In Re Caremark International

698 A2d 959 (1996)

Facts:

The Court considered a motion pursuant to Chancery Rule 23.1, to approve as fair and reasonable a proposed settlement of a consolidated derivative action on behalf of Caremark International, Inc. ("Caremark").

The suit involves claims that the members of Caremark's board of directors (the "Board") breached their fiduciary duty of care to Caremark in connection with alleged violations by Caremark employees of federal and state laws and regulations applicable to health care providers.

Such suit arose from the fact that Defendant corporation, Caremark International, Inc., provides health care services and products to patients who are often referred to them by a physician. Since the business is reliant on referrals, there is a temptation by companies, such as Caremark, to compensate physicians.

A federal law, the Anti-Referral Payments Law ("ARPL") is in place to prevent such compensation, and in 1991 the Department of Health and Human Services began investigating Caremark for potential ARPL violations. The Department of Justice joined the investigation soon thereafter, and by 1992 Caremark instituted several new policies and procedures in attempt to find any internal wrongdoings.

In 1994, Caremark was indicted for violating the ARPL, and charged with multiple felonies.

It thereafter entered into a number of agreements with the Department of Justice and others.

Those agreements included a plea agreement in which Caremark pleaded guilty to a single felony of mail fraud and agreed to pay civil and criminal fines.

Subsequently, Caremark agreed to make reimbursements to various private and public parties. In all, the payments that Caremark has been required to make total approximately $ 250 million.

The shareholder derivative action suit was filed in 1994, purporting to seek on behalf of the company recovery of these losses from the individual defendants who constitute the board of directors of Caremark. Such suit alleged that the Board of Directors did not exercise the appropriate attention to this problem.

The parties now propose that it be settled and, after notice to Caremark shareholders, a hearing on the fairness of the proposal was held on August 16, 1996.

Question/Issue:

The issue is whether the Board of Directors of Caremark exercised an appropriate level of attention to the possibility of ARPL violations.

Decision:

Generally, where a claim of directorial liability for corporate loss is predicated upon ignorance of activities creating liability within the corporation, this will establish the lack of good faith that is a necessary condition to liability.

Such a test of liability -- lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight -- is quite high.

There was no evidence that the directors knew that there were ARPL violations under federal law, and there was no systemic or sustained failure to exercise oversight. Moreover, the terms of the settlement merely required Caremark to institute policies to further assist in monitoring for violations.

The Court further found that a demanding test of liability in the oversight context is probably beneficial to corporate shareholders, as a class, as it is in the board decision context, since it makes board service by qualified persons more likely, while continuing to act as a stimulus to good faith performance of duty by such directors.

As indicated above, the court stated that the record did not support the conclusion that defendants either lacked good faith in the exercise of their monitoring responsibilities or conscientiously permitted a known violation of law by the corporation to occur, and that the claims asserted against them had to be viewed as very weak.

A breach of duty to exercise appropriate attention, as the court noted, is more difficult for Plaintiffs to prove than a breach of the duty of loyalty. Most decisions that would come under this duty, will thereby resemble many decisions shielded by the business judgment rule.

Despite the weakness of plaintiffs' claims, the court concluded that the proposed settlement appeared to be an adequate, reasonable, and had a beneficial outcome for all parties. The Court thereby approved the settlement.