

IS THIS THE NEW ERA OF *CAREMARK* CLAIMS?

Compliance as the key corporate governance issue.



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What is a *Caremark* Claim?

- Duty of Oversight
- The *Caremark* Holding
 - Question: What is the board's responsibility with respect to the organization and monitoring of the enterprise to assure that the corporation functions within the law to achieve its purposes?
 - Plaintiffs must show:
 - The directors knew OR should have known that violations of the law were occurring, *and in either event*
 - The directors took no steps in a good faith effort to prevent or remedy the situation, and
 - Such failure proximately resulted in the losses complained of (though this last element may be thought to constitute an affirmative defense).
 - Application of the *Caremark* test.



Recent Changes in the Litigation of *Caremark* Claims – Section 220

Section 220

- Grants shareholders a qualified right to inspect the company's books and records.
- In recent years, the Delaware courts have liberalized its interpretation of 220 allowing a broader scope of internal documents to be provided to potential plaintiffs, thus easing the burden of meeting the *Caremark* standard



Recent Changes in the Litigation of *Caremark* Claims – *Merchand v. Barnhill*

Merchand v. Barnhill

- Listeria outbreak at Blue Bell ice cream
- Plaintiffs overcame a Motion to Dismiss by showing that the company had no system to monitor and report on listeria *despite* the board receiving risk reports from management generally
- Court noted that the fact that the board never discussed food safety indicated a possible utter failure of compliance.



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Recent Changes in the Litigation of *Caremark* Claims – *Clovis Oncology*

Clovis Oncology

- Allegations that the board in a monoline company “ignored multiple warning signs” of inaccurate reporting of its drug efficacy in violation of internal protocols and FDA regs with respect to a product that was “intrinsically critical to the [C]ompany’s business operation.”
- The Court held that a board’s oversight obligations are enhanced with respect to “mission critical” products while operating in a heavily regulated industry.



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Recent Changes in the Litigation of Caremark Claims – *Hughes v. Hu*

Hughes v. Hu

- Chinese auto parts company
- Company struggling to meet financial reporting requirements
- The Court allowed a claim to go forward where it found that “the trappings of oversight” such as the mere existence of audit committees and compliance departments were not sufficient to justify dismissal



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Recent Changes in the Litigation of *Caremark* Claims – *Teamsters Local 443 v. Chou*

Teamsters Local 443 v. Chou

- Breach of the duty of oversight claim against the board of AmerisourceBergen Company, based on allegations that the directors had ignored “red flags” of regulatory and operational non-compliance at a subsidiary, based, among other things, on the board’s failure to require updates and progress reports after the deficiencies were flagged.
- The board was alleged to have ignored a negative assessment from outside counsel regarding the company’s compliance program, a *qui tam* suit was presented to management but never reported to the board, and a DOJ subpoena and FDA search warrant were not discussed by the board.



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Recent Changes in the Litigation of *Caremark* Claims – *Inter-Marketing Group USA v. Armstrong*

Inter-Marketing Group USA v. Armstrong

- Allegations of an utter failure to implement or properly oversee a pipeline integrity reporting system, which resulted in a pipeline rupturing and spilling 3,400 barrels of oil into an environmentally sensitive part of the West Coast.
- In permitting the claim to proceed, the court gave significant weight to trial testimony of the company’s CEO in California criminal proceedings in which he testified that pipeline integrity was “not discussed at the board level.”



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WHAT DOES THIS ALL MEAN FOR BOARDS?

1. In 2021, boards of Delaware companies should expect that any significant negative event affecting the company will be followed by demands for books and records by stockholder plaintiffs, potentially followed by *Caremark* claims alleging that the board failed to exercise adequate oversight.
2. Boards should prepare for such claims by ensuring they (i) are kept reasonably informed of all material risks facing the company and (ii) make informed decisions about how the corporation should navigate significant risks.
3. As important, the board's formal records – including board minutes, board books and other centrally maintained files – should reflect, at a high level, all of the information the board receives and the decisions it makes so that courts are not left to evaluate the board's exercise of its oversight duties on an incomplete record.



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Kimberly E. Blair

Wilson Elser Moskowitz Edelman & Dicker LLP
55 West Monroe Street - Suite 3800
Chicago, IL 60603-5001
312.821.6139 (Direct)
312.259.6414 (Cell)
312.704.0550 (Main)
312.704.1522 (Fax)
kimberly.blair@wilsonelser.com



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