

UNITED STATES DISTRICT COURT  
DISTRICT OF RHODE ISLAND

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SECURITIES AND EXCHANGE COMMISSION,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Case No.
	)	
CVS CAREMARK CORP.,	)	
	)	
Defendant.	)	

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**COMPLAINT FOR INJUNCTIVE AND OTHER RELIEF**

Plaintiff Securities and Exchange Commission (“the Commission”) alleges the following against defendant CVS Caremark Corp. (“CVS”):

**PRELIMINARY STATEMENT**

1. This enforcement action concerns securities law violations by CVS, one of the nation’s largest public companies, with annual revenue of more than \$126 billion. CVS contains two business segments: CVS retail, the nation’s second-largest chain of drugstores, and Caremark, the nation’s second-largest pharmacy benefits manager (“PBM”). The violations involve misconduct concerning both segments:

a. Materially incomplete and misleading disclosures in September and November 2009 regarding the expected results of operations of the PBM line of business for 2010; and

b. Inappropriate accounting treatment for the acquisition of a chain of drugstores, which caused the results of operations for the retail line of business to be materially overstated in the third quarter of 2009.

2. On September 8 and 9, 2009, CVS filed Prospectus Supplements for a \$1.5 billion senior note offering. Those Prospectus Supplements omitted recent material information about the PBM line of business – specifically, the expected loss of significant PBM contract revenue in 2010, and the expected loss of significant Medicare Part D revenue in 2010. When CVS disclosed bad news about its PBM line of business on November 5, 2009, the price of CVS common stock fell 20% in one day. However, during the November 5 earnings call with analysts, the then-CEO announced a slight improvement in the “retention rate” (a key metric of retained business often used to compare PBM companies), without disclosing that CVS had changed how it calculated the rate, thereby concealing the full extent of lost PBM business.

3. On November 5, 2009, CVS filed a quarterly report on Form 10-Q containing adjustments to the purchase price allocation (PPA) for the acquisition of the Longs chain of drugstores back in October 2008. The PPA adjustments did not comply with generally accepted accounting principles (GAAP) and overstated third-quarter earnings per share (EPS) by as much as 17% (or 9.3¢).<sup>1</sup> Also on November 5, CVS made public statements about the quarterly results of operations for its retail line of business that were materially misleading in that they failed to disclose the impact of the one-time PPA adjustments or the improper accounting.

4. Because of its improper accounting for the Longs PPA, CVS violated a cease-and-desist order that the Commission had issued in June 2007 concerning a separate matter.

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<sup>1</sup> CVS emphasizes, and analysts usually focus on, the company’s “adjusted” EPS – GAAP EPS minus amortization and net of tax. All references to EPS in this Complaint are to adjusted EPS.

5. Through the activities alleged in this Complaint, CVS engaged in: (a) intentional or reckless fraud in connection with the purchase or sale of securities, in violation of Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 10b-5 thereunder; (b) intentional or reckless fraud in the offer or sale of securities, in violation of Section 17(a)(1) of the Securities Act of 1933 (“Securities Act”); (c) negligent fraud in the offer or sale of securities, in violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act; (d) failure to file accurate quarterly reports with the Commission, in violation of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder; (e) failure to maintain accurate books and records, in violation of Section 13(b)(2)(A) of the Exchange Act; (f) failure to maintain an adequate system of internal accounting controls, in violation of Section 13(b)(2)(B) of the Exchange Act; and (g) violation of a previous cease-and-desist order of the Commission.

6. Accordingly, the Commission seeks: (a) the entry of a permanent injunction prohibiting CVS from future violations of the relevant provisions of the federal securities laws; and (b) the imposition of an appropriate civil penalty.

### **JURISDICTION**

7. The Commission seeks a permanent injunction pursuant to Section 20(b) of the Securities Act [15 U.S.C. §77t(b)] and Section 21(d)(1) of the Exchange Act [15 U.S.C. §78u(d)(1)]. The Commission seeks the imposition of a civil penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. §§78u(d)(3)].

8. This Court has jurisdiction over this action pursuant to Sections 20(d) and 22(a) of the Securities Act [15 U.S.C. §§77t(d), 77v(a)] and Sections 21(d), 21(e), and 27 of the

Exchange Act [15 U.S.C. §§78u(d), 78u(e), 78aa]. Venue is proper in this District because the corporate headquarters of CVS is located here.

9. In connection with the conduct described in this Complaint, CVS directly or indirectly made use of the mails or the means or instruments of transportation or communication in interstate commerce.

10. The conduct of CVS involved fraud, deceit, or deliberate or reckless disregard of regulatory requirements, and resulted in substantial loss, or significant risk of substantial loss, to other persons.

### **DEFENDANT**

11. CVS is a Delaware corporation with its corporate headquarters in Woonsocket, Rhode Island. Its common stock is traded on the New York Stock Exchange under the symbol “CVS”. On June 29, 2007, in a proceeding unrelated to the matters addressed in this Complaint, the Commission issued an order that CVS cease and desist from future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 13a-1 and 13a-13. *Matter of CVS Caremark Corp.*, Exch. Act Rel. No. 55982 (A.P. File No. 3-12673).

### **FACTS COMMON TO ALL COUNTS**

#### **Background on CVS**

12. CVS currently ranks #13 on the Fortune 500 list, with revenue of more than \$126 billion in 2013. It has two segments of approximately equal size: (1) CVS retail – more than 7,600 drugstores, including approximately 525 “Longs” stores acquired in October 2008; and (2) Caremark – a pharmacy benefits manager (“PBM”) acquired in March 2007.

13. The retail segment derives most of its revenues from the sale of prescription drugs, which are dispensed by more than 26,000 retail pharmacists. The PBM segment has a “commercial” business that manages prescription drug plans for employers, unions, and other sponsors of health benefit plans, and an “insurance” business that fills prescriptions for persons covered by the Medicare Part D program begun in 2006.

### **Failure to Disclose Bad News about the PBM Segment**

#### **September 2009 Offering of Senior Notes**

14. On September 8 and 9, 2009, CVS filed Prospectus Supplements for a \$1.5 billion senior note offering. The note offering was made pursuant to a Form S-3 automatic shelf registration of a well-known issuer filed on May 21, 2007. The Prospectus Supplements were filed pursuant to Rules 424(b)(2) and 424(b)(3) of the Securities Act.

15. Issuers are responsible for ensuring that any prospectus used in connection with a registered offering contains the information required to be included therein by Section 10 of the Securities Act, which provides that a prospectus should contain information required by Commission rules and regulations. Item 11 of the Form S-3 ASR Registration Statement states that an issuer must “describe any and all material changes in the registrant’s affairs which have occurred since the end of the latest fiscal year for which certified financial statements were included in the latest annual report to security holders and which have not been described in a report on Form 10-Q ... or Form 8-K ... filed under the Exchange Act.”

16. The \$1.5 billion note offering began on September 11, 2009.

### **Undisclosed Bad News**

17. When CVS filed its September 8 and 9, 2009 Prospectus Supplements, it failed to disclose material changes in its affairs that had occurred after the fiscal year ended December 31, 2008 and which had not been described in any subsequently filed Form 10-Q or Form 8-K, including the quarterly report on Form 10-Q for the second quarter ended June 30, 2009 that CVS filed with the Commission on August 4, 2009:

a. On August 6, 2009, CVS learned that the state of New Jersey was not going to renew a PBM contract that would have been worth more than \$930 million of revenue in 2010. Between August 7 and August 11, CVS learned that it had lost several more large PBM contracts for 2010. Overall, the net lost revenue for the 2010 PBM selling season grew by 125% in the brief period from August 6 to August 14, and the retention rate fell from 96% to 92%. (The process of trying to land new PBM contracts and negotiate the renewal of existing contracts is known as the “selling season”.) Nearly 40% of the net lost 2010 PBM contract revenue was not known to the market as of September 2009.

b. On August 13, 2009, the Centers for Medicare & Medicaid Services (“CMS”) announced the benchmarks for the Medicare Part D bidding process for 2010. (CMS supervises an annual bidding process that allocates “covered lives” – persons covered by Medicare Part D – to insurance companies whose bids fall below the “benchmark” in different regions of the country.) CVS fared very poorly in the benchmarks for 2010. According to an internal projection on August 14, CVS stood to lose 580,000 covered lives and as much as \$101 million of 2010 EBIT (earnings before interest and taxes) due to the bid results.

### **November 5, 2009 Earnings Call**

18. On November 5, 2009, CVS held a conference call with analysts to discuss its financial results for the third quarter of 2009. During the call, the then-CEO announced: (a) the PBM segment had lost an additional \$2 billion of contract revenue since the August 4 earnings call, and the net loss to date for the 2010 PBM selling season was now \$3.1 billion of revenue; (b) the PBM segment would lose \$1.7 billion of Medicare Part D revenue in 2010 due to the bid results; (c) the PBM segment had renegotiated its PBM contract with the federal government at a reduced margin; and (d) the President of the PBM segment was leaving the company, and the then-CEO himself would be the interim president. The then-CEO explained that CVS had previously assumed that the PBM segment's EBIT would grow 2% to 4% in 2010, whereas CVS now expected that the segment's EBIT would decline 10% to 12% in 2010.

19. During the November 5 call, the then-CEO also stated that, despite the losses, the PBM segment's retention rate for 2010 was 92% – slightly better than the 91% figure for 2009. That statement was materially false and misleading because the actual retention rate was only 88% – an unusually low figure for CVS or its competitors. In announcing the 92% figure, CVS manipulated the retention rate, changing the way that it was calculated, and thereby excluding the expected \$1.7 billion revenue loss from its lack of success in the Medicare Part D bidding process. CVS did not disclose this change in calculation methodology from previous quarters.

20. On November 5, 2009, the price of CVS common stock closed at \$28.87 per share – down \$7.28 (20%) from the closing price of \$36.15 per share on November 4. (By contrast, the S&P 500 was up 1.9% on November 5.) The trading volume of CVS stock on November 5 was 185 million shares, compared to 13 million shares on November 4.

## **Improper Accounting and Disclosures about the Longs Acquisition**

### **Form 10-Q for Third-Quarter 2009 with Adjustments to the Longs Purchase Price Accounting**

21. On October 20, 2008, CVS acquired the Longs chain of approximately 525 drugstores. CVS hired a major accounting firm to prepare a valuation for the Longs purchase price accounting (“PPA”). On January 27, 2009, the valuation firm submitted a draft report. As required by its contract with CVS, the valuation firm applied a “continued use” premise – that CVS would retain and continue to use all of the Longs stores’ property, plant and equipment (except for stores to be closed, as identified by CVS). The firm valued the Longs stores’ property, plant and equipment at more than \$1.2 billion, including \$937 million of real property and \$229 million of personal property. The valuation results were included in CVS’s audited financial statements for the fiscal year ended December 31, 2008, which were incorporated by reference in the annual report on Form 10-K that CVS filed with the Commission on February 27, 2009.

22. On November 5, 2009, CVS filed with the Commission a quarterly report on Form 10-Q for the third quarter ended September 30, 2009 containing unaudited financial statements that included adjustments to the Longs PPA. Compared to the valuation firm’s January 2009 draft report, the reported value of Longs tangible assets was reduced by \$212 million, with a corresponding increase in “goodwill”. CVS also made a one-time catch-up adjustment reversing \$49 million of depreciation taken on Longs assets from October 20, 2008 through June 30, 2009, and it did not take an additional \$19 million of depreciation that would otherwise have been taken on Longs personal property in the third quarter. The one-time depreciation reversal increased third-quarter 2009 EPS by approximately 2.4¢.



23. The reduction of tangible assets resulted primarily from a \$189 million decrease in the reported value of the Longs stores' personal property (from \$229 million to \$40 million). Despite the "continued use" premise that had been contractually required for the valuation firm's report, CVS now completely wrote off all personal property in approximately 430 of the 525 Longs stores, including more than 360 stores that were going to be operated for the long-term.

24. The Longs PPA adjustments did not comply with GAAP, specifically SFAS 141 ("Business Combinations"), because: (a) they did not reflect the expected future use of the Longs personal property as of the acquisition date in October 2008; (b) they did not reflect information that CVS knew or had arranged to obtain as of the acquisition date; and (c) they did not account for CVS's use of the assets to generate revenue after the acquisition date.

25. The failure to comply with GAAP had a material impact on the company's third-quarter 2009 financial results. With proper accounting, current-period expenses in the third quarter would have been as much as \$189 million higher than was actually reported. For the quarter, the failure to recognize those current-period expenses overstated operating profit by as much as 13.7%, overstated income from continuing operations by as much as 12.5%, overstated net income by as much as 12.5%, and overstated EPS by as much as 17% (or 9.3¢).

26. The November 5, 2009 Form 10-Q stated that, compared with the third quarter of 2008: (a) consolidated operating expenses had increased due to Longs integration costs; and (b) retail operating expenses had decreased as a percentage of net revenues due to lower depreciation expense offset by Longs integration costs. Those statements were materially false and misleading because: (a) CVS mentioned Longs integration costs, which reduced its profitability, but did not mention the one-time \$49 million reversal of previously recorded depreciation expense, which caused its EPS to increase by 2.4¢; and (b) retail operating expenses

as a percentage of net revenues would have increased, not decreased, if not for the one-time depreciation reversal.

### **November 5, 2009 Earnings Call**

27. On November 5, 2009, as noted above, CVS held a conference call with analysts to discuss its financial results for the third quarter of 2009. During the call, the then-CFO stated that third-quarter EPS was 65¢, “just above” the company’s guidance of 62¢ to 64¢. That statement was materially false and misleading because: (a) third-quarter EPS only exceeded the company’s guidance (and the analysts’ consensus of 64¢) because of the 2.4¢ increase due to the one-time \$49 million depreciation reversal; and (b) third-quarter EPS was overstated by as much as 9.3¢ due to the improper Longs PPA accounting.

28. During the November 5 call, the then-CFO also stated that, compared to the third quarter of 2008, retail operating expenses had decreased as a percentage of net revenue due to “good spending discipline” partially offset by one-time Longs integration expenses. That statement was materially false and misleading because, as discussed above, retail operating expenses would have increased, not decreased, as a percentage of net revenues if not for the one-time \$49 million depreciation reversal.

### **FIRST CLAIM FOR RELIEF** **(Violation of Section 10(b) of the Exchange Act and Rule 10b-5)**

29. The Commission repeats and incorporates by reference the allegations in paragraphs 1-28 above.

30. As set forth above, the Prospectus Supplements for the \$1.5 billion note offering failed to disclose certain material events that had occurred after CVS filed its second-quarter Form 10-Q on August 4, 2009.

31. As set forth above, during the November 5, 2009 earnings call, CVS made a material misstatement about the PBM segment's retention rate for 2010.

32. By reason of the foregoing, CVS, directly or indirectly, acting intentionally, knowingly or recklessly, by the use of means or instrumentalities of interstate commerce or of the mails, in connection with the purchase or sale of securities: (a) employed devices, schemes or artifices to defraud; (b) made untrue statements of material fact or omitted to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) engaged in acts, practices or courses of business which operated as a fraud or deceit upon certain persons.

33. As a result, CVS violated and, unless enjoined, will continue to violate Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 thereunder [17 C.F.R. §240.10b-5].

**SECOND CLAIM FOR RELIEF**  
**(Violation of 17(a)(1) of the Securities Act)**

34. The Commission repeats and incorporates by reference the allegations in paragraphs 1-33 above.

35. As set forth above, the Prospectus Supplements for the \$1.5 billion note offering failed to disclose certain material events that had occurred after CVS filed its second-quarter Form 10-Q on August 4, 2009.

36. By reason of the foregoing, CVS, directly and indirectly, acting intentionally, knowingly or recklessly, in the offer or sale of securities by the use of the means or instruments of transportation or communication in interstate commerce or by the use of the mails, employed

devices, schemes or artifices to defraud which operated as a fraud or deceit upon purchasers of CVS securities.

37. As a result, CVS violated and, unless enjoined, will continue to violate Section 17(a)(1) of the Securities Act [15 U.S.C. §77q(a)(1)].

**THIRD CLAIM FOR RELIEF**  
**(Violation of Sections 17(a)(2) and (3) of the Securities Act)**

38. The Commission repeats and incorporates by reference the allegations in paragraphs 1-37 above.

39. As set forth above, the unaudited financial statements in the Form 10-Q that CVS filed on November 5, 2009 contained adjustments to the Longs PPA that did not comply with GAAP, and the failure to comply with GAAP had a material impact on the company's financial results.

40. As set forth above, the Form 10-Q filed on November 5, 2009 and CVS's remarks during the November 5, 2009 earnings call included statements about CVS's financial performance in the third quarter that were materially false and misleading.

41. At all relevant times, CVS had registered and was offering and selling to the public billions of dollars of stock, bonds, and other securities. Through the Form 10-Q filed on November 5, 2009 and the earnings call the same day, the unaudited financial statements that did not comply with GAAP and the false and misleading statements about the company's financial performance in the third quarter were available to persons considering whether to purchase CVS securities.

42. By reason of the foregoing, CVS, directly or indirectly, acting negligently, in the offer or sale of securities by the use of the means or instruments of transportation or

communication in interstate commerce or by the use of the mails: (a) obtained money or property by means of untrue statements of material fact or omissions to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and (b) engaged in transactions, practices or courses of business which operated as a fraud or deceit upon purchasers of CVS securities.

43. As a result, CVS violated and, unless enjoined, will continue to violate Sections 17(a)(2) and (3) of the Securities Act [15 U.S.C. §§77q(a)(2), (3)].

**FOURTH CLAIM FOR RELIEF**  
**(Violation of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B)**  
**of the Exchange Act and Rules 12b-20 and 13a-13)**

44. The Commission repeats and incorporates by reference the allegations in paragraphs 1-43 above.

45. Section 13(a) of the Exchange Act and Rule 13a-13 thereunder require an issuer to file with the Commission accurate quarterly reports on Form 10-Q. Rule 12b-20 requires that these reports contain such further material information as is necessary to make the required statements in the reports not misleading.

46. Section 13(b)(2)(A) of the Exchange Act requires an issuer to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of its assets.

47. Section 13(b)(2)(B) of the Exchange Act requires an issuer to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that its financial statements are prepared in conformity with GAAP or any other criteria applicable to such statements.

48. As set forth above, the unaudited financial statements in the Form 10-Q filed on November 5, 2009 contained adjustments to the Longs PPA that did not comply with GAAP and that had a material impact on the company's financial results.

49. As a result, CVS violated and, unless enjoined, will continue to violate Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§78m(a), 78m(b)(2)(A), 78m(b)(2)(B)] and Rules 12b-20 and 13a-13 [17 C.F.R. §§240.12b-20, 240.13a-13].

**FIFTH CLAIM FOR RELIEF**  
**(Violation of Previous Cease-and-Desist Order)**

50. The Commission repeats and incorporates by reference the allegations in paragraphs 1-49 above.

51. As set forth above, on June 29, 2007, the Commission issued an order in an unrelated matter requiring CVS to cease and desist from future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 13a-1 and 13a-13.

52. Through the conduct alleged in this Complaint, CVS violated Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rule 13a-13.

53. As a result, CVS violated the 2007 cease-and-desist order and is liable for a civil penalty pursuant to Section 21(d)(3)(A) of the Exchange Act [15 U.S.C. §78u(d)(3)(A)].

**PRAYER FOR RELIEF**

WHEREFORE, the Commission requests that this Court:

A. Enter a permanent injunction restraining CVS and each of its agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, including facsimile

transmission or overnight delivery service, from directly or indirectly engaging in the conduct described above, or in conduct of similar purport and effect, in violation of:

1. Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 [17 C.F.R. 240.10b-5];
2. Section 17(a)(1) of the Securities Act [15 U.S.C. §77q(a)(1)];
3. Sections 17(a)(2) and 17(a)(3) of the Securities Act [15 U.S.C. §§77q(a)(2), (3)]; and
4. Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§78m(a), 78m(b)(2)(A), 78m(b)(2)(B)] and Rules 12b-20 and 13a-13 [17 C.F.R. §§240.12b-20, 240.13a-13];

B. Order CVS to pay an appropriate civil penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. §§78u(d)(3)];

C. Retain jurisdiction over this action to implement and carry out the terms of all orders and decrees that may be entered; and

D. Award such other and further relief as the Court deems just and proper.

Respectfully submitted,

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