it in carrying out its duties.

**Meetings**

By majority vote the Committee will recommend to the Board of Directors their meeting schedule. There shall be not less than nine (9) meetings each year. Reports shall be made to the Board after each meeting. The Committee also has the authority to convene additional meetings, as circumstances require. The Committee will invite members of management, external actuarial firms, internal actuarial staff and/or others to attend meetings and provide pertinent information, as necessary. Subject to open meeting laws, the Committee will hold executive sessions and private meetings with actuaries and auditors, when required in the performance of their duties. A quorum will be a majority of the Committee members.

## **Duties and Responsibilities**

The Actuarial Committee shall have responsibility for the following:

1. Recommend actuarial consultants for the Board to use for the funds specified in the Ohio Revised Code.
2. Review calculation on rate schedules and performance prepared by the actuarial consultants with whom the Board contracts.
3. Supervise for the Board's consideration the preparation of an annual report of the actuarial valuation of the assets, liabilities and funding requirements of the state insurance funds to be submitted to the Workers' Compensation Council and the Senate and House.
4. Coordinate with other Board Committees on issues of common interest.
5. At least once every five (5) years have actuarial investigation of experience of employers; mortality, service and injury rate of employees; payment of benefits in order to update the assumptions on the annual actuarial report.
6. Have actuarial analysis prepared of any legislation expected to have measurable financial impact on the system, within 60 days after introduction of legislation.
7. Consult in the appointment of and oversee the work of any actuarial firm engaged by Ohio Bureau of Workers' Compensation to complete actuarial studies.
8. Recommend retention and oversight of consultants, experts, independent counsel and actuaries to advise the Committee on any of its responsibilities or assist in the conduct of an investigation.
9. Seek any information it requires from employees – all of whom are directed to cooperate with the Committee's requests, or the request of internal or external parties working for the Committee. These parties include the internal actuaries, all external actuaries, consultants, investigators and any other specialties working for the Committee.
10. At least annually, this charter must be reviewed by the Actuarial Committee and any proposed changes submitted to the Governance Committee and to the Board for approval.
11. Make recommendations to the Board of Directors of the Ohio Bureau of Workers' Compensation for Board decisions.

Actuarial Committee Charter.doc Draft 092607 Review & Approved 112107, Chuck Bryan, Chair
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**OBWC Board of Directors  
Governance Committee Charter  
November 21, 2007**

**Purpose**

The Committee shall assist the Ohio Bureau Board of Directors in fulfilling its oversight responsibilities relating to developing and implementing sound governance policies and practices. The Committee is responsible for:

- reviewing and recommending to the Board the adoption of governance guidelines and committee charters;
- recommending director assignments to Board committees; overseeing compliance with federal and state laws, ethics, regulations and policies;
- developing a process for the Board's assessment of its performance and the performance of Board committees and a self assessment by Directors; and
- making recommendations for Board Vice-chair and committee chairs for the Chair's consideration and the Board's approval.

**Membership**

The Committee shall be composed of a minimum of three (3) members. One member shall be the Chair of the Ohio Bureau of Workers' Compensation Board of Directors. The Board, by majority vote shall appoint two additional members.

The Committee Chair will be responsible for scheduling all meetings of the Committee and providing the Committee with a written agenda for each meeting. The Committee encourages all Board members to attend their meetings. The Governance Committee is a standing committee of the Ohio Bureau of Workers' Compensation (BWC) Board of Directors. The Committee will have a staff liaison designated to assist it in carrying out its duties. This Board liaison will be responsible for all communication, handling of responses and public record requests of the Board.

**Meetings**

The committee shall meet quarterly or more frequently as it shall determine is necessary to carry out its duties and responsibilities. The Chair will schedule regular meetings; additional meetings may be held at the request of two or more members of the Committee, or the Chair of the Board. A majority of the members shall constitute a quorum. At least one meeting shall be in executive session for the purpose of the performance review of the Administrator.

## **Duties and Responsibilities**

In carrying out its oversight responsibilities, the Committee shall:

1. At least annually review the Board's Governance Guidelines and the charters of the Board's standing committees, and making such recommendations as the Committee determines necessary or appropriate; and consistent with HB 100, including recommendations concerning the structure, composition, membership and function of the Board and its committees, subject to Board approval.
2. The Committee shall make recommendations for Board Vice-chair, committee chairs and committee members for the Chair's consideration and the Board's approval.
3. The Committee shall develop and coordinate the annual self-assessment of the Board and its Committees.
4. The Committee shall coordinate annual review process of the Administrator with the Board.
5. Make recommendations to the Board for retaining fiduciary counsel.
6. The Committee shall oversee the process for the annual report by the Board for submission to the Governor, General Assembly or the Workers' Compensation Council as required by ORC 4121.12(F)(3).
7. The Committee shall oversee compliance with laws, ethics, regulations and policies.
8. Oversee the BWC orientation process for newly appointed members of the BWC Board and assist the Board in its implementation. The Committee shall also regularly assess the adequacy of and need for additional continuing director education programs. At a minimum, the education components must meet the requirements of ORC 4121.12(F)(16). These requirements include: orientation for new members; continuing education for those Board members who have served for more than one year; board member duties and responsibilities; compensation and benefits; ethics; governance processes and procedures; actuarial soundness; investments; and any other subject matter the board believes is reasonably related to the duties of a board member.
9. The Committee shall make reports to the Board following their meetings.
10. Coordinate with other Board committees on issues of common interest.
11. Perform such other duties required by law or otherwise as are necessary or appropriate to further the Committee's purposes, or as the Board may from time to time assign to the Committee.

Draft reviewed Oct. 4, 2007 and Oct. 14, 2007  
Approved as edited Nov. 21, 2007; Alison Falls, Chair

**WORKERS' COMPENSATION  
BOARD OF DIRECTORS**

**GOVERNANCE COMMITTEE**

**WEDNESDAY, OCTOBER 24, 2007, 4:00 P.M.  
WILLIAM GREEN BUILDING  
THE NEIL SCHULTZ CONFERENCE CENTER  
30 WEST SPRING ST., 2<sup>nd</sup> FLOOR (MEZZANINE)  
COLUMBUS, OHIO 43215**

Members Present: Alison Falls, Chair  
Bill Lhota  
Robert Smith

Members Absent: None

**CALL TO ORDER**

Ms. Falls called the meeting to order at 4 P. M. and the roll call was taken.

**MINUTES OF OCTOBER 4, 2007**

Mr. Smith moved that the minutes of October 4, 2007, be approved. Mr. Lhota seconded and the minutes were approved by a unanimous roll call vote.

**DISCUSSION ITEMS**

**REVIEW/INTERVIEW FIDUCIARY COUNSEL CANDIDATES**

F. Ronald O'Keefe and Stephen Chappelle, Hahn Loeser & Parks, LLP, gave a presentation on selection of the firm and Mr. O'Keefe as fiduciary counsel for the Workers' Compensation Board. Mr. O'Keefe described his experience as general counsel for a financial institution and as attorney representing several boards of directors of publicly held corporations. He responded to questions from Ms. Falls, Mr. Lhota, and Mr. Smith and from Philip Fulton, Workers' Compensation Board Director, and Marsha Ryan, BWC Administrator.

## **EXECUTIVE SESSION**

A motion was made, seconded, and unanimously approved that the Governance Committee enter executive session to consider the appointment of a public official under Ohio Revised Code §121.22(G)(1) with BWC management and Mr. Fulton.

## **RECESS**

There was a motion, second, and recess of the executive session.

## **RECOMMENDATION OF SELECTION OF FIDUCIARY COUNSEL**

Mr. Smith moved to recommend to the Workers' Compensation Board that the Attorney General engage the law firm of Hahn Loesser & Parks and H. Ron O'Keefe as fiduciary counsel to the Workers' Compensation Board. Mr. Lhota seconded and the motion was approved by unanimous voice vote.

## **NEW BUSINESS/ACTION ITEMS**

## **PARLIAMENTARY RULES REGARDING EX OFFICIO MEMBERS AND POWERS OF COMMITTEE CHAIR**

Ann Shannon, BWC Legal Counsel, reported on the provisions in Robert's Rules of Order on ex officio membership of committees and the powers of committee chairs. An ex officio member has the same rights as other members of a committee, including voting rights, but has none of the obligations. In small committees (less than twelve), the chair may move and second motions.

After discussion, Ms. Falls ruled the Governance Committee would take under advisement whether to add Mr. Lhota as an ex officio member of all Workers' Compensation Board statutory committees and to add one additional member in order to maintain an odd number of voting members.

## **REVIEW AND APPROVAL OF GOVERNANCE COMMITTEE CHARTER**

Donald Berno, Board Liaison, conducted a discussion in which the proposed charter of the Governance Committee was amended by members of the committee and Mr. Fulton to reflect legal requirements and to make it consistent with other committee charters. Ms. Ryan thanked Mr. Berno for the work he did in editing the charters of all four committees to bring them into identical format.

Mr. Lhota moved that the Governance Committee approve its charter as amended. Mr. Smith seconded and the committee approved its charter by unanimous voice vote.

## **REVIEW AND APPROVAL OF BOARD COMMITTEE CHARTERS**

Mr. Berno conducted a further high-level discussion of the charters of the statutory committees to amend them in accordance with the format and provisions of the charter of the Governance Committee. Mr. Lhota recommended that the committees not approve their charter at their meetings of October 25, 2007, given that the Governance Committee spent one and one-half hours on its review. Ms. Falls concurred.

## **ADJOURNMENT**

There was a motion by Mr. Smith, second by Mr. Lhota, and adjournment by Ms. Falls.

Prepared by: Larry Rhodebeck, Staff Counsel  
H:\Word\ldr\WCB Govrnc 1007.doc  
October 31, 2007

# APPOINTMENT CYCLE OF BOARD OF DIRECTOR MEMBERS

*Initial appointment addressed in RC §4121.12(B) as follows:*

Employee representative ( <b>Fulton</b> )	<b>1 year</b>
(1) Employer representative ( <b>Hummel</b> )	<b>1 year</b>
Public representative ( <b>Price</b> )	<b>1 year</b>
(2) Employer representative ( <b>Matesich</b> )	<b>2 years</b>
(1) Employee organization rep ( <b>Caldwell</b> )	<b>2 years</b>
(1) Investment & Securities expert ( <b>Smith</b> )	<b>2 years</b>
CPA ( <b>Haffey</b> )	<b>2 years</b>
(3) Employer representative ( <b>Lhota</b> )	<b>3 years</b>
(2) Employee organization rep ( <b>Harris</b> )	<b>3 years</b>
(2) Investment & Securities expert ( <b>Falls</b> )	<b>3 years</b>
Actuary ( <b>Bryan</b> )	<b>3 years</b>

At expiration of all terms noted above, subsequent terms of office will be three years. RC §4121.12(B)

## **To fill a vacant seat: (RC §4121.12(C))**

- Nominating Committee submits list of 4 names for each vacant seat to Governor.
- Must submit list within 60 days of expiration of term, or 30 days for other vacancies.
- Sitting Board members continue in office subsequent to the expiration of his/her term until a successor takes office or until 60 days has elapsed, whichever occurs first. (RC §4121.12(B))
- Within 14 days after submission of list, Governor must either:
  - appoint from the list, or
  - request more names.
- Within 14 days from Governor's request for more names, the Nominating Committee must give the Governor 4 more names for each unfilled position; the Governor has 7 days after that to appoint from someone from either list.
- To submit a name, the Nominating Committee must approve that individual by an affirmative vote of a majority of its members.

# APPOINTMENT CYCLE OF BOARD OF DIRECTOR MEMBERS

## Nominating Committee:

- Composition: (RC §4121.123(A))
  - 3 members affiliated w/ AFL-CIO
  - 2 members who represent employees, one w/ an active workers' comp claim
  - CEO of Ohio Chamber of Commerce
  - CEO of OMA
  - CEO of Ohio Self-Insurers' Association
  - CEO of Council of Retail Merchants
  - CEO of either NFIB or Ohio Farm Bureau
  - Director of Development (serves as Chairperson)
  - President of the Municipal League
  - President of the Ohio Township Association
  - President of the Ohio County Commissioners Association
  
- Duties:
  - Review and evaluate possible appointees to the Board. (RC §4121.123(F)(1))
  - In reviewing possible appointees, may accept comments from, cooperate with, and request information from any person. (RC §4121.123(F)(1))
  - Make recommendations to the Governor for the appointment of Board members. (RC §4121.123(F)(2))