

August 31, 2020

Caremark, Inspection Demands, and Board Record-Keeping:  
Emerging Risks and Solutions for Oversight and Duty-to-Monitor Claims

For the third time in a year, the Delaware Court of Chancery last week [sustained a complaint alleging a board's failure of duty](#) to monitor material legal and regulatory risk under the *Caremark* doctrine. A stockholder plaintiff can state a *Caremark* claim only by pleading facts showing that directors “utterly failed” to monitor such risks or knowingly failed to respond to “red flags” indicating employee conduct that exposes the company to liability. For this reason, *Caremark* claims were historically the most difficult stockholder claims to plead, and lawsuits alleging *Caremark* violations rarely survived a motion to dismiss.

Since last summer, however, [when the Delaware Supreme Court reversed a trial court order dismissing a Caremark complaint](#), there has been a surge in *Caremark* filings—and in their rate of survival past the pleadings stage. Each of the complaints that has recently withstood a pleadings motion alleged egregious facts and relied heavily on documents produced to the stockholder plaintiff pursuant to a books-and-records inspection demand. In last week’s decision, for example, the defendant directors were alleged to have knowingly permitted a long-running “criminal enterprise” that generated corporate profits from the illegal and dangerous sale of non-sterile cancer treatment drugs to unsuspecting patients. Whether these allegations can be proven remains to be seen. But most stockholder suits take on substantial settlement value in discovery, regardless of their ultimate evidentiary merit, because of the asymmetrical costs of the litigation.

[Caremark liability nevertheless remains rare and preventable](#). As discussed in our recent publication, [Risk Management and the Board of Directors](#), boards should adopt procedures ensuring suitable director attention to enterprise-level legal risks—and redouble their efforts to ensure that minutes and other board documents reflect that attention. Last week’s decision suggests that board materials showing mere director “review” of red flags, when “tangible action” is called for, may not suffice to defeat a *Caremark* pleading. Rare indeed is the public company board that fails to take action to mitigate material legal risks. But it is becoming increasingly important for directors to not only take that action, but also to contemporaneously document that action in board records.

William Savitt  
Ryan A. McLeod  
Anitha Reddy

*If your address changes or if you do not wish to continue receiving these memos,  
please send an e-mail to [Publications@wlrk.com](mailto:Publications@wlrk.com) or call 212-403-1443.*