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Delaware Court of Chancery Again Sustains Oversight Claims

Posted by William Savitt, Ryan A. McLeod, and Anitha Reddy, Wachtell, Lipton, Rosen & Katz, on Saturday, October 5, 2019

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Editor's Note: William Savitt, Ryan A. McLeod and Anitha Reddy are partners at Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton memorandum by Mr. Savitt, Mr. McLeod, and Ms. Reddy and is part of the Delaware law series; links to other posts in the series are available here.

Further extending the practical reach of the *Caremark* doctrine, the Delaware Court of Chancery this week upheld claims against directors of a life sciences firm for failing to ensure accurate reporting of drug trial results. ***In re Clovis Oncology, Inc. Derivative Litig.*, C.A. No. 2017-0222-JRS (Del. Ch. Oct. 1, 2019)**.

Clovis's stock dropped sharply in 2015 when it disclosed poor clinical trial results for its most promising experimental cancer drug. Federal securities actions challenging the company's previous disclosures about the drug and a related SEC investigation followed, and were settled. Stockholders then brought a derivative action alleging that the board breached its fiduciary duties by disregarding "red flags" that reports of the drug's performance in clinical trials were inflated.

The Court of Chancery recognized that the board had implemented robust reporting procedures regarding drug development and regularly received reports of the new drug's progress in clinical testing. Crediting allegations that the directors ignored "warning signs that management was inaccurately reporting [the drug's] efficacy," however, the court nevertheless sustained the claims. The Clovis directors argued, and the court accepted, that duty-to-monitor claims require a showing of *scienter*—that is, evidence that the directors knew they were violating their duties. But the court did not require the plaintiff to allege particular facts showing such knowledge. Instead, reasoning that Clovis had a board "comprised of experts" and "operates in a highly regulated industry," the court concluded that the directors "should have understood" the problem and intervened to fix it. Also notably, the "corporate trauma" alleged here was a stock drop upon the announcement of bad news for the company's financial expectations—the typical stuff of federal securities claims—rather than corporate liability for public-facing corporate crimes or torts that are more often the basis of duty-to-monitor claims.

Clovis thus highlights the widening risk to boards of directors of fiduciary litigation when bad news can be tied to an alleged compliance failure. **As we recently noted**, a compliance program is no longer enough. Courts now look for engaged board oversight, and directors should consider implementing procedures to ensure that the board itself monitors "mission critical" corporate risks.

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