THE CONTINUED EVOLUTION OF CAREMARK OVERSIGHT LIABILITY

Date: 23 October 2024

US Litigation and Dispute Resolution Alert

By: Matthew B. Goeller, Kelly A. Terribile

In the last year, Delaware courts have issued several notable opinions that further define—and in some cases expand—the scope of liability for failures of oversight at a corporation. Claims by shareholders that one or more corporate directors (and now also corporate officers) breached their duty of oversight to the corporation are known as *Caremark* claims, named after the seminal Court of Chancery case *In re Caremark International Inc. Derivative Litigation*.[1] Under *Caremark* and its progeny, to plead a viable claim for breach of the duty of oversight, a plaintiff must allege sufficient facts to support a reasonable inference that a director (or corporate officer) (1) "utterly fail[ed] to implement any reporting or information system or controls," or (2) "having implemented such a system or controls, consciously fail[ed] to monitor or oversee its operations," which disabled them "from being informed of risks or problems requiring their attention."[2]

This pleading standard is high, and the Court of Chancery has noted a *Caremark* claim is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win judgment."[3] In recent years, however, the Delaware courts have sustained *Caremark* claims at the pleading stage, exposing corporate directors (and now, as discussed below, corporate officers) to a higher potential for liability.

THE EVOLVING LANDSCAPE: *COLLIS, CLEM, SEGWAY, AND CENTENE*

Below, we highlight the key facts and findings of four recent, notable *Caremark* litigation rulings.

Collis

In *Lebanon County Employees' Retirement Fund v. Collis*,[4] the Delaware Supreme Court reversed the Court of Chancery's dismissal of a *Caremark* claim that alleged that the directors and officers of AmerisourceBergen had breached their fiduciary duties of oversight through "bad faith failure to oversee [AmerisourceBergen's] compliance with laws governing the distribution of opioids."[5]

Because the plaintiffs sued derivatively, the complaint was subject to Court of Chancery Rule 23.1's special pleading requirements, which require a plaintiff to allege his efforts to obtain the action plaintiff sought from the directors (i.e., to make a demand on the board) or the reasons why plaintiff believed it would be futile to do so. Plaintiff chose the latter, and the defendants moved to dismiss the complaint for failure to adequately allege demand futility and for failure to state a claim.

At the Court of Chancery, Vice Chancellor J. Travis Laster reasoned that the *Caremark* allegations in plaintiffs' complaints—"identif[ying] over seventy examples of subpoenas, settlements, civil litigation, congressional reports, and analyses of regulatory risk that put the directors on notice of problems at the Company" and alleging that

©2005-2026 K&L Gates LLP. All Rights Reserved.

"defendants knew that some level of corrective action was required" but wanted to "save [corrective] measures to use as settlement currency when they could obtain a global release"[6]—*would* be sufficient to survive a motion to dismiss. The Court of Chancery dismissed the case, however, based on a decision by a West Virginia federal court, which had recently found that "no culpable acts by defendants caused an oversupply of opioids...."[7] Vice Chancellor Laster concluded that the federal court's findings were "not preclusive," but they were "persuasive."[8] Vice Chancellor Laster noted that the West Virginia court's findings "knock[ed] the stuffing out of the plaintiffs' claim[s]" and made it impossible to infer that a majority of the directors who were in office when the complaint was filed face a substantial likelihood of liability on the plaintiffs' claims, such that demand was not futile.[9] The Court of Chancery dismissed.

On appeal, the Delaware Supreme Court concluded that the Court of Chancery erred by taking judicial notice of factual findings made in the West Virginia decision under Delaware Rule of Evidence (DRE) 202. The Supreme Court reasoned that DRE 202 may be invoked for judicial notice of *findings of law* by other courts, such as recognizing rules or principles of law, but not for judicial notice of *fact findings*.[10] The Supreme Court thereafter evaluated whether the Court of Chancery could take judicial notice of the factual findings made in the West Virginia decision under DRE 201 and concluded that it could not "when the underlying fact is reasonably disputed." Because of the Court of Chancery's "misapplication of judicial notice" to the West Virginia decision, the Supreme Court determined that "reversal" of the Court of Chancery was "required, unless…the complaint fails to state a claim even if the West Virginia Decision is not considered."[11]

Ultimately, the Supreme Court agreed with the Court of Chancery that the complaint had adequately alleged a *Caremark* claim sufficient to survive a motion to dismiss at the plaintiff friendly pleading stage. In particular, the Supreme Court was "not moved by the defendants' handwringing claim that, if the Court of Chancery's analysis of the adequacy of the plaintiffs' pleading is allowed to stand, it will 'chill' companies' ability to defend lawsuits and attract directors," and saw "no reason why companies with meritorious defenses to lawsuits will not raise them with vigor and directors who heed their fiduciary duties will not continue to serve on the board of Delaware corporations."[12]

Segway

Caremark's momentum slowed that same month, however, in *Segway Inc. v. Hong Cai*.[13] In one of the first cases applying the *Caremark* standard to corporate officers, the Court of Chancery dismissed plaintiff's *Caremark* claim, holding that *Caremark* cannot be used to hold corporate officers accountable for everyday business problems.

After its acquisition in April of 2015, Segway's business began declining. Over the next few years, the company suffered layoffs and closed its corporate headquarters. Cai, hired by Segway in 2015 as vice president of finance, appointed as Segway's interim president in December 2015, reappointed as Segway's interim president in February 2017, and finally appointed as Segway's president in 2018, was terminated in 2020.[14] Segway filed suit against Cai asserting a *Caremark* claim that she breached her fiduciary duty of oversight to the company by "'consciously disregarding' certain financial discrepancies" and "'willfully ignor[ing]' problems within her areas of responsibility."[15]

Cai moved to dismiss. In its briefing, Segway appeared to the Court of Chancery to argue that "the high bar to plead a *Caremark* claim is lowered when the claim is brought against an officer." The court rejected this

©2005-2026 K&L Gates LLP. All Rights Reserved.

"distressing reading of our law"[16] and confirmed that the pleading standard for a *Caremark* claim is the same regardless of whether the claim is against a director or an officer. As the court explained, a *Caremark* claim:

> is intended to address the extraordinary case where fiduciaries' "utter failure" to implement an effective compliance system or "conscious disregard" of the law gives rise to a corporate trauma. These tenets of [Delaware] law persist regardless of whether a *Caremark* claim is brought against a director or an officer.[17]

The court further confirmed that "[d]espite a proliferation of modern jurisprudence, bad faith remains a necessary predicate to any *Caremark* claim" and dismissed the claim, finding that "Segway's attempt to hold a corporate officer accountable for unexceptional financial struggles flouts these enduring principles."[18]

The court concluded: "The *Caremark* doctrine is not a tool to hold fiduciaries liable for everyday business problems.... Officers' management of day-to-day matters does not make them guarantors of negative outcomes from imperfect business decisions."[19]

Clem

In *Clem v. Skinner*,[20] a Walgreens stockholder brought a derivative action against the company's directors and officers alleging they breached their duty of oversight in connection with the company's billing practices for a particular insulin pen product, which led to a government investigation and a whistleblower lawsuit.

The Court of Chancery dismissed the claims under Rule 23.1 for failure to allege demand futility. According to the court, the plaintiff's allegations demonstrated that Walgreens' board fulfilled its oversight duty by enacting a board-level monitoring system and by responding to red flags. Indeed, "[w]ithin months of learning about the whistleblower action," the company considered and remedied the problem through software changes. According to the court, the plaintiff's contention that the board's actions "came too late and did too little" was "incompatible with bad faith—a necessary component of any *Caremark* claim,"[21] "the court's role is not to second-guess a board's response to a red flag" and "[c]laims that quibble with the timing or success of corrective action necessarily fail."[22]

Notably, the court expressed concern about the uptick of *Caremark* suits, cautioning that "more harm than good comes about if *Caremark* claims are reflexively filed whenever a government investigation is announced, a class action lawsuit succeeds, or a big-dollar settlement is reached."[23]

Centene

Most recently, in *Bricklayers Pension Fund of Western Pennsylvania v. Brinkley*,[24] the Court of Chancery dismissed (on Chancery Court Rule 23.1 grounds) a *Caremark* claim brought against the company's directors and officers relating to the company's administration of Medicaid pharmaceutical benefits. Certain senior officers of the company had implemented a "cost reporting scheme" to manipulate the company's administration of Medicaid pharmaceutical benefits so that those officers could receive incentive payments. The scheme resulted in handsome incentive payments to these officers, but also violated applicable law and the company's subsidiaries'

©2005-2026 K&L Gates LLP. All Rights Reserved.

contracts with state Medicaid agencies,[25] ultimately resulting in settlements with Ohio for US$88.3 million, Mississippi for US$55.5 million, and 11 other states for an aggregate of US$596 million.[26]

Plaintiff did not argue that the company "lacked an adequate oversight framework on paper." Rather, plaintiff argued that the defendant directors knew the framework was inadequate because the compliance committee of the board of directors was repeatedly informed of the deficiencies in the health care compliance program and presumably shared that information with the remainder of the directors. The court rejected this argument, at least in part because the compliance committee was informed by management as to the specific measures being taken to address the deficiencies identified by the committee.[27]

Next, Plaintiff argued that the defendant directors ignored "red flags" relating to the "cost reporting scheme." The court explained that "[w]hether an event or report is a red flag depends on context" and "[t]he receipt of a subpoena or notice a lawsuit has been filed is not per se evidence that the company is engaged in ongoing wrongdoing."[28]

Plaintiff's alleged "red flags" included (1) a subpoena served on the company's auditor by the Ohio attorney general, (2) updates received by the directors relating to the company's continued "regulatory and legal scrutiny," and (3) updates concerning the regulatory investigations in Ohio and other states. Because "nothing in the record suggests that the directors knew of the subpoena's contents or the conduct the Ohio attorney general was investigating," the court concluded that the subpoena "could not have put the demand board on notice of any impending corporate trauma."[29] As to the regulatory and legal scrutiny and regulatory investigations, the court was unable to conclude that the defendant directors had sufficient detail to suspect a risk of "corporate trauma" and, in all events, the directors were informed that management was actively working to "mitigate exposure" and take "corrective action." Finally, the court found that plaintiff failed to demonstrate that the defendant directors "ignored that information in bad faith" or "failed to respond in bad faith," even assuming that "the added knowledge of a known faulty compliance system to knowledge of investigations, a subpoena, and regulatory scrutiny would put the Board on notice that [the company] was heading for major corporate trauma."[30]

TAKEAWAYS

In the last five years, more *Caremark* claims have survived dismissal than they did in the prior 23 years. Delaware's most recent decisions show that the scope of *Caremark* is still evolving. Delaware companies and their boards of directors should remain vigilant regarding their duties of oversight and sharpen their attention to the processes in place that can reduce the risks of *Caremark* litigation. This includes, by way of example, reviewing whether the necessary control processes are in place and evaluating whether there are sufficient resources and expertise to monitor these processes. Additionally, as always, companies are well served by a fulsome record documenting directors' and officers' efforts and oversight.

Our lawyers are pleased to discuss how these decisions impact our clients as they consider the risks that the current *Caremark* litigation landscape may pose to them. Regularly appearing before all Delaware trial and appellate courts, our litigators have practical insights that allow us to pursue the litigation strategy most aligned with our clients' business objectives and manage their corporate governance litigation risks.

©2005-2026 K&L Gates LLP. All Rights Reserved.

**This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

FOOTNOTES

[1] 698 A.2d 959 (Del. Ch. 1996).

[2] *See* Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006).

[3] Segway Inc. v. Cai, C.A. No. 2022-1110-LWW, 2023 WL 8643017, at *5 (Del. Ch. Dec. 14, 2023) (quoting *Caremark*, 698 A.2d at 967).

[4] 311 A.3d 773 (Del. 2023) [hereinafter *Collis II*].

[5] *Id*. at 780 (internal quotation marks omitted).

[6] Lebanon Cnty. Emps.' Ret. Fund v. Collis, C. A. 2021-1118-JTL, 2022 WL 17841215, at *16 (Del. Ch. Dec. 22, 2022).

[7] *Id*. at *13 (quoting City of Huntington v. AmerisourceBergen Drug Corp., 609 F. Supp. 3d 408, 423 (S.D. W. Va. 2022)).

[8] *Id*. at *17.

[9] *Id*.

[10] *Collis II*, 311 A.3d at 797.

[11] *Id*. at 802.

[12] *Id*. at 805.

[13] *Segway*, 2023 WL 8643017.

[14] *Id*. at *1–2.

[15] *Id*. at *4.

[16] *Id*. at *1.

[17] *Id*. at *5.

[18] *Id*. at *1.

[19] *Id*. at *5.

[20] C. A. 2021-0240-LWW, 2024 WL 668523 (Del. Ch. Feb. 19, 2024).

[21] *Id*. at *1.

[22] *Id*. at *8.

[23] *Id*. at *23.

[24] C.A. No. 2022-1118-MTZ, 2024 WL 3384823 (Del. Ch. July 12, 2024) [hereinafter *Centene*].

©2005-2026 K&L Gates LLP. All Rights Reserved.

[25] *Id*. at *3–4.

[26] *Id*. at *11.

[27] *Id.* at *14–15. The compliance committee met at least 15 times during the relevant period, "reported to the Board at each of its quarterly meetings," *id*. at *4, received "quarterly updates on the company's health plan compliance program evaluation" from the company's corporate compliance team, and "[a]t each meeting, the compliance committee was expressly informed of the specific measures management was taking or had taken to address" each deficiency in the company's health care compliance program identified for the committee, *id*. at *14.

[28] *Id*. at *16.

[29] *Id*. at *17.

[30] *Id*. at *19.

KEY CONTACTS



MATTHEW B. GOELLER
ASSOCIATE

WILMINGTON
+1.302.416.7082
MATTHEW.GOELLER@KLGATES.COM



KELLY A. TERRIBILE
PARTNER

WILMINGTON
+1.302.416.7036
KELLY.TERRIBILE@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.