11.7.02
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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE NCS HEALTHCARE, INC., SHAREHOLDERS LITIGATION	:	Consolidated C.A. No. 19786

NOTICE OF FILING PURSUANT TO RULE 5(g)

TO:

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PLEASE TAKE NOTICE that pursuant to Court of Chancery Rule 5(g), the NCS Defendants are today filing a public version of the following document, which was filed under seal on the date indicated:

The Plaintiffs' Memorandum of Law In Support Of Their Motion For A Preliminary Injunction, filed on November 3, 2002

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DATED: November 7, 2002

CERTIFICATE OF SERVICE

I, Katherine J. Neikirk, hereby certify that I caused to be served two copies of the Notice of Filing Pursuant to Rule 5(g), on November 7, 2002, upon the following counsel of record in the manner indicated:

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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE NCS HEALTHCARE, INC. SHAREHOLDERS LITIGATION	:	Consolidated C.A. No. 19786
	:	**CONFIDENTIAL**
	:	**FILED UNDER SEAL**

PLAINTIFFS' MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION FOR PRELIMINARY INJUNCTION

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Dated: November 3, 2002

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PRELIMINARY STATEMENT

Plaintiffs seek to enjoin the proposed merger of NCS Healthcare, Inc. ("NCS" or the "Company") into Genesis Health Ventures, Inc. ("Genesis") for Genesis stock worth less than one-half the value of a competing offer by Omnicare, Inc. ("Omnicare"). To guarantee consummation of the Genesis merger, the individual defendants, who constitute the Board of Directors of NCS, have entered (or caused NCS to enter) into agreements precluding the NCS Directors from exercising their statutory and fiduciary duties in an extraordinary corporate transaction and depriving the owners of 80% of the company from any voice in the outcome. These agreements include a variety of draconian and preclusive devices designed to lock up the deal for Genesis even though NCS's directors and their investment advisor have now abandoned the Genesis merger.[1] Without a meaningful vote or directorial protection or financial guidance, NCS' public shareholders' only hope lies in this Court to stop a transaction which is the product of a fundamentally flawed process and is indisputably and grossly unfair.

The Genesis merger agreement was accompanied by voting agreements among Genesis and two of the defendant directors, John H. Outcalt ("Outcalt") and Kevin B. Shaw ("Shaw"), pursuant to which Outcalt and Shaw agreed to vote their NCS stock in favor of the Genesis merger, and in furtherance of that undertaking granted Genesis an irrevocable proxy to vote their shares (the "Voting Agreements"). Critically, Outcalt and Shaw collectively own 4,617,219 shares of NCS super-voting Class B Common Stock, representing about 65% NCS' outstanding voting power. The Voting Agreements, therefore, render the shareholder vote on the merger a foregone conclusion, even though Outcalt and Shaw only own approximately 20% of

[1] In the S-4/A (at 45) (Ex. 48), the NCS Board of Directors has recommended that the NCS stockholders vote against the Genesis Merger Agreement. By letter dated October 25, 2002, NCS's financial advisor declined to allow its fairness opinion to be included in the merger proxy statement and affirmatively stated that that opinion should not be relied upon. *Id.* at 50.

NCS. The merger agreement guarantees success for Genesis because NCS's directors have committed themselves to submit the agreement for shareholder approval even if the directors withdraw their support, as has happened already. Thus, absent relief in this action, Genesis has locked up the deal and NCS's shareholders are locked in.

In this brief, Plaintiffs will demonstrate that the agreements among defendants are void and unenforceable in light of the salutary principles enunciated by the Supreme Court and this Court in *Paramount*, [2] *Ace*[3] and *Cyprus Amax*. [4] In addition to unlawfully impinging on the ability of the NCS directors to discharge their fiduciary responsibilities, the agreements are the product of serious breaches of the director defendant's duty of care and fall far short of the entire fairness standard of review against which the directors' conduct must be measured. An injunction should issue to protect the innocent NCS shareholders from a transaction their fiduciaries now admit was improvidently agreed to and to ensure that Genesis does not profit at the shareholders' expense from an ill-gotten windfall.

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[2] *Paramount Communications, Inc. v. QVC Network*, 637 A.2d 34, 43 (Del. 1994).

[3] *Ace Ltd. v. Capital Re Corp.*, 747 A.2d 95, 105 (Del. Ch. 1999).

[4] *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255 (Del. Ch.).

NATURE AND STAGE OF THE PROCEEDINGS

Commencing in August 2002, the Stockholder Plaintiffs filed complaints in this action that were superseded by a Consolidated Amended Complaint filed on September 20, 2002. On September 12, 2002, the Court granted the Stockholder Plaintiffs' motion to expedite discovery. Summary judgment as to Count I of the Consolidated Amended Complaint was entered by the Court in favor of defendants by virtue of an Opinion and Order dated October 28, 2002.

This is Plaintiffs' Memorandum of Law in Support of Their Motion for Preliminary Injunction.

STATEMENT OF FACTS

A. The Parties

1. Plaintiffs and NCS

Plaintiffs are public stockholders of NCS, an independent provider of pharmacy and related services to long-term care and acute care facilities, including skilled nursing centers, assisted living facilities and hospitals. As of July 28, 2002, NCS had 18,461,599 Class A shares and 5,255,210 Class B shares outstanding. Form 14D-9 at 1 (Ex. 45)[5]. The Class B shares have ten times the voting power of the A shares.

2. The Director Defendants

Defendant Outcalt is Chairman of the Board of Directors of NCS. Outcalt owns 202,063 shares of NCS Class A and 3,476,086 shares of Class B common stock. Voting Agmts. (Ex. 39 and 40).

Defendant Shaw is President, Chief Executive Officer and a Director of NCS. At the time he entered into the Voting Agreement with Genesis, Shaw owned 28,905 shares of NCS Class A and 1,141,134 shares of Class B common stock. *Id.*

The NCS Board of Directors has two other members, defendants Sells and Osborne.

3. Genesis

Defendant Genesis is a Pennsylvania corporation with its principal place of business in Kennett Square, Pennsylvania. Defendant Geneva Sub, a wholly owned subsidiary of Genesis, is a Delaware corporation formed by Genesis to acquire NCS. Genesis recently emerged from bankruptcy proceedings and, as of June 30, 2002, had more than $625 million of

[5] The Exhibits cited herein are attached as exhibits to the Affidavit of Carmella P. Keener, dated November 3, 2002 ("Ex. ___.").

net debt and redeemable preferred stock. Genesis has never declared or paid cash dividends on its common stock, and its ability to pay dividends is restricted by its senior credit facility and senior secured notes. *See* Genesis Form 10-Q for Period ending June 30, 2002 (Ex. 44). Moreover, Genesis is a corporation whose management and business have been in a state of flux. Its Chief Executive Officer left in May 2002 and the position of CEO is presently being filled on an interim basis by a member of the Genesis Board of Directors. *See id.* at 18. Additionally, on June 21, 2002, Genesis announced that its Vice Chairman had resigned. *See id.*

On October 2, 2002, Genesis announced that it had retained two investment banking firms to explore certain business alternatives, including the potential sale or spin-off of Genesis's ElderCare businesses. S-4/A at 27. For the three months ended June 30, 2002, Genesis's ElderCare businesses generated about 52% of Genesis revenues and about 53% of its operating income, and comprised about 49% of Genesis's total assets. *Id.* at 16-17. Additionally, in Amendment No. 2 to its Form S-4/A filed with the Securities and Exchange Commission on November 1, 2002, Genesis disclosed: "Effective October 1, 2002, Genesis' revenues are adversely affected by expiring Medicare provisions; although Congress may restore a portion of lost Medicare revenues." Form S-4/A at 19 (Ex.48). The loss of these revenues and income which totals $30 million annually, Hager 14 (Ex. 4), is highly material to Genesis's results of operations. For example, for the quarter ended June 30, 2002, the most recently reported quarter, Genesis's income before tax was just $15.8 million. *See* Genesis Form 10-Q for quarter ended June 30, 2002. As a result of the foregoing adverse disclosures and others, the price of Genesis shares has declined materially from $16.00 on July 26, 2002 since the announcement of the proposed Genesis merger. Indeed, those shares have traded as low as $11 per share and are currently trading in the $13-14 per share range. *See* footnote 15 *infra*.

B. NCS's Initial Efforts To Sell Itself

In early 2000, NCS fell out of compliance with the covenants on its senior credit facility and retained a prominent investment bank, Warburg Dillon Read, LLC, predecessor in interest to the firm now known as UBS Warburg LLC, ("Warburg"), as its financial advisor to explore "the potential sale, transfer or other disposition . . . of the assets or securities of the Company." Letter to NCS from Warburg, dated Feb. 16, 2000, NCS000789-796 (Ex. 14). NCS's financial condition deteriorated further and in April 2000, NCS received a formal notice of default from its senior lenders. *Id.* at 32. At approximately the same time, NCS instructed Warburg to identify potential strategic and financial acquirors and, over the next several months, Warburg targeted more than 50 different entities to solicit their interest. *Id.* However, NCS terminated Warburg before the end of the year and replaced it with Brown Gibbons, Lang & Company Securities, Inc. ("Brown Gibbons"), a local restructuring firm. *Id.* at 33. During this period, NCS's financial condition continued to deteriorate and, in April 2001, NCS received a formal notice of default and acceleration from the trustee for holders of NCS 5 ¾% Convertible Subordinated Debentures (the "NCS Noteholders"). *Id.*

In July 2001, Omnicare President and Chief Executive Officer Joel Gemunder met Shaw at a meeting of the Long Term Pharmacy Association and discussed with him Omnicare's interest in acquiring NCS. Gemunder 12-13 (Ex. 2). Shortly thereafter, on July 20, 2001, Gemunder sent Shaw a written proposal to acquire NCS for $225 million. Letter from J. Gemunder to K. Shaw, dated July 20, 2001 (Ex. 15). In August 2001, Omnicare raised its bid by 20% and sent NCS a new proposal (in the care of Brown, Gibbons, as NCS had insisted) to acquire NCS for $270 million. Letter from J. Gemunder to K. Shaw, dated Aug. 29, 2001 (Ex. 17). Both proposals contemplated acquisitions in the context of a purchase of NCS's assets under Section 363 of the United States Bankruptcy Code, but both indicated that Omnicare was willing to consider alternative transaction structures and willing to negotiate the terms of its offer. *Id.*

Omnicare and NCS executed a confidentiality agreement in August 2001. *See* S-4/A at 34) (Ex. 48). Nonetheless, NCS refused to provide Omnicare with important financial information that Omnicare requested in order to analyze the proposed acquisition and evaluate NCS's publicly reported financial statements, including profit and loss information by pharmacy site and schedules of purchasing volume and cost information. Gemunder 19-20 (Ex. 2); Greany 93-94 (Ex. 3). NCS also refused to speak to Omnicare directly, but insisted that all contact be funneled through Brown Gibbons. Gemunder 23-24 (Ex. 2).

Frustrated by the slow pace of these negotiations, Omnicare arranged a meeting on November 15, 2001 with Judy Mencher of DDJ Capital Management LLC ("DDJ"), the representative of an Ad Hoc Committee of NCS Noteholders, to discuss Omnicare's interest in acquiring NCS. *Id.* at 21-22. By January 2002, Omnicare and DDJ had agreed in principle to an Omnicare acquisition of NCS for $313,750,000 in cash as part of a Section 363 transaction. *Id.* at 29-30; Mencher 59 (Ex. 6). The Ad Hoc Committee conveyed this proposal to NCS in February 2002, Form S-4/A at 36 (Ex. 48), and on March 25, 2002, Omnicare delivered a draft asset purchase agreement to DDJ and was advised by DDJ and its counsel that the draft would be conveyed to, and discussed with, NCS. *See* Draft Asset Purchase Agmt. (Ex. 20). Although DDJ eventually sent a revised version of the agreement to Omnicare on May 22, 2002 (almost two months later), Omnicare never received any comments or contact from NCS about its proposal.

C. The NCS Special Committee

1. The Formation of the Special Committee

In the Spring of 2002, while Omnicare and DDJ were working on their proposed Section 363 transaction, the NCS Board of Directors established a committee (the "Special Committee"), consisting of defendants Sells and Osborne, for the express purpose of reviewing, evaluating and negotiating possible strategic transactions. Form 14D-9 at 7 (Ex. 45). However, no NCS witness has been able to articulate clearly why a Special Committee was necessary for this task.

REDACTED

7), and misunderstood that to mean they should put the interests of NCS creditors above those of its stockholders.

was important that

REDACTED

Although contrary to the shareholders interest, the NCS Board ultimately heeded this advice, but did not follow any deliberate process in choosing members for the Special Committee.

independent n

REDACTED

REDACTED

ndeed, the NCS board minutes reflect no discussions whatsoever regarding the issue of whether to establish a special committee. Instead, the Board simply acted by unanimous written consent to appoint a special committee consisting of Sells and Osborne -- two current directors, who like Outcalt and Shaw, were also large NCS shareholders and thus subject to the same conflicting interests that Outcalt believed would taint his own participation.[6]

2. **The Special Committee's Advisors**

(a) **The Special Committee's Legal Advisors**

Although nominally an "independent committee," the Special Committee was steered by Outcalt and Shaw from the outset.

REDACTED

REDACTED

[6] It is unclear when the Special Committee was actually formed. Although NCS claims in its public filings, Form S-4/A at 36 (Ex. 48); Form 14D-9 at 7 (Ex. 45), that the Special Committee was formed in March 2002,

REDACTED

REDACTED

. *Id.*

at 51.[7]

(b) <u>The Special Committee's Financial Advisor</u>

The Special Committee followed a similar "process" in selecting its financial advisor. From approximately February 2000 until December 2000, Warburg, one of the most experienced investment bankers in the health care industry, had been advising NCS in exploring strategic alternatives.

REDACTED

Surprisingly, the NCS Board acceded to this demand, fired Warburg, and began a search for a replacement.

REDACTED

When the Special Committee was formed, it blindly accepted Pollack and Brown Gibbons as its financial advisors, as well. REDACTED

---

7 Significantly, Skadden, Arps, Meagher & Flom LLP, one of the nation's most experienced law firms in the field of mergers and acquisitions, was not retained by NCS or its outside directors until *after* the Genesis merger agreement was executed. Sells 52 (Ex. 10).

Osborne 70-71 (Ex. 7). REDACTED

REDACTED

REDACTED

In fact, Brown Gibbons's and Pollack's prior experience in these areas is marginal, at best.

REDACTED

In July 2001, Pollack left Brown Gibbons to form a new firm, Candlewood Partners, LLC ("Candlewood"). Thereafter, Pollack worked as a consultant for Brown Gibbons on the NCS assignment, together with a small group of Brown Gibbons associates under the supervision of Scott Berlin, a Brown Gibbons director. REDACTED

8 Although Pollack testified that he was retained by other public companies to provide advice on potential mergers or strategic transactions, none of the engagements that he cited involved the sale of a publicly traded corporation. Pollack 18-20 (Ex. 9).

9

REDACTED

REDACTED

REDACTED

Thus, Sells and the Special Committee were unaware that Brown Gibbons's entire auction process had been tainted.

REDACTED

REDACTED

3. The Work of the Special Committee

The Special Committee met for the first time on May 14, 2002.

REDACTED

The Special Committee entrusted this auction process almost entirely to Pollack and Brown Gibbons.

REDACTED

Nor did the Special Committee monitor Pollack and Brown Gibbons with any particular care.

REDACTED

Not surprisingly, then, Pollack took no steps to ensure Omnicare's participation in an auction after the May 14, 2002 board meeting.

REDACTED

REDACTED

REDACTED

and, on July 3, 2002, Genesis provided NCS with a draft merger agreement pursuant to which NCS stockholders would receive Genesis common stock valued at $20 million.[10] *See* Draft Merger Agmt., dated July 3, 2002 at 3 (Ex. 28). This proposal placed a total enterprise value on NCS of $308 million, almost $6 million less than the $313.8 million offer that NCS had already received from Omnicare. *Id.*; Form S-4/A at 36 (Ex. 41); Sells 138-39 (Ex. 10).

REDACTED

[10] Genesis's Form S-4/A represents that Genesis indicated that it would increase the value of Genesis common stock to be received by NCS stockholders to $24 million (approximately $1 per share) for a total enterprise value of $312 million. Form S-4/A at 37 (Ex. 48).

REDACTED

D. The Exclusivity Agreement

On or about July 1, Genesis insisted on a locked up transaction as a condition to negotiating a final agreement, and told NCS that it would only negotiate if NCS entered into an exclusivity agreement. That exclusivity agreement, which NCS accepted, provided that, for a period of 23 days, beginning July 3,[11] NCS would not, *inter alia*, "directly or indirectly . . . engage or participate in any discussions or negotiations with respect to a Competing Transaction or a proposal for one [or] . . . accept, recommend or enter into any Competing Transaction." *See* Exclusivity Agmt., dated July 1, 2002, at 1 (Ex. 28). Because the exclusivity agreement contained no "fiduciary out" of any kind, it precluded NCS from even considering a superior offer from Omnicare or anyone else.

Genesis explained to Pollack why it wanted the exclusivity agreement, and Pollack related that explanation to the Special Committee.

REDACTED

[11] The exclusivity agreement provided for expiration on July 19, 2002 with an automatic extension through July 26, 2002 if the parties were still negotiating. Exclusivity Agmt., NCS000158 (Ex. 27). On or about July 25, 2002, NCS agreed to further extend the exclusivity agreement through July 31, 2002. Letter Agmt., dated July 25, 2002 (Ex. 30). Although the Special Committee supposedly authorized this extension during a telephonic meeting on the morning of July 26, 2002, Form S-4/A at 38 (Ex. 48), there are no minutes of any such meeting and no record that such authorization was ever in fact given.

REDACTED

REDACTED

Under the Special Committee's "stalking horse" strategy, this would have been a natural time for NCS to have contacted Omnicare, informed it of the Genesis proposal, and solicited a higher offer.

REDACTED

As a result, NCS entered into the exclusivity agreement without even attempting to see if a better offer was available.

E. Negotiations Between July 3 and July 26, 2002

Between July 3 and July 26, 2002, the Special Committee did not participate directly in the negotiations with Genesis or its advisors, but rather, delegated this responsibility entirely to Pollack and the Benesch attorneys. Form S-4/A at 38 (Ex. 48). After three weeks of discussions, the parties had not yet reached an agreement. Genesis's proposal at this point provided that NCS stockholders would receive approximately $24 million worth of Genesis common stock. *Id.* at 37.

Although neither the Special Committee, nor NCS's advisors nor any other NCS representative ever informed Omnicare of the ongoing Genesis negotiations, Omnicare learned at the beginning of the week of July 22 of evidence that NCS and Genesis were close to completing a merger agreement. Omnicare's Schedule TO dated August 8, 2002 at 18 (Ex. 43).[12] Over the next few days, Omnicare conferred with its advisors and decided to make an offer for NCS at a level that it was confident would be well in excess of any possible Genesis proposal. *Id.* at 18-19. Accordingly, during the afternoon of July 26, 2002, Omnicare faxed a letter to NCS offering to acquire NCS in a transaction that would assume or pay off all NCS's existing debt and would

[12] As Mr. Gemunder testified, an Omnicare consultant learned at a cocktail party that an attorney was "working on the merger of NCS" with a "company coming out of bankruptcy." Gemunder 80) (Ex. 2). Because that description fit Genesis and because Mr. Gemunder was already aware of Genesis's interest. Mr. Gemunder correctly surmised that NCS and Genesis were working on a merger agreement.

pay $3.00 in cash per share, resulting in approximately $78.6 million to the shareholders. Letter from J. Gemunder to J. Outcalt, dated July 26, 2002 (Ex. 32).

F. The Weekend of July 26-28, 2002: NCS Ignores Omnicare's $3.00 Per Share Offer And Locks Up A Merger Agreement With Genesis For $1.60 Per Share Instead

1. The July 26, 2002 NCS Special Committee Meeting

After receiving Mr. Gemunder's letter, the NCS Special Committee met by telephone for approximately one hour on the evening of July 26, 2002. *See* July 26, 2002 Indep. Comm. Mins. (Ex. 31). Pollack and Benesch attorneys participated in the meeting. Pollack reviewed Omnicare's prior offers with the Special Committee and discussed the $3.00 per share offer in the July 26 letter. Pollack also told the Special Committee that Genesis's CFO, George Hager, was insisting that NCS execute a merger agreement before the markets opened on July 29. *Id.*

Following a discussion, the Special Committee directed Pollack to go back to Genesis armed with the Omnicare letter to seek additional consideration. *Id.*; Pollack 185 (Ex. 9). Although Genesis would not participate in a "stalking horse" strategy which might elicit a better offer from Omnicare, Genesis responded by increasing the amount it would pay the NCS noteholders by $31 million and by modifying the stock-for-stock exchange ratio, resulting in an approximately 80% increase in the number of Genesis shares that would be issued to NCS stockholders. Form 14D-9 at 8 (Ex. 45); Pollack 184-85 (Ex. 9); Sells 171 (Ex. 10).

REDACTED

Although the obvious explanation for Genesis's increase is that Genesis believed the Omnicare proposal was a real one, this message was obviously lost on the NCS Board and

Special Committee, which refused to contact Omnicare and did not respond to either Mr. Gemunder's letter or to telephone messages from Omnicare's advisors.

REDACTED and, according to NCS's public statements, "highly conditional." Form 14D-9 at 3 (Ex. 45); Form S-4/A at 64 (Ex. 48).

REDACTED

2. **The Special Committee and NCS Board Meet on July 28 to Approve the <u>Genesis Merger Agreement and the Voting Agreements</u>**

REDACTED neither the Special Committee nor the full NCS board met at all on Saturday, July 27, 2002. Both the

Special Committee and the full board only had one further meeting apiece. Those meetings, which were both called on July 28, 2002 to approve the Genesis Merger Agreement and the Voting Agreements, were telephonic and brief.

REDACTED

In addition to Pollack of Candlewood, whom the minutes identify as NCS's financial advisor, two Benesch attorneys provided advice to the Special Committee, all of which has been redacted from the minutes. July 28, 2002 Indep. Comm. Mins. at 1-3 (Ex. 34). Over the weekend, Pollack and Benesch represented the Special Committee, the full board of directors and NCS itself. Even at this critical juncture, the Special Committee chose to continue to proceed without independent legal and financial advice. Osborne 66-67 (Ex. 7); Pollack 51-52 (Ex. 9).

3. <u>The July 28, 2002 Special Committee Meeting</u>

At the meeting of the Special Committee that commenced at 10:35 a.m., Pollack first reported on the status of Genesis's current offer and Genesis's threat to withdraw:

> Mr. Pollack reported that he was advised by George Hager, Chief Financial Officer of Genesis Health Ventures, Inc.'s ("Genesis") that the Genesis Board had met and decided that Genesis would withdraw its offer if the definitive merger agreement is not executed by midnight tonight. Subject to execution of the definitive documents by tonight, Genesis' Board authorized the following enhanced economic terms for the Committee's and NCS Board of Directors' consideration:
>
> 1. The requirement to execute the agreements today forced Genesis' Board's conclusion that the Noteholders must be redeemed in cash at par plus accrued interest. A redemption under the Indenture will also require payment of a premium equal to 1.64% which Genesis will pay. Mr. Pollack noted that this approach requires approximately $31 Million in additional cash outlay from Genesis.

REDACTED

REDACTED

Pollack next reviewed Genesis's financial condition and financing sources for the merger. *Id.* at 1-2. Pollack and the Special Committee knew that Genesis had filed for bankruptcy in June 2000 and had only emerged from bankruptcy in October 2001. Fairness Opinion Presentation at 5 (Ex. 41). Under the circumstances, the Special Committee should have been particularly vigilant to assure itself that Genesis could finance the NCS acquisition. Instead, the Special Committee simply took Pollack's word for it.

REDACTED

[13] The closing price of Genesis stock on the preceding Friday, July 26, 2002 was $16.00 per share. *See* http://finance.yahoo.com. (Ex. 49).

REDACTED

The minutes of the meeting also reflect a brief discussion of the Genesis Merger Agreement and the Voting Agreements. July 28, 2002 Indep. Comm. Mins. at 1-3 (Ex. 34).

REDACTED

In fact, the minutes strongly suggest that even the lawyers from Benesch did not understand the import of what they were asking the Special Committee to approve.

REDACTED

REDACTED

But in its Form S-4/A, Genesis asserts that Benesch lawyers told the Special Committee and the NCS board something different on July 28:

> In particular, legal counsel reminded the NCS independent committee that under the terms of the merger agreement and because NCS stockholders representing in excess of 50% of the outstanding voting power would be required by Genesis to enter into stockholder voting agreements contemporaneously with the signing of the merger agreement, and would agree to vote their shares in favor of the merger agreement, stockholder approval of the merger would be assured even if the NCS board of directors were to withdraw or change its recommendation. These facts would prevent NCS from engaging any alternative or superior transaction in the future.

Form S-4/A at 40 (Ex. 48). **REDACTED**

The Special Committee meeting concluded with Pollack's presentation of Candlewood's fairness opinion. That presentation, which was repeated for the full board and is discussed more fully below, concluded that the Genesis Merger Agreement was fair, from a financial point of view, to NCS stockholders. Accordingly, the Special Committee voted to recommend that the full NCS Board approve the Genesis Merger Agreement, and the meeting was adjourned at 11:25 a.m.. after only 50 minutes.

4. **The July 28, 2002 NCS Board Meeting**

The full board met telephonically at 11:25 a.m., immediately after the rushed and perfunctory meeting of the Special Committee. Mehalko Notes (Ex. 36).

REDACTED

14

REDACTED

(a) The Board's Flawed Understanding of Its Fiduciary Duties

When the NCS board convened to consider the Special Committee's recommendation and whether to approve the Genesis Merger Agreement and Voting Agreements, they did so with a fundamental misunderstanding of the nature of their fiduciary duties. The NCS directors all believed that they owed fiduciary duties not simply to NCS's stockholders but to its creditors, as well. Sells 86 (Ex. 10); Osborne 51 (Ex. 7); Shaw 39-40 (Ex. 11); Outcalt 47-49 (Ex. 8). Beginning in approximately January or February 2000, NCS's directors believed that NCS's financial straits had placed it in "the zone of insolvency" and that, as a result, they owed fiduciary duties to NCS's creditors.

REDACTED

REDACTED

REDACTED As a result, on July 28, 2002, NCS no longer faced imminent bankruptcy and the NCS directors owed fiduciary duties only to NCS stockholders.

This misunderstanding about the nature of their fiduciary duties dramatically affected the manner in which the NCS directors proceeded at the July 28, 2002 meeting.

REDACTED

Pollack presented the full board with the same presentation regarding fairness that he had given to the Special Committee a few minutes earlier. The minutes reflect that the entire discussion of fairness during the Special Committee's 50 minute meeting on July 28 was:

REDACTED

Of course, that opinion has now been withdrawn. S-4/A, 51 (Ex. 48).

Candlewood's underlying analysis was equally perfunctory: an 18-page analysis

REDACTED

The only financial analysis contained in Candlewood's back-up for its opinion was an analysis of NCS. Candlewood and Pollack used three customary techniques -- a comparable companies analysis, a comparable transactions analysis and a discounted cash flow analysis -- to value NCS. July 28, 2002 Fairness Op. at 1-3 (Ex. 37). Their analysis arrived at a negative number for NCS's equity value. Pollack 215 (Ex. 9). Pollack then concluded that since, according to him, shares of NCS common stock had a negative value, any price offered by Genesis would be "fair." *Id.* In fact, Pollack testified that before Genesis upped its offer to .10 Genesis share for each share of NCS, REDACTED

To make matters worse, neither Candlewood nor the NCS board had any basis to conclude that Genesis's .10 per share offer was the highest Genesis would go.

REDACTED

REDACTED

Candlewood also gave the NCS directors no basis to gauge the intrinsic value of the merger consideration -- Genesis common stock.

REDACTED

Thus, the Candlewood analysis contains no projections for Genesis, no discounted cash flow analysis of Genesis, and no contribution analysis showing the revenues and net income contributed and to be contributed by each company. The analysis does not set forth the expected synergies or attempt to quantify for the board how much Genesis could afford to pay for NCS.

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, and, in fact, Genesis's stock price has declined significantly since the Genesis Merger Agreement was signed.[15]

Nor did the fairness opinion consider the fact most relevant to valuation – that a higher price was available. First, the opinion recites that "[w]e were not requested to solicit and we did not solicit any expressions of interest from any other parties with respect to the sale of all or a part of [NCS] or any alternative transaction . . ." *Id.* at 219. That may have been literally true (because *Candlewood's* engagement was brand new), but both the NCS board and Pollack knew that Pollack and Brown Gibbons had in fact solicited numerous expressions of interest from others. *Id.* at 48-50.

The opinion goes on to recite that it "does not address the relative merits of the merger [with Genesis] as compared to any alternative business strategies that might exist for [NCS] or the effect of any transaction in which [NCS] might engage." *Id.* at 218.

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[15] On Friday, July 26, 2002, Genesis closed at $16.00 per share. *See* http://finance.yahoo.com. (Ex. 49). Over the July 28, 2002 weekend, Pollack valued the Genesis merger proposal at $1.75 per share based on an incorrect stock price -- $17.50 per share. July 28, 2002 Bd. Mins. at 1 (Ex. 35). Since July 28, 2002, Genesis's stock price has traded as low as $11.00 per share. *See* http://finance.yahoo.com. *Id.*

(b) The NCS Board Approves The Merger Agreement

Misinformed about its fiduciary duties and misguided by Candlewood's fairness opinion, the NCS board voted at the conclusion of its meeting to approve the Genesis Merger Agreement. As explained below, that merger agreement fully satisfied NCS's creditors -- who were not only paid in full but also received an early redemption premium -- but precluded NCS's stockholders from any opportunity of ever receiving the full value of their shares. Accordingly, now that Omnicare has presented NCS with a signed merger agreement offering to acquire NCS for $3.50 per share and to pay NCS's creditors in full -- REDACTED REDACTED, -- NCS' shareholders are powerless to accept it. *Id.* at 180.

G. The Terms of the Genesis Merger Agreement

The Genesis Merger Agreement provides for each outstanding share of NCS stock to be exchanged for 0.1 share of Genesis common stock -- worth approximately $1.60 per share of NCS stock at the time the transaction was announced. Notably, there is no "collar" or other price protection for NCS stockholders in the transaction; nor did NCS or its Directors reserve the right to terminate the transaction in the event of a material adverse change in Genesis's business. The Genesis Merger Agreement also includes a series of defensive provisions that, taken together, completely lock up the transaction.

1. Voting Agreements

The Voting Agreements (a) require that defendants Outcalt and Shaw, who collectively hold approximately 65% of the outstanding voting power of NCS through their holdings of NCS Class B common stock grant an irrevocable proxy to Genesis to vote, and who have agreed to vote their respective shares of NCS common stock in favor of the Proposed

Genesis Merger and against proposals for other transactions, no matter how superior, and (b) prohibit them from transferring their shares of NCS common stock prior to consummation of the Proposed Genesis Merger. Voting Agmts. §2(a)-(c) (Exs. 39 or 40). The Voting Agreements purport to be terminable if the Genesis Merger Agreement is terminated (an impossible occurrence, and thus an empty provision, as demonstrated below). *Id.* at § 8(b).

The Voting Agreements are premised on the concept that Outcalt and Shaw control sufficient voting strength to ensure approval of the Genesis Merger Agreement because, while the of Class A shares have one vote per share, holders of Class B shares (principally Outcalt and Shaw) have ten votes per share. Thus, prior to execution of the Voting Agreements, defendants Outcalt and Shaw held sufficient voting strength to ensure approval of the Proposed Genesis Merger. Accordingly, by approving the grant to Genesis of an irrevocable proxy to vote Outcalt's and Shaw's shares in favor of the Proposed Genesis Merger, the NCS Board of Directors sought to lock up 65% of the vote and guarantee its approval of the Genesis deal. Thus, the intended effect of the Voting Agreements is to render any shareholder vote approving the Genesis Merger Agreement not merely a formality, but a preordained conclusion, and to preclude entirely the possibility of any vote either against the Proposed Genesis Merger or in favor of any alternative proposal.

2. **<u>The No Termination Provision</u>**

The illusory nature of the "termination" provision of the Voting Agreements becomes apparent when considered in light of the No Termination Provision in the Genesis Merger Agreement itself, which prohibits the NCS board of directors from terminating the agreement prior to the stockholder vote to approve it. NCS itself offers the best description of how it has tied its own hands in its Schedule 14D-9: "the terms of the Genesis Merger

Agreement do not permit NCS to terminate the agreement to accept a competing proposal [and] the terms of the Voting Agreements do not provide Messrs. Outcalt and Shaw with termination rights in these circumstances." Form 14D-9 at 11 (Ex. 45).

3. **The No-Shop/No-Talk Provision**

Not content merely to lock up the vote, the NCS Board of Directors surrendered any ability to fulfill their fiduciary duties to NCS and its stockholders by prohibiting themselves from considering alternative superior offers (the "No-Shop Provision"). Pursuant to the No-Shop Provision, the NCS board may not, among other things,

> (i) solicit, initiate, encourage (including by way of furnishing information), knowingly facilitate or induce (directly or indirectly) any inquiry with respect to, or the making, submission or announcement of, any proposal that constitutes, or could reasonably be expected to result in, a proposal or offer for an Acquisition Proposal, (ii) *participate in any discussions or negotiations* regarding, or furnish to any Person any nonpublic information with respect to, or take any other action to knowingly facilitate any inquiries or the making of any proposal that constitutes or may reasonably be expected to lead to, an Acquisition Proposal, (iii) *approve, endorse, or subject to Section* 5.1(c)(ii),[16] *recommend* any Acquisition Proposal, or (iv) enter into any letter of intent or similar document or any contract, agreement or commitment contemplating or otherwise relating to any Acquisition Proposal or transaction contemplated thereby.

Genesis Merger Agmt. at § 5.3(c) (Ex. 42) (emphasis added).

Although the Genesis Merger Agreement purports to permit the Director Defendants to furnish non-public information to or enter into discussions with "any Person in connection with an unsolicited bona fide written Acquisition Proposal by such person" that the board deems likely to constitute a "Superior Proposal," that provision is completely illusory. Even if the NCS board "changes, withdraws or modifies" its recommendation, as it has *done*, it

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[16] Section 5.1(c)(ii) purports to provide the NCS board with a "fiduciary out" to its obligation to include a recommendation in favor of the Genesis Merger Agreement in the proxy statement, but as noted below, this "out" is a sham because the vote has already been decided in advance by virtue of the board's approval and, by the terms of the Genesis Merger Agreement itself. Thus, the votes of the remaining shareholders are of no consequence.

must *still* solicit proxies from the stockholders in favor of the merger and "take all other action necessary or advisable to secure the vote or consent" of the NCS stockholders. Genesis Merger Agmt. at § 5.3(c) (Ex. 42). The No-Shop Provision is thus, in effect, the equivalent of a "no-talk" provision because, when considered in light of the rest of the terms of the Genesis Merger Agreement, there really is no "fiduciary out" at all; as a practical matter, there are *no* circumstances under which a "superior" deal can succeed.

H. <u>The Board And The Financial Advisor Reverse Their Positions</u>

On October 22, 2002, the NCS board announced it had withdrawn its recommendation for and, instead, unanimously recommended that NCS stockholders vote *against* the Genesis merger. Form S-4/A at 50 (Ex. 48). Moreover, on October 25, 2002, Candlewood sent a letter to the NCS board withdrawing its consent to include the fairness opinion it had provided to the Special Committee and the NCS board on July 28, 2002 as an annex to the proxy statement and prospectus to be sent to stockholders in connection with the Genesis merger. *Id.* at 51. Accordingly, the Form S-4/A further states:

> The NCS independent committee and the NCS board of directors considered this opinion in determining to approve the Genesis transaction on July 28, 2002; however, NCS stockholders are reminded that Candlewood's opinion was issued on and as of July 28, 2002 and has not and will not be updated. *Stockholders should not rely on the Candlewood opinion as a recommendation as to how any stockholder should vote with respect to the Genesis merger.*

Id. (emphasis added).

ARGUMENT

I. THE PRELIMINARY INJUNCTION STANDARD

The standards governing issuance of a preliminary injunction are well settled. Plaintiffs must show [i] that there is a reasonable probability that they will succeed on the merits, [ii] that irreparable harm is imminent in the absence of the injunction, and [iii] that the harm to the plaintiffs if relief is denied will outweigh the harm to defendants if relief is granted. *See e.g.*, *SI Mgmt. L.P. v. Wininger,* 707 A.2d 37, 40 (Del. 1998); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986); *In re Anderson, Clayton S'holders Litig.*, 519 A.2d 694, 698 (Del. Ch. 1986). Each of these requirements is satisfied and a preliminary injunction should be issued.

II. PLAINTIFFFS' CLAIMS HAVE A REASONABLE PROBABILITY OF SUCCESS ON THE MERITS.

A. The Director Defendants Breached Their Duty Of Care

As fiduciaries, directors of Delaware corporations have an affirmative common law duty to inform themselves of all material information reasonably available to them in considering any extraordinary corporate transaction, and must "proceed with a critical eye" in assessing such information for purposes of their decision. *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). In the merger context specifically, the Board's obligations are statutory as well. Section 251(b) of the DGCL requires that directors "act in an informed and deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders." *See McMullin v. Beran*, 765 A.2d 910, 919 (Del. 2000); *Van Gorkom*, 488 A.2d at 873; *see also Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993) ("*Technicolor II*"). A showing that a board of directors has failed to inform itself adequately with respect to a proposed transaction or otherwise in discharging its duty of care will render the business judgment presumptions inapplicable. *See Technicolor II*, 634 A.2d at 367-69; *Van Gorkom*, 488 A.2d at 873.

1. The Director Defendants Precluded Themselves From Adequately Evaluating Alternatives, Including The Superior Omnicare Offer

At the core of the duty of care is an obligation to evaluate fully all potential alternatives that are reasonably available under the circumstances. That obligation inheres not only where the Board has put the corporation up for sale and therefore undertaken to maximize shareholder value under the principles articulated in *Revlon* and its progeny (*see* Section II.A.2, *infra*), but to *all* decisions made by the Board. As the significance of the board action at issue increases, so too does the need to carefully consider and evaluate potential alternatives. As this Court has explained:

> It is essential for valid director action that it be taken on an informed basis. Indeed, it is essential of any rational human choice that alternatives to the proposed action be considered. The more significant the subject matter of the decision, obviously, the greater will be the need to probe and consider alternatives.

In re Fort Howard S'holders Litig., 1988 WL 83147, at *1 (Del. Ch.)[17]; *see also Cinerama, Inc. v. Technicolor, Inc.*, 1991 WL 111134, at *16 (Del. Ch.) ("Prudence ordinarily would be expected to require a greater depth of knowledge of alternatives, of costs and consequences when the decision being made is of greater potential impact or importance"), *aff'd in pertinent part, rev'd in part on other grounds*, *Technicolor II*, 634 A.2d 345 (Del. 1993); *City Capital Assocs. L.P. v. Interco Inc.*, 551 A.2d 787, 802-03 (Del. Ch. 1988) ("When the transaction is so fundamental as the restructuring here (or a sale or merger of the Company), the obligation to be informed would seem to require that reliable information about the value of alternative transactions be explored"); *Freedman v. Rest. Assocs. Indus., Inc.*, 1987 WL 14323, at *8 (Del.

[17] A compendium of unreported decisions is being filed simultaneously herewith.

Ch.) ("A fiduciary is entitled to, indeed required to, consider all of the factors surrounding alternative possible transactions").

Here, the Director Defendants foreclosed NCS from adequately evaluating any deal with Omnicare, both before and after they approved the Genesis Merger Agreement. At the outset, they ignored Omnicare for many months, notwithstanding their knowledge that Omnicare was interested in acquiring NCS, had the financial wherewithal to do so, had made three separate proposals to acquire NCS at ever increasing prices, and was in a position to offer the highest value for NCS. Sells 119 (Ex. 10). REDACTED

REDACTED Then, almost a month before signing the Genesis Merger Agreement, and at a time when they knew Omnicare had offered a higher price, the Director Defendants caused NCS to enter into an exclusivity agreement (Ex. 27), denying themselves the opportunity to consider or even discuss any transaction other than one with Genesis.

The Director Defendants continued this pattern of willful blindness when they were presented with the Omnicare merger proposal on July 26, days before they entered into the agreement with Genesis. The Omnicare proposal was superior as to price *and* contained none of the draconian lock-up provisions demanded by Genesis. Yet, the Director Defendants chose to ignore that obviously superior alternative. The mere fact that the Director Defendants were pressed by Genesis to accede to deadlines or other ultimatums does not serve to excuse these defendants from failing to investigate Omnicare's merger proposal. *See, e.g., McMullin*, 765 A.2d at 922 ("The imposition of time constraints on a board's decision-making process may compromise the integrity of its deliberative process") (citation omitted).

NCS's financial advisor confirmed in its "fairness" opinion that NCS had not adequately explored potential alternatives prior to entering into the Genesis Merger Agreement, expressly warning, among other things:

> [o]ur opinion does not address the relative merits of the [Genesis] Merger as compared to any other alternative business strategies ... or the effect of any other transaction in which the Company might engage. (*Id.*).

NCS and its Directors then compounded their breaches of fiduciary duty by rushing to sign the Genesis deal and agreeing to the host of preclusive lock-up devices that insured that no superior proposal could ever succeed. Those included the unusually restrictive No-Shop Provision, the No Termination Provision, the requirement that NCS hold a stockholders' meeting even if the board no longer supported the Genesis merger (which it no longer does), and the approval of the Voting Agreements with Defendants Outcalt and Shaw that ensured stockholder approval of the Genesis merger at that mandatory meeting. The NCS Board and Special Committee were advised by their attorneys that those provisions "would prevent NCS from engaging in any alternative or superior transaction in the future" because "stockholder approval of the merger would be assured even if the board of directors were to withdraw or change its recommendation." Form S-4/A at 48 (Ex. 48). They approved those provisions nonetheless.

By precluding all other potential alternatives, including the Omnicare offer, the Director Defendants breached their duty of care. When a board approves a merger agreement without adequately exploring alternative transactions prior to that time, directors breach their duty of care *unless* they have retained the ability to receive and evaluate other offers and in the event other offers should arise, either retain to themselves the ability to terminate the agreement in favor of a superior transaction or preserve for the stockholders the ability to decline to approve the initial merger. *See Ace*, 747 A.2d at 109 (holding that when a board approves a merger agreement, "where the board is making a critical decision affecting stockholder ownership and voting rights, it is especially important that the board negotiate with care and retain sufficient flexibility to ensure that the stockholders are not unfairly coerced into accepting a less than optimal exchange for their shares"); *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255, at * 1-2 (Del. Ch.) (Bench Ruling) (ruling that "even the decision not to negotiate [with alternative bidders] ... must be an informed one," that it is inappropriate for a board "ex ante [to] bargain[] away its right to even become informed about whether or not to negotiate," that the board "should not have completely foreclosed the opportunity" when it entered into a merger agreement to negotiate with a third party through a preclusive "no talk" provision, which was the legal equivalent of "willful blindness," and that on the basis of such foreclosure, plaintiffs had demonstrated a probability of success on the merits of their due care claim).

2. The Director Defendants Failed To Obtain The Highest Price Reasonably Available For The NCS Shares

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At a minimum, such a complete abdication of duty suggests a fundamental misunderstanding on the part of the Director Defendants of their obligations to NCS and its stockholders to secure the best price and an appalling lack of due care.

In precluding themselves from obtaining for the NCS stockholders a higher price – which they knew Omnicare to be able and willing to offer – the Director Defendants not only breached their omni-present duty of care, but breached their obligations as well under *Revlon*[18] and its progeny to "act[] reasonably to seek the transaction offering the best value reasonably available to the stockholders." *See Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 43 (Del. 1994). It is well settled that a board's responsibilities under *Revlon* are triggered (among other circumstances) where the board "initiates an active bidding process seeking to sell itself...." *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989); *see also Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1287 (Del. 1989) ("As we held in *Revlon*, when management of a target company determines that the company is for sale, the board's *responsibilities* ... are significantly altered) (emphasis in original). In *City Capital Assocs. L.P. v. Interco Inc.*, this Court explained:

> When, as in *Revlon*, two bidders are actively contesting for control of a company, the most reliable source of information as to what may be the best available transaction will come out of an open contest or auction. Thus, *Revlon* holds that *where it is clear that the firm will be sold, and such a contest is going forward*, the board's duty is to act with respect to it so as to encourage the best possible result from the shareholders' point of view.

City Capital, 551 A.2d at 803 (emphasis added).

Here, there is no question that NCS, Brown Gibbons, and the Ad Hoc Committee had put NCS up for sale, that they claim to have moved to carry out an auction, flawed as that process may have been, and that they continued to shop NCS actively through July 3, 2002 (when NCS entered into the Exclusivity Agreement with Genesis). Indeed, the Special

[18] *See Revlon, Inc. v. MacAndrews & Forbes Holdings*, 506 A.2d 173 (Del. 1986).

Committee was formed for the express purpose of reviewing, evaluating and negotiating a possible acquisition. Form 14D-9 (Ex. 45); Shaw 51 (Ex. 11).

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Because the Director Defendants undertook to maximize short-term value by selling NCS, they were required to seek and secure the deal that offered the NCS stockholders the best available price. They nonetheless agreed to accept the Genesis offer, which indisputably offered NCS stockholders roughly *half* the consideration Omnicare was then offering. *A fortiori*, they breached their duty of care. *See* Hon. Vice Chancellor Leo E. Strine, Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 BUS. LAW. 919, 937-38 (2001). Indeed, the Director Defendants fully understood that by entering first into the Exclusivity Agreement and then the Genesis Merger Agreement, they were cutting short the auction and foreclosing their ability to obtain a higher price:

> [W]e knew that in signing [the Genesis Merger] agreement, that we were severely limiting our ability to do what we tried to do all along, which was to have a legitimate auction. We knew we were truncating that option....
>
> ... [B]y doing this, we are shutting down our auction and, therefore, enabling [the Genesis proposal] to go forward as a very possible winner. And that we have

done this with full knowledge that we are truncating the ability to take any other opportunity.

Sells 73, 89 (Ex. 10); S-4/A at 48 (Ex. 48). The Directors thus breached their duties under *Revlon* by prematurely ending the auction in a way that foreclosed other bids. *See Revlon*, 506 A.2d at 182-83, 185 (holding that by granting auction-ending lock up that effectively foreclosed further bidding, "the directors allowed considerations other than the maximization of shareholder profit to affect their judgment ... to the ultimate detriment of its shareholders" and that "[n]o such defensive measure can be sustained when it represents a breach of the directors' fundamental duty of care") (citation omitted).

Defendants may argue that *Revlon* duties are not implicated because the Genesis merger is a stock-for-stock deal that does not involve a "change of control." Such an argument is contradicted not only by the Directors' professed intent to sell NCS through a value-maximizing "structured auction" process, Pollack 65-66 (Ex. 9); Sells 118-119 (Ex. 10), but also by the complete absence of any evidence suggesting that the directors retracted their decision to pursue an auction and chose instead to focus on long-term strategic prospects. Indeed, the Director Defendants paid no heed to the future prospects for Genesis or to the value of the Genesis shares which the NCS stockholders would receive in the Merger.

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Candlewood's fairness opinion also warns that "we have not made ... an independent valuation or appraisal of the assets, liabilities or solvency of ... [Genesis]" and "are expressing no opinion ... as to the value of [Genesis] Common Stock when issued to the stockholders pursuant to the Merger, or as to the price at which it will trade at any future time." Fairness Opinion Presentation (Ex. 37 at 2). Rather, Candlewood simply used the then-current market price of Genesis stock for purposes of valuing the stock-for-stock transaction, ignoring the fact that Genesis had just emerged from bankruptcy, was heavily debt-laden, had an ever-changing management, and was facing loss of revenues and income due to the expiration of Medicare reimbursement provisions. Notwithstanding Candlewood's failure to value Genesis or to assess the potential risks associated with ownership of Genesis stock, the Director Defendants did not obtain a "collar" or "floor" on the price of Genesis shares or reserve the right to terminate the merger agreement in the event of a material adverse change in the business of Genesis or the value of its shares.

Those failures appear to have resulted from a fundamental misunderstanding by the Director Defendants of their obligations in approving the Genesis merger.

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see Van Gorkom, 488 A.2d at 876-78 (holding that board breached its duty of care in relying solely on market price of Trans Union's stock in evaluating Pritzker's offer).

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Their failure to do so was a gross breach of their fiduciary duty of care, even if Revlon and its concomitant obligation to maximize short term value does not apply. Their traditional duty of care still would oblige the Director Defendants to act in the best interests of NCS and its stockholders "without regard to a fixed investment horizon." *Time*, 571 A.2d at 1150. As this Court observed in *Ace*:

> As a matter of corporate law, *QVC* does not say that directors have no fiduciary duties when they are not in "*Revlon*-land." *QVC* simply defines when a board

> enters *Revlon*-land and is required to seek the highest available value. But *QVC* does not say that a board can, without exercising due care, enter into a non-change of control transaction affecting stockholder ownership rights and imbed in that agreement provisions guaranteeing that the transaction will occur and that therefore absolutely preclude stockholders from receiving another offer that even the board deems more favorable to them. Put somewhat differently, *QVC* does not say that a board can, in all circumstances, continue to support a merger agreement not involving a change of control when: (1) the board negotiated a merger agreement that was tied to voting agreements ensuring consummation if the board does not terminate the agreement; (2) the board no longer believes that the merger is a good transaction for the stockholders; and (3) the board believes that another available transaction is more favorable to the stockholders. The fact that the board has no *Revlon* duties does not mean that it can contractually bind itself to sit idly by and allow an unfavorable and preclusive transaction to occur that its own actions have brought about. The logic of *QVC* itself casts doubt on the validity of such a contract.

Ace, 747 A.2d at 107-08 (discussing *Paramount Communications Inc. v. QVC Network,* 637 A.2d 34 (Del. 1993)). Unfortunately, unlike the Capital Re directors who wisely determined to terminate the flawed merger agreement with Ace, here, too, the Director Defendants refuse to fulfill their fiduciary duties. Thus, injunctive relief is mandated.

3. The Director Defendants Further Breached Their Duty Of Care By Failing To Inform Themselves Fully Of The Material Terms Of The Genesis Merger Agreement

The Directors' breaches are not limited to their failure to consider alternatives, to obtain the best price, and to consider the future prospects of Genesis. Directors are required to act in an informed and deliberate manner, to inform themselves of all material information reasonably available to them, and "to proceed with a critical eye in assessing information...." *Van Gorkom*, 488 A.2d at 872-73, 883 n.25.

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[19] To the extent the Director Defendants have hidden behind the attorney-client privilege to shield the reasons the Merger Agreement was approved before the Voting Agreements and that Section 203 protection was otherwise waived, they are not permitted to use the privilege as both a sword and a shield. *See, e.g.*, Sells 103-05 (Ex. 10); *In re Pure Res., Inc., S'holders Litig.*, 2002 Del. Ch. LEXIS 112, at *23-24 & n.8 (Del. Ch.) (noting that the Court can draw a negative inference when a board invokes the attorney-client privilege to shield its actions from view). They accordingly are precluded from presenting evidence regarding their reasons, and from defending their position that their decision was reasonable and made with due care. *See Chesapeake Corp. v. Shore*, 771 A.2d 293, 300-01 (Del. Ch. 2000).

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For the foregoing reasons, the Director Defendants have breached their duty of care and the Merger should be enjoined. *Arnold v. Society for Sav. Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994); *see also Technicolor II*, 634 A.2d at 361.

B. The Deal Protection Devices Are Draconian, Unreasonable And <u>Unenforceable</u>

A second reason for enjoining the Genesis Merger Agreement is that the defensive devices approved by the NCS Board in connection with the challenged merger violate the *Unocal/Unitrin* test to which they are plainly subject and cannot withstand the enhanced judicial scrutiny that this test mandates.

1. <u>*Unocal/Unitrin* is the Applicable Standard of Review</u>

Defensive deal protection devices approved by a target board in order to insulate a challenged transaction from competing bids are subject to enhanced judicial scrutiny under the *Unocal/Unitrin* doctrine. *Time*, 571 A.2d at 1151 (holding that "structural safety devices" including lock-up agreements and no-shop clauses in challenged stock-for-stock merger not subject to *Revlon* analysis "are properly subject to a *Unocal* analysis."); *see also Arnold v. Society for Sav. Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994); *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59 (Del. 1995) (applying *Unocal* analysis to defensive provisions in stock-for-stock, non-*Revlon* transactions); *Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1378

(Del. 1995); *Stroud v. Grace*, 606 A.2d 75, 82 (Del. 1992); *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1144 (Del. 1990) (declaring *Unocal* analysis applicable to any defensive action taken in response to control-related threat to corporate policy).

As stated by this Court in *McMillan v. Intercargo Corp.*, 768 A.2d 492 (Del. Ch. 2000),

> Under a "duck" approach to the law, defensive "deal protection" terms self-evidently designed to deter and make more expensive alternative transactions would be considered defensive and reviewed under the *Unocal Corp. v. Mesa Petroleum Co.*, Del. Supr., 493 A.2d 946 (1985) standard . . . . Provisions of this obviously defensive nature (e.g. no-shops, no-talks, termination fees triggered by the consummation of an alternative transaction, and stock options with the primary purpose of destroying pooling treatment for other bidders) primarily "protect" the deal and the parties thereto *from* the possibility that a rival transaction will displace the deal. Such deal protection provisions accomplish this purpose by making it more difficult and more expensive to consummate a competing transaction and by providing compensation to the odd company out if such an alternative deal nonetheless occurs.

Id. at 506, n.62 (emphasis in original).

As a result, the defensive devices approved and authorized by the NCS board can withstand judicial review only if the NCS board succeeds in carrying its burden to satisfy the two part test imposed by *Unocal/Unitrin*. Pursuant to that constructive test, Defendants first must satisfy the Court that they have reasonable grounds to believe, upon a good faith investigation, that a competing bid would pose a danger to corporate policy and effectiveness. Second, Defendants must show that the challenged defensive actions were proportionate to that threat, meaning that the target board's response is neither preclusive nor coercive and that it falls within a range of reasonableness. *Unitrin*, 651 A.2d at 1372, 1384-86; *Kahn v. Roberts*, 679 A.2d 460 (Del. 1996); *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998). This the Defendants cannot do.

2. The NCS Board Cannot Satisfy the First Prong of the *Unocal/Unitrin* Test

The first prong of the *Unocal/Unitrin* test can be satisfied only if the NCS board establishes that it acted to approve the challenged defensive action in good faith and after reasonable investigation. Here, such a conclusion can only abide in defiance of the undisputed facts of the record. As noted in detail above in connection with the argument addressing the breach of the duty of care on the part of the NCS directors, the NCS board not only failed to conduct a reasonable investigation with respect to Omnicare's willingness and its ability to pay more, but, with the inexplicable approval of its inexperienced advisors, affirmatively determined to refrain from doing so. Instead, they opted to tie their own hands, as well as their shareholders and to contract away their ability and fiduciary obligation to consider superior alternatives either before or after the execution of the Genesis Merger Agreement.

To appreciate fully the ill-considered and all-encompassing scope of the director defendants' preclusive and coercive actions, the Court need only look to the unhappy dilemma that the NCS board currently confronts. Having only now been confronted with the reality that a reasonable, good faith investigation would previously have revealed, the NCS board has now determined, too late in the absence of judicial intervention, that in light of the Omnicare bid, it can no longer recommend that its stockholders accept the clearly inferior Genesis merger it has contractually coerced them to accept. That belated advice, however, is no longer of any value or pertinence to the NCS stockholders. By virtue of the directors' impetuous action, the board is required to proceed with the inevitable implementation of the Genesis merger and thereby to force the NCS stockholders to accept an unquestionably inferior bid.

3. The NCS Directors Cannot Satisfy the Second Prong of the *Unocal/Unitrin* Test

Even assuming that defendants could establish that Omnicare's far richer offer reasonably could be characterized as a threat of any sort in the common understanding of that term, and, all evidence to the contrary, that they had reached that conclusion following a reasonable investigation conducted in good faith, they nonetheless cannot meet the proportionality test that constitutes the second prong of the *Unocal/Unitrin* test. This test implements and enforces the declaration by the Supreme Court in *Unocal* that a board's power to fend off perceived threats to corporate policy is not absolute, and that it "does not have unbridled discretion to defeat any perceived threat by any Draconian means available." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985). Rather, the board may implement defensive devices only to the extent that they are reasonably proportionate to the perceived threat. Moreover,

> As common law applications of *Unocal's* proportionality standard have evolved, at least two characteristics of draconian defensive measures taken by a board of directors in responding to a threat have been brought into focus through enhanced judicial scrutiny. In the modern takeover lexicon, *it is now clear that since Unocal, this Court has consistently recognized that defensive measures which are either preclusive or coercive are included within the common law definition of draconian.*
>
> If a defensive measure is not draconian, however, because it is neither coercive or preclusive, the *Unocal* proportionality test requires the focus of enhanced judicial scrutiny to shift to "the range of reasonableness."

Unitrin, 651 A.2d 1387-88 (emphasis supplied and citation omitted). *See also Carmody v. Toll Bros., Inc.*, 723 A.2d 1180 (Del. Ch. 1998).

Defensive obstacles are disproportionate to the threat posed, and are unreasonable as a matter of law, if, as here, they are coercive or preclusive. *See, e.g., Carmody*, 723 A.2d at 1195. In *Carmody*, the Chancery Court held that a "dead hand" provision that limited newly elected directors' powers and that would make a proxy contest "realistically unattainable" could not withstand scrutiny under *Unocal*. *Id.* "A defensive measure is preclusive if it makes a bidder's ability to wage a successful proxy contest and gain control either 'mathematically impossible' or 'realistically unattainable.'" *Id.* (citing *Unitrin* 651 A.2d at 1388-89).

Here, the Voting Agreements, coupled with the Defendants' irrevocable agreement to put the merger to a predetermined stockholder vote regardless of intervening circumstances, preclude any outcome other than consummation of the Proposed Genesis merger. As a result, a successful proxy contest to defeat the Genesis Merger is both "mathematically impossible" *and* "realistically unattainable." *Carmody*, 723 A.2d at 1195. Pursuant to the Voting Agreements authorized and approved by the NCS board, Defendant Directors Outcalt and Shaw have committed to Genesis, *inter alia*, to cast their majority voting interest in NCS in favor of the proposed merger and against any alternative transaction and contrary to the wishes and welfare of the owners of 80% of the company. This method of ensuring the requisite stockholder approval for the Genesis merger is rendered airtight by the accompanying inclusion in the merger agreement itself of a so-called "force the vote" provision. Pursuant to this provision, the NCS board has obligated itself to submit the Genesis merger to a vote of the NCS stockholders, even if the board should determine (as it now has) that it can no longer recommend that merger as consonant with the best interests of its shareholders. In tandem, these devices ensure the Genesis merger will be approved by the requisite percentage of NCS stockholders and that it will be consummated under virtually any circumstance. The effectiveness of this device is starkly demonstrated by the fact that the NCS board has now concluded that it can no longer support the Genesis merger in light of the pending offer from Omnicare at more than twice the price. October 22 Press Release (Ex. 46). Yet the contractual obligations improvidently undertaken by

NCS require that the Genesis merger proceed toward approval and implementation. The accompanying no-talk, no-shop and termination fee provisions are plainly designed, if redundantly so, to serve the same ends, now apparently no longer regarded as desirable even by the NCS board that so thoughtlessly embraced them only months ago.

There can be little question that these lock-up provisions are collectively both preclusive and coercive, and *a fortiori* fall outside the range of a reasonably proportionate response to any perceived threat. They are preclusive in that they flatly prevent the NCS stockholders from accepting a far higher offer for their shares. They are coercive in that they will require the NCS stockholders to accept the offer from Genesis. They are by definition unreasonable and disproportionate to any conceivable threat posed to NCS or its stockholders by the superior Omnicare offer, a fact that is once again best evidenced by the recent change of heart on the part of the NCS board. The only realistic threat now confronted by the NCS stockholders is that Genesis will continue to insist upon and, in the absence of judicial intervention, undoubtedly secure the performance of the contractual rights conferred upon them by the defendant directors.

Vice Chancellor Strine's decision in *Ace* is again on point. There, the parties had entered into voting agreements that locked up almost 46% of the necessary stockholder votes in favor or a merger agreement that also included a no-shop provision. *Ace*, 747 A.2d at 97-98. After Capital Re received a superior offer, the directors, consistent with their fiduciary duties, sought to terminate the merger agreement between Ace and Capital Re. In response, Ace sued Capital Re and sought an order temporarily restraining Capital Re from terminating the agreement. As with the no-shop provision in the Genesis Merger Agreement, the Ace agreement appeared to contain a "fiduciary out" clause. In attempting to enforce the agreement, however, the bidder proffered an argument which, if accepted, would essentially have rendered the "fiduciary out" clause meaningless – precisely what the Exclusivity Agreement, the Voting Agreements and the no-shop provision purport to do here. In rejecting this argument, the Court observed that so restrictive a reading of the fiduciary out provision would almost surely render it invalid and unenforceable:

> Absent an escape clause, the Merger Agreement guarantees success of the merger vote and precludes any other alternative, no matter how much more lucrative to the Capital Re stockholders and no matter whether the Capital Re board itself prefers the other alternative. As a practical matter, it might therefore be possible to construct a *plausible* argument that a no-escape merger agreement that locks up the necessary votes constitutes an unreasonable preclusive and coercive defensive obstacle within the meaning of *Unocal.*

Ace, 747 A.2d at 108 (emphasis in original) (footnote and citations omitted).

This is not a circumstance in which the NCS board may claim that the preclusive Voting Agreements are purely stockholder acts for which they have no responsibility. First, NCS is a party and a signatory to these agreements. (Exs. 39 and 40). Second, the most egregiously preclusive effect of those agreements is felt when they are combined with the "force the vote" provision to which the NCS board agreed with full knowledge of the consequences that would result from the combination.[20] Third, the Voting Agreements themselves would have been without practical utility had the NCS directors withheld approval of these agreements for purposes of Section 203, approval that they afforded hastily and without understanding.[21]

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[20] *See* S-4/A at 40 ("legal counsel reminded the NCS independent committee that under the terms of the merger agreement and because NCS stockholders representing in excess of 50% of the outstanding voting power would be required by Genesis to enter into stockholder voting agreements contemporaneously with the signing of the merger agreement, and would agree to vote their shares in favor of the merger agreement, stockholder approval of the merger would be assured even if the NCS board of directors were to withdraw or change its recommendation."); *see id.* at A-38 (Merger Agreement § 5.3(a)) (Ex. 42).

[21] *See e.g.*, Sells 103-05 (Ex. 10); note 14 *supra*

The extent to which the parties to the Genesis Merger Agreement intended to preclude any interference with its approval, an effect now plainly rued by the NCS board, is evidenced by the inclusion of additional and plainly redundant lock-up provisions. As discussed above, the effect of the Voting Agreements, coupled with the "force the vote" provision, is more than sufficient to ensure approval of the Genesis Merger. Yet the agreement also included a no-talk provision and a break-up fee of punitive dimension for good measure.

This Court has recently held that no-talk provisions are inherently in conflict with a board's duty to make an informed judgment with respect to "ownership" decisions. *See Phelps Dodge*, 1999 WL 1054255, at *1 ("No-talk provisions ... are troubling precisely because they prevent a board from meeting its duty to make an informed judgment with respect to even considering whether to negotiate with a third party.").

In addition, the termination fee incorporated in the Genesis Merger Agreement is unquestionably unreasonable. It requires NCS to pay $6 million (15% of the equity value of the transaction), plus up to $5 million in expenses, if NCS (or in some cases *Genesis*) terminates the Genesis Merger Agreement. It is excessive on its face. The sum is *four to five times* the percentage of equity value Delaware courts have generally endorsed as reasonable. *See, e.g.*, *McMillan*, 768 A.2d at 505 (3.5% is at or near the maximum permissible termination fee). Vice Chancellor Chandler, for example, has expressed grave doubts about a 6.3% fee, noting that it seemed "to stretch the definition of range of reasonableness and probably stretches the definition beyond its breaking point." *Phelps Dodge,* 1999 WL 1054255, at *2; *see also* Hon. Vice Chancellor Leo E. Strine, Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 BUS. LAW. 919, 935 n.48 (2001).

The combined preclusive and coercive effects of the defensive devices render the Genesis Merger Agreement invalid. That courts will look at the combined effect of the defensive measures taken in evaluating their reasonableness is made clear in *QVC*. There, the Supreme Court invalidated an agreement that contained several defensive devices, including a termination fee, a no-shop provision and a stock option agreement:

> The Stock Option Agreement had a number of unusual and potentially 'draconian' provisions.... Furthermore, the Termination Fee, whether or not unreasonable by itself, clearly made Paramount less attractive to other bidders, when coupled with the Stock Option Agreement. Finally, the No-Shop Provision inhibited the Paramount Board's ability to negotiate with other potential bidders....

QVC, 637 A.2d at 49 (footnote omitted); *see also Unitrin*, 651 A.2d at 1387 ("Where all of the target board's defensive actions are inextricably related, the principles of *Unocal* require that such actions be scrutinized collectively as a unitary response to the perceived threat.") (citation omitted). Here, the combined effects of the defensive measures make it impossible for the stockholders to reject the Genesis Merger Agreement and mandate its approval.

Finally, enhanced scrutiny *still* requires NCS and the Director Defendants to demonstrate that their defensive measures fall within a "range of reasonableness." *See Unitrin*, 651 A.2d at 1387-88. In *Unitrin*, the Supreme Court set forth several factors to be considered when determining whether deal-protection measures fall within a range of reasonableness, including (a) whether the measure adopted by the board is a statutorily authorized form of business decision which a board may routinely make in a non-takeover context; (b) whether it was limited in degree or magnitude in relation to the threat it was intended to protect against; and (c) whether the board recognized that not all stockholders are alike and provided immediate liquidity for those who wanted it. *See id.* at 1387-89.

The defensive provisions in the Genesis Merger Agreement fall well outside any "range of reasonableness." First, they are not authorized by statute; indeed, they violate DGCL §§141(a) and 251. Second, the Merger Agreement, coupled with the Voting Agreements are not limited in degree or magnitude, but make it *impossible* for any "threat" to the Proposed Genesis Merger to succeed. And third, they provide no immediate liquidity for stockholders desiring that option. Rather, the arsenal of defensive weapons deployed against Omnicare affirmatively prevents NCS stockholders from obtaining the highest available value for their shares. Thus, injunctive relief is appropriate.

In entering into the Proposed Genesis Merger Agreement the Defendant Directors breached their duties of loyalty and good faith. As a result of this, and of their breach of their duty of care, as discussed above, the Defendants bear the burden of proving the entire fairness of the transaction. *See Technicolor II*, 634 A.2d at 361; *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993).

C. <u>The Special Committee Was Neither Functional Nor Independent</u>

Unlike the typical situation, this Special Committee was purportedly formed to ensure that the shareholders of NCS were not favored in a situation where the Board believed it owed fiduciary duties to creditors. Outcalt 47 (Ex. 8); Shaw 45 (Ex. 11). In apparent recognition of the fact that Outcalt and Shaw were conflicted, the Board appointed a Special Committee for express purpose of reviewing, evaluating and negotiating possible strategic transactions. Form 14D-9 at 7 (Ex. 45). Although a board may satisfy or shift the burden of proof for entire fairness review by appointing a special committee of disinterested and independent directors to negotiate and approve the transaction at issue, *Aronson*, 473 A.2d at 812, this is so only when the special committee is independent, disinterested and diligent and it must function in a manner consistent with protecting the shareholders' interests. *See Kahn v.*

Tremont Corp., 1994 WL 162613, at *3 (Del. Ch.) ("a special committee of allegedly disinterested directors can only be afforded dignity when the Court is content that the committee was truly independent in fact ... energetic, informed and well motivated"). Thus, "[e]ntire fairness remains applicable even when an independent committee is utilized because the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny." *Kahn v. Tremont Corp.*, 694 A.2d 422, 428 (Del. 1997) (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983)).

Here, the NCS Special Committee meets none of the typical and necessary criterion for independence. As Outcalt and Shaw testified, the Special Committee was not functioning in many regards. For example, Osborn, a busy professor, who serves on seven boards of directors and three advisory boards, Osborne 9-13 (Ex. 7), devoted minimal time to the affairs of NCS.

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[22] Here, the Special Committee shared the same financial advisors (Brown Gibbons and Candlewood), and the same legal advisors (Benesch). Indeed, rather than selecting its own financial advisor, Outcalt and Shaw selected those advisors themselves.

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It is clear, therefore, that the Special Committee lacked independence and failed to discharge its obligation to the shareholders.

1. The Proposed Genesis Merger Was Neither The Product Of Fair Dealing Nor Fair Price.

Here, the entire fairness standard is applicable for at least three reasons: (1) the Directors breached their duty of care; (2) the Directors cannot satisfy their burden under *Unocal*; and (3) the Directors cannot satisfy their enhanced scrutiny burden under *Revlon*. *See Unitrin,* 651 A.2d at 1377; *Technicolor II*, 634 A.2d at 361.

The entire fairness standard requires the directors to establish that the challenged transaction was the product of both fair dealing and fair price – in other words that it was the product of a qualitatively fair process resulting in a quantitatively fair price. *See, e.g., Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1162-63 (Del. 1995) ("Technicolor III") (quoting *Weinberger*, 457 A.2d at 711). "Fair dealing" involves the actual conduct of the directors in connection with the challenged transaction, including the timing, initiation, structure, and negotiation of the transaction, as well as the manner in which disclosure was made to the directors and stockholders and the manner in which approvals of the directors and stockholders were obtained. *See, id.; Technicolor III*, 663 A.2d at 1172-76.

"Fair price" typically means a price that a reasonable seller, under all of the circumstances and in an arms' length transaction, would regard as within a range of fair value. *See Cinerama, Inc. v. Technicolor, Inc.*, Del. Ch., 663 A.2d 1134, 1143 (1994), *aff'd, Technicolor III*, 663 A.2d 1156. Thus, for example, in the context of a merger, "fair price" relates to the economic and financial considerations of the proposed merger, including all relevant factors – asset value, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of the company's stock. *Id.* at 1162-63 (quoting *Weinberger*, 457 A.2d at 711). Moreover, where a proposed transaction involves an auction, a change of control, or a break-up of the company, "fair price" mandates that the directors commit themselves to obtaining the highest price reasonably available under the circumstances. *See Technicolor III*, 663 A.2d at 1163; *QVC*, 637 A.2d at 48.

The fairness of the price and the process here cannot withstand scrutiny. With respect to fair dealing, as detailed previously, the process was fundamentally flawed from the outset. *See* Section II.A, *supra*, and Section II.C., *supra*.

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See, e.g., Mills Acquisition, 559 A.2d at 1280 (enjoining transaction where, as here, "[t]he board was torpid, if not supine, in its efforts to establish a truly independent auction ..."). The Director Defendants also blindly entered into the Exclusivity Agreement -- which prevented NCS and its Directors from considering any other proposal, no matter how superior from anyone -- almost a month before signing the Genesis Merger Agreement, at a time when Omnicare was offering a higher price. *See Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1287 (Del. 1989) ("fairness demands a canvas of the market to determine if higher bids may be elicited"). *Compare Fort Howard*, 1988 WL 83147, at *1 (although special committee did not conduct an auction of any kind before signing a merger agreement, it did, however, "negotiate provisions purportedly intended to permit an effective check of the market before the ... offer could close").

Notwithstanding those obligations, NCS and its Directors failed to open their "auction" to Omnicare, which defendants knew had the wherewithal to consummate a transaction Sells 119 (Ex. 10); Brown Gibbons May 14, 2002 Presentation (Ex. 24); entered into the Exclusivity Agreement barring the Directors from evaluating or even testing the bona fides of Omnicare's plainly superior proposal (Ex. 27); and then hastily entered into the Genesis Merger Agreement which locked-up the deal with Genesis

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; (c) exploring Omnicare's substantially higher all-cash offer (Ex. 43); (d) analyzing the prospects for Genesis and its shares; or (e) reserving the right to terminate the transaction in the event of a material adverse decline in the business of Genesis or the value of its shares. Each of these actions was improper; collectively, they demonstrate the complete and utter absence of a fair process.

The Proposed Genesis Merger also fails with respect to a fair price analysis. The simple fact that Omnicare's $3.50 per share is a better offer to the NCS stockholders than Genesis's $1.30 to $1.40 per share is clear to every one, including NCS's directors and the Special Committee's financial advisor. REDACTED

REDACTED : *see* S-4/A (Ex. 48). When faced with a sale of the company, directors "may not exercise a judgment to choose less when more is offered." *Equity-Linked Investors, L.P. v. Adams*, 705 A.2d 1040, 1054 n.47 (Del. Ch. 1997) ("The germinal principle is the fundamental one that a fiduciary may not sell an asset for less cash when more cash is available and no circumstance affecting the trust or its beneficiary justifies choosing less." (citing *Robinson v. Pittsburgh Oil Ref. Corp.*, 126 A. 46 (Del. Ch. 1926); *Wilmington Trust Co. v. Coulter*, 200 A.2d 441 (Del. 1964)).

Importantly, however, the superior value of an Omnicare proposal is not simply recognized by hindsight. Indeed, as early as September 26, 2001, Pollack had informed NCS that the potential synergies of a merger with Omnicare were in the \$77 to \$87 million range. Pollack 80 (Ex. 9); May 14, 2002 Presentation, and S-4/A (Exs. 24 and 48).

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Thus,

[23] Moreover, Candlewood's "fairness" opinion expressly warned:

(a) "[o]ur opinion does not address the relative merits of the [Genesis] Merger as compared to any other alternative business strategies ... or the effect of any other transaction in which the Company might engage" -- i.e., Candlewood did not compare the Genesis deal with Omnicare's substantially higher, \$3.00 per share all-cash offer (Ex. 37).

(b) "we have not made ... an independent valuation or appraisal of the assets, liabilities or solvency of the Company or [Genesis]" and "are expressing no opinion ... as to the value of [Genesis] Common Stock when issued to the stockholders pursuant to the Merger, or as to the price at which it will trade at any future time" (*id.*) -- i.e., Candlewood simply

NCS knew prior to receiving Omnicare's bid that Omnicare would place a greater value on a transaction with NCS than Genesis would and that Omnicare had outbid Genesis on a previous occasion. Accordingly, Defendants cannot satisfy the fair price prong of the entire fairness analysis.

2. **Outcalt Also Breached His Duty of Disclosure By Not Disclosing His <u>Interest In The Proposed Genesis Merger To The Rest Of The Board</u>**

Entire fairness review is also appropriate where a director fails to disclose his material interest in the transaction to the board.

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Nor was this material interest disclosed to the other directors. Such undisclosed interests mandate entire fairness scrutiny:

> [A] financial interest in a transaction that is material to one or more directors less than a majority of those voting is "significant" for burden shifting purposes (or is "instrumental" or "material under the second part of the materiality standard") when the interested director *controls or dominates* the board as a whole or when the interested director *fails to disclose his interest* in the transaction to the board *and* a reasonable board member would have regarded the existence of the material interest as a significant fact in the evaluation of the proposed transaction.

Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1153 (Del. Ch. 1994) (emphasis in original); *aff'd*, *Technicolor III*, 663 at 1168; *cf. Goodwin v. Live Entm't, Inc.*, 1999 WL 64265, at *25

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took the then-current market price of Genesis stock for purposes of valuing this stock-for-stock transaction, thereby ignoring the fact that Genesis had just emerged from bankruptcy, was heavily debt-laden, had an ever-changing management, and was facing the loss of revenues and income due to the expiration of Medicare reimbursement provisions.

(Del. Ch). Indeed, the Special Committee's ineffectiveness is exemplified by this complete breakdown in communication with the Board. Thus, entire fairness scrutiny must apply because the Chairman of the Special Committee was kept in the dark about what compensation the Chairman of NCS's Board was to receive in the transaction.

D. The Genesis Merger Agreement and the Voting Agreements Are Void Because They Were Entered into in Violation of DGCL §141(a)

On October 22, 2002, NCS announced that its board of directors had withdrawn its recommendation of the Genesis Merger. (Ex. 46). Despite having concluded that the Genesis Merger is not in the best interests of NCS or its stockholders, the NCS Board, as a result of having agreed to the Lock-Ups, is powerless to stop the transaction and protect NCS and its stockholders. As NCS conceded in its October 22, 2002 Press Release:

> NCS does not have the right to terminate its July 28, 2002 merger agreement with Genesis, and NCS is required to submit the Genesis merger agreement for stockholder approval notwithstanding the NCS board's withdrawal of its recommendation. By virtue of voting agreements entered into in connection with the Genesis transaction, NCS believes that Genesis has sufficient power to approve the Genesis merger.

(*Id.*) The same day, Genesis issued a press release stating that, while Genesis was "respectful of the continuing duty of the NCS board," the Genesis Merger was locked-up and there was nothing the NCS Board could do to prevent it. Genesis Press Release (Ex. 47). Specifically, Genesis noted that the decision of the NCS board to change its recommendation:

> does not affect the Genesis/NCS merger agreement, which remains binding upon NCS, nor does it affect the related voting agreements which remain binding upon the holders of a majority of the voting power of NCS.

(*Id.*). It is no answer that Section 251 (c) sanctions a "force the vote" provision, because here the Voting Agreements prevent the shareholders from exercising freedeom of choice. *See* Ace, 747 A.2d at 106 n.34.

Based on these undisputed facts, Plaintiffs clearly can establish a probability of success that the Genesis Merger Agreement and the Voting Agreements prevent the Director Defendants from performing their statutory duties to manage the affairs of NCS and, consequently, were entered into in violation of DGCL §141(a). 8 Del. C. § 141(a) (requiring that a corporation "be managed by or under the direction of the board of directors ..."); *see also* *Quickturn*, 721 A.2d at 1291 ("One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business affairs of a corporation.") (citations omitted).

It is well-settled that a Board may not enter into a contract that interferes "with the board's power to protect fully the corporation's (and its stockholders') interests in a transaction that is one of the most fundamental and important in the life of a business enterprise." *Carmody*, 723 A.2d at 1190-92 ("dead hand" poison pill invalid because it interferes with board's statutory power to manage corporation); *see also Ace*, 747 A.2d at 106 (*citing* DGCL §141(a) and noting that no-shop provision "involves an abdication by the board of its duty to determine what its own fiduciary obligations require at precisely that time in the life of the company when the board's own judgment is most important") (citations omitted). Thus, any provision that prevents the board "from *completely* discharging its fundamental management duties to the corporation and its stockholders" is invalid and unenforceable under DGCL §141(a). *Quickturn.*, 721 A.2d at 1291 (emphasis in the original).[24]

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[24] In *Quickturn*, the Delaware Supreme Court invalidated a provision designed to restrict a new board's ability to negotiate a sale after being elected, holding that:

> While the Delayed Redemption Provision limits the board of directors' authority in only one respect, the suspension of the Rights Plan, it nonetheless restricts the board's power in an area of fundamental importance to the shareholders -- *negotiating a possible sale of the corporation.* Therefore, we hold that the

As noted above, on October 22, 2002, NCS conceded that the terms of the Genesis Merger Agreement (including the Voting Agreements) "disable the board and the stockholders from doing anything other than accepting the contract even if another much more valuable opportunity [like Omnicare's] comes along." *See Ace*, 747 A.2d at 104-05.[25] Simply stated, the Director Defendants impermissibly "contracted away" their responsibilities under DGCL §141(a) and "tied their own hands." *See QVC*, 637 A.2d at 51 ("To the extent that a contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable.") (citation omitted). As a result, the Genesis Merger Agreement is invalid and unenforceable. *See, e.g., Quickturn*, 721 A.2d at 1291; *QVC*, 637 A.2d at 55.

E. Genesis Has Aided And Abetted NCS And The Director Defendants In Their <u>Breaches Of Fiduciary Duty</u>

Plaintiffs have shown that the Voting Agreements, in tandem with the Merger Agreement, are void and unenforceable. *See QVC Network, Inc. v. Paramount Communications, Inc.*, 635 A.2d 1245 (Del. Ch. 1993), *aff'd*, 637 A.2d 34 (Del. 1994). Furthermore, Genesis cannot, in any event, complain because it knew full well the consequences of these agreements it demands. A non-fiduciary third-party will be found to have aided and abetted a fiduciary in a breach of that fiduciary's duty where the following elements have been satisfied:

> Delayed Redemption Provision is invalid under Section 141(a), which confers upon any newly elected board of directors *full* power to manage and direct the business and affairs of a Delaware corporation.

Quickturn, 721 A.2d at 1291-92 (emphasis in original) (citations omitted).

[25] Not only did the Director Defendants abdicate their duties when they entered into the Genesis Merger Agreement, they in fact had already done so on July 1, 2002, when they entered into the unprecedented Exclusivity Agreement, which contained no "fiduciary out" whatsoever and purported to bar NCS from communicating with anyone else concerning a prospective buyout. *See* Ex. 27.

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1. the existence of a fiduciary relationship;

2. the fiduciary breached its duty;

3. a defendant, who is not a fiduciary, knowingly participated in a breach; and

4. damages to the plaintiff resulting from the concerted action of the fiduciary and the non-fiduciary.

See Jackson Nat'l Life Ins. Co. v. Kennedy, 741 A.2d 377, 386 (Del. Ch. 1999) (citation omitted).

In the present case, Genesis far surpassed the bounds of typical "arm's length" negotiating by insisting that NCS agree to extremely onerous and restrictive merger terms, which work in concert to force the deal with Genesis to completion—no matter how unfair the result to NCS' shareholders. As discussed above, those terms included the restrictive No-Shop provision, the No Termination provision, the requirement that NCS hold a stockholders' meeting, and the Voting Agreements with Defendants Outcalt and Shaw (which ensured formal approval of the transaction at such a meeting). By insisting on these terms, Genesis "knowingly participated" in the Director Defendants' breaches of their fiduciary duties.

As discussed, *supra* at pages 16-17, REDACTED Genesis had a "history" with Omnicare outbidding it in an auction and insisted on these provisions in order to lock up a "bulletproof" deal and specifically preclude NCS from considering a superior proposal from Omnicare. Genesis also knew, or certainly should have known, that its actions were forcing the NCS directors to breach their fiduciary duties. In 1999, Vice Chancellor Strine noted that

> a suitor seeking to "lock up" a change-of-control transaction with another corporation is deemed to know the legal environment in which it is operating.

> Such a suitor cannot importune a target board into entering into a deal that effectively prevents the emergence of a more valuable transaction or that disables the target board from exercising its fiduciary responsibilities.

Ace, 747 A.2d at 105. In *Ace*, this Court was faced with a bidder's effort to have similarly onerous "lock up" provisions in a merger agreement specifically enforced. In his opinion, the Vice Chancellor discusses an article written by Professor Paul L. Regan in which he identifies four factors a court should weigh in evaluating merger terms that are "fiduciarily improper or that result from a fiduciary breach." *Id.* (discussing Paul L. Regan, *Great Expectations? A Contract Law Analysis For Preclusive Corporate Lock-Ups.* 21 CARDOZO LAW. Rev. 1 (Oct. 1999) ("*Great Expectations*")). One of those factors is "whether the acquirer knew, or should have known, of the target board's breach of fiduciary duty . . . ." *Id.* at 105-06. In *Ace*, the Court found that this element was satisfied because "[a]s a sophisticated party who bargained for, nay demanded, [the "lock up" provision], [the acquirer] was on notice of its possible invalidity." *Id.* at 109. Moreover, in *Great Expectations*, Professor Regan observed: "An acquirer who insists on 'pushing the envelope' with these [lock-up] devices needlessly invites substantial transaction risk; is plainly 'on notice' of potential fiduciary transgressions by the target board; and thus will not qualify as a party with 'justified' expectations." *Great Expectations* at 88. In the present case, there is no dispute that Genesis is highly sophisticated and was advised by sophisticated advisors. For this reason, the Court should find that Genesis was not only "on notice" of the Defendant Directors' breaches of fiduciary duty, but also actively participated in those breaches as an aider and abettor.

III. THE STOCKHOLDER PLAINTIFFS WILL SUFFER IRREPARABLE HARM IF THE MERGER IS NOT ENJOINED.

As a result of the Director Defendants' material breaches of their duty of care and loyalty, NCS shareholders have been deprived of the opportunity to receive the best possible offer for a business combination. *See QVC*, 635 A.2d at 1273 n.50 (shareholders' loss of opportunity itself constitutes irreparable harm). Such damages would be difficult to assess because it is impossible to predict what a true auction and/or unfettered negotiation with Omnicare would have produced. *Sealy Mattress Co. of N.J. v. Sealy, Inc.*, 532 A.2d 1324, 1341 (Del. Ch. 1987). Indeed, they will be compelled to accept a transaction that (because of the Omnicare Offer) neither of the NCS Directors nor Candlewood is recommending. Moreover, because the proposed transaction involves the issuance of Genesis securities that will be traded on a national securities market, the transaction could not be undone, if allowed to go forward. *Gilmartin v. Adobe Res. Corp.*, 1992 Del. Ch. LEXIS 80, at *43; *McMillan*, 768 A.2d at 500 ("[T]he metaphorical eggs have been scrambled").

Finally, even if damages could be reasonably assessed, the NCS Certificate contains a provision adopted pursuant to 8 *Del. C.* §102(b)(7) exempting its directors from monetary liability for any breach of fiduciary duty other than the duty of loyalty or an act not taken in good faith. NCS Amended and Restated Certificate Art. VIII, NCS007656-7677 (Ex. 13); *Arnold*, 650 A.2d at 1286-89. The Defendant Directors will surely argue that the NCS stockholders might be without a monetary remedy after trial for any claims based on violations of the duty of care demonstrating the need for injunctive relief in this case. As the Supreme Court said in *Arnold v. Society for Sav. Bancorp, Inc.*, 678 A.2d 533 (Del. 1996):

> While section 102(b)(7) and charter provisions adopted thereunder will leave stockholders without a monetary remedy in some instances, they remain protected by the availability of injunctive relief. Stockholders are not discouraged from pursuing such remedies when warranted. ...The Court of Chancery is responsive and this Court has demonstrated its willingness and ability to consider expedited appeals in appropriate injunction cases.

Id. at 542 (citations omitted). *See also McMillan*, 768 A.2d at 501.

IV. THE BALANCE OF THE EQUITIES FAVORS THE GRANT OF A PRELIMINARY INJUNCTION

As demonstrated above, unless injunctive relief is granted, Defendants, based upon a conflicted, flawed and coercive process, will have inequitably deprived the public shareholders of NCS of their right to realize full and fair value for their shares. On the other hand, there would be little harm, if any, to defendants in enjoining the Genesis Merger pending fuller review by this Court.

Ace is instructive on this issue as well. Ace sought an injunction preventing Capital Re from terminating a merger agreement between the two companies. The Court held that the harm to Ace if Capital Re were permitted to terminate the agreement was far less than the harm that would be suffered by Capital Re's stockholders if their corporation was forced to abide by the contract. The Court noted that "[b]ecause Ace has the votes [due to voting agreements that locked them up] if the Merger Agreement is not terminated, what it ultimately seeks is an injunction from this court that will result in the consummation of a transaction far less valuable to the Capital Re stockholders than the [superior alternative] offer." *Ace*, 747 A.2d at 110-11 (footnote omitted).

Here, the reverse is true. If not enjoined, the defensive restrictions in the Genesis Merger Agreement would have the same effect as the *Ace* agreement: the public stockholders will be forced to accept the far less valuable Genesis deal.

Moreover, the fiduciary duties owed by the Director Defendants to the public stockholders far outweigh any rights possessed by Genesis. *See Ace*, 747 A.2d at 109 (contract rights subordinate "to stockholders' interests in not being improperly subjected to a fundamental corporate transaction as a result of a fiduciary breach by their board") (footnote omitted). *See also MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc.*, 501 A.2d 1239, 1251 (Del. Ch. 1985)

("In terms of relative hardship to the parties the need for both bidders to compete in the marketplace far outweighs the limiting of [the merger partner's] contractual rights"), *aff'd*, 506 A.2d 173 (Del. 1986). NCS's contractual obligations to Genesis (assuming they are enforceable) thus cannot impede the right of the NCS stockholders to have a disinterested and informed board act in their best interests.

CONCLUSION

For all of the foregoing reasons, Plaintiffs respectfully request that their motion for preliminary injunction be granted.

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