CADWALADER

Quorum
Insights Into Corporate Governance, M&A and Securities Law

Delaware Court of Chancery Sustains Caremark Claims in Shareholder Derivative Action

By **Jared Stanisci**
Partner | Global Litigation

By **Douglas Mo**
Associate | Global Litigation

In a recent decision, *Brewer v. Turner, et al.*,[1] Chancellor Kathaleen McCormick largely denied Regions Financial Corporation's ("Regions")[2] motion to dismiss a shareholder derivative action, which sought to recover $191 million Regions paid pursuant to a Consent Order, that found Regions utilized unlawful overdraft fee practices. Plaintiff principally alleged that the individual defendants "failed to timely establish a system of oversight to monitor compliance and allowed Regions' overdraft policies" to persist unlawfully.[3] Most notably, the court determined that a draft whistleblower complaint penned by Regions' former deputy general counsel qualified as a "red flag." The decision is a good reminder for companies not to neglect detailed whistleblower complaints, especially from high-level employees with legal compliance duties. To avoid potential *Caremark* liability, a board that receives a "red flag" – information putting directors on notice of misconduct and illegality or insufficiency of internal controls – should take affirmative steps to promptly end those practices.

Background

The Consumer Financial Protection Bureau ("CFPB") has enforcement power under the Consumer Financial Protection Act of 2010, which bars deceptive overdraft practices by banks. In 2018, Regions created a working group to evaluate its overdraft practices. In 2019, the Regions board received a draft whistleblower complaint from its former deputy general counsel. The whistleblower complaint alleged, *inter alia*, that Regions terminated him for identifying Regions' unlawful overdraft practice. In particular, the whistleblower complaint laid out Regions' "history of violating laws and regulations related to overdraft fees,"[4] asserted that the author attempted to persuade Regions to cease charging the unlawful overdraft fees as early as March 2019, and indicated that Regions executives intentionally avoided addressing the unlawful overdraft practices due to concerns that doing so could impact revenue. Regions and the former deputy general counsel reached a confidential settlement. In response to the whistleblower complaint, Regions retained a law firm to review its overdraft practices. In December 2019, the law firm wrote a memorandum to the Audit Committee of Regions' board of directors setting forth its conclusions.

In September 2020, the CFPB served a Civil Investigative Demand on Regions with respect to its overdraft practices. Regions thereafter stipulated to a Consent Order, which was entered on September 28, 2022.[5] In a summary of its investigative findings, the CFPB said that Regions ran afoul of the Consumer Financial Protection Act of 2010 and other statutes and regulations by utilizing deceptive "unintelligible and manipulative processes" to charge consumers over a hundred million dollars in overdraft fees to accounts with adequate funds. As part of its settlement with the CFPB, Regions paid a $50 million monetary penalty and approximately $141 million to affected customers.

In October 2022, plaintiff lodged a books and records demand on Regions pursuant to Section 220 of the Delaware General Corporation Law. In response, Regions produced nearly 20,000 pages of documents. In December 2023, plaintiff, who held Regions stock continuously since 1999, brought a derivative action on behalf

of Regions and Regions Bank. Plaintiff asserted claims for breach of fiduciary duty under *Caremark* and *Massey* against the director defendants and claims for breach of fiduciary duty against the officer defendants. Defendants moved to dismiss the complaint under (i) Rule 23.1 for failure to plead demand futility and (ii) Rule 12(b)(6) for failure to state a claim.

The Court of Chancery's Decision

As to demand futility, the court applied the test from *United Food & Com. Workers Union & Participating Food Indus. Empls. Tri-State Pension Fund v. Zuckerberg*, 250 A.3d 862 (Del. Ch. 2020), *aff'd*, 262 A.3d 1034 (Del. 2021).[6] Plaintiff alleged that nine of the 14 demand board members (who sat on the board when the complaint was filed) face a substantial likelihood of liability from the asserted claims, and therefore, demand was futile.[7]

The court focused its analysis on plaintiff's *Caremark* claims, which it viewed as the strongest. As the court reminded readers and the parties, *Caremark* claims seek "to hold directors accountable for a corporate trauma" where the directors knew or should have known about the risk leading to the trauma. To state a *Caremark* director oversight liability cause of action, a plaintiff must allege particularized facts demonstrating (1) that "the directors utterly failed to implement any reporting or information system or controls" or (2) "having implemented such a system or controls, consciously failed to monitor or oversee its obligations thus disabling themselves from being informed of risks or problems requiring their attention [*i.e.*, the red flags theory]."[8] "In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations."[9] The court focused its analysis on plaintiff's red flags theory of *Caremark* liability because it found that both the documentary evidence and the complaint demonstrated that Regions had an information system regarding its overdraft policies and procedures.

Plaintiff alleged that Regions unlawfully charged overdraft fees on transactions that had an adequate balance at the time of authorization but then later settled with an inadequate balance. Plaintiff also alleged the board ignored clear warnings that Regions' overdraft policies were unlawful. Strikingly, the court characterized the whistleblower complaint as the "most powerful red flag."[10] Despite the fact that the whistleblower complaint's author also accused Regions of employment discrimination and Regions characterized him as someone who "creates problems," the court viewed the whistleblower complaint as credible and exhaustive, placing particular emphasis on the whistleblower's role at Regions as an in-house attorney. Furthermore, the whistleblower complaint, *inter alia*, pointed out that charging overdraft fees "on an authorized signature-based point-of-sale transaction that settles into a negative balance" violated the Federal Trade Commission Act.[11] According to the court, "[g]iven its contents, it is reasonably conceivable that the . . . [c]omplaint alerted the Board to the illegal nature of Regions' overdraft fee practice."[12] In the court's estimation, "had the Board cut off illegal overdraft practices when it received the [whistleblower] [c]omplaint, then Regions could have mitigated the damages paid under or avoided the 2022 Consent Order altogether."[13]

As to whether the board failed to act in good faith in response to the red flag, the court reasoned that while "[h]iring counsel to advise regulatory risk is a good thing," "[m]erely hiring an attorney in response to a red flag, therefore, does not provide the absolution Defendants seek."[14] The court rejected defendants' argument that the board responded to the red flags but just not on plaintiff's preferred timeline. According to the court: "Consciously delaying actions that a Board knows to be illegal supports an inference of bad faith."[15]

The court held that plaintiff sufficiently alleged that nine of 14 board members faced a substantial likelihood of liability for ignoring red flags about Regions' overdraft practices between 2018 and 2021.[16] As a consequence, the court maintained that demand was excused as futile, stating that it is "reasonably conceivable that [the relevant board members] are incapable of impartially considering a demand to pursue Plaintiff's *Caremark* claims."[17] The court held that four directors who had left the board before the complaint was filed but after

the whistleblower complaint came to light could also face *Caremark* liability. However, the court granted defendants' motion to dismiss as to the directors who (i) left the board before receiving the whistleblower complaint and (ii) joined the board after the alleged wrongdoing ended.

Takeaways

The court's decision largely to deny defendants' motion to dismiss is consistent with a recent trend in Delaware with respect to *Caremark* claims. Although *Caremark* claims are typically understood as "the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment,"[18] Delaware courts—in the last couple of years—have sustained *Caremark* claims at the pleading stage in numerous cases.[19]

Still, it is notable that the court found a whistleblower complaint to be a red flag at the pleading stage, particularly where the director defendants engaged counsel to review the claims in the letter. While the court observed that defendants made "good points" in arguing that the whistleblower complaint's author had an axe to grind (*i.e.*, the whistleblowing claims "were mixed in with unusual allegations of reverse gender discrimination"[20]), it ultimately concluded that plaintiff's red flags theory was successful because the whistleblower letter came from former in-house counsel. Moreover, it is noteworthy that the court viewed the board's delay—terminating its practices nearly two years after the law firm's report—in acting on the whistleblower complaint as exemplifying bad faith. In previous *Caremark* cases, courts have declared that a board's response to red flags ought not to be second-guessed.[21] This decision demonstrates that there are limits to that principle.

Companies should take note that unreasonable delay in responding to red flags and ending unlawful practices can potentially expose directors and officers to *Caremark* liability. And merely hiring attorneys will also not cut it; a board should take care to proactively follow-up on the attorneys' findings and take steps to address them.

[1] C.A. No. 2023-1284-KSJM, 2025 WL 2769895 (Del. Ch. Sept. 29, 2025).

[2] Regions, a Delaware corporation headquartered in Alabama, operates Regions Bank (an Alabama state-chartered commercial bank). *Id.* at *2.

[3] C.A. No. 2023-1284-KSJM, 2023 WL 9037945 (Del. Ch. Sept. 29, 2025) (Verified Stockholder Derivative Complaint).

[4] C.A. No. 2023-1284-KSJM, 2025 WL 2769895, at *4 (Del. Ch. Sept. 29, 2025).

[5] According to plaintiff, the 2022 CFPB Consent Order was not Regions' first time being fined and ordered by the CFPB to alter its overdraft practices. *See* C.A. No. 2023-1284-KSJM, 2023 WL 9037945 (Del. Ch. Sept. 29, 2025) (Verified Stockholder Derivative Complaint).

[6] "[C]ourts should ask the following three questions on a director-by-director basis when evaluating allegations of demand futility: (i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand; (ii) whether the director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct . . ." *Zuckerberg*, 262 A.3d at 1059. "If the answer to any of the questions is 'yes' for at least half of the members of the demand board, then demand is excused as futile." *Id.*

[7] The demand futility analysis centered around whether plaintiff stated a claim under Rule 12(b)(6) against the demand board members. *See*, *e.g.*, *Grabski v. Andreessen, et al.*, C.A. No. 2023-0464-KSJM, 2024 WL 390890, at *7 (Del. Ch. 2024) ("Because showing that a defendant faces a substantial likelihood of liability from a claim requires that the claim be legally viable, as to the Director Defendants, the Rule 23.1 analysis effectively folds into the Rule 12(b)(6) analysis.").

[8] *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

[9] *Id.*

[10] C.A. No. 2023-1284-KSJM, 2025 WL 2769895, *12 (Del. Ch. Sept. 29, 2025).

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] *Id.* at *13.

[15] *Id.*

[16] The court did not address plaintiff's *Massey* theory in its demand futility analysis.

[17] *Id.* at *14.

[18] *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 125 (Del. Ch. 2009) (internal quotations and citations omitted).

[19] *See, e.g.*, *In re McDonald's Corp. S'holder Deriv. Litig.*, 289 A.3d 343, 380 (Del. Ch. 2023) ("It is enough to hold that the complaint's allegations support a claim against Fairhurst for breach of the duty of oversight."); *Guiliano v. Grenfell-Gardner*, C.A. No. 2021-0452-KSJM, 2025 WL 2502176, at *11 (Del. Ch. 2025) ("Plaintiff adequately alleges at least a red-flags claim against Grenfell-Gardner and Richardson. Just as it is reasonably conceivable that he Board failed to receive notice of red flags, it is reasonably conceivable that Grenfell-Gardner and Richardson were aware of the red flags and failed to report them to the Board.").

[20] C.A. No. 2023-1284-KSJM, 2025 WL 2769895, at *14 (Del. Ch. Sept. 29, 2025).

[21] *See, e.g.*, *Clem v. Skinner*, 2024 WL 668523, at *8 (Del. Ch. 2024) ("Claims that quibble with the timing or success of corrective action necessarily fail."); *id.* ("Because bad faith is the touchstone of *Caremark* liability, the court's role is not to second-guess a board's response to a red flag.").