Review of Compliance

Compliance Programs Have Real Value

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A recent decision of the Delaware Chancery Court recognizes the value of having a compliance program in place (1). In a suit brought by certain shareholders of Caremark International, Inc. seeking to require the members of the company's Board of Directors to reimburse the \$250 million paid by Caremark to settle allegations of criminal violations of various provisions of the Medicare anti-fraud and abuse laws, the court dismissed the case on the grounds that the directors had performed their duties properly and cited the implementation of a compliance program as evidence of those efforts.

The suit alleged that members of the Caremark Board breached their fiduciary duty of care in connection with purported violations by Caremark employees of both federal and state laws pertaining to health care providers. Specifically, Caremark was under investigation by various federal and state agencies for entering into arrangements which purportedly violated regulations prohibiting health care providers from paying any form of remuneration to induce the referral of Medicare or Medicaid patients. Caremark had a practice of entering into contracts with physicians, some of whom prescribed or recommended services or products that Caremark provided to Medicare patients. These payments raised issues as to possible illegal kickbacks. After extended investigations and negotiations, Caremark agreed to settle the claims by paying a \$250 million fine along with other requirements.

The court found that Caremark's Board had made prudent efforts to assure compliance with company policies prohibiting violations of rules. The record in the case sup-

ported the company's position that the Board had implemented several programs which were designed to educate employees as to the company's commitment to abide by all pertinent rules and regulations as well as establishing an internal audit process designed to assure compliance. After reviewing the legal precedents applicable, Judge Allen observed:

...I am of the view that a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may...render a director liable for losses caused by noncompliance with applicable legal standards (2).

To establish a *prima facie* case, the court ruled:

In order to show that the Caremark directors breached their duty of care by failing adequately to control Caremark's employees, plaintiffs would have to show either (1) that the directors knew or (2) should have known that violations of law were occurring and, in either event, (3) that the directors took no steps in a good faith effort to prevent or remedy that situation, and (4) that such failure proximately resulted in the losses complained of...(3)

Following a detailed review of the entire record, Judge Allen dismissed the complaint and held:

...[I]n my opinion only a sustained or systematic failure of the board to exercise oversight such as

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an utter failure to attempt to assure a reasonable information and reporting system exists will establish the lack of good faith that is a necessary condition to liability. Such a test of liability for lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight is quite high...

Here the record supplies essentially no evidence that the director defendants were guilty of a sustained failure to exercise their oversight function. To the contrary, insofar as I am able to tell...[Caremark's] information systems appear to have represented a good faith attempt to be informed of relevant facts. If the directors did not know the specifics of the activities that lead to the indictments, they cannot be faulted (4).

Due to the recognition afforded to decisions of the Delaware Chancery Court, the ruling in the Caremark case will likely establish that any health care provider would be well-advised to implement an effective compliance program. The effort by the board in the Caremark case relieved the directors from any personal liability for repaying the \$250 million paid by the company in settlement.

Endnotes

1. *In re Caremark International, Inc. Derivative Litigation*, Civil Action No. 13670, Delaware Chancery Court (New Castle), September 25, 1996.
2. *Id.* at 39.
3. *Id.* at 40.
4. *Id.* at 42.