Caremark Developments: Business Risk Versus *Massey* Claims

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> See page 5 for key points

Delaware case law recognizes that directors and officers owe a duty of oversight, and failure to adequately exercise such duty may result in liability. Such claims — known as "*Caremark* claims" after the seminal decision in *In re Caremark Int'l Inc.* (Del. Ch. Aug. 16, 1996) — have developed over the years, with stockholders asserting such claims derivatively on behalf of the corporation.

The Delaware Court of Chancery and Delaware Supreme Court have recognized that recently alleged *Caremark* claims tend to fall into two categories — claims alleging failure to properly oversee or monitor business risk and those alleging failure to oversee a corporation's affirmative violation of positive law. Regarding the business risk category, the Court of Chancery has recognized that "the *Caremark* doctrine is not a tool to hold fiduciaries liable for everyday business problems,"[1] and frequently dismisses claims seeking to hold fiduciaries liable either for ordinary business risks that did not turn out as planned or for financial struggles. However, for the second category of claims, the court has looked to the language of *In re Massey Energy*, which sustained *Caremark* claims and reiterated that "Delaware law does not charter law breakers." Referring to these as "*Massey* claims," the court has found that when there are "violations" of positive law such that it "supports a pleading-stage inference that management is operating an enterprise based on recidivous law breaking,"[2] the claims will survive.

Case Dismissals Based on Business Risk

The Court of Chancery has continued to dismiss claims it views as hindsight-motivated challenges to a board's response to ordinary business problems or business risks.

Walgreens:[3] The plaintiffs brought claims alleging breach of fiduciary duty by members of Walgreens' board after the board settled a lawsuit tied to an internal system's default billing practices for a single pharmaceutical product. Walgreens' internal system set the minimum dispensable quantity of insulin pens at five because the manufacturer put five pens in a single box. Thus, if a patient was prescribed fewer than five pens, the system required various levels of resubmission of claims which "prompted premature refill reminders and unnecessary refills for government health care program beneficiaries." A lawsuit was eventually filed regarding this practice and a Department of Justice (DOJ) civil investigation was initiated. The Walgreens board's Audit Committee met numerous times and communicated with the full board to discuss the lawsuit and the DOJ investigation. The board then required the internal system be adjusted to eliminate the default setting for minimum dispensable quantity and resolved both the lawsuit and investigation. Stockholders then sued derivatively, alleging oversight failures by the board in connection with the company's billing practices. In evaluating the motion to dismiss, the court noted many recent *Caremark* cases "fall outside the narrow confines of the *Caremark* doctrine. Fueled by hindsight bias, they seek to hold directors personally liable for imperfect efforts, operational struggles,

[1] *Segway Inc. v. Cai*, 2023 WL 8643017 (Del. Ch. Dec. 14, 2023).

[2] *In re Facebook, Inc. Derivative Litig.*, C.A. No. 2018-0307-JTL, Trans. at 4 (Del. Ch. May 10, 2023).

[3] *Clem v. Skinner*, 2024 WL 668523 (Del. Ch. Feb. 19, 2024).

business decisions, and even when the corporation is the victim of a crime. The present lawsuit is an unexceptional member of this broader group." The court dismissed the claim for failure to plead demand futility, emphasizing that "[t]he Board was required to exercise good faith oversight — not to employ a system to the plaintiffs' liking." The court also noted that as soon as problems with the company's insulin billing became apparent, "information was conveyed to the Board" and it addressed the problems swiftly and appropriately. In sum, the court found that the plaintiffs simply sought to "hold the Board accountable for not addressing a government overbilling practice sooner," which is insufficient to sustain a *Caremark* claim.

Segway Inc. v. Cai:[4] The plaintiff, Segway Inc., brought claims against its former president, Judy Cai, alleging that she breached her duty of oversight. Specifically, Segway pointed to accounting discrepancies that showed an excess of $5 million in accounts receivable that were improperly recorded or booked. Segway argued that "Cai should be held liable for failing to address these [accounts receivables] matters or advise the board about them." The court found "[t]hese allegations are an ill fit for a *Caremark* claim." Segway could point to no actual wrongdoing by Ms. Cai, but "merely asserts that Cai learned (at some point) about 'issues'" with the accounts receivable. "Such generic financial matters are far from the sort of red flags that could give rise to *Caremark* liability if deliberately ignored," the court reasoned, noting as well that "[b]ad things can happen to corporations despite fiduciaries exercising the utmost good faith." The court reiterated that "[l]iability can only attach in the rare case where fiduciaries knowingly disregarding this oversight obligation and trauma ensures. Despite a proliferation of modern jurisprudence, bad faith remains a necessary predicate to any *Caremark* claim. Segway's attempt to hold a corporate officer accountable for unexceptional financial struggles flouts these enduring principles." The court thus dismissed Segway's claim.

In re ProAssurance Corp.:[5] The plaintiffs alleged that the board of ProAssurance, a holding company for property and casualty insurance companies, breached its oversight duties after ProAssurance announced that its loss reserves were inadequate. At the outset, the court noted that "[t]hese events, quite obviously, involve a commercial decision that went poorly — the stuff that business judgment is made of" while cautioning that "[o]versight claims should be reserved for extreme events." The court noted that "[i]nsurance underwriting is, by its very nature, uncertain and risky" and the plaintiffs' "conflation of a bad business outcome with 'bad faith on the part of the Board' necessarily fails." The plaintiffs argued that the board "engaged in bad faith by ignoring risks associated" with new large accounts, but the court reasoned that "[e]valuating business risk is 'the quintessential board function.'" While *Caremark* claims may be tenable in the context of violations of positive law, the court noted that "[b]usiness risks are shades of gray" such that "even if one could envision 'an extreme hypothetical' where the failure to monitor business risk could yield director oversight liability, a showing of bad faith would be a prerequisite." The court dismissed the complaint for failure to plead demand futility, explaining that "[t]his hindsight second-guessing of a business decision that turned out poorly cannot reasonably support an inference of bad faith."

[4] *Segway Inc. v. Cai*, 2023 WL 8643017 (Del. Ch. Dec. 14, 2023).

[5] *In re ProAssurance Corp. S'holder Derivative Litig.*, 2023 WL 6426294 (Del. Ch. Oct. 2, 2023).

Cases That Survived Dismissal

The Court of Chancery and Delaware Supreme Court have sustained *Caremark* claims where the plaintiffs alleged persistent violations of positive law (*Massey* claims).

In re Facebook:[6] The plaintiffs alleged that Facebook had previously agreed to a settlement with the Federal Trade Commission that required the company to end illegal privacy practices. Among other things, the settlement required Facebook to implement procedures reasonably designed to ensure that covered information could not be accessed by third parties from servers under Facebook's control. The complaint alleged that, rather than comply with the decree, the company enacted a policy of monetizing user data by providing partners with access to such data. The court found that there were a "string of red flags that were readily apparent, particularly to insiders like the directors, that related to Facebook's practices." The court additionally held that the complaint "tells a story of directors who were on notice of the law breaking, and who either affirmatively went along with it or consciously disregarded it," and that it was not "isolated" or "immaterial violations," but rather "alleged wrongdoing on a truly colossal scale." The court noted that this was not simply a case involving business risk, and cautioned that "you cannot take legal risk on the theory that we are violating the law, but it's not likely to come back to haunt us." Thus, the court held the plaintiffs stated a claim regarding the defendant's failures of oversight for "knowingly violating the consent order."

AmerisourceBergen:[7] AmerisourceBergen, a major wholesale distributor of opioid pain medication, was sued derivatively stockholders of the company. The plaintiffs alleged that AmerisourceBergen's directors and officers failed to "adopt, implement, or oversee reasonable policies and practices to prevent the unlawful distribution of opioids, and repeatedly failing to act when undeniable evidence of widespread illegal opioid sales emerged." As a result, the plaintiffs alleged that the company suffered "billions of dollars of fines and harms." The Court of Chancery held that the plaintiffs pleaded a viable *Caremark* claim; namely, there was an inference that the "[d]efendants knew that AmerisourceBergen was reporting astoundingly low levels of suspicious orders … and went through the motions of providing oversight while consciously deciding not to take any action." However, the Court of Chancery dismissed the complaint, taking judicial notice of an opinion from a West Virginia court issued after the complaint was filed that found that the company's anti-drug diversion controls were legally compliant. The Court of Chancery therefore held it was unlikely that the plaintiffs' claims posed a substantial threat of liability and demand was therefore not excused. On appeal, the Delaware Supreme Court reversed, finding the Court of Chancery erred in using judicial notice to "effectively adopt the factual findings of another court." The Delaware Supreme Court reiterated the plaintiffs' allegations that "the AmerisourceBergen board, having fostered a 'culture of non-compliance,' was complicit in the Company's evasion of its obligation to monitor orders so as to reduce the likelihood that opioids would be diverted for non-medical use, in violation of the Controlled Substances Act." Additionally, the Delaware

[6] *In re Facebook, Inc. Derivative Litig.*, C.A. No. 2018-0307-JTL, Trans. at 4 (Del. Ch. May 10, 2023).

[7] *Lebanon Cnty. Emps.' Ret. Fund v. Collis*, 311 A.3d 773 (Del. 2023).

Supreme Court noted that "[t]his theory draws its support from former Chief Justice, then Vice-Chancellor Strine's oft-quoted affirmation in *In re Massey Energy Co.*, that 'Delaware law does not charter law breakers' and was dubbed a '*Massey* Theory' or '*Massey* Claim' by the Vice Chancellor here." Since the Delaware Supreme Court "agree[d] with the Court of Chancery's evaluation of the complaint's *Caremark* claims as well-pleaded" and "reject[ed] the court's negation of that assessment in light of the West Virginia Decision," the Delaware Supreme Court reversed the Court of Chancery's dismissal of the complaint and remanded for further proceedings.

Walmart:[8] The plaintiff asserted several derivative claims against Walmart's directors and officers in connection with the company's operations of pharmacies that dispensed prescription opioids and prior acts as a wholesale distributor of prescription opioids. The plaintiffs alleged that "the directors and officers of Walmart breached their fiduciary duties to the corporation and its stockholders by (i) knowingly causing Walmart to fail to comply with a settlement between the U.S. Drug Enforcement Agency (DEA) and Walmart (the DEA Settlement), (ii) knowingly causing Walmart to fail to comply with its obligations under the federal Controlled Substances Act and its implementing regulations (collectively, the Controlled Substances Act) when acting as a dispenser of opioids through its retail pharmacies, and (iii) knowingly causing Walmart to fail to comply with its obligations under the Controlled Substances Act when acting as a wholesale distributor of opioids for its retail pharmacies." One of those claims — the *Massey* claim — was that "Walmart's directors and officers knew that Walmart was failing to comply with its legal obligations and made a conscious decision to prioritize profits over compliance." The court noted that a "*Massey* Claim looks for or implies an affirmative decision to violate the law, which is similarly a decision to act in bad faith." The court also stated that "[a] strong pattern of conduct can support an inference that the corporate fiduciaries intentionally decided to cause the corporation to violate the law, typically because the costs and other burdens associated with compliance would cut into profits. 'The inference that corporate fiduciaries made a decision to violate the law is the foundation for a *Massey* Claim.'" In light of these findings, the court held that the plaintiffs stated a viable claim regarding compliance with Walmart's DEA settlement because the "pleading-stage record supports an inference that the directors … consciously chose not to take action to achieve compliance [with the DEA settlement]." Thus, the court held that the "pleading-stage record also points to a motive for the conscious decision not to devote more resources to compliance" because "[d]evoting more resources to achieving compliance with the DEA Settlement would have cost money and undercut [other] initiatives." The court also sustained the derivative claims relating to Walmart's compliance with its obligations as a dispenser under the Controlled Substances Act, but found that the plaintiffs did not adequately plead that the demand was excused with respect to claims relating to the company's compliance with its obligations as a distributor under the act.

[8] *Ontario Provincial Council of Carpenters' Pension Trust Fund v. Walton*, 2023 WL 3093500 (Del. Ch. Apr. 26, 2023).

Key Points

Over the past several years, *Caremark* claims have tended to fall into two categories — those alleging harms to the corporation based on "business risk" and those alleging harm to the corporation based on affirmative violations of positive law (*i.e.*, *Massey* claims). The court carefully examines *Caremark* claims. While there have been recent *Massey* claims that have survived dismissal, the Court of Chancery has reiterated that "[l]iability can only attach in the rare case where fiduciaries knowingly disregard [their] oversight obligation and trauma ensues. Despite a proliferation of modern jurisprudence, bad faith remains a necessary predicate to any *Caremark* claim."

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