

Caremark

AUG. 12. 1994

3:18PM

CAREMARK LAW GROUP

No. 5473

P. 5/10

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

-----X
CAROLE FRIEDMAN,

Plaintiff,

- against -

JAMES G. CONNELLY, III, RAYMOND D. ODDI, PETER F. WHITTINGTON, BLAINE J. YARRINGTON, IRA J. HARRIS, RALPH W. MULLER, C.A. LANCE PICCOLO, KENNETH W. PONTIKES, NANCY G. BRIDGER, VINCENT A. CALABRO, ROGER L. BRADRICK, THOMAS W. HODSON, and PHILLIP B. ROONEY

Defendants,

and CAREMARK INTERNATIONAL INC.,

Nominal Defendant.
-----X

DERIVATIVE COMPLAINT

Civil Action No. 13670

REGISTERED IN CHANCERY
PROCEEDING OF CAROLE FRIEDMAN

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FILED

Plaintiff, by her attorneys, alleges upon information and belief, except as to the allegations which pertain to plaintiff, which are alleged upon knowledge, as follows:

INTRODUCTION

1. This is a shareholder derivative action brought on behalf of and in the right of Caremark International Inc. ("Caremark" or the "Company") for injuries suffered by Caremark as a result of breaches of the fiduciary and other duties owed to it by the defendants.

AUG. 10. 1994 3:18PM CAREMARK LAW GROUP

No. 8473 F. 13/13

2. The derivative claims arise out of a pervasive and systematic course of conduct involving violations of federal Medicaid and Medicare insurance laws, and associated gross mismanagement, waste of corporate assets, and breaches of fiduciary duty, which have caused Caremark (along with certain officers of the Company) to be investigated and indicted by federal authorities. The indictment relates to illegal kickbacks of over \$1.1 million paid by Caremark to a physician in violation of federal law prohibiting payment of remuneration to induce the referral of Medicare and Medicaid beneficiaries, and covers the period between 1986 and early 1994. Federal investigations of additional wrongdoing are continuing and additional indictments are anticipated shortly. As a result of these indictments, Caremark faces the loss of millions of dollars from criminal penalties, civil restitution (including treble damages) and lost business resulting from possible exclusion from Medicare and Medicaid programs (which accounted for 14% of the Company's 1993 revenues).

THE PARTIES

3. Plaintiff Carole Friedman was at the time of the transactions and events complained of and is still a shareholder of Caremark.

4. Caremark is a Delaware corporation engaged in the business of providing alternative site health care services, including infusion therapy, growth hormone therapy, and hemophilia

AUG. 12. 1994 3:19PM CAREMARK LAW GROUP

No. 8473 P. 7/12

therapy. The Company is based in Northbrook, Illinois, but provides services in numerous locations in the United States and overseas. In fiscal 1993, Caremark's total revenues were approximately \$1.78 billion. According to the Company's Form 10-K for the fiscal year ended December 31, 1993, approximately 14% of the Company's revenues were directly attributable to Medicare and Medicaid patients.

5. Caremark was incorporated in August 1992 as a wholly-owned subsidiary of Baxter International, Inc. ("Baxter"). On November 30, 1992, Baxter distributed to holders of its common stock all of the outstanding shares of common stock of Caremark, together with preferred stock purchase rights.

6. Defendants C. A. Lance Piccolo, James G. Connolly, III, and Thomas W. Hodson are collectively referred to as the "Officer/Director Defendants." Defendant Piccolo has been Chairman of the Board and Chief Executive Officer of Caremark since August 1992. Defendant Connolly has been President and Chief Operating Officer of Caremark since August 1992. Defendant Hodson has been a Senior Vice President and Chief Financial Officer of Caremark since August 1992. Defendants Piccolo, Connolly and Hodson have all been directors of Caremark since 1992.

7. In its Proxy Statement dated March 22, 1994, the Company noted that its "pay philosophy" for executives emphasizes

AUG. 10. 1994 3:19PM CAREMARK LAW GROUP

No. 8473 P. 8/12

"pay-for-performance" incentives with compensation based in part upon pre-tax earnings growth. Each of the Officer/Directors holds options to purchase Caremark stock and restricted performance stock subject to, among other factors, annual performance-based vesting conditions. The Officer/Director Defendants, concerned only with increasing the Company's short term earnings -- and thereby maximizing their incentive bonuses and the value of their stock options -- failed to exercise proper supervision and control over the Company's operations and practices and directed, encouraged, concealed and/or ratified the unlawful practices that are fully described herein below.

8. Defendants Oddi, Whittington, Yarrington, Harris, Muller, Pontikas, Calarco, Headrick and Rooney are and have been directors of Caremark since 1992. Defendant Krinker has been a director since 1993. Defendants Oddi, Whittington, Yarrington, Harris, Muller, Pontikas, Calarco, Headrick and Rooney are collectively referred to as the Non-Officer Directors.

9. Pursuant to the Caremark International Inc. 1992 Stock Option Plan for Non-Employee Directors, each non-employee director receives, in lieu of one-third of their annual retainer of \$33,000, an option to purchase shares of Caremark common stock. The Non-Officer Directors may elect to receive options in lieu of all or a portion of the remaining two-thirds of their retainer and, according to the Company's 1994 Proxy Statement, all of the directors had elected to receive all of their compensation through the date of the annual meeting of stockholders in 1993 in the form

AUG 10 1994 3:19PM CAREMARK LAW GROUP

No. 8473 E. 9/13

of options. As such, the Non-Officer Directors also had a strong incentive to encourage short term earnings.

10. The Officer/Director Defendants and Non-Officer Directors are jointly referred to as the Director Defendants.

OPERATIVE FACTS

11. Defendants' gross mismanagement, waste of corporate assets and associated breaches of fiduciary duty with respect to its operations have pervaded the Company's business. There has been a pattern of illegal conduct involving payments to physicians and hospitals by Caremark officers and employees in violation of federal laws prohibiting payment of remuneration to induce the referral of Medicare and Medicaid beneficiaries. This conduct has resulted in an indictment being brought against the Company, as well as the likelihood of additional indictments resulting from ongoing federal investigations, which could result in millions of dollars in losses from criminal fines, civil restitution, and lost revenues from the possible exclusion from participation in the Medicare and Medicaid programs.

12. In August of 1991, prior to the Company's incorporation and the distribution of its securities to Baxter shareholders, Caremark (formerly a unit of Baxter) was notified that the Office of the Inspector General of the Department of Health and Human Services ("OIG") and the U.S. Department of

AUG. 12. 1994 3:22PM CAREMARK LAW GROUP

No. 8473 P. 12/13

Justice, subsequently with grand jury participation, were investigating Caremark to determine whether the Company's fee-for-service and other arrangements with physicians and hospitals in connection with infusion therapy services violated federal laws prohibiting payment of remuneration to induce the referral of Medicare and Medicaid beneficiaries.

19. Defendants were aware that violation of these laws could result in criminal fines and civil penalties, including exclusion from participation in the Medicare and Medicaid programs. Furthermore, as defendants disclosed in their Form 10-K for the fiscal year ended December 31, 1992, defendants were aware that imposition of these penalties could have a materially adverse effect on the Company's business. The Company's Form 10-K for the fiscal year ended December 31, 1993, states that approximately 14% of the Company's \$1.783 billion dollars in net revenues in 1993 were directly attributed to Medicare and Medicaid patients and that "there can be no assurance that exclusion from these programs would not adversely affect Caremark's ability to attract and retain non-Medicare and Medicaid business." Additionally, as also revealed in the Form 10-K, exclusion from Medicare or Medicaid programs and/or an indictment which has not been dismissed within a 90-day period were events which would be an event of default under the Company's \$150 million bank credit agreement (although no borrowings were outstanding as of December 31, 1993 under the facility).

Aug. 10, 1994 3:20PM CAREMARK LAW GROUP

No. 8473 P. 100/10

14. Although following notification of the government investigation in 1991, Caremark publicly asserted that it was curbing its practice of making payments to doctors for Medicare and Medicaid patients, the Company was recently indicted for illegal payments based on conduct between 1986 and early 1994. Thus, despite their knowledge of the ongoing investigation and the dire consequences which could result, defendants failed to stop the pattern of illegal conduct by Caremark officers and employees, which conduct continued at least until early 1994.

15. On August 4, 1994, a grand jury in Minneapolis indicted Caremark vice presidents James R. Mieszala and Joseph L. Herring, and a former general manager, Judy F. Giel. Also indicted were Edmon R. Jennings, vice president for sales and marketing of Genentech, Inc., and Dr. David R. Brown. The fifty-one count indictment charged that Caremark, Mieszala, Herring, Giel and Jennings conspired to pay over \$1.1 million in kickbacks to Brown to induce him to prescribe a synthetic growth hormone produced by Genentech. The indictment was based on conduct between 1986 and 1994.

16. In addition to the Minneapolis indictment, an article in The Wall Street Journal on August 4, 1994 disclosed that federal investigators were scrutinizing doctors in Columbus, Ohio, and that an additional indictment could come within the next few weeks with respect to regular payoffs by Caremark to a physician

AUG. 12. 1984 3:21PM CAREMARK LAW GROUP

No. 8473 E. 12/83

there. The article further noted that investigators were planning to interview between 100 and 120 doctors who allegedly received large payments from Caremark. Additionally, the article revealed that federal authorities foresee pursuing possible civil restitution (including possible treble damages). The article also noted that the Minneapolis matter is believed to be separate from another investigation involving a Caremark joint venture at the University of Minnesota Hospital. Finally, the article indicated that activities being investigated took place after Caremark was spun-off from Baxter by indicating that "some of the activities under investigation took place while Caremark was part of Baxter."

**DUTIES AND OBLIGATIONS OF
OFFICERS AND DIRECTORS**

17. Each Director Defendant owed to the Company and to its shareholders the duty to exercise due care and diligence in the management and administration of the affairs of Caremark and in the use and preservation of its property and assets.

18. To discharge these duties, each Director Defendant was required to exercise reasonable and prudent supervision over the management, policies, practices, controls and financial affairs of Caremark, and to insure that the Company seeks recompense from those responsible for prior and current wrongs done to it. By virtue of this obligation of due care and diligence, defendants were required, among other duties and obligations:

(a) To manage, conduct, supervise and direct the

Aug. 10. 1994 3:21PM CAREMARK LAW GROUP

No. 8473 P. 13/13

employees, business, and affairs of Caremark, in accordance with State and federal laws and regulations, and the charters, regulations, rules, and by-laws of the Company;

(b) To exercise reasonable control and supervision over the officers, employees and agents of Caremark;

(c) To ensure the prudence and soundness of the policies and practices undertaken or proposed to be undertaken by Caremark;

(d) To remain informed as to how Caremark was, in fact, operating and, upon receiving notice or information of an imprudent or unsound decision, condition, or practice, to make a reasonable investigation in connection therewith and to take steps to correct that decision, condition, or practice; and

(e) To conduct the affairs of the Company in an efficient business-like manner so as to make it possible to provide the highest quality performance of its business and to thereby maximize the profits to the stockholders.

19. By reason of their positions and because of their ability to control the business and corporate affairs of Caremark at all relevant times, the Director Defendants owed to the Company and to its stockholders, fiduciary obligations of fidelity, trust, loyalty, and due care, and were and are required to control the Company in a fair, just and equitable manner, and to act in furtherance of the best interests of the Company and its stockholders.

AUG. 17. 1994 3:22PM CAREMARK LAW GROUP

No. 8473 P. 14/18

20. The Director Defendants breached their fiduciary duties by, among other things:

(a) failing to supervise adequately the operations of Caremark in a manner consistent with preventing the institutionalization of improper and unlawful practices;

(b) failing to supervise adequately the employees and managers of Caremark and failing to instruct them to act with honesty and integrity in order to preserve and enhance Caremark's reputation in the business community;

(c) failing to take action to correct the improper practices complained of herein, and/or concealing, directing and/or encouraging such practices;

(d) recklessly exposing Caremark to millions of dollars of losses, including the loss of future business opportunities as a result of their failure to supervise adequately Caremark operations and employees, and failure to correct (and/or direction and/or concealment and/or encouragement of) the Company's improper practices and the resulting risk to its financial condition; and

(e) failing to institute legal action against those officers, directors and employees responsible for permitting Caremark to engage in the improper practices delineated above and thereby exposing the Company to financial injury resulting therefrom.

AUG. 10. 1994

3:22PM

CAREMARK LAW GROUP

No. 8473

P. 12/13

ALLEGATIONS REGARDING DEMAND

21. Under the circumstances, demand is excused and is inevitably futile, for at least the following reasons:

(a) The Director Defendants, who are presently all of the members of the Board of Directors, have for some time been aware of the wrongs forming the basis for the claims alleged herein and the materiality of such wrongs (as evidenced by the Company's filings with the Securities and Exchange Commission that were required to be signed by the Director Defendants, in which the Company disclosed the federal investigations alleged herein and the material adverse effect of penalties which could be imposed if the conduct was allowed to continue), but have chosen not to protect Caremark or seek to recover amounts due to it and have failed to take action with respect to these claims because any such action would require them to sue themselves, their friends, and their business associates. Prior to the wrongs alleged herein, the Director Defendants also knew (or should have known) of the egregious conduct on the part of Caremark's officers but either affirmatively approved of or acquiesced to such acts.

(b) The Director Defendants participated in, acquiesced in and/or approved the wrongs alleged herein and did so in affirmative violation of their duties to Caremark and its stockholders and have permitted the wrongs alleged and/or have remained inactive although they have long had knowledge of those wrongs. The Director Defendants therefore participated in a long-term continuing course of corporate misconduct and mismanagement.

Aug. 10. 1994 3:22PM CAREMARK LAW GROUP

No. 8473 P. 13/19

(c) Because of their participation in the mismanagement of Caremark, the Director Defendants are in no position to prosecute this action. Each of them is in an irreconcilable conflict of interest regarding the prosecution of this action, and cannot exercise the requisite independence to make good faith business judgments.

(d) The Director Defendants cannot defend their actions by any alleged "independent" business judgment since each of them is responsible for the wrongs alleged, has acted with gross negligence, and would have a personal pecuniary interest adversely affected if an action were brought, since each would be required to sue himself.

(e) The directors of Caremark cannot defend their actions by any alleged "independent" business judgment in seeking to have this action dismissed or by not bringing this action against themselves and their business associates, because it would undoubtedly be to the benefit of Caremark and the detriment of the Defendant Directors to recover the damages caused by the defendants and to assert these derivative claims.

**AS AND FOR A FIRST CAUSE OF
ACTION FOR BREACH OF FIDUCIARY
DUTY AGAINST ALL DEFENDANTS**

22. Plaintiffs hereby incorporate by reference paragraphs 1 through 21, supra, as if fully set forth herein.

AUG. 10. 1994 3:23PM CAREMARK LAW GROUP

No. 8473 P. 17/18

23. Each of the defendants, individually or jointly, as herein alleged, committed one or more of the acts or omissions to act, which constituted waste of corporate assets, mismanagement, gross negligence and violations of their fiduciary duties.

24. As a direct and proximate result of defendants' failures to exercise due care in the performance of their duties, as alleged herein, Caremark has engaged in imprudent and unlawful activities, all of which have caused risk of significant losses to Caremark.

25. The Company was further injured by the waste of valuable corporate assets and loss of goodwill and business opportunities that were proximately caused by the defendants' misconduct.

26. By reason of defendants' misconduct as set forth above, Caremark has suffered damages, in an amount not presently determinable but which is expected to be in the millions of dollars.

**AS AND FOR A SECOND CAUSE OF ACTION FOR
GROSS NEGLIGENCE AGAINST ALL DEFENDANTS**

27. Plaintiffs hereby incorporate by reference paragraphs 1 through 26, SUPRA, as if fully set forth herein.

AUG. 12. 1994 3:23PM CAREMARK LAW GROUP

No. 8473 P. 18/19

28. Each of the defendants committed one or more acts of gross negligence in the conduct of the Company's business. Defendants, as officers and/or directors of Caremark owed Caremark duties of care in the performance of their duties. Each defendant breached his duty of care to Caremark by acting in a grossly negligent fashion in the performance of such duty.

29. Caremark has been seriously and irreparably damaged by the wrongs alleged herein.

30. As to both causes of action, plaintiffs have no adequate remedy at law.

WHEREFORE, plaintiffs demand judgment as follows:

A. Against each defendant and in favor of the Company for the amount of damages sustained by the Company as a result of the breaches of fiduciary duty by each defendant;

B. Against all defendants and in favor of the Company for damages sustained as a result of their gross negligence;

C. Awarding to plaintiffs the costs and disbursements of this action, including reasonable attorneys' fees, accountants' and experts' fees, costs and expenses; and

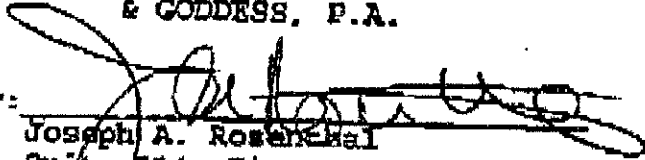
AUG. 10. 1994 3:24PM CAREMARK LAW GROUP

No. 8473 P. 19/19

D. Granting such other and further relief as the Court may deem just and proper.

Dated: August 5, 1994

ROSENTHAL, MONHAIT, GROSS & GODDESS, P.A.

By: 
Joseph A. Rosenthal
Suite 214, First Federal Plaza
Wilmington, DE 19899
(302) 656-4433

Attorneys for Plaintiffs

OF COUNSEL:

BERGER & MONTAGUE, P.C.
1622 Locust Street
Philadelphia, PA 19103
(215) 875-3000

LOWEY, DANNENBERG, BEMPORAD & SELINGER, P.C.
747 Third Avenue
New York, NY 10017
(212) 759-1804

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