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SELF-DEALING AND BREACH OF DUTY: A REVIEW OF THE ULLICO MATTER

HEARING

BEFORE THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

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SELF-DEALING AND BREACH OF DUTY: A REVIEW OF THE ULLICO MATTER

THURSDAY, JUNE 19, 2003

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:06 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Susan M. Collins, Chairman of the Committee, presiding.

Present: Senators Collins, Fitzgerald, Levin, and Carper.

OPENING STATEMENT OF SENATOR COLLINS

Chairman COLLINS. The Committee will come to order.

Today the Committee on Governmental Affairs will examine questionable stock transactions at ULLICO, Incorporated. ULLICO is the parent company of the Union Labor Life Insurance Company, which was founded in 1925 to serve the needs of working men and women by providing affordable health insurance to workers who traditionally had been unable to find such insurance.

Seventy-five years later, many of ULLICO's directors and senior officers forgot their mission. Instead of serving union workers, they served themselves a multimillion dollar helping of the company's assets, assets that belonged to the shareholders.

ULLICO's officers and directors took advantage of their positions to enrich themselves at the expense of the company's primary shareholders, unions, and union pension funds.

ULLICO is not a household word. The names Enron and WorldCom are better known, in large part because of the size and the scope of the damage done by the leaders of these corporations. The wrongs committed at ULLICO total in the millions, not the billions. But in many ways the wrongdoings at Enron, WorldCom, and ULLICO are, in fact, similar. They involve the same betrayal of trust, the same breech of duty, and the same profiteering by executives.

That is why this Committee has actively investigated Enron and WorldCom, and that is why we are here today.

ULLICO's fortunes and misfortunes were closely tied to those of Global Crossing. In 1997, ULLICO invested $7.6 million to get in on the ground floor of what eventually became Global Crossing. Shortly after this investment was made, ULLICO changed the way it valued its stock. Rather than maintaining a fixed share price, as it had in the past, the company decided that it would change its share price once a year.

In August 1998 Global Crossing went public and almost immediately its share price began to have a dramatic impact on ULLICO's value. In May 1998 ULLICO's stock was valued at about $28 per share. By May 1999 the ULLICO stock had nearly doubled to $54 per share. In May 2000 the share price was $146 or nearly triple what it had been just 2 years prior.

Then the wheels began to come off. During the year that ULLICO's stock was set at $146, Global Crossing stock price dropped steadily. By the end of 2000 it was clear that ULLICO's stock price would be substantially lower in 2001.

Many of ULLICO's senior executives and officers and directors manipulated these circumstances to enrich themselves. In 1998 and 1999, after the Global Crossing initial public offering, the chairman of ULLICO, Robert Georgine, provided ULLICO directors and senior officers with three exclusive opportunities to purchase ULLICO stock. Directors and senior officers were each able to purchase up to 8,000 shares at the annually set stock price. These offers were not extended to other shareholders and they were not approved by the board of directors.

Directors and officers purchasing stock were taking little or no risk, as it was clear that ULLICO's stock value would be higher the next year. In fact, the December 1999 stock offer was such a sure thing that three officers, Robert Georgine, Joseph Carabillo, and John Grelle, each personally borrowed more than $200,000 to buy the stock.

Sweetheart deals for directors and officers that were not extended to the workers they represent and serve are troubling enough. But where the ULLICO matter becomes most unsettling is the way in which many of the directors and officers were able to sell their shares in ULLICO after Global Crossing's price started to plummet but before the losses were reflected in ULLICO's stock price.

In November 2002 the company approved a $30 million repurchase program at $146 per share. By that time, Global Crossing stock had dropped significantly and it was clear that many of ULLICO's shareholders would be eager to sell their stock in order to realize their gains before ULLICO's value was lowered the following year.

Despite these circumstances, the company approved a repurchase program with rules that severely limited repurchases from large institutional shareholders. The company repurchased only 2.2 percent of shares offered by large shareholders such as unions and pension funds. On the other hand, it made unlimited repurchases from shareholders with 10,000 shares or less, notably most of the company's directors and officers.

Adding insult to injury, Chairman Georgine also exercised a so-called discretionary authority to repurchase stock. Historically, this power has been used only to provide liquidity to the estates of shareholders who had died, and to shareholders who had resigned from the company or who were experiencing financial distress. In 2000 however, this authority was used to provide substantial financial benefits to company insiders.

In fact, in a staff interview, ULLICO's former executive vice president referred to the discretionary repurchases as the director

and officer repurchase program. That title is certainly accurate. A majority of all of ULLICO's discretionary repurchases at the $146 share price were made from officers and directors. The chart that we have up shows the percentages.[1]

In all, the company spent $44.6 million repurchasing shares at the $146 share price. Thirty-one percent of those funds were spent on repurchasing shares from officers and directors, even though they accounted for less than 2 percent of the company's stock.

A careful review of the facts shows that ULLICO's officers knew exactly what they were doing. Transactions were timed and structured in such a way as to minimize the risk to insiders and to maximize their returns with no apparent regard for the effect on the pension plans and union members who were the primary owners of the company.

One factor suggesting that the participants were aware of the wrongful nature of their actions is that many of the transactions were conducted secretly. As Governor Thompson's thorough report stated, "these directors received preferential treatment over other shareholders and such preferential treatment was never disclosed".

Another troubling aspect of the ULLICO matter is that the company's board of directors, in some cases, was directly involved and benefited personally, and in other cases apparently sat by and let all of this happen. The passive and complicit role of ULLICO's board is all the more noteworthy because many of ULLICO's directors served as presidents of unions that have been critical of excessive corporate compensation.

What happened at ULLICO was wrong. Governor James Thompson, our first witness today, has investigated this matter and prepared a detailed report. He will share his findings and recommendations with us today.

Moreover, it is my understanding that a Federal grand jury, the Department of Labor, the State of Maryland, and the Securities and Exchange Commission are all investigating these ULLICO transactions.

I invited Robert Georgine and ULLICO's former chief legal officer, Joseph Carabillo, to come before us today to answer questions but they have refused to testify voluntarily. In a letter the Committee received on Tuesday, which I will submit for the record without objection, Mr. Georgine's lawyer explained that Mr. Georgine would invoke his Fifth Amendment rights if the Committee were to subpoena him.[2]

To its credit, new leadership at ULLICO has ushered in long overdue reforms. After investigations of ULLICO stock transactions were initiated by a grand jury, the U.S. Labor Department, the SEC, the State of Maryland, and this Committee, a new slate of directors was elected to the board and began to undertake the necessary reforms. Chairman Georgine resigned under pressure and Terence O'Sullivan, whom we will hear from today, was appointed as CEO and chairman of the board. I am pleased to note that the

[1] The chart entitled "Total Repurchases of Stock from Directors/Officers Outside of 2000 Formal Repurchase Program," referred to by Senator Collins appears in the Appendix on page 42.

[2] The letter referred to from Randall J. Turk, Baker Botts, L.L.P., appears in the Appendix on page 100.

new board has voted to adopt all of the Thompson report's recommendations.

These are indeed promising developments but it should not take the spotlight of a Senate investigation or grand jury subpoenas for a company to clean up its act. I look forward to hearing what changes Mr. O'Sullivan will be making to ensure that this scandal never occurs again and that ULLICO does not revert to its old ways when the spotlight shines its beam elsewhere.

I look forward to hearing from our witnesses today and I would now like to call on Senator Levin for his opening remarks.

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Thank you, Madam Chairman, and thank you for the manner in which you are carrying on this investigation and hearing, as always in a very fair and very thorough way and I commend you for it.

This hearing today continues a tradition of the Governmental Affairs Committee of taking a close look at specific examples of corporate misconduct to learn not only what happened but what can and should be done to prevent similar conduct in the future.

For many years, ULLICO was a relatively small, privately held life insurance company serving a special community, the community of unions and union pension funds, investing the savings of working Americans. ULLICO had been successful in meeting its customer and stockholder needs for decades when in the 1990's it expanded its capital base from $8 million to $240 million and increased its outstanding shares from less than 500,000 to more than 10 million.

ULLICO also expanded into new lines of business, transforming itself from a life insurance company into a diversified financial group. ULLICO also hired an investments expert and began investing millions of dollars in startup high-tech companies.

One of these investments in a small high-tech company, later known as Global Crossing, suddenly took off in the stock market and turned a $7 million investment by ULLICO into an after-tax profit of more than $300 million. That money represented a windfall for ULLICO and its stockholders.

At the same time the Global Crossing investment began to take off, ULLICO executives apparently caught the bug infecting too many other U.S. corporations during the 1990's, paying huge compensation to its executives. I remember holding a hearing in a Governmental Affairs Subcommittee back in 1991 examining the issue of runaway executive pay at U.S. corporations and I have been following the issue ever since.

According to the Congressional Research Service, in the early 1990's, CEO pay at large U.S. public companies was about 100 times larger than average worker pay and averaged $2 million. By 1999, CEO pay exceeded average worker pay by more than 500 times and averaged $12 million.

And by the way, J.P. Morgan said that a chief executive's pay should not exceed average worker pay by more than 20 times.

While ULLICO may have been a piker in comparison to the executive compensation paid at some other U.S. companies—and read today's *Washington Post* to get the full flavor of that—it nonethe-

less swam in the same direction. When the 1990's started, ULLICO's top executives were paid base salaries and an annual bonus. Ten years later, ULLICO's top officers were the recipients of a slew of compensation benefits.

For example, before he left the company, ULLICO's CEO was the recipient of not only a base salary and annual bonus, but a second annual cash bonus ranging from $100,000 to $700,000, 40,000 shares of ULLICO stock worth millions of dollars paid for by a company loan to be forgiven after 5 years, a $5 million split-dollar life insurance policy whose $350,000 annual cost was picked up by the company, deferred compensation benefits that allowed him to delay paying taxes on income placed in the program, two separate executive retirement plans, and the use of a corporate jet with annual operating costs of $3.5 million dollars.

In addition to that mind-boggling array of benefits, ULLICO's officers and directors were given special opportunities in 1998, as our chairman has pointed out, to buy ULLICO stock at a time when its value was steadily increasing due to the company's successful investment in Global Crossing. Using discretionary and formal stock offers and repurchase programs over 3 years, from 1998 to 2001, ULLICO's top 4 officers and 20 of its 32 directors used ULLICO stock sales to make over $13 million in profit. While other ULLICO stockholders also benefited from the stock's increased value, those ULLICO officers and investors disproportionately benefited by taking advantage of stock opportunities that were not advertised or made generally available to other shareholders. Those ULLICO officers and directors owned less than 2 percent of the outstanding shares but managed to reap more than 30 percent of the stock profits created by the Global Crossing investment.

During the escalation of executive pay at the company, ULLICO's board of directors appeared to have exercised little meaningful oversight of either the stock awards or overall compensation provided to ULLICO management. Directors on the compensation committee appeared to have simply gone along with the compensation benefits suggested by management and other directors followed the lead of the compensation committee.

After conducting a special investigation into what happened, the Thompson report concluded that there was no evidence of criminal misconduct and insufficient evidence of securities laws violations, but certain ULLICO officers and directors "did not satisfy"—to use the Thompson report words—"their fiduciary duties to the company" and engaged in—again to use their words—"self-interested transactions." The report found that these officers and directors had received "preferential treatment over other ULLICO shareholders" and were allowed to obtain and sell ULLICO shares that "carried little or no investment risk", approved officer and director stock programs despite "conflicts of interest and substantial involvement," and failed to disclose to the board and shareholders the extent of officer and director stock transactions, compensation benefits, and preferential treatment.

The Thompson report recommended that suspect officer and director stock profits be returned to the company and other steps be taken to recover improper compensation, strengthen corporate governance, and prevent similar misconduct in the future.

The facts also indicate that, while executive pay was climbing at ULLICO, company performance outside of the Global Crossing investment was headed in the other direction. A number of management decisions hurt the company's bottom line. By 2002 ULLICO was in trouble, experiencing operating losses due to high costs, non-performing investments, and unprofitable business lines. Company profits had disappeared. The company's stock price was falling and the company's insurance ratings have been downgraded.

Yet executive pay stayed high.

There are similarities and differences to Enron in this matter. Like Enron, fiduciary duties were breached at ULLICO. Unlike Enron, the books were apparently not cooked, the company was not driven into bankruptcy, employee pensions and stockholder savings were not destroyed. In the year 2001, when ULLICO's CEO received more than $5.3 million dollars, the largest amount he was paid in any year at the company, Enron's CEO took home more than $140 million.

As our Chairman has pointed out, there has been an impressive recent change at ULLICO. The company has taken dramatic steps to clean up its own act. When word got out about possible misconduct by ULLICO management, several board members representing the labor movement demanded a special investigation. The Thompson report resulted, which we will be hearing about today.

When ULLICO management and some board members resisted releasing this report to the public, other board members demanded disclosure. And when their demand was rejected, they resigned from the board in protest, increasing pressure on the company. When management and some board members resisted implementing all of the Thompson report recommendations, including the recommendation to return suspect stock profits, other board members were able to rally ULLICO stockholders to oust those who were fighting reform.

Today, all four senior officers at ULLICO have been replaced. Five weeks ago new management took over, including a new CEO, Terence O'Sullivan, whom we will hear from today. A host of changes have followed.

For example, the new management ended the special stock plans for officers and directors and banned company loans to executives. It sent letters to the former officers and a number of directors demanding the return of all suspect stock profits. The company froze the deferred compensation and retirement accounts set up for ULLICO's officers pending a review of the programs.

New rules requiring full disclosure of executive pay to company stockholders are under development. The company discontinued use of the corporate jet and initiated plans to sell a luxury office building under construction.

It has hired a turnaround expert to revamp company operations and began taking steps to strengthen the independence, oversight and financial expertise of the ULLICO board.

So a hopeful chapter at ULLICO is unfolding as the company implements fundamental management, executive pay, and corporate governance reforms. Hopefully this self-cleansing effort will save the company and begin to rebuild investor confidence.

In the Sarbanes-Oxley Act we adopted important corporate reforms including a new accounting oversight board, stronger criminal penalties for securities fraud, and requirements for more independent and capable audit committees. But that law targets publicly traded companies. Whether the same or similar disclosure, oversight, and corporate governance requirements imposed on public companies are appropriate for private companies like ULLICO with a limited number of shareholders raises complex issues.

Some private companies are so large and have such an important impact on their industry and communities that public policy requires Congress to at least take a careful look at that possibility.

Again, I thank you, Madam Chairman, for convening this hearing and look forward to the testimony of our two witnesses.

Chairman COLLINS. Thank you, Senator Levin. I would now like to turn to Senator Fitzgerald, who obviously knows our first witness very well, for any comments that he might want to make about our distinguished witness.

OPENING STATEMENT BY SENATOR FITZGERALD

Senator FITZGERALD. Thank you very much, Madam Chairman. I want to welcome Governor Thompson to this platform.

I just want to say a few words about Governor Thompson. He has had a very distinguished career in my State. He first made a name for himself as a corruption busting U.S. Attorney back in the early 1970's. He went on to be governor of our State for 14 years, and is now chairman of the law firm of Winston and Strawn, one of the most prestigious firms in our city and indeed in the country. Governor Thompson really has had a fabulous career. He was very well qualified to do this report.

I think that the only issue that arises after reading the report is that there is not much more investigating for us to do. I think the facts are pretty well established. We know what happened and when, and Governor Thompson can talk more about that.

The question arises in my mind, as Senator Levin said, are there any legislative changes we should make to our securities laws with respect to privately held corporations? The Sarbanes-Oxley Act that we passed last year dealt with publicly traded corporations. In the case of ULLICO, I am concerned that though it was a privately held corporation, the shareholders of it were, in effect, union pension funds and unions.

So far, more than just a handful of people were affected by the transgressions of the management at the company. And I am wondering if Governor Thompson might have any recommendations along the lines of protections we might be able to add to our securities laws for privately held corporations.

And with that, I would like to welcome Governor Thompson to Washington once more.

Chairman COLLINS. Thank you, Senator Fitzgerald. You essentially introduced our witness. I will just add a couple of points.

Governor Thompson, I believe, served for 14 years as the chief executive of Illinois and I think that is a record that still stands in Illinois for continuous service by a governor, so I wanted to bring that out.

Senator FITZGERALD. Can I add that he was a Republican, too, and that is not easy to do in Illinois.

Chairman COLLINS. This is true. He has twice been named by the National Law Journal as one of the Nation's 100 most influential lawyers. Given his background in law enforcement, I cannot think of anyone who was better qualified to prepare the investigative report on the ULLICO transactions.

So Governor, we are very pleased and honored to have you here with us and you may proceed with your presentation.

STATEMENT OF HON. JAMES R. THOMPSON,[1] FORMER GOVERNOR, STATE OF ILLINOIS, CHAIRMAN, WINSTON AND STRAWN

Mr. THOMPSON. Thank you, Madam Chairman, Senators.

It is an honor for me to appear before this Committee today, and an appearance I have looked forward to. The work of this Committee is well-known and well thought of throughout the country. To the extent that I can add to your body of knowledge and be of help in developing your recommendation for legislation, I would be pleased to do that.

I would like to say at the outset that most all of the credit for the investigation, the unearthing of the facts with regard to ULLICO, and the recommendations of the report ought to go to the very able lawyers at Winston and Strawn who did the spadework, assembled the information, wrote the report, and otherwise I think did exemplary work. So to the extent that you have been complimentary about the report, I would like to pass those complements right to the Winston and Strawn attorneys sitting behind me.

We have prepared a PowerPoint presentation that I will go through as quickly as I can so we can answer your questions that you may have after the presentation. The facts are sometimes complex and lengthy and we thought this was going to be the best device to elucidate it not only for the Committee, but for others who are interested in knowing the facts. So with your permission, I will go through that now.

The first slide is an examination of our mandate. As you know, the first press reports came I believe in the *Wall Street Journal,* a big two-page article in early 2002. And in response to that article and other articles which followed, the board of ULLICO retained me as special counsel to investigate and make recommendations to them.

First, on the issue of ULLICO's purchases and issuances of stock since 1997.

Second, on the interaction between ULLICO and the initial public offering of Global Crossing.

And third, the broad mandate to look into other matters that we thought appropriate.

In 1925, the Union Labor Life Insurance Company was formed and the share price of the capital stock, as it was denominated then, was fixed at $25, investment limited to unions and members of unions. By 1987, ULLICO was formed and for a period of 5

[1] The prepared statement of Mr. Thompson appears in the Appendix on page 45.

years, from 1987 to 1992, ULLICO rewarded its stockholders pretty handsomely. Even though the share price was unchanged from year to year and fixed, the dividends were exemplary, I believe, 10 percent stock dividends and a 9 percent cash dividend in most years, quite a decent return on a $25 investment.

In 1992, the board issued convertible preferred certificates that paid an 8 percent cash dividend and a 4 percent conversion fee, and union pension funds were allowed to become authorized shareholders.

In the period between 1992 and 1997, preferred certificates were converted to Class A voting or Class B non-voting stock.

In 1997, the management of ULLICO put forth a proposal to repurchase stock. In the words of Chairman Georgine, the purpose of the stock repurchase program first announced in 1997 was to provide liquidity to our larger shareholders. The larger shareholders, of course, would have been the unions and the union pension funds, and liquidity meant that there was a desire to see those unions and pension funds reap the reward of their prior investment in ULLICO.

So the $25 fixed share price was replaced by a changing share price set once a year in May based upon the year-end audited financial statements of the year before.

In this first proposed repurchase of stock program there was a 10,000 share proration threshold set. That is to say the shareholders holding less than 10,000 shares could be liquidated and over 10,000 shareholders, principally the unions and the pension funds, would have to take a proration depending on the number of shares to be tendered in response to a repurchase offer and the number of dollars available to fund the repurchase program. The intent was to repurchase $180 million over 11 years with the first tranche of $30 million in 1997. And this applied only to Class A and Class B stock.

Of course, the book value of the ULLICO shares were determined simply by taking stockholders equity at the year end and dividing that by the outstanding shares in the company, which included capital, Class A and Class B shares. And as I said, it was set just once a year.

The 10,000 share proration threshold suggested in 1997 program simply meant that if a tender offer was oversubscribed, those shareholders holding 10,000 shares or more were prorated and those holding less than 10,000 shares, principally officers and directors, were not prorated if they tendered all of their shares

The only rationale that has ever been offered to us for this differing treatment is a tax rationale. And that is to say that those tendering their shares presumably could avoid ordinary income tax application and receive capital gains tax application to the proceeds of their share liquidation. But of course, as we know, both unions and pension funds are tax-exempt. This means that the larger shareholders, the over the 10,000 proration level, had no tax advantage and the tax advantage would have flowed to the directors and the officers or the insiders.

It was also offered, inferentially at least, as a rationale that this threshold would eliminate small shareholders. But of course, the

later-repeated offers of shares to insiders had the effect of keeping smaller shareholders going rather than eliminating them.

In 1997 the executive committee of ULLICO managed to do a wondrous thing. They invested $7.6 million in Nautilus, LLC, the predecessor of Global Crossing. That company, Global Crossing, went public in August 1998. To date, ULLICO's pre-tax Global Crossing gains totaled almost $500 million on the $7.6 million investment, or about a 64-fold return on investment. By anybody's standards, in public or private companies in the corporate and noncorporate world, that was an extraordinary investment with an extraordinary return.

Beginning in 1998 the Global Crossing investment became a larger and larger portion of shareholder equity in ULLICO. As Senator Levin has said in his opening remarks, ULLICO's other investment decisions were not quite so rewarding and some of their lines of insurance businesses began to suffer. And so the Global Crossing investment became a larger and larger share of stockholder equity. And by December 31, 1999 it totaled almost 85 percent of total shareholder equity in ULLICO, thus materially impacting the book value and the stock price.

ULLICO's book value stock price increased significantly, reaching as high as $146 at one point, but lagged behind Global Crossing's market price which was also on the rise. And so the increased ULLICO book value resulted in increased proration when the company decided to repurchase shares. The only ones to benefit, of course, from the proration threshold were the under 10,000 shareholders who were principally officers and directors.

The next chart shows the stock repurchase program timeline. In 1997, $30 million at a price of $27. In 1998, a $15 million program at a price of $28. May 1999, a $15 million program, share price rose to $53.

In May 2000 there was what they call an extraordinary stock repurchase program. It was tied to the price of Global Crossing stock, a trigger price. Global Crossing stock never reached that price in that year and so the May 2000 purchase extraordinary program was abandoned and the company waited until November of that year to put forth a smaller program of $30 million available for repurchase. The share price of ULLICO now climbed to $146.

And as you can see, the proration of the larger shareholders was extreme. They could sell only 2.2 percent of their shares. And the same thing is true for 2001, a much smaller program, $15 million, share price still high, $74, larger shareholders could get back only 2.7 percent of the stock that they offered.

Obviously, the Global Crossing investment was an extraordinary one. It brought great material gains to the company. It significantly increased shareholder equity and it was entirely appropriate to reward management under whose administration this had occurred in some fashion, in terms of compensation. And so the company set up what they called a Global Crossing program of incentives for management to reward this extraordinary investment. This was apart from the normal compensation of salary plus bonus, and it was aimed specifically to recognize the management responsible for the Global Crossing investment decision with extraordinary gains.

By 2001, the end of the 4-year period, five officers received about $5.6 million as a bonus. So they were, in fact, by this singular program compensated for their wisdom in investing in Global Crossing.

Quite apart from that, the chairman eventually gave senior officers and directors the chance to buy stock in ULLICO. July 29, 1998 2,000 shares were offered to each officer and director participating at $28. Later that year, in October, another 2,000 shares at $28. And in December of the following year, 4,000 shares at $53. No other persons were given the opportunity to purchase stock in this fashion, only directors and officers. And a number of directors responded.

Chairman Georgine offered a rationale for this tightly restricted share program available only to officers and directors. He said they did it because management and the board of directors should have their interests in line with the stockholders.

Now that is a commonplace rationale for stock programs at corporations large and small, public and private. Oftentimes, when people join the board of publicly traded companies, they are offered the opportunity to buy shares in the company or they are given options in the company as part of their compensation in an effort to get them to put on a shareholder's hat as well as a director's hat. In fact, some publicly traded companies have a requirement that boards of directors attain a certain level of ownership in the company in line with that stated purpose. And so chairman Georgine's rationale for the share purchase program is not inconsistent with what you see in other parts of the corporate world.

The question, as it later turned out, was whether that rationale happened to apply given the subsequent events.

And he said, officers and directors in conducting their everyday business should have the interests of the stockholders foremost in their mind. That certainly is a truism in the corporate world. In fact, it is a requirement of State and Federal law. But in this case, as we will see, it was not to be.

There has been a running question in this whole affair about whether in fact these offers to allow directors and officers to purchase shares in the company were a form of compensation. Some directors think so, some did not think so. The offers of shares were approved by the compensation committee, though we believe the compensation committee of ULLICO had no authority to do that.

The offers came in anticipation of increased ULLICO stock price because of Global Crossing. The 1999 offer had been approved in May of that year but was actually made or offered just before year-end when everybody knew that the next year's price of ULLICO stock was going to be higher.

Interestingly enough, and quite apart from what ordinarily will happen in the corporate world, there were no restrictions placed on the sale of that stock. There was no vesting period. There was no requirement that the stock be held for a period of time. All these normal devices that companies would employ to make sure that their stated rationale of aligning shareholders and directors would continue for at least some reasonable period of time and would preclude the notion that directors were making short-term manage-

ment or supervisory decisions in hopes of influencing the share price. That did not happen here.

And in 2002, the outside auditors reversed their prior position and concluded that these share purchase officers were indeed compensation because there was little or no investment risk.

If that is how they are viewed, that is compensation, at least as far as the officers are concerned, in addition to the normal salary and bonus and the Global incentive program that had been established.

Another leg of the compensation stool at ULLICO, which we include in this report and presentation to give you the flavor and context of all that went on there, came in July 1998, allowing senior officers to defer up to 25 percent of their base salary and up to 100 percent of their bonuses.

Again, this is not an uncommon phenomenon in the corporate world. It has at least temporary tax advantages and allows compensation or a portion of compensation to grow tax-deferred. It is not surprising to find that in a number of companies. The plan, in this case, allowed the executives, again commonly, to pick the target of their investments.

But what happened here was extraordinary. Because the share price of ULLICO was fixed once a year and could have been forecast well in advance of the fixing of the share price, almost 5 months before, this is not the normal deferred comp, I think I will invest my deferred comp in a stock whose value is determined by the market and moves up and down every day.

So what happened was that the people who had the ability to fix the share price invested their deferred comp in that stock, ULLICO stock, kept it there until the price reached an all-time high and then immediately shifted it out as they saw the value of the shares starting to decline.

Now if you were investing part of your compensation in a tracking stock program at a company, you might change your mind about where you want your investment to go as you watch the market. The difference here is that the market was the result of the actions of the officers themselves and they held the key. The public market did not hold the key.

Between 1999 and 2001, Mr. Georgine made $4 million from this deferred comp program and three other senior officers made between $320,000 and $605,000.

Quite apart from these occasional stock repurchase programs authorized by ULLICO, the chairman of ULLICO had for a longtime, including Mr. Georgine's predecessor, been able to repurchase shares outside of a formal repurchase program known as the Chairman's Discretionary Share Repurchase Program. Historically, and under Mr. Georgine's predecessor, this program was used to help retiring directors, retiring officers, the estates of deceased directors and officers gain liquidity. If shareholders were in financial trouble they could come to the chairman and gain liquidity. But you will recall that the share price was then fixed at $25, and had been $25 for a number of years.

At one point, Mr. Georgine, in referring to this program, said we do not advertise this discretionary program and we do not encourage it. But the evidence shows that it was used to allow officers

and directors to sell shares outside of the formal repurchase programs at the discretion of the chairman with no standards set up by the board, with no standards articulated by the chairman, and in fact with his quite frank statement that we do not advertise this program.

At the May 11, 2000 board meeting the highest price ever for ULLICO stock was adopted, $146.04,[1] a threefold increase from the 1999 price the year before. This was deemed an extraordinary program. The object was to purchase up to 20 percent of outstanding stock. But as I have said before, it did contain a trigger clause that Global Crossing stock had to be $43 a share before the program could be implemented. Global Crossing never reach that level after the announcement of the program.

Shareholders holding fewer than 100 shares had to have all of their shares repurchased. Now this is a big change. The prior proration threshold had been 10,000 shares in 1997. In this extraordinary program in 2000, it is changed for some reason that we have not yet been able to determine to 100 shares. If they had stayed with the 100 shares and if the program had gone ahead, then obviously larger shareholders like unions and pension funds would have been able to sell more of their shares. They would not have been as seriously prorated.

And this 100 share proration threshold did indeed have a fairness opinion from an investment banker.

After the announcement of this extraordinary program, during the summer and fall of 2000, the Global Crossing share price continued to drop. Of course, the ULLICO share price at $146 was static. During that period of time, the summer and fall of 2000, the chairman redeemed $4.6 million of shares from insiders under his discretionary repurchase program. This was while larger shareholders could not gain liquidity because the trigger price of Global Crossing stock had not been met.

So in the fall of 2000, since it would be futile to assume that liquidity could be gained by anybody under the May 2000 proposal because of the failure of the trigger price to be met, the board in November 2000 replaced the extraordinary program, which was never implemented, with a new $30 million program at the $146 per share stock price.

The terms of the plan and the high stock price made extreme proration inevitable. The threshold somehow mysteriously went back to 10,000 shares. That made 20 directors eligible for complete liquidity, tendering all of their shares. There was some question raised about whether the chairman had in fact acted properly in his use of the Chairman's Discretionary Repurchase Program so the board purported to ratify all past actions of the chairman in that program. And of course, there was no trigger price.

In the tender offer documents for this November 2000 program, there were some interesting statements. 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. Although of course, in the months preceding the chairman had been redeeming shares under the discretionary program.

[1] Chart entitled "Total Stock Repurchases at $146.04," appears in the Appendix on page 43.

The company believes ULLICO stock to be an excellent investment opportunity for investors seeking long-term growth of capital, although of course senior officers and directors were in effect cashing out.

There was no disclosure in the tender offer documents of the discretionary repurchases by the chairman from officers and directors. There was never any clear disclosure of the impact of the proration provisions and the subsequent benefit to insiders. And there was no clear discussion of the fact that ULLICO's book value stock price lagged behind Global Crossing's market price.

In response to this offer of November 2000, shareholders tendered more than $1 billion worth of stock to be purchased in a program that had a limitation of $30 million. $1 billion offered, $30 million available. Extreme proration of larger shareholders resulted so that they could redeem only 2.2 percent of their shares while insiders, officers and directors, were able to redeem all of their shares and no director or officer was prorated.

The chart that the chairman had placed on the easel before is repeated in the book. As of May 2000 directors and officers constituted less than 2 percent of all outstanding share holdings but in the repurchases, both formal and discretionary, gained 31 percent of the profit.

In December 1999, ULLICO and Georgine entered into a stock purchase and credit agreement, yet one more leg of the compensation stool, I believe, at ULLICO for senior people. They loaned Georgine $2.2 million to purchase 40,000 shares of Class A stock at $54, then provided that the loan would be forgiven ratably over the next 5 years as long as he continued to be employed. By May 2000, when they reset the price at $146 a share, that 40,000 share bonus program at a cost of $2.2 million was worth $5.8 million.

There were some issues concerning this agreement with Georgine. The board never approved either the stock issuance or the loan. It was purportedly approved by the compensation committee but the company's bylaws prohibited the compensation committee from issuing stock. The compensation committee, at least arguably, lacked the authority to make the loan to Georgine.

Layered on top of that was an agreement that allowed Georgine to sell a portion of the shares he received under the 40,000 share bonus back to ULLICO each year. So while the loan is being ratably forgiven over here, he has got the option to sell back over here, and the $2.2 million cost to him is now worth almost $6 million.

Then, in the fall of 2000, the compensation committee approved an addendum to his employment agreement to allow him to sell back the other ULLICO shares that he held at any time without any restriction. The so-called cash out option.

The slide on the total executive compensation pre-tax for the five senior officers of ULLICO year by year from 1996 to 2001, which includes salary, deferred comp, bonuses, and stock profits has Chairman Georgine going, from a low of $650,000 in the year 1997 to a high of $5.3 million in 2000 and then the others follow, Steed, Grelle, Luce and general counsel Carabillo.

Not included in this chart are any retirement plan dollars for the worth of the split-value life insurance.

These are the laws that we looked at after ascertaining these facts. We looked at the law of Maryland, where ULLICO was incorporated, to see what their standard was for fiduciary duties of officers and directors. We looked at the Federal securities laws. We looked at the State securities laws of States in which these tender offers officially reached across the country, probably all 50. And we looked at the criminal laws.

Maryland statutory law on the duties of directors is similar to that to be found in almost every State in the Nation and that is that directors must act in the best interests of their company and must act with due care and must act in good faith. Sort of reminiscent of Chairman Georgine's statements at one time that it was the duty of directors and officers to act in the interests of the shareholders, or shareholders come first.

When directors are involved, the law in each of the States has come to recognize what is called a business judgment rule. And that is simply that directors are presumed to have acted in accordance with their fiduciary duty. But that is simply a presumption which can be overcome by evidence to the contrary. And it has some standards built around it in the laws.

We cannot tell you, it is unclear, whether officers of Maryland companies are entitled to this presumption, as well. But if they were, that could be overcome by evidence to the contrary.

We looked at the Federal securities laws that we thought might be applicable. Section 10(b) of the Exchange Act, SEC rule 10(b)(5) which prohibits fraudulent schemes, untrue statements of material fact and material omissions concerning the sale of securities, because enough questions had been raised about the tender offers and the repurchases of stock to implicate perhaps the Federal securities laws, Section 14(e) of the Exchange Act which prohibits untrue statements of material fact and material omissions in tender offers.

The standard under the Federal securities laws for proof of violation is that it must be committed with severe recklessness. Not proved beyond a reasonable doubt but nonetheless a very high standard.

Then we looked at State securities laws, or blue sky laws, which prohibit inaccurate or misleading tender offer disclosures. And in many States, the standard drops from that required by the Federal securities laws, extreme recklessness, down to negligence, plain, simple, ordinary, common, everyday garden-variety negligence.

We looked at potential criminal liability. Of course, to find criminal liability, prosecutors must demonstrate beyond a reasonable doubt that the defendant acted with a specific intent to defraud, a very high standard. If this were a civil lawsuit affair, a plaintiff in the civil lawsuit could base a claim on severe recklessness, Federal securities law violation, or negligence, State securities law violation.

Some have raised the question as to whether or not we looked at ERISA or labor management obligations of directors because of their union or pension fund decisions. We did not. That was a deliberate decision, I think taken for a good reason.

First, there was, despite the broad language of the last part of our mandate that said we could look at anything we wanted to look

at, thought that there was enough there, as it turned out, focusing on fiduciary duty, criminal, Federal securities and State securities, and recognizing as we went along before the investigation was concluded that there was a very serious, very troubling situation at ULLICO.

We thought that to delve into LMRDA or ERISA matters would have prolonged this investigation and ultimate report to the board beyond any reasonable measure because once you start looking at ERISA, I think it becomes kind of a slippery slope. You can look at the ERISA implications of ULLICO pension funds, but since a number of officers—as the Chairman said in her opening statement—also sat on pension funds of other unions, there would have been no real rationale between distinguishing between one pension fund or another.

We thought it was more important to find these facts out, the basic facts, and to get a report out to the board than to engage in a prolonged investigation of the discrete subject matter that is ERISA that might or might not have value at the end. And so we stayed outside of that.

It is fair to say that the business purpose of the stock offers were unclear. If the purpose was to align shareholder, director and officer interests obviously that purpose was not achieved by the way the program was designed and implemented.

If the purpose was compensation, as Senator Levin indicated, the compensation of ULLICO officers was already pretty rich. The approval of the stock offers involved what we believe to be an excessive and perhaps impermissible delegation of authority by the board to either the compensation committee or Georgine, although there is some lawyer's dispute about that. The Sidley and Austin report, I believe, disputes that.

Georgine may have exceeded his general authority to issue stock by issuing stock to insiders. Certainly, the terms and the timing of the stock offers minimized, if not entirely eliminated, investment risk.

And if this were to be compensation, it was probably inappropriate compensation, given all the other methods of compensation employed.

We have, to this day, not found a meaningful basis for the 10,000 share threshold in the formal repurchase programs other than to benefit—I mean, the implication in this is the way that insiders would be benefited. And we believe the board ratified the discretionary program in November 2000 without enough disclosure of material information regarding discretionary purposes.

These programs resulted in self-interested transactions that disproportionately benefited insiders at the expense of larger shareholders, despite the chairman's stated purpose of aligning those interests. And we believe that the details and effect of the November 2000 repurchase program were not adequately considered by the board or disclosed to shareholders.

Serious questions exist regarding whether the directors and officers who participated in the repurchase programs acted either in good faith or with due care in a manner that they could reasonably believe was in the best interests of ULLICO. And we cannot say with any degree of certainty that they would be protected by the

business judgment rule. And in any event, it is not clear that the business judgment rule would be available to officers, as opposed to directors.

No outside counsel or professional was specifically asked to evaluate fiduciary duty issues. In fact, the report discloses that at least one lawyer from Arnold and Porter raised the issue of whether or not the 10,000 share proration threshold in the November 2000 was discriminatory and benefited insiders. It did not change. The general counsel of the company denied receiving that caution. And obviously we are in no position to say who is telling the truth.

Chairman COLLINS. Governor, I know you are coming to some of the most interesting parts of the report, on your remedial recommendations and the rest of your analysis. I am going to ask you to proceed a little more rapidly because we are expecting votes and I want you to be able to get——

Mr. THOMPSON. Madam Chairman, I can easily stop here. I know the Committee is familiar with the report and the slides, and I would be happy to go from this point into your questions.

Chairman COLLINS. Why don't you just quickly run through any remaining points that you would like to make for us. Thank you, and I apologize.

Mr. THOMPSON. I will edit myself.

Chairman COLLINS. I apologize for hurrying you. It is only because of the votes that will be coming.

Mr. THOMPSON. Votes come first.

The next several pages are simply conclusions that should be obvious by now. Let us go to the possible defenses to the violation of the laws, because I think that this is important.

We were not able to conclude that Federal securities laws were violated here because we were not able to conclude that a plaintiff or a prosecutor could meet the standard of severe recklessness. We also believe that causation and reliance, which are requirements of the Federal securities laws violations, are at least an open question.

Now, I will also say that a reasonable person could make the contrary argument. But if you are asking us for our opinion, and we include three former Federal prosecutors on this team, we do not believe that the Federal securities laws were violated, although as I say others could come to an opposite conclusion.

Similarly, when you look at the issue of criminal intent, which would require a specific criminal intent proved beyond a reasonable doubt, here too we think that a reasonable person could make the contrary argument. And so I put myself in a position of a former prosecutor looking at this case like I looked at thousands of cases during the course of three different prosecutorial careers. And I simply came to the conclusion that if a reasonable person could say the criminal law was violated and a reasonable person could say that it was not violated, that a prosecutor would have a difficult time reaching the standard of proof beyond a reasonable doubt. And so we did not conclude that criminal laws were violated.

We think that under a negligence standard of many States' blue sky laws, State securities laws, that a credible case could be made that they were violated. But without question the bottom line, we strongly believe, and said so in the report, is that directors and offi-

cers here who participated in these transactions violated their fiduciary duty to ULLICO and its shareholders.

And so we made a series of recommendations involving the return of stock profits and examination of some of the compensation profits by the new board with a fresh look, and a whole long series of corporate governance reform recommendations.

And I am pleased to say that after an initial period of resistance by the old board, who first wanted us to make only an oral report. And I said absolutely not. I am not spending 6 months investigating a very complex set of transactions to come in and give this board an oral report. Then they wanted to keep the report confidential. Of course, I was bound by that judgment. I had no way to release the report, so we never did and never talked about it. It eventually leaked, as you might suspect it would.

Then the old board refused to accept the recommendations of the report. I briefed a special committee of the old board, which then voted to reject our recommendations. And that is when the American labor movement stood up and said enough is enough. A number of directors on the board, men like Sweeney, Wilhelm, and O'Sullivan, said this is the end, we are changing this place. And they have. They have put together quite a distinguished new board, I believe, with outsiders beyond the union movement. An old Congressional colleague, Abe Mikva, an old friend of mine from Chicago and a man of extraordinary repute, Ravitch from New York, and others.

And that new board has voted to adopt all of the recommendations of the Thompson report and has a committee to study some of the compensation questions that we thought should be re-examined.

So my belief is, as both the Chairman and the Ranking Member have said in their opening statements, that ULLICO today, under its new administration, is to be commended for standing up and doing what a lot of companies have continued to drag their feet on.

So I am pleased that is at least one result of our ULLICO investigation.

And I thank the Committee very much for their allowing me to make this report, and for your kind and lengthy attention.

Chairman COLLINS. I want to thank you, Governor, for your very thorough presentation and helping the Committee understand the findings of your investigation, as well as the recommendations.

The Committee staff interviewed some of the former ULLICO officers and directors and talked to them about their participation in 1998 and 1999 stock offers. Some of the officers claimed that they were taking risk and said they had to purchase the stock with their own money and that essentially they got lucky, that they were not manipulating the stock purchase and repurchase rules.

Do you think that the officers and directors who purchased stock in 1998 and 1999 were just lucky? Were they taking on any sort of serious risk? Or essentially were they in a position to know what the stock price was going to be or likely to be?

Mr. THOMPSON. I think the issue of whether they, in fact, had to purchase this stock with their own money is of little relevance because that is the common experience in corporations. Occasionally a corporation will loan officers money to make stock purchases,

to get them invested in the company. But the days when that was more freely done are over, and now corporate loans to officers for the purchase of stock are disfavored and looked upon with some suspicion.

But passing that issue, my belief is that there was little or no risk. And second, that they were in a position to know and control the increasing share price. So I would not agree with their conclusions.

Chairman COLLINS. I want to talk to you about the role of the board prior to your report and then the response after.

As I read through your report I was struck by how much control the board of directors ceded to management, particularly to the president and CEO, Georgine. It seems to be a common pattern that we saw in the extensive hearings that Senator Levin and I conducted, Senator Levin was the Chair, of the Enron scandal that we saw, again the board essentially rubber stamping decisions made by the CEO.

Do you agree that is what happened in this case, and that the board simply did not exercise enough independent oversight of management?

Mr. THOMPSON. Generally, yes, I agree with that conclusion. I would add that board attendance by members was sporadic and not what would be expected at a publicly traded corporation. Meetings were infrequent.

But I also think a reading of this record leads you to the inescapable conclusion that management told the board as little as they had to tell them. So I think there were those three dynamics at work here.

Chairman COLLINS. Is there also a dynamic at work that some of the board members did not want to know because they were benefiting from the transactions that were proposed by Mr. Georgine? So in a sense, the incentives were to not ask questions?

Mr. THOMPSON. I guess I cannot come to the conclusion that they did not want to know because I would have to inquire into their minds. But certainly their ratification or acquiescence, however you want to characterize it, of management's proposals and decisions obviously benefited them enormously as insiders, the designs of the programs. And so whether it was culpability or whether it was inattention or whether it was not understanding the impact of what they were doing, for example, in adopting the 10,000 share proration threshold, it is hard for me to say. It may have been any or all of those.

Chairman COLLINS. After you submitted your report to the ULLICO board, it is my understanding that the company hired other sets of lawyers to prepare rebuttals to your report. Is that accurate?

Mr. THOMPSON. That is accurate.

Chairman COLLINS. Did it surprise you that the board, which after all commissioned you to get to the bottom of this, had as a response hiring other people to refute your findings?

Mr. THOMPSON. I think perhaps initially I was surprised, simply because your own pride of authorship would lead you to the conclusion that the board would immediately adopt all of your recommendations and say thank you very much. But on reflection,

given what we discovered and how we have characterized it, I was not ultimately surprised.

Chairman COLLINS. Did the board actually vote to reject your recommendations?

Mr. THOMPSON. I cannot recall whether the board itself voted to reject them or whether they simply took no action. But the special committee they later formed did vote to reject them.

Chairman COLLINS. The old ULLICO board had essentially 5½ months to act upon your recommendations before they were ousted and the new reform board came in. Are you aware of any actions that the board took during that time to try to follow one of your primary recommendations, which was to seek the return of the ill-gotten gains that Mr. Georgine and Mr. Carabillo had secured as a result of the stock transactions? Was any action taken to your knowledge?

Mr. THOMPSON. No, I am not aware of any such action.

Chairman COLLINS. So it is only recently, when the new board came in, that there has been any attempt to secure the return of that money?

Mr. THOMPSON. That is correct.

Chairman COLLINS. I would like to turn to the issue of Mr. Georgine's compensation. I have a chart that I would like to have put up.[1]

It seems to me that Mr. Georgine earned a great deal of money from the company between 1998 and 2001. In addition to his annual salary of $650,000 and bonuses totaling $800,000, neither of which I should emphasize are under investigation, Mr. Georgine received almost $2.6 million in profits from stock transactions, $4 million in profits from his deferred comp program, and he is now claiming that he is entitled to $2 million in severance pay, and $6.3 million in a supplemental retirement account.

This also does not take into account the loan that you discussed, which has been forgiven in part.

Therefore excluding the loan, excluding his base salary, excluding his base bonus, there is almost $15 million that Mr. Georgine has been asked to return or is under investigation by ULLICO's new management, as well as other parties.

Now I realize that you were not engaged to review compensation issues but you did have some comments in your report and I would be interested in your judgment about whether the board was fully aware of the extent of the money, whether you call it direct compensation or not, that Mr. Georgine was receiving.

Mr. THOMPSON. Madam Chairman, I would doubt that the board ever really focused on the totality of the Georgine or other senior officer compensation. As you say, I am not a compensation expert and it was not within my mandate to opine on compensation, other than to explore it and give this whole thing a context because of the issue of whether the share sales were part of compensation or not.

It is pretty clear that Mr. Georgine, for that 3-year period, was pretty well rewarded. Now on the one hand, if you are the chair-

[1] Chart entitled "Funds Robert Georgine has been asked to return or are under investigation by ULLICO's new management," appears in the Appendix on page 44.

man of a company, the CEO of a company that makes an extraordinary investment and there is a great shareholder return, you are entitled to some credit. Whether it was your specific decision or not, you are the boss. It is like politics, if the economy is good the incumbent gets the credit. If the economy is bad, the incumbent gets the blame. That is just the rules of the territory.

But I would have to say that the total compensation during this 3-year period gives me pause, in part because of what the Ranking Member said in his opening statement. With all the focus on the Global Crossing investment and the rich rewards that were brought to the company, to have it end up that Global Crossing was 85 percent of shareholder equity at one point, with all of the other investment decisions which presumably management okayed going south, and lines of businesses going south, you would think that compensation decisions would at least reflect the troubled parts of the company as well as the accumulation of shareholder equity. And that does not seem to have been the case.

Chairman COLLINS. In addition, as your statement pointed out, there was already compensation or a reward, if you will, for the Global Crossing investment through the Global Incentive Program; is that correct?

Mr. THOMPSON. That is correct.

Chairman COLLINS. Senator Levin.

Senator LEVIN. Thank you, Madam Chairman.

Just on the compensation issue for a brief moment, I know that was not the direction that you had to look at the compensation issues, in terms of whether they were appropriate but rather whether they were proper. And so I want to get into this pay for performance question with you.

Did you consider, in your recommendations, urging the compensation committee to link pay and performance, unlike what happened here where pay and performance were not linked?

Mr. THOMPSON. I believe our recommendations to the board, which have now been accepted or are under study by the new board, did put some pretty defined and stricter parameters on the issue of compensation and asked that they look at it with the eye towards rewarding performance rather than rewarding just showing up.

Senator LEVIN. Your report concluded, as you just said in the last few minutes, indicated that there was insufficient evidence to establish a Federal securities law violation.

Mr. THOMPSON. In our opinion, yes.

Senator LEVIN. In your opinion. Even though we had their officers setting up discretionary grant programs that allowed officers and directors to obtain stock that was not available to other stockholders, and at a time that it was known that the official price of that stock was lower than its value, and that obtaining the stock would provide an essentially risk-free profit to the person obtaining it, and although we had a CEO handing out stock under an alleged discretionary program that the board did not know about and which it only ratified after the fact.

I accept your findings and the reason for your findings, by the way. I think you laid them out very carefully and thoughtfully here from a prosecutorial point of view.

My question is should we consider changes in the law, in your judgment, to make those actions which I just identified and you identified in your report violations of securities laws?

Mr. THOMPSON. I think that, going to the first part of your question, one of the reasons that we did not conclude that there were violations of Federal securities laws was that we were troubled by the difficulty of proving causation and reliance which is a standard, and by the issue of severe recklessness which is a standard.

But passing that in our conclusion, I think it is worth a legislative effort, certainly a legislative study, to determine whether or not the Federal securities laws should be broadened to include the things that you have talked about without being able to give you a conclusion now, since I have not obviously studied that subject.

In the same way, I think I would give the same response to a question posed by the Chairman in her opening statement about whether or not the law should require more from private companies. I think that, too, is worth legislative study and perhaps a legislative effort.

Senator LEVIN. I would assume, Madam Chairman, that this record and that the findings of the Thompson inquiry then would be referred to the appropriate committee that has jurisdiction over these laws to see whether or not, in fact, our securities laws should be tightened to address more specifically actions here which seem to me so totally inappropriate. And yet, under current standards, for perfectly legitimate reasons that Governor Thompson has told us, do not constitute violations.

So perhaps when we are done we could make reference to the Banking Committee, I believe it would be, for that consideration as well as for this public/private issue which a number of us have raised.

Chairman COLLINS. I would anticipate, as with all of our oversight hearings, that we would refer any significant findings either to Federal agencies or to Congressional committees.

Senator COLLINS. I would also perhaps, I hope appropriately, welcome from Governor Thompson any further thoughts that he has on that issue to be shared with us so we could forward them that way.

Mr. THOMPSON. I will.

Senator LEVIN. Governor, the number of corporate governance recommendations in your report are based on current standards at the stock exchange and at NASDAQ. For instance, you recommended a majority of the ULLICO board of directors be independent, recommend treating former or current union presidents or pension fund trustees as inside directors who lack this independence.

That raises some interesting questions to me, if I am reading the recommendation correctly. Unions and union pension funds are the primary stockholders of ULLICO, and it seems to me that most private companies want their shareholders on the board. As a matter of fact, that is usually the purpose of most privately held companies is to have their shareholders be on the board and you really make decisions and to link directly the operations of the company to their shareholder interests.

The SEC is now considering a proposal, as a matter of fact, to require public companies to allow large shareholders, at least large shareholders, to be able to nominate directors.

So we have, on the one hand, the desirability of linking the interest of shareholders to the company's management and direction more directly. As you pointed out in your testimony, some companies even require their directors to own stock in the company.

So where is the disconnect here, if there is any?

Mr. THOMPSON. I will have to say in all candor that this was a subject that we debated within our team at length, and I am not sure we are all of one mind on this issue.

I think for me the bottom line is that the most important—and I recognize the strength of what you say about interested shareholders and the representation of large shareholders on the board. I see it in my own experience every day. And obviously a director who owns shares has an interest of some sort that most often is thought of as a healthy interest if the right sort of restrictions are placed around those shareholdings so that you are not making 30-day decisions on behalf of the company.

I think I would perhaps come down, more importantly, on the side of requiring that a clear majority of the directors on the board be independent by any standard and then dealing with the sort of interested director issue by full disclosure of the interest and a forbearance from voting on something when there is a true and obvious conflict. I think that would perhaps be satisfactory in the great majority of cases.

Senator LEVIN. These pension funds want to protect those pension funds. They want to be there.

Mr. THOMPSON. Absolutely.

Senator LEVIN. It is not a conflict, they are protecting their funds and the future of their funds that put together this corporation, private corporation just for that purpose.

Mr. THOMPSON. Correct.

Senator LEVIN. And I am not sure I see the conflict. It seems to me it is the very purpose of the company.

Mr. THOMPSON. I am not saying that there is necessarily a conflict in that context. All I am saying is that I think for good corporate governance a majority of the board ought to be independent of any sort of outside interests and transparency and disclosure can probably handle the rest.

Senator LEVIN. One of Georgine's compensation aspects, or part of it, was a retirement trust called a rabbi trust apparently, which protects his pay if the company were to declare bankruptcy. Apparently these arrangements are common, these so-called rabbi trusts.

Mr. THOMPSON. Yes.

Senator LEVIN. On the other hand, they are troubling to me, at least at first glance, because they permit executives to retain the high-level of their pay right into retirement despite the faltering or the failure of a company.

Did the employees of ULLICO have the same protections for their retirement benefits, for instance?

Mr. THOMPSON. They did not.

Senator LEVIN. Is it something that you looked into as being inconsistent for the executives to have protections for their retire-

ment? And this is common, by the way. This is not something unique to ULLICO. But it is something which troubles me and I want to just ask you, because you are in a field here which in a sense is broader and has lessons for us beyond ULLICO. Is that not a troubling aspect?

Mr. THOMPSON. Yes, and at least one highly ranked corporate executive in the several months has lost his position over the differential between how his pension was to be treated and the workers' pensions were to be treated, American Airlines where the workers were being asked to make sacrifices while the board quietly made arrangements for the protection of the leaders' pensions.

This was not part of our mandate, so we did not look at it with that eye, but I think you are quite correct. It is a troubling issue especially in today's economy, where workers are being asked to make sacrifices or to participate in plans to save the company to a far greater degree than they ever have before in my experience and disparities either the difference between the treatment of the managerial pensions and the workers' pensions or the disparity that you have noted in the difference between managerial compensation and worker compensation increasing from I think you said 100 times to 500 times become troubling.

So that is why I think we ought never—and certainly the Congress ought never to close its eyes to issues raised that perhaps were not as troubling in prior times but may be troubling now and in the future.

Senator LEVIN. Thank you. Thank you, Madam Chairman.

Chairman COLLINS. Senator Fitzgerald.

Senator FITZGERALD. Thank you, Madam Chairman. Governor Thompson, thank you very much for the report. I think it was very good, very thorough, and very well balanced.

Are you aware of any civil lawsuits that has been filed against the directors or officers?

Mr. THOMPSON. I do not know about the directors. Several civil lawsuits been filed against the company by unions or union locals who feel aggrieved.

Senator FITZGERALD. Shareholders?

Mr. THOMPSON. Shareholders, yes. At least two or three, I think. Those are pending and I am sure Mr. O'Sullivan, in his testimony, can elaborate on that.

Senator FITZGERALD. That explains why the board might not have liked your report because I assume that report could be used as evidence in lawsuits, although you do not conclude that there is definitively any violation of civil laws.

Mr. THOMPSON. I think frankly that those who hold contrary opinions to those that we reached on either the violation of Federal, civil, or criminal laws or State securities laws will proceed full pace with their investigations or considerations without regard to our legal conclusions. I think basically the old board and the old management did not like our report because it said you violated your fiduciary duty and you ought to give the money back. I think that is why they did not like the report.

Senator FITZGERALD. As I said at the outset, I think the issue here for us is what changes in the law should we consider. I am troubled that because this is a privately held corporation, some of

the disciplines we have imposed statutorily on publicly traded corporations do not apply to them. The company is incorporated under Maryland law. I see that Sidley and Austin, in its rebuttal to your report, notes that under Maryland law officers of a Maryland corporation owe no statutory duties.

One of the thoughts that I have is—boards of companies or incorporators of companies decide which States' laws to incorporate under, which causes boards to look around for the corporate law that is most favorable not to the shareholders necessarily but to protecting the board from legal liability. And so naturally, they are going to choose corporate laws of States that imposed the fewest duties on them.

Do you think it might make sense for Congress to amend Federal securities laws to give shareholders the right to determine the State of incorporation? The reason I raise this is because I think when directors or officers are in charge of deciding which State they are going to incorporate under, there is a race to the bottom, and States start to compete to have the most liberal corporate laws. I see the Senator from Delaware perking up.

Senator CARPER. I sure am glad I came to this hearing.

Senator FITZGERALD. Not to impugn the laws of the State of Delaware—Delaware has an additional advantage in that there is a very well developed body of case law that explains exactly what that State's corporate laws mean.

But what would you think about if we gave shareholders the right to determine the State of incorporation?

Mr. THOMPSON. Senator, with all respect, I do not think that issue is that large. It would be very difficult, I think, to find a way to involve shareholders other than the initial incorporators in a corporation decision without the requiring that once an incorporation decision is made that future generations of shareholders can go back and change it to another State.

Frankly I think—and I am not saying this simply because Senator Carper has entered the room, Delaware is obviously the preference of most companies, at least most publicly traded companies, and that has been true for a long time. And I do not believe that is going to change.

And they, of course, have developed in Delaware a very stringent body of corporate governance law that gets, as I read the press, more stringent everyday.

I have not, at least in my experience, Senator, I have not noticed a rush to the least regulatory State. You might find a greater rush to a lesser taxing State than you would to a State with lesser structures on corporate governance.

And I am not sure I would agree with the conclusion—I know with all respect to my colleagues in the profession at Sidley and Austin, I do not agree with many of their rebuttal conclusions. We employed a neutral expert on Maryland corporate law, Dean Sergeant, who is with us today. And I do not think he believes that there is a significant difference between Maryland corporate law and the duties it imposes on officers and directors and the laws of most other States.

Senator FITZGERALD. Do you have any ideas on what we might do to protect shareholders of privately held corporations? I suppose

the reason we have not been concerned about the privately held corporations, as your report reflects if they have under 500 shareholders, is that they are covered by the statutes that apply to publicly traded corporations.

I suppose most privately held corporations are just mom and pop operations, maybe family held, maybe your local dry cleaner or automobile dealership, and while there may be some insider dealing, but they are probably brothers and sisters and aunts and uncles and we are just not going to get in the middle of that.

But this is a privately held corporation that is quite big, over $1 billion market value at one time or capitalization book value. Although they had under 500 shareholders, those shareholders, in turn, represented thousands, or tens of thousands of people.

Do you have any ideas on what we might be able to do to bolster the protections for shareholders in such corporations?

Mr. THOMPSON. Senator, off the top of my head, I do not and I would hesitate to tread in this area without some more deliberate study. But I would be pleased to go back and, with my staff, discuss this issue. And if we come up with things that are viable, to bring them to the attention of this Committee.

The principal difference today, of course, between public and private corporations is in reporting obligations under Federal law. And in fact, oftentimes there is a desire of a company to go from private to public but the cost considerations of becoming a publicly traded company, in terms of reporting and oversight, are sometimes significant for what you call the smaller companies.

Senator FITZGERALD. Consider a tender offer though. If a publicly traded company were to do a repurchase of shares, I would imagine the SEC would approve the tender offer terms?

Mr. THOMPSON. Absolutely.

Senator FITZGERALD. In this case, you just have insiders with nobody supervising them deciding the terms of the tender offer. The insiders came up with a policy that was discriminatory to the larger shareholders and beneficial for the inside managers.

Did they retain an outside counsel to help them with their tender offer program?

Mr. THOMPSON. Yes, there were a number of law firms advising ULLICO, quite large, quite reputable firms. But the pattern, I think, that we saw was that they kept the lawyers and their legal advice sort of what I would call compartmentalized. They did not ask their law firms for too much information or too much advice on the broad topic of fairness or things of that mature, or ask them specific questions and then come back with specific answers.

Senator FITZGERALD. You mentioned that Arnold and Porter raised questions about whether fiduciary duties rising under Maryland corporate laws had been violated, and they just brushed it off. Do you know if Arnold and Porter was the law firm that was asked to advise on the tender offer?

Mr. THOMPSON. I do not recall who did the tender offer. We can certainly get that answer for you out of our files and get back to you.

The reference that I made was to an assertion by a partner at Arnold and Porter that he had told the company, told management, that in his view the November 2000 share purchase offer 10,000

threshold was unfair or discriminatory. Carabillo, whom the Arnold and Porter lawyer said was given the advice, denied that any conversation like that took place. There is nothing in writing, so it is disputed.

Senator FITZGERALD. Do you know if the bylaws of the corporation provided for director and officer indemnification?

Mr. THOMPSON. I do not know that. It would be unusual if it did not.

Senator FITZGERALD. My guess is that it probably did.

Mr. THOMPSON. I do not know of many corporations today that would go without D&O.

Senator FITZGERALD. One final point regarding Credit Suisse First Boston. They did the fairness opinion on May 11, 2000, for the shareholders. Were they hired by the shareholders? Or, who hired Credit Suisse First Boston to do the fairness opinion as to the price at which their shares were going to be purchased?

Mr. THOMPSON. The company.

Senator FITZGERALD. So they were retained by the company to do the fairness opinion for the people whose shares the company was buying.

Mr. THOMPSON. Right.

Senator FITZGERALD. OK. Thank you very much, Governor.

Mr. THOMPSON. Thank you, Senator.

Chairman COLLINS. Thank you, Senator. Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thanks, Madam Chairman.

Governor, good to see you. I think the last time we spent some time together was about 4 years ago and I recall being in your old home.

Mr. THOMPSON. Right, in the kitchen of the executive mansion in Springfield, Illinois.

Senator CARPER. That is right. Governor Ryan had invited my family and me, we were coming to the end of a National Governors Association meeting in St. Louis and with my wife and two boys we had gone to Springfield to visit the Lincoln sites and to see a little bit of your State and ended up being house guests of the Ryans that evening. And you and I, and I think your daughter were there, as well.

Mr. THOMPSON. That is correct.

Senator CARPER. It is a really neat Governor's house, a huge place, almost as big as the White House, I think. I do not know who built that place, but they did a nice job.

Mr. THOMPSON. It is the third oldest continuously occupied governor's mansion in the Nation. It is the largest and it is the largest because during former Governor Ogilvie's time the place was literally falling down and they had to decide whether to restore it or to tear it down. And they decided to restore it because it was a quite beautiful mid-19th Century structure. While they were restoring it, they just simply doubled its size and matched the architecture on the outside so that unless you know the history of the house you cannot tell where the old house and new house began.

Senator CARPER. I remember remarking to my wife on our way back to Delaware when we left, that the governor's mansion in Illi-

nois has more bathrooms than we had rooms at the governor's house in Delaware by far.

But they had taken the third floor of the governor's house and the Ryan's had turned it into like a playroom for their grandchildren.

Mr. THOMPSON. The attic, yes.

Senator CARPER. And our kids, at the time, were about 9 and 10 years old and I thought we would never get them in the car to leave, to go back.

Mr. THOMPSON. I have to take credit for putting the pinball machines and the exercise equipment and things of that sort up there.

Senator CARPER. We still talk about it.

How did you get drawn into this imbroglio with ULLICO?

Mr. THOMPSON. I was recommended to the board as a special counsel to investigate the issue of share purchases and repurchases but officers and directors and the company's good fortune that came about as a result of their Global Crossing investment.

Senator CARPER. Just briefly, I am bouncing back and forth between about three hearings today, but just briefly for what a Senator who serves on this Committee needs to know, what did you find that I should be especially aware of?

Mr. THOMPSON. We found that at ULLICO, the stock purchase and repurchase programs were conceived and implemented in such a fashion as to benefit what we call the insiders, the officers and directors, who were allowed to purchase shares without risk, to resell them to the company without restriction both within the context of formal programs and informal programs, and that they violated their fiduciary duties under Maryland law, the State of their incorporation.

We came to no conclusion that they had violated Federal securities or Federal criminal laws, although as I noted earlier in my testimony, a reasonable person could make the contrary argument.

Senator CARPER. I understand there has been a change in the leadership of the company?

Mr. THOMPSON. That is correct.

Senator CARPER. And of the board itself, and I think that occurred in May?

Mr. THOMPSON. May 8, the new board was elected and new officers were elected, and they have been vigorous since their election in both accepting the recommendations of our report and implementing the recommendations of our report and demanding the return of the unjustified profits gained by the insiders on their stock sales.

Senator CARPER. Do I understand that before May 8 that a special committee of the board chose to accept some of your recommendations but not all?

Mr. THOMPSON. No, they voted to reject our recommendations, the special committee of the old board, yes.

Senator CARPER. The newly constituted board has accepted and acted on all of your recommendations?

Mr. THOMPSON. Yes, sir, or is the process of acting on all of them.

Senator CARPER. What is there for us to do here in the Senate, with regards to lessons learned?

Mr. THOMPSON. I think what there may be for you to do, and this I think will require further study by staff and others whom you may wish to refer the matter to, is whether in fact there ought to be greater obligations imposed by Federal law on the actions of private companies. Now that poses all sorts of challenges, of courses, as we recognized here this morning. But that certainly is an open issue for debate.

And I think there is some tangential efforts off of that study that could go forward with regard to the issue of compensation and properly structured programs, director independence.

This shows that there is sort of a hidden side, I think, to the corporate world that the private companies occupy. And it may or may not be appropriately treated today by Federal law.

Senator CARPER. A member of my staff was good enough to prepare a briefing paper and I just want to read a sentence or two from it and ask you to say is that a fair statement, is it a fair representation of the truth as you know it.

While the actions of ULLICO's directors were certainly reprehensible, they may ultimately be guilty of no more than engaging in deceptive practices and gross mismanagement. And they go on to say unlike Enron and other high-profile scandals however, Governor Thompson will report that he found no evidence of criminal intent by ULLICO's officers. Is that a fair statement?

Mr. THOMPSON. That is a fair statement.

Senator CARPER. Thank you very much. Thank you, Madam Chairman.

Chairman COLLINS. Thank you.

I want to thank you, Governor, for your testimony this morning, for the amount of time you have spent on this issue with me and with my staff. We very much appreciate your contributions.

Mr. THOMPSON. Thank you very much, Madam Chairman and Members of the Committee. It was a privilege.

Chairman COLLINS. I would now like to hear from our second and final witness today, Terence M. O'Sullivan, the General President of the Laborers International Union of North America and, for purposes of this hearing, he is testifying in his capacity as the new chairman of the board and CEO of ULLICO.

He assumed this position in May. He and a new slate of directors have pledged to make significant changes at ULLICO, and we welcome you here today, Mr. O'Sullivan. You can proceed with your statement.

STATEMENT OF TERENCE O'SULLIVAN,[1] CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, ULLICO, INC

Mr. O'SULLIVAN. Thank you, Chairman Collins.

Good morning, Chairman Collins, Senator Levin, and other members of the Committee. By name is Terry O'Sullivan and since May 8, I have served as Chairman and CEO of ULLICO, Inc.

In fact, I would guess that few corporate chairman and CEOs have had the honor of appearing before your Committee after being on the job for only 45 days.

[1] The prepared statement of Mr. O'Sullivan appears in the Appendix on page 76.

I am also privileged to have served as General President of Laborers International Union of North America since the beginning of 2000. I appear today on behalf of ULLICO. However, there are differences of opinion on the board on some of the matters under discussion here and my views are not necessarily those of all directors.

I will report to the Committee on the scope and nature of my involvement with ULLICO over the past 3 years. I was first elected to the board of ULLICO at the annual shareholders meeting in May 2000. The first board meeting I attended was in November 2000. As it happens, that was the meeting at which the board adopted the 2000 stock repurchase plan that served as the vehicle for many of the stock transactions Governor Thompson has described for the Committee.

Directors had no prior notice of the modifications to the stock repurchase program that were going to be proposed at that meeting. There was no disclosure at that meeting of the 1998 and 1999 stock offerings to directors and officers. There was no disclosure of the significant changes in the rules of the repurchase program from those approved in May 2000, including the increase from 100 shares to 10,000 shares of those stock tenders that would be excused from proration. There was no disclosure of the way the decline in the price of Global Crossing stock affected the price of the ULLICO stock that was being repurchased. Finally, there was no disclosure of the way the 10,000 share proration rule would benefit insiders.

I voted with the majority at that meeting, a decision I now regret. I can only say that because of the lack of disclosure of the salient facts, my vote was uninformed. My conduct after that meeting shows that I would have voted differently had I been fully advised.

For the next 15 months I was unaware that anything was wrong at ULLICO other than the decline in business performance. When press reports of insider transactions first appeared in March 2002, I and many other labor leaders learned for the first time of the true nature of the stock repurchase program.

In light of the serious nature of the matters being reported there was broad support, including my own, for AFL–CIO President John Sweeney's call for an independent investigation. Jim Thompson, former Governor of Illinois, was ultimately chosen by ULLICO's board and agreed to serve as independent counsel to the company to investigate these matters.

I received a copy of Governor Thompson's report in November 2002. It was only then that I understood that when the company offered stock to directors and officers on December 17, 1999 it was offering them a sure thing that other stockholders were being denied. It was only then I understood the discretionary repurchase program had become a multimillion dollar benefit limited to certain insiders. Further, it was only then that I understood the impact of excusing shareholders with less than 10,000 shares from proration, how it guaranteed that most of the money would go to a few officers and directors.

The board met in December 2002 and decided to appoint the special committee to review the report and make recommendations to

the board. Because I have never owned or sold ULLICO stock, I was one of eight directors asked to serve on the special committee.

I am no lawyer and make no claim of legal expertise. I am a trade unionist. Everything I have I owe to the working men and women of the Laborers International Union of North America. The conclusions to which I came with respect to Governor Thompson's report grew out of my duty to the union I serve, to ULLICO so long as I serve on the board, and to the pension funds my members are counting on.

After I heard Governor Thompson and read his report, I became convinced that these stock repurchase deals were bad for my union, bad for my union's pension funds, and bad for ULLICO and its shareholders.

The special committee considered Governor Thompson's recommendations in two parts. We unanimously adopted his governance recommendations with minor modifications. Unfortunately, we were divided on whether to accept his remedial recommendations. Hotel Employees and Restaurant Employees President John Wilhelm and I found ourselves in the minority as those who felt that directors and officers should be required to return profits from the stock repurchase program.

President Wilhelm resigned after the special committee rejected our position. At various points in time AFL–CIO President Sweeney, Executive Vice President Linda Chavez-Thompson, Operating Engineers President Frank Handley, Carpenters President Doug McCarron, and NFL Players President Gene Upshaw also resigned. However, I continued to work with all of them and other trade union leaders to address the ULLICO crisis.

At this point, I feared for the company's survival after the board had rejected Governor Thompson's remedial recommendations. The labor community had lost confidence in management. The company's financial situation was and remains challenged. But I believe that ULLICO is too important to the labor movement as a whole and to my union, the Laborers International Union, to be allowed to fail.

I, therefore, chose to stay on the board but with a broad group of concerned union leaders, began to organize a reform slate of directors to run for the board at the upcoming annual shareholders meeting.

Our slate included former Federal Circuit Court Judge Abner Mikva, former U.S. Secretary of Labor Alexis Herman, and former Chairman of the New York State Urban Development Corporation, Richard Ravitch, as well as 11 prominent elected union leaders drawn from among the company's major shareholders.

With the assistance of our shareholders, the AFL–CIO, the Building Trades Department, the International Brotherhood of Electrical Workers and numerous unions and their pension funds and their QPAMS, we were able to secure the backing of more than 70 percent of the shareholders.

On May 8, a little more than a month ago, our slate was accepted by the former management and unanimously elected at the annual shareholders meeting. Immediately prior to that meeting, Bob Georgine resigned from all of his ULLICO offices. In the Board of Directors meeting that followed on the same day, I was elected

Chairman and Chief Executive Officer. I serve in those positions without compensation.

All members of former management who were deeply involved in the stock repurchase program have now been replaced. In addition to my election as Chairman and CEO, ULLICO has now retained an Acting President Edward Grebow, a professional with extensive experience in fixing troubled businesses.

The former chief legal officer and chief financial officer have also left the company.

On May 9, the company asked the trustees of ULLICO's management's rabbi trusts to make no payments to anyone pending a board investigation of those trusts. Since then, we have also stopped payment on a series of executive compensation plans including a deferred compensation plan and contributions on an executive split-dollar insurance policy.

The new board met again on May 13, less than a week after its first meeting. At that time, we reconsidered and adopted all of Governor Thompson's remedial recommendations. Those recommendations include a recommendation that we demand the return of $5.6 million in stock profits from directors and officers participating in the stock repurchase program. At the same time, the board also authorized an inquiry into the role of outside service providers in the stock repurchase program.

On May 13, the board also approved the appointments of a number of committees. Among these was a committee chaired by Judge Mikva which is charged with the task of reviewing the remaining stock transactions as well as past executive compensation and past attorney and other service provider conduct.

We have now sent demand letters to all those whom the board has asked to repay money. If arrangements for returning the profits are not made within 30 days the board has voted to take whatever steps are necessary to effect the removal from any position within ULLICO.

The board awaits the recommendation of Judge Mikva and his committee on what further steps may be necessary to accomplish return of the money.

All currently active union presidents have either returned or pledged the return of their stock repurchase profits.

All in all, we are pleased with our record over the last 5 weeks. We must do more in the weeks and months to come but we think we have set a standard for how boards should deal with wrongdoing and its consequences. We are seeking to make our company whole.

The Committee may be aware that there are a number of U.S. Attorney and regulatory investigations of the matters at issue here. We have and will continue to cooperate fully with those investigators.

Let me conclude by saying this, the good news at ULLICO is that our directors and shareholders and the labor movement has on a whole stood their ground, fought and won, and the company is now acting to obtain the return of unwarranted gains.

Our fight to do the right thing at ULLICO feels like it is making a difference. The company has not failed. No one has lost a pension or other benefit as a result of what has occurred. ULLICO employ-

ees have a defined benefit pension plan which is properly diversified and in no danger of defaulting on its obligations.

There will be sacrifices in the months ahead at ULLICO. The company faces a range of challenging business issues that extend beyond the stock repurchase program. But what sacrifices there must be to put ULLICO back on track will be shared and shared fairly.

I and my colleagues on the board and in the management team are totally committed to carrying our efforts through to a successful conclusion. The working people who are both our ultimate owners and our customers deserve no less.

I would be happy to answer any of your questions and thank you for the opportunity to be here today.

Chairman COLLINS. Thank you, Mr. O'Sullivan, for your testimony.

Let me begin by telling you that I have a great deal of confidence in you personally and I commend you for the steps that you have taken. You mentioned in your testimony that on May 13 the new ULLICO board voted to adopt all of the remedial recommendations of the Thompson report; is that correct?

Mr. O'SULLIVAN. That is a correct, Chairman Collins.

Chairman COLLINS. That is in contrast to the special committee which voted to reject some of the recommendations?

Mr. O'SULLIVAN. Yes, the special committee voted, it was unanimous in our support for Governor Thompson's corporate governance recommendations. The vote for his remedial recommendations were six against and three for, actually. But there was a difference in two of us completely embraced Governor Thompson's remedial recommendations. There was one board member, who while he supported it, urged that we encourage those officers and directors that participated in the 2000 stock repurchase program to return their profits.

Chairman COLLINS. I am pleased, obviously, that the new board has voted to adopted all of the remedial recommendations, as well, but I am concerned to learn that vote was not unanimous. In fact, it was not close to unanimous. It is my understanding that the new board voted 14 to 8 to adopt the remedial recommendations; is that accurate?

Mr. O'SULLIVAN. That is accurate, Madam Chairman.

Chairman COLLINS. We have asked your counsel for the names of the directors who voted against accepting the remedial recommendations and we have not yet received that information. Do you have that information today?

Mr. O'SULLIVAN. I do not have the information today. The minutes from the meeting on May 13 are in draft form. It will be approved at a board meeting we have on June 25. We want to ensure their accuracy, since the vote was close, as you said, at 14 to 8, that we have recorded each of the director's vote appropriately.

Chairman COLLINS. Would you share those minutes with the Committee, or the names of the eight directors who voted against accepting?

Mr. O'SULLIVAN. Yes, we will.

Chairman COLLINS. Thank you.

The first recommendation was that the 18 directors and officers return profits made from stock purchased in 1998 and 1999. It is my understanding that the profits from those stock sales totaled $5.6 million. Do you know how much has been voluntarily returned to date?

Mr. O'SULLIVAN. The amount we will get you. There have been four active presidents that had either returned or committed to returning the proceeds from those stock transactions.

Chairman COLLINS. It is my understanding that less than $700,000 has been returned this point; is that correct?

Mr. O'SULLIVAN. I would say that is a fair number.

Chairman COLLINS. What actions will you take if the directors and officers fail to return the money? It is my understanding there are five directors still on ULLICO's board which, according to the Thompson report, should return their profits.

Mr. O'SULLIVAN. As I testified, the active presidents that continue to sit on the board have committed to return the stock profits.

Our plan of action is two-fold. First, as I testified, we sent the letters out on June 16. We approved it May 13 at our board meeting. The reason for the delay between May 13 and June 16 was tax considerations. We hired outside tax professionals before we sent those letters out. The letters are now out. The 18 directors in question have 30 days to return their profits.

We have also turned this issue over to Judge Mikva's committee as to our other options if the proceeds from the stock transactions are not returned, as to what other legal options and other options that we have to pursue.

Chairman COLLINS. When Mr. Georgine resigned or was forced out from ULLICO, it is my understanding that he sent you a letter in which he claimed he was entitled to a $2 million severance payment.[1] My information is that he told you that he wanted the $2 million to count as his repayment of profits made in his stock deals, but also as a return of profits on behalf of six specific directors of the company. And five of those six directors that were singled out in Mr. Georgine's letter as the recipients of his largess are still sitting on the board of directors.

Do you know why Mr. Georgine is trying to bail out directors who are still sitting on the board out of his severance pay?

Mr. O'SULLIVAN. Chairman Collins, I did, in fact, receive Bob Georgine's resignation letter, as you said. I did not have any conversations with Mr. Georgine as to how he chose that group of directors that he wanted his golden parachute or severance package to cover.

I will say that on June 13 as well, not only with the demand letter for the return of the stock profits, another letter was sent to Mr. Georgine regarding his resignation. If you will bear with me, there is one paragraph that if I could, for the record, read. It is addressed to Mr. Georgine from me as Chairman and Chief Executive Officer.

[1] The letter from Mr. Georgine, to Terrence M. O'Sullivan, dated May 8, 2003, referred to appears in the Appendix on page 98.

"Dear Mr. Georgine, we received your letter dated May 8, 2003 in which you advise the company of your decision to resign.

"I am writing to inform you that as of this date, ULLICO does not agree with certain representations or characterizations set forth in your May 8 letter concerning the events that proceeded your resignation. We are continuing to review this matter and will provide you with a more complete response in the near future."

Chairman COLLINS. I am sure you can understand, Mr. O'Sullivan, that I cannot help but wonder if any of the directors singled out by Mr. Georgine to be the recipients of some of his severance pay are the same directors who voted against accepting the remedial recommendations that required the repayment. That is why I had hoped before this hearing that we would receive from ULLICO the names of the directors who voted no.

Mr. O'SULLIVAN. As I said, Chairman Collins, and I apologize for not having the information today, but to make sure that we are completely accurate, we wanted to get those draft minutes approved. Once they are we will provide you with that information.

Chairman COLLINS. Governor Thompson informed us that after he concluded his investigation and presented his report that ULLICO hired another outside law firm, Sidley Austin Brown and Wood, to prepare a counter-report refuting his findings and recommendations.

Do you believe that it was a prudent use of company funds, after hiring a prestigious law firm headed by Governor Thompson to do a fair evaluation of what happened, to then go and hire another law firm to try to counter what was found?

Mr. O'SULLIVAN. Whether it was prudent or not, I found it interesting. They were hired by the company not with the approval of the board. I should have stated before——

Chairman COLLINS. Excuse me, can I clarify? The board did not approve the hiring of the second firm?

Mr. O'SULLIVAN. Not to my knowledge, it was hired by the company.

What I found odd is, knowing Governor Thompson and his reputation and his work, I should have also said when I started that I believe not only ULLICO but the American labor movement was well served with his investigation, with his professionalism in the way that he has handled this whole matter. And I think that because of his investigation, it flushed out a lot of things that have allowed us to not only change management at ULLICO, but to provide us with an opportunity to move ULLICO forward.

Chairman COLLINS. Senator Levin.

Senator LEVIN. Thank you.

On that one comment of yours, you say that second firm which was hired to review the Thompson report was hired by the company. You meant by the management?

Mr. O'SULLIVAN. Yes, Senator.

Senator LEVIN. As far as you know, not by the board?

Mr. O'SULLIVAN. As far as I know, not by the board.

Senator LEVIN. I want to, first of all, commend you for what you have done, and organized labor for what it has done here in cleaning up this problem. It is not easy to take on your own. Too many corporate boards refuse to take on their own.

I want to just read this regarding some excerpts from a *Business Week* column of May 27[1] because I think it is important not just to give you the recognition that is appropriate for cleaning up the situation here. But also, it seems to me, it gives you an opportunity to speak with even greater strength on corporate reforms which we need. Ironically enough, having gone through this situation, you are now in a position where you can put that to good use not just to clean up the ULLICO situation but to help those of us that are trying to reform some of the corporate abuses in this world, to give us your experience and to speak with strength because you were able to take on a board which is made up of friends, colleagues, and former associates. And that is not so easy. I want to read just a couple of paragraphs.

This is from the *Business Week* of May 27: "When it comes to good governance, corporate America can learn a useful lesson from the labor movement. For more than a year, the AFL–CIO has been plagued by a stock scandal at ULLICO, labor-owned insurer. The company's former chief executive and more than a dozen of his 28 directors, most union leaders, pocketed millions of dollars by selling ULLICO stock at the expense of the union pension funds that own most of the company.

"What is notable is that after months of internecine battles, AFL–CIO President John Sweeney and other labor leaders who sat on ULLICO's board moved decisively to clean up the mess. They ousted CEO Robert Georgine and put directors on notice that they will have to pay back the profits that they made. That could amount to at least $6 million.

"These actions stand as a model for other large companies. It is painfully clear today that corporate boards rarely fulfill their designated role as watchdogs over the CEO. Complacent directors allowed apparently illegal abuses to occur at a string of companies from Enron to Tyco International. Many other directors do little to rein in executive excesses."

And then jumping down in the article:

"Yet Sweeney and a few other such as Laborers Union President Terence O'Sullivan, who has since been named ULLICO's new CEO, defied the institutional taboos and took on their chums. 'We still have boards that are hand-picked by the CEO for the most part and those directors do not usually stand up to the CEO,' says University of Delaware Management Professor Charles Elson. 'Directors need to have the guts to make change. That is the lesson from ULLICO.'"

We have had a number of hearings in this Committee and the Permanent Subcommittee on Investigations, a Subcommittee of this Committee, looking into the failures of board of directors to take on management and to carry out their fiduciary duties. And we are going to need all the help we can get in getting some additional legislation passed relative to the responsibilities of directors and how to hold them accountable.

For instance, right now the SEC does not have the authority to impose administrative fines on boards of directors who violate reg-

[1] Article from *Business Week,* dated May 27, 2003, submitted by Senator Levin, appears in the Appendix on page 91.

ulations of the SEC. They can impose administrative fines on the stockbrokers that violate the regulations but they cannot impose those fines on the boards of directors or on auditors. We are trying to change that. As a matter of fact, we passed an amendment here in the Senate, that I introduced, which would give the SEC that authority. We cannot get it out of the House yet. We hope it comes out of conference but we are not sure.

It seems to me the labor movement, having gone through firsthand and personal, up close and personal here, a problem such as you had at ULLICO, can really speak with authority. I know the labor movement wishes it had not had that experience. But it can be put to good use.

I would urge you to do that. In addition to all of the work that you are doing, which you have taken on as its new CEO, that you also help us to take that experience and to put it to good use in terms of corporate governance generally. That would be a real gift to this country. And I would hope that you would be able to do that, in addition to your other responsibilities.

Mr. O'SULLIVAN. Senator Levin, thank you. And I would be remiss, Chairman Collins, if I did not thank you and Senator Levin for your confidence in your comments.

I think that while my name shows up in the press quite often, or has, it is the American labor movement that deserves the credit because there, in fact, were not a few. There were more than many who, once Governor Thompson's report was released, and those findings disturbed us greatly, led to the events of May 8 and the new management team at ULLICO.

So I accept your comments. As you said, Senator, I think it is reflective of organized labor's commitment to good corporate governance, to transparency at every level. And when you are going to point fingers at others, you need to make sure that you have sound corporate governance yourself. I feel confident, completely confident, that the new corporate governance that we have adopted at ULLICO, and the fine-tuning that we will do in the months and years to come, ULLICO will serve as the model for all corporations when it comes to corporate governance.

I would also say that as a large privately held company, we support Sarbanes-Oxley. As we develop our corporate governance, we are taking Sarbanes-Oxley into consideration for complete transparency. And as you said, Senator, we would look forward to working with this Committee and corporate America in how we better police corporate behavior.

Senator LEVIN. I hope that you will include in that the whole issue of executive compensation.

Mr. O'SULLIVAN. Without a doubt.

Senator LEVIN. It has now grown at the larger companies to the point where the CEO is making 500 times the average worker. It was 100 times, which was excessive, but 100 times the average worker in 1990 or 1991.

It has gone totally out of kilter here. And it is not easy to get a handle on this issue, by the way, because you cannot legislate it very easily or appropriately even directly.

But we are going to need the labor movement, it seems to me, to help us in this. And we are going to need you at ULLICO, when

you look into this issue, to correct the situation where your former CEO has a base salary of $650,000, an annual bonus $500,000 in 2001, a second cash bonus that ranged from $100,000 to $700,000 each year, a stock award of 40,000 shares paid for by a company loan over 5 years, deferred compensation plans that allowed him to invest in what were called deemed ULLICO stock which netted him $4 million more, a split-life labor insurance policy, a company jet, and so forth.

I know you are going to be looking into all of that, but I really hope that you will set a really good standard in terms of corporate pay and correcting what is such excess to me, such shocking excess for a CEO whose corporate responsibilities, fiduciary responsibility, are to people who are in his labor movement. These are workers. These are pensioners. And we had someone here who was making this kind of executive pay?

This, by the way, is peanuts compared to some of the corporations that you read about in today's *Washington Post.* But nonetheless, they are mighty large peanuts. And they are too big, it seems to me. And I hope that in addition to all of the other governance issues that you are going to have to look at—and I know you are not getting paid at all. You indicated you are serving without pay, which I did not even know about. It does not surprise me, knowing what your commitment is and what the labor movement's commitment is to cleaning up this problem.

But keep an eye on this corporate pay issue. Set a standard for the rest of the corporate world on what a board should do and what a compensation committee should do relative to corporate pay. Because it is really the only hope we have since legislation is very difficult and very dubious in this area.

Mr. O'SULLIVAN. I hope that me not getting paid is not a reflection on my ability but we could not agree more. On behalf of ULLICO, and I think on this issue I can speak on behalf of the AFL–CIO, we would look forward to working with this Committee and this Congress to address executive compensation.

We clearly plan on addressing the issue of executive compensation within ULLICO as we hire new senior management and new officers for the company.

I might also add that while I am chairman and chief executive officer of the company today, it is not my intention to continue to be the chief executive officer. As I said in my testimony, I am a labor representative. I am not an insurance executive. And we do plan on hiring a seasoned financial services executive to run the company on a day-to-day basis.

Chairman COLLINS. Mr. O'Sullivan, first let me thank Senator Levin for this comments. I have just one final question for you, and it concerns Mr. Carabillo.

As you know, we had invited Mr. Carabillo, along with Mr. Georgine, whom I consider to be the two central figures in these stock transactions, to testify today. Both of them refuse to come voluntarily and, in the case of Mr. Georgine, his lawyer informed

us that if he were subpoenaed he would have invoked his Fifth Amendment rights.[1]

It is my understanding that Mr. Carabillo was supposed to have resigned from ULLICO in March but that upon taking control of the company in May, you discovered that he was still on the payroll even though he had not shown up at work for some time. And that if he had been on the payroll for just one more week he would have been eligible for a lucrative early retirement program.

I know that you have since taken action to terminate him from the payroll, but have you learned how this happened?

Mr. O'SULLIVAN. I have not. That matter has been turned over to Judge Mikva's committee to ascertain as to what role he played, what monies he received from the time that he left ULLICO until the time that we discovered that he was still on the payroll.

Chairman COLLINS. And it was a surprise to you that he was still on the payroll?

Mr. O'SULLIVAN. A complete and total surprise. And that is why once it came to our attention we immediately addressed the situation and then terminated his employment with the company.

Chairman COLLINS. I thank you for your testimony.

Senator LEVIN. Madam Chairman, I just thought of one additional question, and that has to do with the options which are going to be provided by Judge Mikva as to how to go after the money which the Thompson report suggests should be returned. Will he be making recommendations in addition to giving options?

Mr. O'SULLIVAN. That committee will be making recommendations to the full Board of Directors.

Senator LEVIN. Would you be willing to share those recommendations with this Committee?

Mr. O'SULLIVAN. Yes, we would.

Senator LEVIN. On the executive trust issue, so-called rabbi trusts, that is a very troubling problem for me. It bothers me greatly that executives would protect their retirements with these kind of trusts to protect themselves from any bankruptcy or the company going south, whereas the workers do not have that protection. I know, of all groups, the labor movement would have a similar concern.

Do you know offhand how many rabbi trusts ULLICO established for executives? Do we have numbers on that? And are they all frozen?

Mr. O'SULLIVAN. I do not know the number. I know that there was one for Mr. Georgine. They all have been frozen. They were frozen when we came in as a new board and then handed over to Judge Mikva's committee for consideration. In many instances we had not even seen the documents that established those trusts. We have those now. Those are being reviewed by the committee.

I would also, certainly not to correct Governor Thompson, but on the protection of the employees pension fund, there was a question about that before. That is a separate pension fund that covers the rest of the employees, rabbi trust aside. That is a fund governed and overseen by ERISA.

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[1] The letter from Randall J. Turk, dated June 17, 2003, referred to appears in the Appendix on page 100.

As I testified before, the matters at hand, while they have had a financial impact on shareholders, the pension fund of ULLICO is healthy and there is no concern about the employees of ULLICO not being able to secure their retirement benefits when they leave the company.

Senator LEVIN. Thank you.

Chairman COLLINS. Mr. O'Sullivan, I want to wish you well. I think you have a big job ahead of you. It will be interesting to see how many more unpleasant surprises you discover as you delve more deeply into ULLICO's operations.

We look forward to receiving from you the information that both Senator Levin and I had requested.

And I want to thank you for testifying and for undertaking the reforms that you have put in place.

I want to thank all of our witnesses today. The lessons of Enron, WorldCom, and ULLICO should be applied to all corporations. Whether a company is large or small, or publicly or privately held, shareholders should be treated fairly and executives must fulfill their ethical and legal obligations.

There still remains much to learn about what happened at ULLICO as well as at the other corporations who have been involved in questionable transactions. We need to restore the faith of shareholders in American corporations. That remains a work in progress.

This hearing record will remain open for 15 days for the submission of additional materials.

Again, I thank our witnesses and the hearing is now adjourned.

[Whereupon, at 12:34 p.m., the Committee adjourned.]

APPENDIX

PREPARED STATEMENT OF SENATOR LAUTENBERG

Madam Chairman, some ULLICO officers and directors made money selling ULLICO stock on favorable terms that weren't available to the company's other shareholders. That was wrong; Governor Thompson was called in to investigate; ULLICO's management team has been replaced.

Wall Street Journal reporters and editorial page writers have likened what happened at ULLICO to the Enron, Tyco, ImClone, WorldCom and other corporate scandals that have rocked our economy and led to massive job losses.

Nothing could be farther from the truth. I am not condoning the ULLICO stock transactions in question. But to compare ULLICO to Enron is ludicrous for several reasons.

First and foremost, Governor Thompson found no evidence that ULLICO's directors and officers acted with "criminal intent" or "severe recklessness."

ULLICO is a private corporation; therefore, it is not generally subject to Federal regulations.

Many of those who profited from the transactions have returned the money.

The new Chairman, Terry O'Sullivan—who is serving without compensation—and the new Board have cleaned house and are implementing Governor Thompson's recommendations expeditiously.

ULLICO is *not* bankrupt. Union pension funds have *not* lost money investing in ULLICO stock. Union members have *not* lost their jobs or their retirement savings or their pensions. Shareholders have *not* lost billions of dollars.

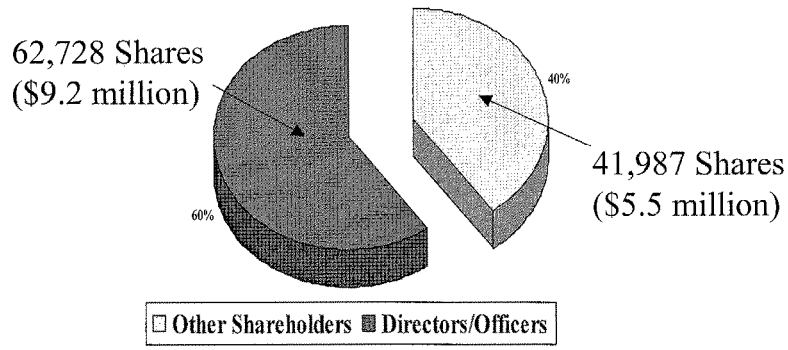
If anything, we ought to be looking at what is happening at ULLICO as an example of how to reform corporate America.

It's sad that the *Wall Street Journal* and other like-minded groups who don't care about ordinary working men and women are on a vendetta to discredit labor unions and labor leaders at every opportunity. And it's sad that a *few* people have given them an opening. But, as I said, to liken ULLICO to Enron, to tar and feather all labor leaders, is preposterous. The fact remains that trade unionism has been and continues to be one of the great reform movements in our Nation's history. Our society is more prosperous and more just because of the labor movement.

Thank you, Mr. Chairman. I look forward to hearing from our witnesses.

Total Repurchases of Stock from Directors/Officers Outside of 2000 Formal Repurchase Program

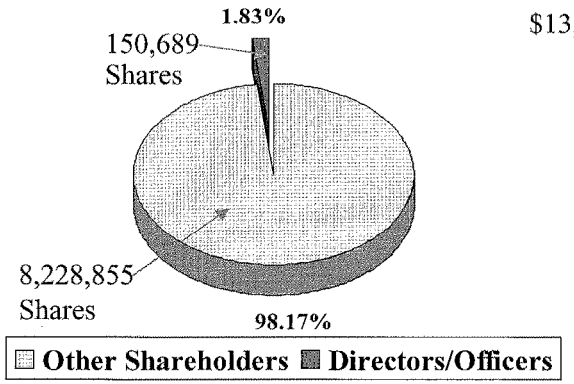
Outside Repurchases at $146.04



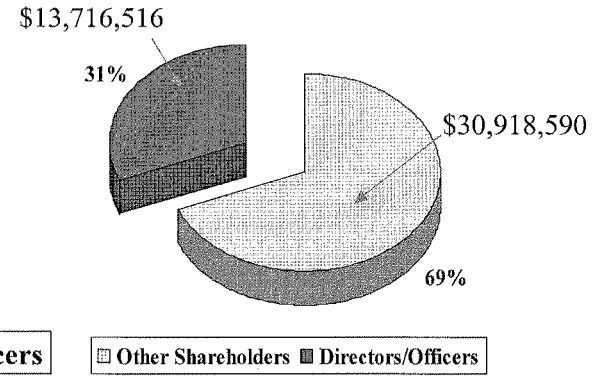
MAJORITY OF DISCRETIONARY REPURCHASES WERE FROM DIRECTORS/OFFICERS

Total Stock Repurchases at $146.04

ULLICO Shareholders (as of May 2000)



Stock Repurchases at $146.04 (formal & discretionary)



DIRECTORS/OFFICERS DISPROPORTIONATELY BENEFITED

Funds Robert Georgine has been asked to return or are under investigation by ULLICO's new management

Profits from actual stock transactions	$2,598,378
Profits from "deemed" transactions	$4,051,060
Disputed severance pay	$2,000,000
Supplemental Retirement/Rabbi Trust	$6,300,000
Total:	**$14,949,348**

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

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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

3

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

4

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

5

"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

6

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**

7

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

8

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

9

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

10

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

11

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	--

12

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

13

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 ONLY WERE GIVEN OPPORTUNITIES TO PURCHASE ULLICO STOCK AFTER GLOBAL CROSSING IPO

14

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."

15

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

16

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

17

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

18

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

19

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

20

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

21

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

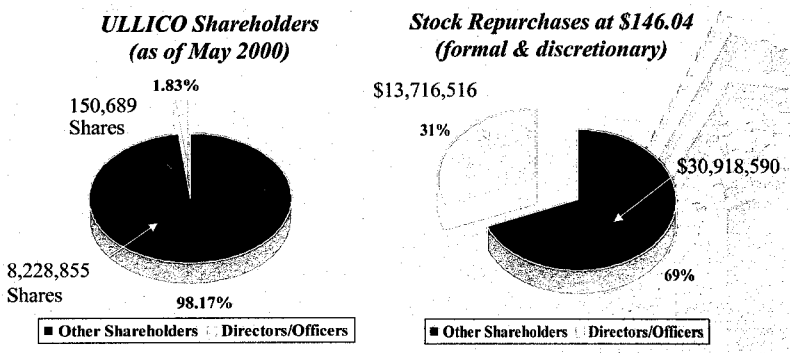
22

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

23

Total Stock Repurchases at $146.04



DIRECTORS/OFFICERS DISPROPORTIONATELY BENEFITED

24

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

25

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**

26

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

27

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

28

Law

29

Governing Law - Overview

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

30

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**

31

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**

32

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

33

State Securities Laws

State "Blue Sky" laws prohibit inaccurate or misleading tender offer disclosures

Many states apply negligence standard

34

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

35

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

36

Analysis

37

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

38

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**

39

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**

40

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

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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

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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

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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

44

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)**

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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**

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Special Counsel Report Recommendations

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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

48

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

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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

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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**

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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**

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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)**

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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**

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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**

55

Principal Corporate Governance Recommendations

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

56

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**

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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**

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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"

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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

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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**

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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**

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Testimony of Terence M. O'Sullivan, Chairman & CEO of ULLICO Inc.

Good morning Chairman Collins, Senator Levin, and members of the Committee. My name is Terry O'Sullivan, and since May 8th I have served as Chairman and CEO of ULLICO Inc. In fact, I would guess that few corporate chairmen and CEOs have had the honor of appearing before your committee after being on the job for only 45 days. I am also privileged to have served as the General President of the Laborers' International Union of North America since the beginning of 2000. I appear today on behalf of ULLICO. However, there are differences of opinion on the board on some of the matters under discussion here and my views are not necessarily those of all directors.

I will report to the committee on the scope and nature of my involvement with ULLICO over the past three years.

I was first elected to the board of ULLICO at the annual shareholders meeting in May 2000. The first board meeting I attended was in November 2000. As it happens, that was the meeting at which the board adopted the 2000 stock repurchase plan that served as the vehicle for many of the stock transactions Governor Thompson has described for the committee.

Directors had no prior notice of the modifications to the stock repurchase program that were going to be proposed at that meeting. There was no disclosure at that meeting of the 1998 and 1999 stock offerings to

directors and officers. There was no disclosure of the significant changes in the rules of the repurchase program from those approved in May 2000, including the increase from 100 shares to 10,000 shares of those stock tenders that would be excused from pro ration. There was no disclosure of the way the decline in the price of Global Crossing stock effected the price of the ULLICO stock that was being repurchased. Finally, there was no disclosure of the way the 10,000 share pro ration rule would benefit insiders.

I voted with the majority at that meeting, a decision I now regret. I can only say that because of the lack of disclosure of the salient facts, my vote was uninformed. My conduct after that meeting shows that I would have voted differently had I been fully advised.

For the next 15 months, I was unaware that anything was wrong at ULLICO other than a decline in business performance. When press reports of insider transactions first appeared in March 2002, I and many other labor leaders learned for the first time of the true nature of the stock repurchase program. In light of the serious nature of the matters being reported, there was broad support, including my own, for AFL-CIO President John Sweeney's call for an independent investigation. Jim Thompson, former governor of Illinois, was ultimately chosen by ULLICO's board and agreed to serve as independent counsel to the company to investigate these matters.

I received a copy of Governor Thompson's report in November 2002. It was only then that I understood that, when the company offered stock to directors and officers on December 17, 1999, it was offering them a sure thing that other stockholders were being denied. It was only then that I understood that the discretionary repurchase program had become a multi-million benefit limited to certain insiders. Further, it was only then that I understood the impact of excusing shareholders with less than 10,000 shares from pro ration, how it guaranteed that most of the money would go to a few officers and directors.

The Board met in December 2002 and decided to appoint the Special Committee to review the report and make recommendations to the board. Because I have

never owned or sold ULLICO stock, I was one of eight directors asked to serve on the Special Committee.

I am no lawyer and make no claim of legal expertise. I am a trade unionist. Everything I have I owe to the working men and women of the Laborers' International Union of North America. The conclusions to which I came with respect to Governor Thompson's report grew out of my duty to the union that I serve, to ULLICO so long as I serve on its board, and to the pension funds my members are counting on.

After I heard Governor Thompson and read his report, I became convinced that these stock repurchase deals were bad for my union, bad for my union's pension funds and bad for ULLICO and its shareholders.

The Special Committee considered Governor Thompson's recommendations in two parts. We unanimously adopted his governance recommendations with minor modifications. Unfortunately, we were divided on whether to accept his remedial recommendations. Hotel Employees and Restaurant Employees President John Wilhelm, Letter Carriers President Vincent Sombrotto and I found ourselves in the minority as those who felt that directors and officers should be required to return profits from the stock repurchase program.

President Wilhelm resigned after the Special Committee rejected our position. At various points in time AFL-CIO President Sweeney, Executive Vice President

Linda Chavez-Thompson, Operating Engineers President Handley, Carpenters President McCarron and NFL Players President Gene Upshaw also resigned. However, I continue to work with all of them, and other trade union leaders, to address the ULLICO crisis.

I feared for the company's survival after the board had rejected Governor Thompson's remedial recommendations. The labor community had lost confidence in management. The company's financial situation was, and remains, challenged. But, I believed that ULLICO was too important to the labor movement as a whole and to my union, the Laborers' International Union, to be allowed to fail. I therefore chose to stay on the board, but with a broad group of concerned union leaders began to organize a reform slate of directors to

run for the board at the upcoming annual shareholders meeting.

Our slate included former Federal Circuit Court Judge Abner Mikva, former U.S. Secretary of Labor Alexis Herman, and former Chairman of the New York State Urban Development Corporation Richard Ravitch, as well as eleven prominent elected union leaders drawn from among the company's major shareholders.

With the assistance of our shareholders, the AFL-CIO, the Building Trades Department, the United Brotherhood of Carpenters, and numerous unions and their pension funds and their QPAMS, we were able to secure the backing of more than 70% of the shareholders. On May 8, a little more than a month

ago, our slate was accepted by the former management and unanimously elected at the annual shareholders meeting. Immediately prior to that meeting, Bob Georgine resigned from all of his ULLICO offices. In the board of directors meeting that followed on the same day, I was elected Chairman and CEO. I serve in those positions without compensation.

All members of former management who were deeply involved in the stock repurchase program have now been replaced. In addition to my election as chairman and CEO, ULLICO has now retained an acting President, Edward Grebow, a professional manager with extensive experience in fixing troubled businesses.

On May 9th the company asked the trustees of ULLICO management's rabbi trusts to make no payments to anyone pending a board investigation of those trusts. Since then we have also stopped payment on a series of executive compensation plans, including a deferred compensation plan and contributions on an executive split dollar life insurance policy.

The new board met again on May 13, less than a week after its first meeting. At that time we reconsidered and adopted all of the Governor Thompson's remedial recommendations. Those recommendations included a recommendation that we demand the return of $5.6 million in stock profits from directors and officers participating in the stock repurchase program. At the same time, the board also authorized an inquiry into the

role of outside service providers in the stock repurchase program.

On May 13th the board also approved the appointments of a number of committees. Among these was a subcommittee chaired by Judge Mikva, which is charged with the task of reviewing the remaining stock transactions, as well as past executive compensation and past attorney and other service provider conduct.

We have now sent demand letters to all those whom the board has asked to repay money. If arrangements for returning the profits are not made within 30 days, the board has voted to take whatever steps are necessary to effect their removal from any position within ULLICO. The board awaits the recommendation of Judge Mikva

and his committee on what further steps may be necessary to accomplish return of the money. All currently active union presidents have either returned or pledged the return of their stock repurchase profits.

All in all, we are pleased with our record over the last five weeks. We must do more in the weeks to come, but we think we have set a standard for how boards should deal with wrongdoing and its consequences. We are seeking to make our company whole.

The Committee may be aware that there are a number of U.S. Attorney and regulatory investigations of the matters at issue here. We have and will continue to cooperate fully with those investigators.

Let me conclude by saying this. The good news at ULLICO is that our directors and shareholders---and the labor movement as a whole---stood their ground, fought and won, and the company is now acting to obtain the return of unwarranted gains.

Our fight to do the right thing at ULLICO feels like it is making a difference. The company has not failed. No one has lost a pension or other benefit as a result of what has occurred. ULLICO employees have a defined benefit pension plan which is properly diversified and in no danger of defaulting on its obligations.

There will be sacrifices in the months ahead at ULLICO. The company faces a range of testing business issues that extend beyond the stock repurchase program. But what sacrifices there must be to put

ULLICO back on track will be shared, and shared fairly.

I and my colleagues on the board and in the management team are totally committed to carrying our efforts through to a successful conclusion. The working people who are both our ultimate owners and our customers, deserve no less.

I would be happy to answer any of your questions.

Thank you.

Business Week Online May 27, 2003 Tuesday

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At scandal-tainted **Ullico,** AFL-CIO leaders ousted one of their own as CEO and set an example Corporate America should heed

BYLINE: Aaron Bernstein

BODY:
When it comes to good governance, Corporate America can learn a useful lesson from, of all places, the labor movement. For more than a year, the AFL-CIO has been plagued by a stock scandal at **Ullico,** a labor-owned insurer. The company's former chief executive and more than a dozen of its 28 directors, mostly union leaders, pocketed millions of dollars by selling **Ullico** stock at the expense of the union pension funds that own most of the company.

What's notable, is that after months of internecine battles, AFL-CIO President John Sweeney and other labor leaders who sat on **Ullico's** board moved decisively to clean up the mess. They ousted CEO Robert Georgine and put directors on notice that they'll have to pay back the profits they made. That could amount to at least $6 million.

These actions stand as a model for other large companies. It's painfully clear today that corporate boards rarely fulfill their designated role as watchdogs over the CEO. Complacent directors allowed apparently illegal abuses to occur at a string of companies, from Enron to Tyco International. Many other directors do little to rein in executive excesses: Consider former General Electric (GE) CEO Jack Welch's outsize retirement package, or the tens of millions raked in this year by the CEOs of American Airlines (AMR) and Delta Air Lines (DAL), despite huge losses.

TOUGH FIGHT. The problem, of course, is that many boards remain clubby conclaves with little desire to check egregious CEO behavior. **Ullico's** board was perhaps even more inbred than most, since many of the directors Sweeney confronted are leaders of unions that elected him and pay dues to the AFL-CIO.

Yet Sweeney and a few others, such as Laborers' Union President Terence O'Sullivan, who has since been named **Ullico's** new CEO, defied the institutional taboos and took on their chums. "We still have boards that are handpicked by the CEO, for the most part, and those directors don't usually stand up to the CEO," says University of Delaware management professor Charles Elson. "Directors need to have the guts to make change. That's the lesson from **Ullico."**

No question, it wasn't easy for labor leaders to oppose Georgine. He was was the head of the AFL-CIO's building-trades department for 26 years -- 10 of them after he took over at **Ullico** in 1990. Georgine packed the insurer's board with building-trades pals, who remained loyal even as the scandal triggered investigations by a grand jury, the Labor Dept., and other agencies.

Sweeney, O'Sullivan, and other labor leaders had to mount an all-out battle. When the scandal broke last year, Sweeney, then a **Ullico** director, prodded fellow board members to mount an investigation.

CREDIBILITY BOOST. Sweeney didn't make any money from selling stock himself and quit the board in December after **Ullico** refused to release the resulting report. After failing this year to win over a majority of directors, Sweeney and O'Sullivan lined up the union pension funds to vote their shares against Georgine at **Ullico's** annual meeting on May 8.

Even so, the battle went down to the wire: Georgine handed O'Sullivan his resignation at 2 p.m., just as the meeting began. AFL-CIO and Laborers' officials had arrived armed with proxy resolutions that would have forced emergency changes to **Ullico's** bylaws if Georgine hadn't offered his resignation. Those would have allowed shareholders to override directors (see BW Online, 5/9/03, "Tense Moments in a Labor Power Struggle").

In the end, Georgine backed down, and on May 13, a new board with a dozen union leaders untouched by the scandal voted to require directors to return their stock profits. Georgine's lawyer didn't return calls for comment.

The outfit still faces plenty of trouble. Congressional hearings are due in June, and the criminal investigation remains unresolved. But the AFL-CIO now can cite **Ullico** -- not just as a case of executive greed but as an example of how to deal with it. Good thing, too, since the AFL-CIO is spearheading dozens of shareholder resolutions on CEO pay this year. Having fixed its own greed problem, labor can claim some credibility in that campaign.

ULLICO Inc.
111 Massachusetts Ave., N.W.
Washington, DC 20001
202/682-0900

July 7, 2003

Senator Susan Collins
Chairman
Senate Governmental Affairs Committee
U. S. Senate
Washington, DC

Dear Chairman Collins:

Attached you will find a corrected copy of the transcript of the testimony of Terry O'Sullivan, Chairman and CEO of ULLICO from the Committee's hearing on June 19, 2003. Also attached are two letters to be included in the hearing record further clarifying issues raised by the Committee during the hearing.

In an effort to be complete it should be noted that one issue raised during the hearing is not addressed in these materials , that is to what extent and in what amounts have monies been returned and by whom. The deadline of thirty days for the return of funds adopted by the ULLICO Board and stated in its demand letters expires on July 16th. A Board meeting is scheduled for July 18th. Shortly after that Board meeting we expect to be able to fully account for the status of funds returned, agreements reached to further the return of monies (tax issues and payment schedules), identify those who have neither returned nor agreed to return monies and the Board's actions with respect to these matters. We will report to the Committee shortly after the meeting with this information.

Thank you for your consideration.

Sincerely,

Donald J. Kaniewski
Legislative and Political Assistant
to the Chairman

cc: Senator Carl Levin

ULLICO Inc.
111 Massachusetts Ave., N.W.
Washington, DC 20001
202/682-0900

July 7, 2003

Senator Susan Collins
Chairman
Senate Governmental Affairs Committee
United States Senate
Washington, D.C.

Dear Senator Collins,

I am writing on behalf of ULLICO Inc. to supplement the record of the Governmental Affairs Committee hearing of June 19 on insider stock transactions at ULLICO Inc. At that hearing two issues arose which are of great significance to our company. The first related to the question of what constitutes an independent director at a private company such as ours where many of our directors are also officers or trustees of specific shareholders. The second concerned the relative security of ULLICO employees' pensions compared to certain ULLICO Inc. executive benefit plans. This letter seeks to supplement the record of that hearing on those two issues. I respectfully ask that this letter together with the material attached be included in the record of the hearing.

At the hearing, Senator Levin expressed concern that Governor Thompson might be suggesting that representatives of shareholders could not serve as independent directors. Prior to the change of management on May 8, the incoming slate of directors consulted with Governor Thompson's staff on the issue of the meaning of the term "independent director" in their report's corporate governance recommendations. The slate was concerned not to inadvertently place any obstacles in the way of the company's complying with Governor Thompson's recommendations. The slate was told by Winston and Strawn that simply being an officer or trustee of a shareholder did not per se compromise a director's independence. I have attached a letter from Governor Thompson to Richard Trumka, the chair of the ULLICO board's Corporate Governance Committee, that spells out in further detail the meaning of Governor Thompson's recommendations in this area. We would be pleased to answer any further questions the Committee has on this issue.

On the issue of pension security, you asked Governor Thompson at one point in his testimony whether ULLICO employees enjoyed the same protections for their pensions as those provided to former Chairman Georgine by certain "rabbi" trusts. ULLICO is not certain today of the validity of those trusts or the benefit plans they fund, and the following comments should not be interpreted to mean that the company concedes their validity.

The new management of ULLICO has identified two "rabbi" trusts established to benefit senior executives. One trust was established to pay benefits under ULLICO Inc.'s Deferred Compensation Plan. The other trust funds a Supplemental Executive Retirement Plan benefiting Mr. Georgine. Both trust documents provide that if ULLICO Inc. is unable to pay its debts or files as a debtor under the U.S. Bankruptcy Code the trusts will cease paying benefits and the trusts' assets will become available to satisfy the debts of ULLICO Inc.

ULLICO employees participate in the ULLICO Inc. Pension Plan and the ULLICO Inc. 401-k Plan. The ULLICO Inc. Pension Plan and the ULLICO Inc. 401-k Plan are both ERISA qualified plans funded by ERISA qualified trusts that are separate legal entities from ULLICO Inc. Unlike the "rabbi" trusts, under no circumstance will creditors of ULLICO Inc. have access to the assets of the Pension Plan and the 401-k

Plan Participants in the ULLICO Pension Plan, like other defined benefit plan participants, have their benefits ultimately protected by the Pension Benefit Guaranty Corporation.

In recent corporate scandals such as Enron and Worldcom, workers lost retirement benefits because their 401-k defined contribution plan was heavily invested in employer stock. The ULLICO Inc. Pension Plan, like other defined benefit plans, is in compliance with ERISA's requirement that it invest less than 10% of its assets in employer stock. The ULLICO Inc. 401-k plan does not provide its participants an opportunity to invest in ULLICO Inc. stock.

In light of these circumstances, ULLICO Inc. believes that our employees' retirement plans are better protected than the plans funded by the two "rabbi" trusts. It is extremely important to ULLICO that our employees' retirement security be protected and that our employees' retirement security not be put at risk by the events that were the subject of the Committee's hearing.

We would welcome any further questions you or the Committee staff would have on these issues.

Sincerely,

Damon A. Silvers
Counsel to the Chairman

cc. Senator Carl Levin

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GOVERNOR JAMES R. THOMPSON
(312) 558-7400
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July 1, 2003

Mr. Richard Trumka
Chairman
Corporate Governance Committee
ULLICO Inc.
111 Massachusetts Avenue, N.W.
Washington, DC 2001

Dear Mr. Trumka:

This letter responds formally to a request made by certain directors prior to the May 8 annual meeting of ULLICO Inc. ("ULLICO") and reiterated by ULLICO counsel following last week's Senate hearing. Counsel for ULLICO inquired as to whether officers of unions and trustees of pension funds who are ULLICO shareholders are independent directors for the purposes of compliance with our corporate governance recommendations to the Board of Directors of ULLICO.

As you know, our Report recommends that at least a majority of the members of ULLICO's Board of Directors, and all of the members of certain Board committees, be "independent." Our view is that a director's association or affiliation with a shareholder should not, by itself, disqualify such director from being independent under our corporate governance recommendations. In fact, it would seem quite unreasonable to develop a concept of director independence that restricted the ability of ULLICO's shareholders, the true owners of the company, from being well represented on ULLICO's Board.

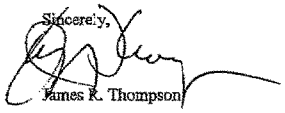
As discussed in our Report, an independent director is one who is free from the influence of management or corporate relationships that could improperly influence his or her judgment as a director. Associations or affiliations between directors and members of management, as well as transactions between a director or his or her affiliated entities and ULLICO and other relationships, should be examined carefully to ensure that no improper influence or actual or potential conflicts of interest exist. The inquiry must begin with full disclosure to the Board of all director relationships and a careful examination by the Board of the likelihood that such relationships could result in improper influence or conflicts of interest. The determination should be fact-specific and based on the totality of circumstances, although, as we noted in the Report, there are certain relationships that are so inherently suspect that they should

be disqualifying. Affiliation with a shareholder, by itself, is not such a relationship. Rather, it is but one factor that should be considered by the Board in making an independence determination.

Finally, the Board's basic criteria for making independence determinations, as well as any specific findings that a given relationship between a director and ULLICO would not compromise a director's independence, should be fully disclosed to ULLICO's shareholders. Full disclosure and transparency are critical components of any policy that is designed to ensure an independent and effective board of directors.

Of course, the above discussion relates only to the concept of general independence. In connection with any specific matter or transaction, a particular director may have an interest that is in conflict with the interests of ULLICO. In such a case, the director should recuse himself or herself from consideration of the matter. The Board should adopt procedures to ensure that in such circumstances the matter is reviewed and approved by disinterested directors.

Sincerely,



James R. Thompson

cc: Damon Silvers
Ted Green

Robert A. Georgine
Chairman, President and CEO

ULLICO Inc.
111 Massachusetts Ave., N.W.
Washington, DC 20001
202/682-0900

May 8, 2003

Terence M. O'Sullivan
President, Laborers' International
Union of North America
905 16th Street, NW
Washington, DC 20006

Re: ULLICO Inc.

Dear Terry:

I write to you in the confident expectation that you will be confirmed later today as the new leader of ULLICO Inc., the company I have had the privilege to manage for the past twelve and a half years as Chairman, Chief Executive Officer and President. First, let me extend to you my congratulations and best wishes for your tenure as ULLICO's new Chairman and CEO. I don't need to tell you what a fine company this is, or that it offers not only excellent financial and insurance products, but also great promise, to the working men and women of this country. I am confident ULLICO will quickly return to profitability and renewed growth with you at its helm.

For me the time has come to move on. The slate of directors to be elected today will be seeking a new direction for the Company. I have been advised that were I to assert my rights under my employment contract to stay on as ULLICO's President, I would be stripped of my duties and responsibilities, reduced in effect to President in name only. I have also been told that if I do not resign, the new slate will effectuate a change in control in a matter of weeks for the explicit purpose of ousting me. Under these circumstances, I see no point in staying on. It could only operate to damage ULLICO at a time when the focus should be on returning the company to profitability. Therefore, I ask that you please accept my resignation as President of ULLICO, effective today.

I do not, however, intend to collect from the Company the more than $2 million in severance and amenities to which I am entitled under my contract. Instead, I want that money to remain as part of the Company's operating funds to help see ULLICO through its current financial difficulties. Equally important, I want that money to serve as repayment to the Company of the profits I made on the sale of ULLICO stock purchased in 1998 and 1999. As you well know, those stock transactions and the controversy they have spawned have distracted this Company long enough.

I remain confident that neither I nor anyone else on the board did anything improper in participating in those transactions. We were advised by competent and respected counsel every step of the way, and would have never proceeded without their blessing. Nevertheless, it is plain that this issue will continue to dog the Company until the profits have been returned. For that reason, I want the balance of my severance to serve as repayment to the Company of the profits received by Messrs. Bernard, Boede, Casstevens, La Sala, Maloney and McNulty for those same stock transactions, in all cases calculated on an after-tax basis. That way, you and the new board can begin your tenure with this issue squarely behind you, and devote yourselves fully to the very real business challenges facing the Company.

Finally, it is my understanding that you would like me to assist you and the new board in the transition to new management at ULLICO. Please know that I would be pleased to assist in any way that I can, and that all you need to do is ask. Nor would I expect or accept any financial remuneration for such assistance.

Fraternally yours,

Bob

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June 17, 2003

Susan M. Collins, Chairman
Joseph I. Lieberman, Ranking Member
United States Senate
Committee on Governmental Affairs
Washington, D.C. 20510-6250

Dear Chairman Collins and Senator Lieberman:

I write on behalf of our client, Robert A. Georgine, in response to your letter inviting Mr. Georgine to testify before your Committee on Thursday. Unfortunately, Mr. Georgine must respectfully decline the Committee's invitation at this time.

As you may know, Mr. Georgine is no longer an officer of ULLICO Inc., having resigned from the company on May 8, 2003. As such, Mr. Georgine no longer has access to the company's books and records. Prior to resigning, however, Mr. Georgine testified at length in connection with the internal investigations recently conducted at ULLICO by the law firms of Winston & Strawn and Sidley & Austin, the results of which I understand have been made fully available to the Committee.

After a thorough review of all the facts, both law firms concluded there was no evidence of any criminal conduct in connection with ULLICO Inc.'s stock repurchase program. Sidley & Austin, moreover, relying on the expert opinion of Professor Jim Hanks, the leading authority on Maryland corporate law, concluded along with Professor Hanks that none of ULLICO's officers or directors violated their duties to the Company or its shareholders under Maryland corporate law. We believe that this is the most persuasive conclusion based on all of the facts and the proper application of the relevant law.

Given, however, the pendency of numerous governmental investigations, out of prudence I have instructed Mr. Georgine to assert his Constitutional right to decline to testify further about these matters at this time. I accordingly ask that the Committee excuse Mr. Georgine from appearing to testify before the Committee.

Sincerely,

Randall J. Turk

Post-Hearing Questions and Responses for the Record
Submitted to Governor Thompson
From Senator Frank Lautenberg

"Self-Dealing and Breach of Duty: An Initial Review of the ULLICO Matter"

June 19, 2003

1. Thank you for your comprehensive report. Did you find any actionable legal offense, criminal or civil?

   We believe there was compelling evidence supporting a breach of fiduciary duty by Georgine, Carabillo and the directors who engaged in self-dealing. Report at 54-65, 91-92.

   We believe that while there may be a basis to bring private shareholder or regulatory actions for violations of federal or state securities laws that there are defenses to such actions. Report at 65076, 92-93.

   We did not find sufficient evidence of criminal intent, a necessary element of any criminal prosecution. Report at 76, 94.

   We did not fully evaluate ERISA or LMDRA issues, as they were beyond our mandate. However, we did note in the Report that the applicability of the fiduciary obligations of pension fund trustees and union officers as set forth in those statutes should be evaluated in light of the conduct we uncovered. Report at 65.

2. Has the new board of ULLICO been cooperative and have they implemented your recommendations in good faith?

   The new Board has been cooperative. We have been advised that the Board is in the process of implementing our recommendations, but you will have to contact Chairman O'Sullivan for facts concerning the same.

3. Concerning the Report from the law firm Sidley, Austin, there was a suggestion that ULLICO executives were historically under compensated. Is this supposed to be a defense to the allegations of self-dealing?

   As we note in the Report, while we were not hired as compensation experts the "draft" compensation report submitted by Sidley, Austin was not persuasive for several reasons. See Report at 95-97. In any event whether certain directors or officers were under-compensated is not a defense to the breaches of fiduciary duty we found.

4. In Mr. Georgine's resignation letter, he claimed that he was due more than $2 million in "severance and amenities" under his employment contract with ULLICO. Georgine stated that he did not intend to collect those funds, and asked instead that the money serve as repayment by Georgine of profits he made on stock purchased in 1998 and 1999. Georgine also asked that the $2 million count as repayment of profits by six other directors of ULLICO.

   What do you think about this arrangement?

   We were not asked to evaluate Mr. Georgine's offer and are not fully informed of the evidence he claims to justify the $2 million he alleges is due him. We understand that the Company is contesting his claim. We recommend that Messrs. Georgine, Carabillo and all of the directors who benefitted from the self-interested transactions return all of the pre-tax profits made thereon. Report at 97-99.

RESPONSES BY TERENCE O'SULLIVAN
TO QUESTIONS FROM
THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
REGARDING THAT COMMITTEE'S HEARING ON
"SELF DEALING AND BREACH OF DUTY: AN INITIAL REVIEW OF THE ULLICO MATTER."

Questions from Chairman Collins

1. In his July 1, 2003 letter to Richard Trumka, Governor Thompson wrote:

> In connection with any specific matter or transaction, a particular director may have an interest that is in conflict with the interests of ULLICO. In such a case, the director should recuse himself or herself from consideration of the matter. The Board should adopt procedures to ensure that in such circumstances, the matter is reviewed and approved by disinterested directors.

Governor Thompson also made this point in his earlier written report to the full Board.

a. What procedures are in place, if any, to ensure that only disinterested directors have a role in making decisions on matters where some directors have a financial stake in the outcome?

b. As the Board considers additional remedial measures, will directors continue to be allowed to vote on matters in which they have a personal financial interest.

ANSWER: The ULLICO board voted at its June 23rd meeting that the votes of directors with a personal interest in a matter being considered by the board that is distinct from the interests of the company and its shareholders shall not be counted. The resolution establishing that only directors without a distinct personal interest in a matter may vote on the matter does not interfere with the ability of directors who are also officers or trustees of shareholders from voting on matters that affect all shareholders.

The Corporate Governance Committee is in the process of making recommendations to the board as to how conflicts of interest will be called to the attention of other, disinterested members of the board. Currently that responsibility rests with the company's Chief Compliance Officer. The Corporate Governance Committee intends to report on certain of its recommendations at the Board meeting scheduled for July 22.

2. According to information you provided to the Committee, seven directors who had purchased ULLICO stock in 1998 and 1999 voted on the May 13, 2003 resolution adopting the first remedial recommendation of the Thompson Report. Three more abstained or were absent. Given that directors who participated in the stock transactions at issue have a personal financial interest in the outcome, why were they allowed to cast votes?

ANSWER: The May 13th meeting that considered the Thompson Report's recommendations occurred five days after the May 8th board meeting at which I was elected Chairman. At the time of the May 13th meeting at which the board adopted the Thompson Report's remedial recommendations the Board had no express policy as to voting on matters where a conflict of interest might exist. Fortunately, in my view, the voting by interested board members did not affect the result of the vote to adopt the first remedial recommendation of the Thompson Report. Frankly, I expected that this would be the case, as the slate of directors that had been voted into position on May 8, 2003, had all committed themselves to a thorough reexamination of the Thompson Report, a reexamination I was reasonably certain would lead to their support for adopting Governor Thompson's remedial recommendations. Thus, as a matter of orderly proceeding I did not find it necessary to implement any procedural changes at that meeting. However, the fact that those interested directors did not see fit to recuse themselves voluntarily from voting on the Thompson Report did influence my decision to ask the board to address the issue at its June 25th meeting.

At the next meeting of the board on June 25th, the policy was adopted as I discussed above, expressly providing that the votes of directors with a personal interest in any matter under consideration will not be counted. I am confident that, with the adoption of that policy, we have captured the point made in Governor Thompson's July 1, 2003, letter to Mr. Trumka, and would incidentally point out that we had adopted that policy before Governor Thompson sent the letter.

3. According to the information you provided to the Committee, six directors abstained from voting on the May 13, 2003 resolution adopting the first remedial recommendation of the Thompson Report and one excused himself. What are the reasons for each abstention and recusal?

ANSWER: The vote in question was a roll call vote that followed a discussion of the issues at stake in the Thompson Report. There was no particular opportunity or requirement during the vote itself for those directors who had not explained their position during the discussion to do

so during the vote. Joseph Hunt, the director who recused himself, said he had a conflict which was the basis for his recusal. He did not indicate what the conflict was. None of the directors who abstained offered any explanation for their abstentions. This was also the case for a significant number of the directors who voted both yes and no. I believe you have already been provided with the minutes of that meeting.

Questions from Senator Lautenberg

1. In Mr. Georgine's resignation letter, he claimed that he was due more than $2 million in "severance and amenities" under his employment contract with ULLICO. Georgine stated that he did not intend to collect those funds, and asked instead that the money serve as repayment by Georgine of profits he made on stock purchased in 1998 and 1999. Georgine also asked that the $2 million count as repayment of profits by six other directors of ULLICO.

   What do you think of this arrangement?

ANSWER: ULLICO has referred matters relating to Mr. Georgine's compensation to the Litigation and Regulatory Affairs Subcommittee of the Board of Directors chaired by University of Chicago Law School faculty member and former U.S. Court of Appeals for the D.C. Circuit Judge Abner Mikva. That Committee has retained its own counsel and is in the process of preparing its report to the board. As I stated at the hearing on June 17th, I have written to Mr. Georgine informing him that ULLICO disputes his claim that he is due $2 million in "severance and amenities" and is awaiting the further recommendations of Judge Mikva's Committee. As a result, ULLICO does not at the present time recognize that there are any monies due to Mr. Georgine to offset against the repayment obligations of the six other present and former directors he mentions in his resignation letter. As Chairman I wrote to those six individuals on June 16th demanding repayment of the stock trading profits listed in Governor Thompson's Remedial Recommendation 1. Management intends to ask the shareholders of ULLICO at a special meeting on July 18 to remove from the board those individuals who are listed in Thompson Remedial Recommendation 1 who remain directors of the company and who have not made arrangements for the repayment of those profits. Judge Mikva's Subcommittee is reviewing what further steps the company should take to obtain return of those profits to the company.

2. What will you do to make sure this will never happen again?

Since May 8 when I became Chairman and CEO of ULLICO Inc. ULLICO's board and management have been aggressively taking steps to ensure that the misconduct of prior management not be repeated. We have worked to deter future misconduct by seeking the return of profits from improper insider transactions as recommended by Governor Thompson. Currently the board is considering other further deterrent measures to enforce our demand.

In the area of preventive measures we have taken steps to reform ULLICO's corporate governance to ensure management and directors are held accountable in the future to the interests of the company. We also are removing from office those transacting directors who do not return their profits. In so doing we have gone well beyond the governance and disclosure obligations imposed on private companies like ULLICO under the law of Maryland, our state of incorporation.

At the heart of our efforts is ULLICO's new board. The board has met four times since it was elected on May 8, and another meeting is scheduled for July 22. In addition, the Executive Committee of the Board has met twice, and most of the board's committees and subcommittees have met at least once in the last month. The board has been strengthened by the addition of new non-labor affiliated directors such as Alexis Herman, Judge Mikva and Richard Ravitch.

The company's Corporate Governance Committee is developing a new Code of Ethics and Corporate Governance Guidelines, which will substantially follow the Corporate Governance Recommendations of the Thompson Report and will include the voluntary adoption of many of the provisions of Sarbanes-Oxley and the new NYSE listing requirements. Already the board has voted not to count the votes of directors on matters where those directors have a personal interest different from that of the company, and has voluntarily upgraded our annual disclosure of executive compensation related matters in our proxy statement to levels comparable to that of public companies.

Until the board can adopt fair procedures for providing our shareholders with liquidity, it is my position that the company's policy should be not to repurchase the stock of any shareholder, and particularly not the shares of any officer or director.

Finally, I serve as Chairman and CEO without compensation from ULLICO, though I do continue to receive my salary as President of the Laborers International Union. I intend to continue to serve as Chairman of ULLICO's board and to accept no salary from ULLICO. My intention is for the company to hire a financial services professional to serve as permanent CEO. I believe this arrangement to separate the Chairman and

CEO positions in the long-run will maximize accountability on the part of management to the board and the shareholders. In the short run a similar result is being accomplished by the separation of duties currently between myself and Edward Grebow, our Acting President.

Together, all these measures should place substantial obstacles in the path of any individual at ULLICO who would wish to act improperly at the expense of our company, its shareholders or its other constituents.

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