Case: Caremark
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Interviewer: John Marc Zeberkiewicz Richards, Layton & Finger
Interviewee: Kenneth Jon Nachbar, Morris, Nichols, Arsht & Tunnell

Zeberkiewicz: So Ken, before we get started talking about the Chancery Court's landmark opinion in Caremark, let me get a little bit of background on your position at Morris Nichols, who you were representing, where you were in the firm at that time?

Nachbar: Sure. So the case was 1996, I believe. I had joined the firm in 1981. I was a partner in 1989. So I was a relatively young partner, but a couple of years under my belt as partner. And you know, it was a time when I was beginning to have my own clients and develop my own practice.

Zeberkiewicz: So do you remember when the call came in, how it came in, where it came from? How did you get involved?

Nachbar: I don't. Probably at that time it probably came through somebody else, you know, being the young partner. It was probably something that came from Lew Black or Gil Sparks or somebody like that. But I don't remember.

Zeberkiewicz: But you were a lead on the case?

Nachbar: I was a lead on the case.

Zeberkiewicz: That must have been pretty exciting. Now when the case first came in, was this a case that you recognized right off the bat as unique or was it just another case that was similar to any derivative case that you had on your docket?

Nachbar: A little of each. You know, the company had been found to have engaged in some pretty serious wrongdoing. It pled guilty to criminal counts, it paid a lot of money, I mean, you know, 325 million dollars, I think it was. It's a lot of money now, it was a lot more money then. So it was you know, we knew that it was a significant issue for the company. And when you're in that situation, you know, there's two sides to every story. But it's a pretty big indicator that something was amiss. Sometimes there's an innocent explanation, sometimes it's less innocent. But it was certainly a big headline number.

Zeberkiewicz: [00:02:17] And do you remember who was representing the plaintiffs?

Nachbar: Joe Rosenthal locally. And then he had some outside counsel, I think, Goodkind, Labaton at the time. And Lowey Dannenberg,

Zeberkiewicz: And who was leading the charge for the plaintiffs? Was it mostly Joe Rosenthal, or Labaton, also involved?

Nachbar: I think it was... I mean, locally, in the procedural fronts here, I think Joe was handling most of that. But I think talking about the substance and the negotiations that led the settlement, I think that was primarily the Labaton folks.

Zeberkiewicz: Got it. And anything about that particular firm that influenced your strategy, your defense strategy, or...

Nachbar: No. I mean, they were a firm that you know, it's a little bit different now, I guess you have firms like Stuart Grant and Joel Friedlander, who everybody knows is not afraid to try a case. They'll take them to trial, they seem to like taking them to trial. I think back then most of the plaintiffs firms... I mean, they would take a case to trial if they had to, but they did prefer to settle cases and settlements were, you know, almost all the... you won't see a lot of reported decisions from plaintiffs cases going to trial back then. It was not unheard of. There are certainly some, but you know, there were a lot of preliminary injunctions, not that many trials. So they were somebody, you know, I think everybody [00:04:00] knew that if you made a reasonable settlement offer, they'd be certainly willing to listen.

Zeberkiewicz: So put us in the context of 1995-96 and that framework where there was at least some expectation that a settlement was likely if not expected. Who makes the first bid? Is that the defense side? Speaking not in connection of Caremark, but just speaking generally. How do those discussions arise back in that era?

Nachbar: Yeah, I mean, usually it's the plaintiffs who's going to make the first bid. But that doesn't mean that they necessarily initiate the settlement discussions. A lot of times the defendants might reach out and say, you know, we're all going to incur a lot of cost for you plaintiff, once we've sunk the cost, the defense cost in, we're never getting them back. And at that point, we may as well go to trial. But before we incur all that cost, maybe you guys want to make a settlement offer. Or maybe they would, you know, the plaintiffs would do the approach. But somebody's gotta open that dialogue. And I don't think it's necessarily different from today. You know, it's still who wants to be the first one to broach settlement? You know, sometimes it's perceived as a sign of weakness. So nobody wants to be the first... But if somebody doesn't say anything about settlement, the talks never begin. So you know, typically, it's more often the plaintiffs, but not always.

Zeberkiewicz: Can you speak to the tenor of the discussions? You know, in that time frame. Were folks generally, and this is broad generalizations. But generally, can they be courteous professionals? Were there particular firms that were more aggressive than others? Any general observations that you would have from that era?

Nachbar: Sure. Yeah, I mean, back then, you know, I guess there's a feeling that monopolies aren't a good thing, but sometimes they are a good thing. And Joe Rosenthal had maybe not a monopoly, but probably a ninety percent market share in doing the plaintiff's work. And he did a great service not only to the plaintiffs bar, but to the defendants' bar and to the state generally because he was respected by everybody, particularly the plaintiff's bar. And when they would have disputes over lead counsel and who's got which role, they would come to Joe and he would you know, sort of mediate those disputes. And they all got resolved. And so you know, we have all these lead counsel fights. We almost never had them back then because they would all just go to Joe. And they had so much respect for him that whatever he decided was the law. And that's how those things got resolved.

Zeberkiewicz: The plaintiffs bar?

Nachbar: Yeah. No, he absolutely was the godfather. And you know, I mean, for a guy named Rosenthal you wouldn't think of him as the godfather, but you know, he served that role in the plaintiffs bar.

Zeberkiewicz: That's incredible. So now I want to move into just kind of the context in which Caremark was operating at the time. So you mentioned that they had been under investigation by the Department of Health and Human Services [00:07:28] also the Department of Justice. Can you give us a little bit of a sense of what did the nature of the allegations were at issue, and how Caremark had dealt with them generally?

Nachbar: Sure. And it's sort of interesting because so it was basically in the home infusion business where human growth hormone and other types of therapies would be infused at patients' homes. And the claims were that there were illegal kickbacks or payments for referrals, which under Medicare and Medicaid were impermissible. So there were allegations that that had happened on a sort of large scale. But what's interesting is Caremark was spun off from another company, and a lot of the conduct was pre-spin off. So it was sort of on somebody else's watch. But you know, Caremark was the successor and they specifically, I believe in the spin off, were assigned those liabilities. And so they were kind of stuck with them for better or worse. And it was their operations. I mean it's not like you know, these were strangers who had done this. It was the same core team who had been at the predecessor Baxter and then became Caremark.

Zeberkiewicz: And so post spin, we've got a situation where the board is, you know, named in a lawsuit in Delaware. Were they surprised at all to be named in a derivative suit, or at that point had they been so accustomed to being named as defendants or having the company named as a defendant in a lawsuit that it was no great shakes?

Nachbar: I don't think they were surprised. You know, the company obviously there was a pretty long onramp to this litigation, there was an investigation that spanned a few years.

There were steps taken along the way to address some of the practices. There's sort of a series of cascading remedial steps that ultimately led up to the settlement with the government and the guilty plea, and pretty much simultaneously a settlement with the plaintiff. So as all those things are developing I think the board understands that there's some pretty high likelihood that the other shoe is going to drop, and the other shoe being a derivative lawsuit.

Zeberkiewicz: Now your recollection of that board, is it relatively modern public company board in a sense that it's composed of independent directors? Meaning non-management types?

Nachbar: Yes. I mean there were management, more management people as I recall on the board then you would see today. I mean, you know, it's gotten to the point today where you know, a lot of times the only management member is the CEO or sometimes you have the CEO and maybe the CFO or somebody like that but the rest are outsiders. I think back then it was more common to have two, three, four members of management on the board. And I think probably for spun off companies, that's probably more of the case, although I haven't done a numerical examination. But that's sort of my sense.

Zeberkiewicz: [00:11:01] That's sort of the impression. And of the outsiders, any sense as to whether they were kind of active and engaged outsiders? I imagine that they had to be to some extent in dealing with all of the litigation?

Nachbar: Yeah, I think they were, you know, I wasn't there before any of this happened, so I don't know how engaged they were. And I guess somebody could say well then maybe if they were more engaged things would have unfolded differently. But you know, once the possibility of a criminal investigation and a criminal indictment comes up, that sort of focuses people's attention. So they were definitely engaged, as I said, there were a series of steps that were taken to essentially terminate some of these programs that were causing the problems, and eventually to get out of the home infusion business and ultimately to sell the business.

Zeberkiewicz: So Caremark's one of these cases that have, like you know, Revlon, Unocal or now MFW or Corwin, kind of stands for a broad proposition of law. And I think it's fair to say that it had a pretty significant impact on the development of the law, particularly governance and oversight. But Caremark, the company that you were representing, what was operating essentially from a legal standpoint in a pre-Caremark (italicize) [00:12:36] environment. What if anything were they doing in terms of putting in place, monitoring, policies procedures, relative to their peers at the time? Did you have any impressions or thoughts on that?

Nachbar: Yeah I mean they... What's interesting when you go back and re-read the opinion is they had pretty robust systems in place, and that's why Chancellor Allen found that the claims were, I think he said exceedingly weak or words to that effect. Because you know,

they did have an audit committee that was monitoring these types of things. They did get reports from both inside and outside counsel. They were fully aware of the legal regulations. They knew that some of the things that they were doing had been questioned and perhaps were questionable. But they got legal advice that they were on the right side of the law in terms of the programs that they were doing. And to just expand a little bit, I mean, it's a little bit, so you can't get money for referrals in Medicare and Medicaid. Outside of Medicare and Medicaid there weren't regulations, so I guess you could, although some people might say it was unethical. But sort of where is the line like obviously if you say ok, I'll pay you five hundred dollars for every patient they refer, that's pretty clearly a payment for referral. But if you're paying a doctor to give a seminar and that doctor refers patients, you know, where is that on the spectrum?

Zeberkiewicz: At what point is it specifically [00:14:28 crosstalk]

Nachbar: Yeah, and if you're doing research grants. You know, so there's a whole range of activities that is sort of normal things that a company like Caremark might do. And where you've crossed the line is at least was thought to be at that time a little bit of a grey area. A lot of a grey area. And they got legal advice and were told that they were in compliance with the law, and that while allegations had been made, that didn't mean the allegations were correct. And so what they were doing, they were told, was proper.

Zeberkiewicz: I'm wondering your reaction to how their systems stacked up against companies of similar size, nature of operations at that time, and then maybe compare it to how things stack up today?

Nachbar: I think their systems were actually pretty robust as I've said. I mean you know, we've seen a lot of instances where companies you know, have gotten into trouble. Obviously, we see the trauma, we see the ones where people pled guilty or some environmental problem or safety problem has happened. And so we tend to see the pathology. But a lot of times you know, the systems aren't as robust as you know, maybe with the benefit of hindsight you'd like them to be. These were pretty robust. I mean, you know, the board was monitoring this and they knew it was going on, and you know, this isn't like “I had no idea that this type of marketing was happening.” This was “we knew it was happening, we asked the questions, we got legal advice, we were told it was proper.” And I think their systems actually stack up pretty well compared to systems today.

Zeberkiewicz: So I'm getting down to some of the more granular legal issues. And I want to go back to what the landscape of the common law looked like at that time. First and foremost, the nature of the claims - essentially, breach of the duty of care?

Nachbar: Yes. You know, there's good faith as well, I suppose, which I suppose is a brand of breach of duty of loyalty. But there was no allegations that any of the directors were making

money from these alleged kickbacks. It's rather that there was a deliberate agreement to engage in wrongdoing and/or a failure of a duty to monitor.

Zeberkiewicz: And the company indeed had included in its certificate of incorporation of provision under section 102(b)(7) and the BGCL to explicate its directors.

Nachbar: As did everybody post Van Gorkhom. So it's 102(b)(7)

Zeberkiewicz: We're looking at a company that has a 102(b)(7)exculpatory clause. And we're looking at essentially care claims maybe with a good faith flavor to them at that time it was not as clear as it is now become a good faith was a component of duty of loyalty, you still had cases talking about the triad of duties: care, good faith, and loyalty. But you're looking essentially at care claims, a company that has a 102(b)(7) provision, these are not, these are outside directors... What did you perceive to be the strength of the plaintiff's claims? And it's a long winded question but I want to get to in light of what the case law was like for that time. In terms of in particular Graham v. Allis Chalmers. [00:18:20] And so if you could just maybe reflect on those points broadly, I want to get your reaction at the time, how you were looking at this case?

Nachbar: Yeah, no we thought there were very weak, very weak claims. Now, you know, the problem is there's a lot of money at stake. So if you're saying the plaintiffs have a really small chance, a five percent or ten percent chance, it's still a five percent chance at three hundred plus million dollars. So that's a big check for somebody to write. And I don't recall what people's D&O insurance was in the particular case, but I'm guessing it wasn't 325 million dollars. So you know, it's a small likelihood that have a really catastrophic event. Plus Caremark had really, by the time of the settlement, had cleaned up its act. It had stopped the programs that were arguably compensating physicians. It actually stopped taking new home infusion customers, I think in 1993, two years before the settlement. And it eventually sold that whole division to a third party. So they were exiting the business, and my sense was that they just wanted to put this behind them. They wanted to clean it up and they didn't want to be litigating this even if they thought they had a very strong likelihood of prevailing. So a settlement made sense for them.

Zeberkiewicz: The law at the time was, you know, I referred to it as pretty director favorable.

Nachbar: It was very director favorable.

Zeberkiewicz: In the sense of you know, directors were not expected to engage in corporate espionage, wrongdoing.

Nachbar: So Allis Chalmers used those terms and said you know, basically, unless there were red flags sort of waving in the director's face, they couldn't be liable and they weren't

required to, as you say, install espionage systems to ferret out wrongdoing if they had no suspicion that something was amiss. You know, the Chancellor was sort of diplomatic in discussing that 1963 case, you know, thirty some odd years later, he sort of said well they didn't really mean that and they wouldn't have really said that today. And they probably wouldn't even have said it then. Sort of unfortunate words. [00:21:08] You know, they may have been unfortunate words, but there were a lot of defendants who wrote a lot of briefs saying we don't have to put in systems to ferret out, you know, wrongdoing.

Zeberkiewicz: Exactly. And I guess one question I have is in light of the legal framework... and I completely understand the prospect of a massive liability, it would certainly focus anyone's attention. But was there any contention on the Caremark side of the V in terms of whether to settle, whether to move forward with the litigation on the merits, or was it mostly everybody rowing in the same direction?

Nachbar: Oh I think everybody was rowing in the same direction. I wasn't involved in the guilty plea. My guess is that the guilty plea, you know, was a lot more, if there was controversy, there may have been not, but if there was controversy, it was probably around the guilty plea and the terms of the guilty plea. The settlement was, you know, putting in place some corporate therapeutics that were frankly already mostly in place and paying some attorneys fees. And I don't think that was a hard decision.

Zeberkiewicz: So the settlement was negotiated and reached fairly quickly. And I think it was, you know, around 1995 it all wrapped up for I think a month. Is it normal for a settlement to be up that quickly?

Nachbar: Yeah I think it was a little bit longer than that. I think it was sort of a May to July thing. But still that's two months, it wasn't six months. Yeah, we've seen this subsequently. Again, it tends to be in my experience, then and today, it's really the settlement with the government and you know, are we going to plead guilty to a felony count? To a misdemeanor count? It's just going to be a civil penalty. You know, are we talking about 100 million, 300 million? What are we talking about prospectively, those things tend to be you know, very important when you're talking about a lot of money [00:23:33] at stake. I think once you've put that behind you and once you've sort of crossed that Rubicon, the settlement of the derivative case is not necessarily easy. But it's relatively smaller compared to the overall liability. And a lot of times you have securities cases as well that need to be resolved as part of the group. So it's not the derivative case and the underlying wrongdoing, a lot of times there's a securities case that needs to be resolved. And you try to, you know, once people wrap them all up, they want to wrap up everything.

Zeberkiewicz: So you kind of suggested a lot of the compensation that the company provided in the settlement kind of ice in the winter, nature to it. It was we will agree to put in these therapeutic provisions, we'll have committees that honor these things, we won't let anybody

break the law, etc, etc. I mean really was not a huge con--there was nothing as I would categorize as a huge concession on the part of the company, Do you remember whether there was anything that the plaintiffs had asked for that the company said no way?

Nachbar: I don't remember. It wouldn't be uncommon. And again, I don't think this has changed the way it typically works is when the plaintiffs want to settle, they'll give you a list of demands that's sort of ludicrous. But it's like any negotiation, right? If you ask for the sun, the moon, the stars, and maybe you'll get a small planet somewhere. So I don't remember specifically, but I wouldn't be surprised if they had a list of thirty items that went from the sensible, you know, all the way on to the absurd. [00:25:35] And you know, we said no to the absurd and yes to the sensible, it's typically how it works. I don't remember specifically in the Caremark case.

Zeberkiewicz: Now did you have any thought that perhaps that wasn't enough, what the company was giving to get the settlement approved or any thoughts on that side?

Nachbar: No, really didn't. This is an area where the law has changed. I think the seminal case goes back to the Graham v. Alllis Chalmers and Rome v. Archer, I think it was a 1964 case, so it's the same a year later. I hope that one has better legs than Allis Chalmers had because Rome v. Archer says look, we favor settlements and they're good for society, and they're what we want. Now, you know, disclosure-only settlements, that's a different subject for a different time. And obviously there had been abuses, but this was not a disclosure-only settlement. I think we all felt that these were not strong claims. [00:26:54] that the settlement was very likely to be approved because there was real consideration. I mean obviously if there were some fantastic claim and you know, the board had never reporting in place and there was a real, you know, what we now know as a viable Caremark claim, and we were settling it for, you know, something that wasn't real, it would be a problem. But you know, it's funny, what was put in place was very good consideration. It was you know, an independent committee with outside directors that would function on these issues going forward, and you know, four meetings a year and reports from management. That's all great corporate governance. The only reason it wasn't good consideration in the Caremark case is it already existed. But that's the exact reason why it was such a weak claim. I mean if none of that existed you'd have a much stronger claim, but you could do the exact same settlement and say this is a real benefit to the company cause it had nothing before and now you know, everything that's in this settlement is new. Very little was new in the settlement, but that's exactly why the claims were so weak.

Zeberkiewicz: At any point in the case up until the time that you actually saw the opinion, did you have any inkling that this was going to become you know, a case that's synonymous with [00:28:30] a legal proposition?

Nachbar: I wish I could take credit for any part of that but the short answer is no, we you know, the people on the defense side, you know, we all thought this was just another settlement. It was going to get approved, you know. Back then I think there were opinions in most cases, so we figured there'd be an opinion, but we figured there'd be five or ten pages talking about the background facts. And the claims were weak and the settlement consideration is sufficient, and an award of attorney's fees and that would be that. I don't think anybody on our side of the v. had any inkling that this was going to be a landmark case.

Zeberkiewicz: So the court finds that the consideration is not so robust but also finds that the claims are incredibly weak so the consideration matches the [00:29:28 cough] strength of the claims. Nevertheless, takes an opportunity to write an opinion that sends a very clear signal about the need for having monitoring and compliance systems in place. Any thought as to why the court... and this is pure speculation on your part, but why the court uses this particular case as a vehicle for that message?

Nachbar: Yeah I think it was something that was probably on Chancellor Allen's mind, but I think in particular when you look back at it... I mean, I have my own theory, I've heard other theories, but number one, I think he understood that Graham v. Allis Chalmers was not really very good law, and that it's sort of almost a little bit embarrassing for the state of Delaware, frankly, that, you know, corporate espionage to ferret out wrongdoing, that can't be the standard. So I think he wanted to fix that. I also think that you know, you look at a case and if you're a judge how do you write the opinion in this case, knowing that you want to do something with Graham v. Allis Chalmers. So you go ok that can't be the standard, but I can't just say that, I have to have a different standard. I have to propose something. You can't just tear it down. And plus he's got to justify the settlement here. [00:31:03] So he says look Graham v. Allis Chalmers, that's bad law, we shouldn't really do that. We have to have more robust systems. He still had to justify the settlement in this case, and he's got to, you know, to do that. I mean, I think he thought that the board here hadn't really done anything wrong. And I think anybody looking at this case today would say that, that you know, some unfortunate things happened, but you know, if anything perhaps they got some bad legal advice. But you know, what do we want boards to do? We want boards to consult with lawyers, to listen to their advice and follow their advice. And that's what this board did, inside and outside counsel. And they were aware, as I said, that there were some grey areas. But they were told they were on the right side of those areas. And by and large they were. I mean there were a couple of doctors. I mean, this was a nationwide program with you know, hundreds, maybe thousands of physicians. And certainly thousands of home infusion sites. And you know, when you look at what they actually got charged with it's a doctor in Minnesota, a doctor in Ohio. It's, you know, you can make the argument that they were by and large on the right side of the line. You can also say well really, why'd they pay three hundred twenty-five million dollars? Fair question. My only point is they did what boards are supposed to do. So I think the Chancellor in writing an opinion wanted to say that this board really didn't do anything wrong. [00:32:46] And so he was, I think looking for what is the right standard if we're

going to replace Allis Chalmers, what are we going to replace it with? And he seized on the sentencing guidelines, which I think was very clever on his part, and it sort of typical of Bill Allen, because one of the things that I always admired about him is he sort of has this you know, he understands the particular case and the equities of a particular case, but he also sees where it fits into the entire framework of Delaware law and sort of societal values more generally. And so, you know, it's obviously an opinion that stood the test of time and has served Delaware very well. And for good reason.

Zeberkiewicz: And then, did you recognize when you first read the opinion that it was going to have a long term impact and that it did represent a fundamental shift? Or was it thank God my clients are out and this is approved?

Nachbar: No we wanted our clients to be out and our settlement approved, so that part, you know, we always read opinions, you know, you probably do in cases you're involved with when there's an opinion. You turn to the back, you see what the result is, and then you turn to the front and see why. And so we turned to the back and we saw approved, and that was you know, not unexpected. And there were no objectors, I don't think, so that's also an unobjected settlement is probably going to be approved in any event. And then, you know, reading, I think yes, we all were like wow, this is great, why didn't we think of this. Sort of that type of reaction. But yeah, I think we knew that this was an important decision as soon as we read it. And obviously it's something that the Chancellor thought about greatly. It may have been something on his mind before he even wrote the opinion. I suspect it was. [00:34:41] But it was certainly you know, fully formed and very very well thought out. And we knew that it was going to be an important decision going forward.

Zeberkiewicz: [00:34:55] Corporate lawyers are great mimics, whether they're litigators, transactional guys, advisory folks. Did you see an uptick in Caremark claims after this?

Nachbar: I don't think so. You know, Allis Chalmers was a somewhat impossible standard for the plaintiff's bar. But you know, Caremark still sets the bar pretty high for plaintiffs to overcome the protections of Caremark. I mean, you know, I think Chancellor Allen says it, that these are going to be difficult claims to establish. I can't remember the exact words he uses, but you know, it's going to be the rare case. And I think subsequently, cases have said Caremark claims are among the hardest to plead and prove. And that's proved to be the case, but there certainly have been Caremark claims that have survived motions to dismiss. And I'm sure they'll be more.

Zeberkiewicz: In the immediate aftermath did you get any calls from general counsel, you know, lead directors, chairman, saying hey we need to get you in here to guide us as to what types of policies, procedures, we should have in place?

Nachbar: Yeah, I think there probably were some. I don't think there was a groundswell. But and you know, I am not somebody who, a, fairly young, and b, somebody not generally doing corporate advice or work. So I didn't get those calls. But what I did get is you know, when people, when there were derivative suits, you know, sort of having your name on the Caremark opinion was not a bad thing.

Zeberkiewicz: Exactly right. What was your client's reaction? Were they just happy to be done with it?

Nachbar: Yeah, and again, I don't think they expected anything different. [00:37:03] This was a pretty solid settlement as I said, we thought we had very good defenses. So I don't think there was a great deal of concern that somehow the settlement was not going to get approved. There were no objectors and so that all... you know, that all leads to an expectation that's going to be approved.

Zeberkiewicz: No second guy saying no, the court said it was so weak we should have just gone with the board.

Nachbar: No, I don't think so at all. And again, I don't remember the details, but my guess is that the attorneys fees were not paid by the individual defendants but were rather paid by a D&O insurer or somebody.

Zeberkiewicz: That would be my guess as well. Any other observations about your time or experience in this case? Anything you want to add?

Nachbar: No, I think you've done a good job of covering it and bringing up the high points.

Zeberkiewicz: Very good. Well I appreciate the time.

[00:38:21 end of tape]