Genesis

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

PUBLIC VERSION

DEFENDANTS JON H. OUTCALT AND KEVIN B. SHAW'S JOINT MEMORANDUM IN OPPOSITION TO PLAINTIFFS' MOTION FOR PRELIMINARY INJUNCTION

SQUIRE, SANDERS & DEMPSEY L.L.P.
Frances Floriano Goins
Thomas G. Kovach
4900 Key Tower
127 Public Square
Cleveland, OH 44114
(216) 479-8500

Jon E. Abramczyk
MORRIS, NICOLS, ARSHT & TUNNELL
1201 North Market Street
Wilmington, DE 19899
(302) 658-9200

Attorneys for Jon H. Outcalt

SPIETH, BELL, McCURDY & NEWELL CO., L.P.A.
James R. Bright
Timothy G. Warner
2000 Huntington Building
Cleveland, OH 44115
(216) 696-4700

Edward M. McNally
Michael A. Weidinger
Elizabeth A. Brown
MORRIS, JAMS, HITCHENS & WILLIAMS L.L.P.
222 Delaware Avenue, 10th Floor
Post Office Box 2306
Wilmington, DE 19899
(302) 888-6800

Attorneys for Defendant Kevin B. Shaw

November 15, 2002

TABLE OF CONTENTS

TABLE OF CONTENTS (continued)

TABLE OF CITATIONS

TABLE OF CITATIONS (Continued)

PRELIMINARY STATEMENT

The Plaintiffs have asked this Court to prevent a merger from going forward. The merger at issue represents the culmination of a long series of attempts by NCS HealthCare, Inc. ("NCS" or the "Company") to restructure itself in a fashion to best preserve its overall value, pay off its creditors and maximally benefit its stockholders. During a two-year period, NCS and its advisors evaluated numerous strategic alternatives including a refinancing and a merger and discussed possible transactions with all interested parties. NCS finally arrived at an agreement with Genesis Health Ventures, Inc. ("Genesis"). The merger agreement with Genesis, signed on July 28, 2002, guaranteed a benefit to both equity holders and creditors of the Company, unlike any other option the Company had at the time.

Plaintiffs now assert that, rather than executing a sure deal with Genesis on July 28, 2002, NCS should have taken a chance on a non-binding expression of interest from Omnicare, Inc. ("Omnicare"), a competitor of NCS that had previously expressed interest only in purchasing the Company's assets at a fire-sale price, returning no value to NCS equity holders and less than full value to creditors. Omnicare's July 26, 2002 letter (the "July 26 letter") was a last minute, highly conditional proposal to negotiate. Indeed, even when told specifically by NCS' creditors committee that only an unconditional offer would be viable, Omnicare declined to make such an offer.

All of the Directors, including particularly Messrs. Outcalt and Shaw, had an incentive to obtain the highest price possible for the stockholders because they were themselves stockholders of the Company. In fact, had the Directors been able to obtain the price of $3.00 per share that the Plaintiffs claim Omnicare offered on July 26, 2002, Mr. Outcalt would have stood to make at least $5,149,408 and Mr. Shaw $1,638,054[1] more than they will realize from the Genesis transaction. Despite this extremely substantial indicator that the Directors had the incentive to and did do the best they could to get the stockholders the highest possible price, Plaintiffs now ask this to Court substitute its judgment for that of the Directors. The facts of this case are simply not such as require a court to discard the deference ordinarily given to corporate directors' business judgment.

At the time in question, NCS and Genesis were in the last days of an exclusive negotiation period, facing a Genesis offer that would expire at midnight on Sunday, July 28, 2002, when the Company received the faxed Omnicare July 26 letter. NCS was able to use the July 26 letter to gain additional value from Genesis. The NCS Directors determined, however, that losing the firm Genesis offer to explore a non-binding, highly conditional expression of interest from Omnicare would be detrimental to its stockholders. The NCS Board of Directors (the "Board"), composed of defendants Jon H. Outcalt, Kevin B. Shaw, Boake A. Sells and Richard L. Osborne, (collectively the "Directors" or the "Board") therefore approved the merger agreement with Genesis (the "Merger Agreement") on July 28, 2002.

Plaintiffs now seek to invoke the extraordinary remedy of preliminary injunction, asking the Court to bar NCS and Genesis from proceeding with their agreed merger. Plaintiffs seek a preliminary injunction despite the manifest weaknesses in the merits of their case, including a lack of any authority that the Directors' fiduciary duties barred them from entering into the Merger Agreement. Moreover, NCS will sustain severe and irreparable harm absent the ability to proceed with the merger. NCS has repeatedly sought to restructure in a fashion that

---

1 Calculated using the difference between Genesis $1.60 price and Omnicare's $3.00 proposal as of July 28, 2002 and the share ownership given in the Voting Agreements, as cited at page 4 of the Plaintiffs' Memorandum.

both preserves NCS' equity value and protects the interests of all of its constituencies. The Plaintiffs are asking the Court to second-guess the decision the Directors made after a long search and arduous negotiations, in reliance on all information available to the Board at the time, and based on their reasoned assessment of the best course of action. Regardless of information now available in hindsight, the law asks no more of Messrs. Outcalt and Shaw than what they did in this instance. Plaintiffs' insistence otherwise is erroneous both on the law and on the facts.

Defendants Outcalt and Shaw join in the Memorandum in Opposition filed by defendant NCS, which properly sets out the factual and legal basis for denying Plaintiffs' Motion. However, Plaintiffs' Memorandum of Law in Support of Their Motion for Preliminary Injunction ("Plaintiffs' Memorandum") contains numerous misstatements of fact specifically regarding the conduct of Messrs. Outcalt and Shaw. Accordingly, Messrs. Outcalt and Shaw set forth more fully in this Memorandum in Opposition the reasons why the Plaintiffs are not entitled to the extraordinary preliminary relief that they seek.

STATEMENT OF FACTS

I. NCS CONDUCTS AN EXTENSIVE SEARCH FOR STRATEGIC ALTERNATIVES.

In 1999, facing severe financial difficulties, NCS began searching for strategic alternatives to ensure the long-term viability of the Company and protect the interests of its stockholders and creditors. (Schedule 14D-9 of NCS HealthCare, Inc. filed August 20, 2002, as thereafter amended ("Schedule 14D-9"), at 4 (Pltfs. Ex. 45))[2]. In February 2000, NCS retained

---

[2] Messrs. Outcalt and Shaw cite to Exhibits herein as follows: "Ex. ___ hereto" for materials attached as Exhibits to this Memorandum and "Pltfs. Ex __" for materials filed with the Transmittal Affidavit of Carmella P. Keener, Esquire in Support of Plaintiff's Memorandum of Law in Support of Motion for Preliminary Injunction, filed November 3, 2002.

UBS Warburg LLC ("UBS Warburg") as its financial advisor to assist NCS in identifying possible strategic alternatives. Id. UBS Warburg identified potential strategic and financial acquirers, as well as potential financial investors in NCS. Id.

In July 1999, Messrs. Outcalt and Shaw met with Omnicare's Chairman, Joel F. Gemunder ("Gemunder"), and Omnicare's Chief Financial Officer, David W. Froesel, to discuss a possible sale of NCS to Omnicare for the first time. (Outcalt 37-38; Gemunder 8-9; Froesel 42-45, 52-53)[3].

REDACTED

The Company's financial problems continued, and, in April 2000, NCS defaulted on its senior credit facility. (Schedule 14D-9 at 4-5). Despite UBS Warburg's efforts, by the end of the year 2000, NCS had only received one non-binding indication of interest, and was facing severe pressure from its creditors. Id. at 5. In December 2000, NCS terminated its engagement of UBS Warburg and engaged Brown, Gibbons, Lang & Company L.P. ("Brown Gibbons") as its financial advisor. (Pollack 26-27). Brown Gibbons expanded the scope of alternatives to be considered by NCS in hopes that a non-bankruptcy restructuring plan could be developed.

REDACTED

In January and February 2001, NCS met with its senior lenders to discuss a variety of non-bankruptcy restructuring scenarios. (Schedule 14D-9 at 5). The lenders could not

---

3 Messrs. Outcalt and Shaw cite to deposition testimony herein by last name of witness and page, (e.g., Gemunder 263-81). All depositions cited herein have been lodged with the Court pursuant to the Notice of Lodging filed by NCS on November 8, 2002.

reach consensus, however, and it became clear to NCS that a full recovery for the holders (the "Noteholders") of NCS' 5 ¾ % convertible subordinated debentures due in 2004 (the "Notes") was remote, and recovery for the Company's equity holders appeared extremely unlikely. (Id.). In February 2001, NCS went into default on the Notes. (Id.). Throughout the spring and summer of 2001, various investor groups proposed restructuring NCS in a "pre-packaged" bankruptcy. (Id.). NCS, however, decided to continue searching for a non-bankruptcy restructuring scenario that would provide the greatest degree of financial recovery to its stockholders and creditors. (Id.).

A. Omnicare Makes An Initial Bankruptcy Proposal.

In July 2001, Omnicare expressed an interest in a potential transaction with NCS. (Id. at 5-6). Omnicare proposed to acquire substantially all of NCS' assets under Section 363 of the United States Bankruptcy Code at a purchase price of $225 million, conditioned upon satisfactory completion of due diligence and other matters. (Letter from Joel F. Gemunder to Kevin B. Shaw, dated July 20, 2001 (Pltfs. Ex 15)). Omnicare's proposal included a purchase price substantially less than the face value of the outstanding NCS debt and would have provided little, if any, recovery to the Noteholders and no value at all to NCS equity holders. (Schedule 14D-9 at 5). At that time, Omnicare never indicated a willingness to negotiate a transaction that would provide any value to the NCS stockholders.

B. Omnicare REDACTED ' and Refuses to Execute a Standard Confidentiality Agreement with NCS.

Despite the inherent drawbacks that NCS recognized in the Omnicare proposal, NCS requested that Omnicare execute a confidentiality agreement containing provisions that had previously been agreed to by the other parties that had expressed an interest in a potential transaction with NCS. (Schedule 14D-9 at 5-6). The confidentiality agreement was especially important to NCS because Omnicare was NCS' largest competitor. (Id.). Surprisingly, however, Omnicare refused to agree to the standard terms of the confidentiality agreement that numerous other suitors of NCS had signed. (Id.) Specifically, Omnicare refused to accept customary restrictions on its ability to solicit NCS' customers, use competitively sensitive non-public information, and acquire NCS debt securities during the due diligence process. (Amendment No. 2 to Form S-4 of Genesis Health Ventures, Inc., filed November 1, 2002 ("Form S-4") at 34 (Pltfs. Ex 48)).

REDACTED

Given th: competitive history between the two companies, NCS needed a strong confidentiality agreement with Omnicare. When Omnicare refused to accept customary restrictions on its ability to solicit NCS' customers and use competitively sensitive non-public information, NCS was rightfully cautious of Omnicare's intentions regarding its use of NCS' confidential information. Conducting due diligence was acceptable; stealing customers through the use of confidential information was not. As a result, the discussions between NCS and Omnicare stalled. (Schedule 14D-9 at 5-6).

C. Omnicare Makes Another Bankruptcy Proposal.

Despite Omnicare's refusal to accept standard confidentiality provisions, NCS continued its discussions with Omnicare. (Id. at 5-6). On August 29, 2001, NCS received a revised indication of interest from Omnicare, again suggesting an Omnicare purchase of NCS' assets under Section 363 of the United States Bankruptcy Code at a purchase price of $270 million and still conditioned on due diligence and other conditions. (Letter from Joel F. Gemunder to Kevin B. Shaw, dated Aug. 29, 2001 (Pltfs. Ex. 16)). Omnicare also attached its own proposed form of a watered-down confidentiality agreement that did not protect NCS' competitive and confidential information or prevent Omnicare from using that private information REDACTED to solicit NCS customers. (Id.) NCS was very concerned that Omnicare still was unwilling to agree to standard confidentiality provisions, but did not want to lose the opportunity to consider Omnicare's proposal. (Schedule 14D-9 at 5-6). Therefore, NCS resumed its discussions with Omnicare, and the two companies eventually executed a limited confidentiality agreement in September 2001. (Id. at 6).

D. The Due Diligence Process Finally Begins.

Thereafter, NCS provided Omnicare with almost all of the due diligence documents and information that Omnicare requested. (Id.). Because the Omnicare confidentiality agreement was limited in scope, and cognizant of Omnicare as a strong competitor, NCS made a prudent decision not to provide a limited amount of highly sensitive, competitive, non-public, confidential information to Omnicare. (Id.)

REDACTED

E. Omnicare Refuses to Negotiate Its Proposed Bankruptcy Transaction Structure.

In October 2001, NCS advised Omnicare that NCS was not interested in a bankruptcy-related proposal and urged Omnicare to consider a non-bankruptcy acquisition of NCS that would provide value to all of NCS' stakeholders. (Pollack 63-64). Glenn C. Pollack ("Pollack"), NCS' financial advisor from Brown, Gibbons, explained:

REDACTED

REDACTED

From October 2001 through January 2002, NCS continued its efforts to engage Omnicare in discussions regarding a non-bankruptcy transaction with an equity component, but Omnicare adamantly refused. Pollack further stated:

REDACTED

Following the October meeting with Merrill Lynch, Pollack provided additional due diligence material to Merrill Lynch and discussed it with them on behalf of NCS. (Id. at 64). Pollack "offered to hold discussions with Merrill Lynch regarding Omnicare's interest at their convenience," but Merrill Lynch and Omnicare "stopped discussing the matter with [Pollack] sometime in late October, early November." (Pollack 64). Omnicare and Merrill Lynch resurfaced in January 2002 but then disappeared again. According to Pollack:

REDACTED

(Pollack 63-64) (emphasis added). Pollack's email to Alan Hartman's associate at Merrill Lynch stated:

REDACTED

(Electronic Mail from Glenn C. Pollack to L'em Do, CP001249-CP1251 (Ex. C hereto)). The email included Pollack's mailing address, email address, fax number, and three different telephone numbers (main, direct, and mobile). Id. Yet, Merrill Lynch never again communicated with Pollack. Pollack 63-64; 67 ("Omnicare did not call back to discuss alternate transactions.").

In January 2002, NCS learned that while NCS was repeatedly reminding Omnicare that NCS was not interested in a bankruptcy-related transaction, Omnicare was secretly negotiating with an *ad hoc* committee of Noteholders of NCS (the "Ad Hoc Committee") concerning a proposed bankruptcy filing by NCS in which Omnicare would acquire the assets of NCS at a price that would pay all of NCS' bank debt and some portion of its debt to the Noteholders, but would provide nothing to the NCS stockholders. (Gemunder 29-30; Pollack 64-65). From February, 2002 through July 26, 2002, ***Omnicare made no attempt to communicate with NCS***; rather, all of Omnicare's discussions were with the Ad Hoc Committee. (Pollack 65-66, 68-69, 97-98, 101); REDACTED ; Mencher 114). According to the principal representative for the Ad Hoc Committee, Judy K. Mencher ("Mencher"), "we [the Ad Hoc Committee] were the ones who were having the negotiations with Omnicare. . . ." (Mencher 114). NCS had repeatedly told Omnicare and the Ad Hoc Committee that NCS was not interested in any bankruptcy-related proposal, yet Omnicare and the Ad Hoc Committee continued to pursue one. (Pollack 64-69, 89). Pollack testified:

REDACTED

(Pollack 68)(emphasis added)).Nevertheless Pollack cont.nued to attempt to communicate with Omnicare through the Ad Hoc Committee. (Pollack 64-66). He explained:

REDACTED

F. Genesis Makes an Offer to NCS That Provides Value to NCS Stockholders.

While the bankruptcy-related discussions between the Ad Hoc Committee and Omnicare were continuing, and because the negotiations between NCS and Omnicare had not been fruitful, NCS continued to search for other suitors. (Schedule 14D-9 at 6-7). Genesis executed NCS' standard confidentiality agreement and began the due diligence process in February 2002. (Hager 18). NCS continued its discussions with Genesis into the spring of 2002. (Id. at 41).

REDACTED

4

REDACTED

Following its due diligence review, Genesis proposed a merger transaction in late June 2002, which, for the first time, provided value to NCS' stockholders as well as its creditors, and did not require a bankruptcy filing. (Id. at 62-65). The Genesis offer, however, "came with a requirement . . . that shareholders representing a majority of the voting interest would . . . agree to the transaction. . . ." (Id. at 63-65). George V. Hager, Jr., the Chief Financial Officer of Genesis ("Hager"), testified in his deposition as follows:

> Q. When you refer to stockholders representing a majority of the voting interest, do you understand that at the time to mean Messrs. Outcalt and Shaw?
>
> A. They clearly could have been included in that group. We really did not care how the majority voting interest was obtained.
>
> Q. Did you know at the time that Messrs. Outcalt and Shaw collectively held the majority of the voting interest in NCS?
>
> A. We did.
>
> Q. Was there any specific discussion at that time with respect to obtaining voting agreements from Messrs. Outcalt and Shaw, committing them to vote in favor of any proposed merger agreement?
>
> A. Our offer was conditioned upon getting a majority voting interest in the common stock to approve of our transaction.
>
> Q. How was that offer communicated?
>
> A. The offer was communicated verbally by phone from me to Mr. Pollack.

(Id. at 64-65).

In his deposition, Mr. Outcalt testified as follows regarding the voting agreement:

> Q. How was the voting agreement first presented to you?
>
> A. As I recall, I first heard about the possibility of a voting agreement in June '02. I was told by my advisors that Genesis was unwilling to continue with its due diligence process and work toward completion [of a] merger agreement, unless they had some

assurance that I would sign a voting agreement in the event the NCS board approved of a merger agreement.

. . .

Q. After the issue of the voting agreement was first brought to your attention, what was your reaction?

A. My reaction was that ***it was very important to NCS that we keep Genesis in the process.*** I did not object to the idea of a voting agreement in principle, ***but I made no promises.***

Again, my willingness to sign a voting agreement was ***contingent upon our board approving a merger agreement with Genesis.***

Q. Was it your understanding then that if you were going to sign a voting agreement, you would sign ***after*** NCS and Genesis signed a merger agreement?

A. Absolutely.

(Outcalt 74-75) (emphasis added)). Mr. Shaw gave similar testimony in his deposition:

> . . . I became convinced that if the board thought that the merger agreement was good for all of our constituents and asked that I sign a voting agreement, that it would be a good thing for me to do. . . . The conclusion that I reached was that if our board believed this to be the best transaction, and that if this, ***subsequent to that determination***, was how that transaction was going to be effected, I would participate in this, ***subsequent to their decision***.

(Shaw 65-66 (emphasis added)). The Minutes of the July 28, 2002 Board meeting to consider the Genesis merger state,

REDACTED

Shortly after making the offer to NCS in late June 2002, Genesis also demanded an exclusivity agreement from NCS. (Hager 68). According to Hager:

> [W]e . . . requested -- not requested, but we ***required*** of them if they were going to -- if they wished us to continue to try to move this process to a definitive agreement, ***that they would need to do***

> ***it on an exclusive basis with us.*** We were going to, and already had incurred significant expense, but we would incur significant additional expenses . . . both internal and external, to bring this transaction to a definitive signing. We wanted them to work with us on an exclusive basis for a short period of time to see if we could reach agreement.

(Id.). Hager further testified, "[w]e told them that we wouldn't proceed further without [an exclusivity agreement]. We weren't going to be a stalking horse in a transaction." (Id. at 77). In fact, from early on in the due diligence process, Genesis was adamant that it would not be a "stalking horse." (Hager, 34, 36-37, 41-42, 77, 163-164, 171, 180; 24 ("We . . . made it very clear to them that if we were going to engage in any process, that we would not do so as a stalking horse.")). Hager testified:

> Q. Was it in fact the case that Genesis would not have proceeded further with the transaction had no exclusivity agreement been signed?
>
> A. Yes.

(Id. at 77). Hager also testified:

> Q. In your many years of experience have you been involved in the negotiation of exclusivity agreements of this nature in the past?
>
> A. We have obtained exclusivity and granted exclusivity in many transactions in the past. . . .

(Id. at 103).

After canvassing the other potential bidders and determining there were no other alternatives, Pollack advised the NCS Board that the proposed exclusivity agreement

REDACTED

REDACTED

Therefore, NCS agreed to execute an exclusivity agreement on July 3, 2002 (dated as of July 1, 2002) in order to keep Genesis at the negotiating table. (Letter Agreement between NCS HealthCare, Inc. and Genesis Health Ventures, Inc. dated July 1, 2002 ("Exclusivity Agreement")(Pltfs. Ex. 27)); Hager 68 ("... We ultimately negotiated an agreement to have a two-week period of exclusivity, with an automatic renewal, to the extent the parties were continuing to work in good faith, to come to an agreement.")). Genesis later asked for an extension of the Exclusivity Agreement. (Hager 127; Pollack 131). Pollack testified as follows:

> Genesis asked for an extension, I believe, through Monday [July 29]. We discussed that with the Independent Committee [of the Board] Friday morning [July 26]. We advised the committee of our belief that we were close to completing the negotiations of a transaction that would be favorable to all constituencies. And they consented to extend the exclusivity period.

(Pollack 131). Pollack further testified:

> Q. So it was your understanding that unless NCS agreed to extend the exclusivity agreement, that Genesis would not have continued discussions or pursued its offer?
>
> A. Correct.

(Id. at 132). Thus, on the morning of July 26, NCS and Genesis extended the exclusive negotiating period under the Exclusivity Agreement until July 31, 2002 because NCS and Genesis "were very, very close to completing everything to sign ... the merger agreement." (Letter Agreement between NCS HealthCare, Inc. and Genesis Health Ventures, Inc. ("Exclusivity Agreement Extension")(Pltfs. Ex. 30; Hager 127-28; Pollack 130-32, 136-37).

II. THE NCS DIRECTORS FULFILLED THEIR FIDUCIARY DUTIES BY CHOOSING THE FIRM GENESIS OFFER -- THE ONLY OFFER NCS RECEIVED THAT PROVIDED ANY VALUE TO THE NCS STOCKHOLDERS -- AND REJECTING OMNICARE'S HIGHLY CONDITIONAL OFFER TO NEGOTIATE.

A. After Rebuffing NCS' Efforts To Negotiate For Months, Omnicare Reappears With A Highly Conditional, Last-Minute "Offer To Negotiate" With NCS On July 26, 2002.

During NCS' negotiations with Genesis, Omnicare never communicated directly with NCS. (Schedule 14D-9 at 7). At the last minute, however, at the tail end of the final negotiations with Genesis, Omnicare broke its six-month silence and sent the July 26 letter expressing renewed interest in NCS. (Letter from Joel F. Gemunder to Jon H. Outcalt, dated July 26, 2002 (Pltfs. Ex. 32)). Omnicare suggested it would negotiate toward a transaction that would provide value to NCS stockholders ($3.00 per share in cash), but its proposal was highly contingent, requiring the completion of due diligence (although Omnicare had already engaged in substantial and extensive due diligence), the negotiation of a mutually acceptable merger agreement, and the receipt of required regulatory and third party approvals and consents. (Id; Schedule 14D-9 at 7).

At the time Omnicare sent the July 26 letter, Omnicare was still in discussions with the Ad Hoc Committee. Because of these discussions, Omnicare knew that NCS and Genesis were close to reaching a deal. (Gemunder 158-59). Gemunder testified as follows regarding a conversation he had with Mencher, the representative of the Ad Hoc Committee, on Friday, July 26, 2002:

REDACTED

REDACTED

Q. . . . When did this conversation take place?

A. It was a Friday afternoon, the day that Omnicare issued their bear hug letter.

Q. What letter are you referring to?

A. I think they sent a letter out to the company offering to acquire the stock for some price. That's what I call a bear hug letter.

. . .

REDACTED

Thus, Omnicare was fully aware that they were unlikely to reach an agreement with NCS with the due diligence conditions contained in their July 26 letter. Despite this knowledge, Omnicare did not withdraw those conditions.

B. Genesis Threatens to Withdraw Its Offer.

Within a few hours after NCS received Omnicare's last-minute July 26 letter, Pollack faxed a copy of Omnicare's letter to Hager at Genesis and called him to ask that Genesis consider increasing its offer as a result of Omnicare's proposal. (Hager 129, 131). In response to Pollack's suggestion, Genesis increased its offer in two ways. (Id. at 132-139). Genesis agreed to pay the Noteholders their accrued interest and redemption premium, in addition to the par value of their Notes. (Id at 138). Genesis also increased the offer to the NCS stockholders by increasing the dollar per share to an implied $1.75 per share offer. (Id. at 138). In addition, Genesis reduced the amount of the termination fee in the Merger Agreement from $10 million to $6 million. (Id. at 139).

Genesis also warned NCS that the Genesis offer was a "take it or leave it" proposal -- it had to be accepted by midnight on Sunday, July 28, or Genesis would withdraw the offer and terminate further negotiations with NCS. (Hager 149; Pollack 187-88; Sells 204-05).

Mr. Hager testified:

> Q. What did you tell [Pollack] would happen if you hadn't obtained a signed deal by midnight on Sunday?
>
> A. ***We would walk away.***
>
> Q. Had you not received a signed deal by midnight on Monday [sic] would Genesis [have] walked away, as you put it?
>
> A. ***Absolutely.***

(Hager 151).

C. The Genesis Offer Was the Only Existing Offer on July 28, 2002.

With the Genesis offer about to expire at midnight, the NCS Board met on July 28, 2002 to evaluate its options and to vote on whether to accept the Genesis merger proposal.

(July 28, 2002 Minutes (Pltfs. Ex. 35); Schedule 14D-9 at 7-8). The Directors were fully informed about the Genesis merger proposal. (July 28, 2002 Minutes). At the July 28 Board meeting the Directors received a summary of the material terms of the Merger Agreement and discussed the ramifications. Id. at NCS 8265. Outcalt explained:

> I had reviewed a number of drafts of the merger agreement over the course of the preceding weeks. What I did prior to signing the merger agreement was to be certain that I understood any changes that had been made since I had last reviewed it, which would have been a few days earlier.

(Outcalt 91).

At the time of the Board meeting, the Genesis transaction was the only transaction available to NCS. Indeed, during its extensive search process, NCS had not received a single proposal that would have provided any value to the NCS stockholders; every other proposal offered to pay only a portion of NCS' debt. The Board approved the Genesis transaction because it was the best and only offer the NCS stockholders and creditors had received after a long and exhaustive search. (Schedule 14D-9 at 7-9). Omnicare's "indication of interest" was so conditional that it did not rise to the level of being an "offer" and could not even be considered. Pollack described NCS' predicament as follows:

> Q. When was it that you came to the conclusion that NCS should enter into a transaction?
>
> A. July 28th, I believe is the date.
>
> Q. Did you believe that if NCS didn't enter into the transaction on that date it would be unable to continue in business?
>
> A. No. I believed that ***given the circumstances, if NCS didn't enter into the transaction it had available to it on that date, it might not be able to meet its obligations to all of its constituents.***
>
> Q. What do you mean, "meet its obligations to all its constituents"?

> A. The compar y had a defaulted senior credit facility for $206 million, an accelerated, subordinated note issue, $100 million in principal, approximately 12 or $13 million of accrued and unpaid interest, overdue trade accounts, approximately $40 million. It had been marketed for well over 24 months. ***It had not received an indication of interest or a proposal prior to that, July 28th, that would not only allow for a transaction, but would allow for a transaction that paid all of its obligations in full, as well as provided a return to the equity security holders.***
>
> Q. So the urgency that you perceived was the potential loss of that [Genesis] deal?
>
> A. Was the stated risk that that deal would not be available past that date.

(Pollack 58-59) (emphasis added).

Therefore, at the July 28 Board meeting, the Directors only had two options. NCS could accept the Genesis offer -- the only firm offer NCS had received that capable of being accepted -- or the Directors could begin negotiations with Omnicare in hopes that they could reach a suitable agreement. If they decided to begin negotiations with Omnicare, however, they would lose the Genesis deal altogether and, if negotiations with Omnicare were unsuccessful, NCS would be left with ***nothing*** for the NCS stockholders and creditors. (Hager 151 ("Q. Had you not received a signed deal by midnight on Monday would Genesis [have] walked away, as you put it? A. Absolutely.")). The Directors made a reasonable business judgment that it was in the best interests of the stockholders, creditors, and the Company to accept the Genesis offer. (July 28, 2002 Minutes). The Minutes for the July 28, 2002 Board meeting reflect that decision:

> .. [R]eliance on Omnicare's July 26 letter would not be reasonable in light of Omnicare's historic conduct in negotiations with the Company. After further discussion, the Board concluded that ***balancing the potential loss of the Genesis deal against the uncertainty of Omnicare's letter, results in the conclusion that the only reasonable alternative for the Board of Directors is to approve the Genesis transaction.***

(July 28, 2002 Minutes at NCS 8265)(emphasis added)).

D. Outcalt and Shaw Execute Voting Agreements With Genesis In Connection With the Genesis Merger Agreement Without Receiving Any Additional Consideration.

After all the material aspects of the Merger Agreement had been negotiated and agreed upon by NCS and Genesis, and the Board had approved the Genesis transaction, Outcalt and Shaw each executed voting agreements with Genesis and NCS on July 28, 2002. (Outcalt 78-79; July 28, 2002 Voting Agreement by and among Kevin B. Shaw, NCS HealthCare, Inc. and Genesis Health Ventures, Inc. (Pltfs. Ex. 39); July 28, 2002 Voting Agreement by and among Jon H. Outcalt, NCS HealthCare, Inc. and Genesis Health Ventures, Inc. (Pltfs. Ex. 40)(both Voting Agreements hereinafter "Voting Agreements")). Pursuant to the Voting Agreements, Outcalt and Shaw each agreed to vote their shares in favor of the Genesis Merger Agreement and against any other competing proposals, and granted an irrevocable proxy to Genesis to vote the shares in favor of the Genesis merger and against certain competing transactions. (Voting Agreements § 2(b)). Contrary to the Plaintiffs' unsupported allegations, Outcalt and Shaw got ***nothing*** in exchange for their Voting Agreements other than Genesis' agreement to the merger. (Id., generally). As Mr. Outcalt testified:

> Q. Did you believe that by executing the voting agreement you were acting in a manner inconsistent with the fiduciary duties you owed to NCS' stakeholders?
>
> A. No.
>
> Q. Why not?
>
> A. Because at the time our board approved of the merger agreement with Genesis, I felt that we had fulfilled our responsibility to get the highest and best value for our stakeholders.

> Q. And by stakeholders, again, you're ncluding the lenders, the noteholders, the creditors and the sharehc lders, correct?
>
> A. *Yes, but most especially the shareholders.*

(Outcalt 82)(emphasis added). Mr. Shaw further explained:

> Q. Did you believe that signing the voting agreement was inconsistent with your fiduciary duties as a board member of NCS to NCS' stakeholders?
>
> A. No, I did not.
>
> Q. Can you tell me why not?
>
> A. Because our board had considered all the available information and evaluated that information in the context of some 30 months of reviewing restructuring alternatives. And it was our board's judgment that moving forward with Genesis was the best alternative for all of our constituents.

(Shaw 71-72).

Genesis, NCS, and Outcalt also executed a Binding Term Sheet Agreement (the "Term Sheet") after the Merger Agreement was executed. (Binding Term Sheet Agreement, Exhibit 99 filed August 20, 2002 to NCS HealthCare, Inc 14D-9 (Ex. D hereto)). Mr. Hager explained:

> Q. What are the plans for management of the combined entity of the NCS and Genesis merger, if successful?
>
> . . .
>
> A. [T]he consulting agreement entered into with Jon Outcalt . . . is a traditional agreement that we enter into with what we call the founders of the businesses that we've acquired in this sector. And we enter into similar type arrangements with those -- with many of those founders of the businesses we've acquired. We utilize those people for marketing purposes, and lobbying purposes, for customer relations purposes, prospectively. And we found them to be historically very helpful.

(Hager 105-106). The Term Sheet provides for Mr. Outcalt to serve as a consultant to the combined NCS/Genesis entity and, in exchange for his services, to receive the sum of $175,000[5] per year for four years, as well as the continuation of his life and health insurance benefits. (Term Sheet § 2(a)-(b); Outcalt 101-102). In addition, Genesis agreed to allow Mr. Outcalt to continue to occupy his office at the Beachwood, Ohio facility as long as the company maintains operations at that facility and to continue to receive secretarial support and a parking space. (Term Sheet § 2(b); Outcalt 102). Finally, as is common in many such transactions, Genesis agreed to honor NCS' pre-existing commitments to pay Mr. Outcalt $400,000 in severance under a Salary Continuation Agreement dated September 29, 2000, as thereafter amended, and a $200,000 "success fee" under a pre-existing agreement between NCS and Mr. Outcalt, reflected in the minutes of the November 29, 2000 NCS Board meeting for completing the restructuring of the Company. (Binding Term Sheet Agreement § 1(a), (c); Outcalt 104). Mr. Outcalt would have been entitled to these sums regardless of who purchased NCS. (Outcalt 104). The Term Sheet also specifies that Genesis will consider Mr. Outcalt to fill the next available Board of Directors seat of Genesis, but it does not assure him of any such position. (Binding Term Sheet Agreement § 4; Outcalt 104).

NCS also has pre-existing commitments to make a $200,000 payment to Mr. Shaw and to continue his salary for a period of two years upon a change in control of the Company, and Genesis will honor those commitments. (Shaw 76). Like Mr. Outcalt, Mr. Shaw

5 Rather than pay Mr. Outcalt such sums entirely in the form of consulting fees, Genesis agreed to make charitable contributions to not-for-profit institutions identified by Mr. Outcalt in the aggregate amount of up to $100,000 per year. (Binding Term Sheet Agreement § 2(c)). For example, Mr. Outcalt may direct Genesis to pay him only $75,000 and make a charitable contribution in the amount of $100,000, in lieu of paying Outcalt consulting fees in the sum of $175,000. (Binding Term Sheet Agreement § 2(c)).

would have been entitled to these sums regardless of who purchased NCS. (Id.). Mr. Shaw testified:

> Q. Are there any benefits that inure to your directly as a result of the Genesis/NCS merger, if it's approved?
>
> A. There are benefits that the NCS board put in place in 2000 and 2001 that occur because of a transaction. They do not occur because Genesis is acquiring or is merging with NCS Healthcare.
>
> Q. If the Genesis/NCS merger is approved, will you have any role with the new company?
>
> A. Not that I'm currently aware of.

(Id.).

At the time the full NCS Board met on July 28 to consider the Genesis merger, the Board members were fully aware of the interests of Messrs. Outcalt and Shaw. (Shaw 118; Form S-4 at 40-41). Mr. Shaw testified:

> Q. Is it also your recollection or understanding that the full board of NCS considered those possible individual interests of you or Mr. Outcalt as they considered the Genesis merger?
>
> A. [T]he full board considered the interests of myself and Jon, and was aware that agreements were ongoing and discussions were ongoing.

(Id. at 118).

ARGUMENT

I. LEGAL STANDARD FOR THE GRANT OF A PRELIMINARY INJUNCTION.

Plaintiffs may only prevail on their motion for a preliminary injunction if they can clearly demonstrate (1) that they will sustain irreparable injury prior to an adjudication of their claims on their merits and (2) that such adjudication is likely to be in their favor. See, e.g., Formosa Plastics Corp v. Wilson, 504 A. 2d 1083, 1087-88 (Del. 1985) ("To obtain injunctive relief, a plaintiff must show a reasonable probability of success on the merits and the likelihood of irreparable injury absent the injunction. In deciding the matter the Court may balance the conveniences of and the possible injuries to the parties. In short, an injunction must be earned. It does not issue on any less significant basis."). See also Thompson v. Enstar Corp., 509 A.2d 578, 581 (Del. Ch. 1984), reversed on other grounds, In re Enstar, 604 A.2d 404 (Del. 1992) (injunctive relief is never granted unless earned -- a showing that there is a dispute and ***possibility*** of injury is insufficient).

As movants, the Plaintiffs thus have a heavy burden to establish their entitlement to an injunction. They must show each of the following: (1) that they have a reasonable probability of success on the merits; (2) that they will suffer immediate and irreparable harm if they cannot obtain a preliminary injunction; and (3) that the balance of the hardships weighs in their favor. See, e.g., Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361, 1371 (Del. 1995); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341 (Del. 1987); In re Siliconix, Inc. Shareholders Litigation, Del.Ch., C.A. No. 18700, Noble, V.C. (June 19, 2001) (Ex. E hereto).

Here, the Plaintiffs have failed to sustain their burden, first and foremost because they cannot show a likelihood of success on the merits. The NCS Directors did not breach their fiduciary duties to the stockholders, but instead acted carefully and reasonably in pursuing the merger with Genesis and executing the Merger Agreement despite Omnicare's attempts to disrupt the transaction. Where the moving party cannot show any likelihood of prevailing on the merits, the question of whether they will sustain harm absent the grant of an injunction is of little weight. See Formosa Plastics, 504 A.2d at 1088 (affirming the denial of a preliminary injunction where "despite the threat of imminent irreparable injury, the Chancellor found that there was no reasonable probability of success on the merits of [movant]'s claims.").

II. PLAINTIFFS WILL NOT PREVAIL ON THEIR CLAIM THAT THE DIRECTORS VIOLATED THEIR FIDUCIARY DUTIES.

Plaintiffs' argument that the Court should prevent the merger from going forward is premised on the notion that the Directors should somehow have conducted an auction of the company, despite the lack of bids. Messrs. Outcalt and Shaw contend that the transaction they and the other NCS Directors entered into was a fair product of a fair process: NCS entered into the Merger Agreement with Genesis as a result of a carefully reasoned and well informed process and gave the other stockholders the best price the Director stockholders were able to obtain for them. Plaintiffs have failed to bring to bear any evidence that Messrs. Outcalt and Shaw breached their fiduciary duties by entering into the Merger Agreement with Genesis, given that lack of bidder interest made them unable to conduct an auction for the Company. Accordingly, the comparative price analysis underlying much of the law on auctions has no bearing on the instant case.

The simple history of the dealings between the parties was this: On July 1, 2002 when NCS entered into the Exclusivity Agreement, Omnicare did not have even a proposal on the table with NCS, much less a "bid," so NCS' decision to engage in exclusive dealings with Genesis on that date could only have been intended as an incentive to Genesis, not a "defensive" measure to preclude Omnicare from offering a superior transaction. Omnicare offered ***zero*** value to the stockholders until July 26, 2002, making any Omnicare proposal before that date clearly inferior to the terms of the Genesis merger. On July 28, 2002, when NCS faced the certain loss of the only firm offer that provided value to its stockholders, the Directors still had no other alternative. Regardless of the proposed dollar value mentioned in the July 26 letter, Omnicare's proposal was still subject to conditions; the proposal could not be accepted on the spot and hence was not comparable to or competitive with Genesis' firm offer.

A. The Court Should Review The Directors' Decision In Light Of The Protection Accorded By The Business Judgment Rule.

The proper standard of review is whether or not the Directors' actions are protected by the business judgment rule. The business judgment rule is the appropriate standard for assessing the decisions of corporate directors, in these circumstances. See, e.g., Williams v. Geier, 671 A.2d 1368, 1377 (Del. 1996). Here, the Plaintiffs challenge the application of the rule, arguing that a more rigorous standard of review applies. However, they have been unable to demonstrate that the Directors' circumstances here invoke a more exacting standard.

"A hallmark of the business judgment rule is that a court will not substitute its judgment for that of the board if the latter's decision can be 'attributed to any rational business purpose.'" See Unocal Corp. v. Mesa Petroleum Co., 493 A. 2d 946, 954 (Del. 1985), quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). Under the circumstances of this case, the Directors have demonstrated their actions were reasonable and were taken in good faith to protect the interests of the corporation and its stockholders, and thus the Court should accord their decision the protection of the business judgment rule. The deal protection measures the Directors employed to foster a merger with Genesis were rational and appropriate inducements to Genesis, not draconian devices to forestall a superior transaction or coerce the stockholders; therefore, even under an enhanced scrutiny standard, the Directors acted appropriately.

B. The Business Judgment Rule Protects The NCS Directors' Decisions.

1. The Directors Used Reasonable Means To Protect The Genesis Opportunity.

The NCS Board's actions in the period leading up to the challenged Merger Agreement, as well as during the actual negotiations, were all directed to one end – the consummation of a transaction that would give NCS stockholders value, pay NCS creditors, and ensure the continuing existence of the business. This was an eminently rational and desirable goal which the Directors struggled to accomplish over an extended period. During this time they received no offers that they felt equaled the Company's true value, or which gave the stockholders any value at all. Prior to Genesis, their only substantial negotiating opportunity came with Omnicare, which offered only an asset purchase pursuant to Section 363 of the Bankruptcy Code, failed to enter into an adequate confidentiality agreement, and offered nothing for the equity holders of the company. When the opportunity finally arose for a transaction that paid a majority (and finally all) of the Company's debt and gave stockholders adequate value, the Directors used reasonable means to protect that opportunity for the Company. The Directors were entitled to, and did, decide that a sure thing – Genesis' firm offer – was a better option for the Company than taking a risk with a questionable negotiating partner. (A point of view, notably, endorsed by their creditors; see Mencher 102-05). The loss of the opportunity with

Genesis would have been detrimental to the Company, and such loss was something that the Board properly sought to protect against.

Where corporate directors face a threat to their corporate control, such as a takeover, courts require directors to demonstrate that the defensive measures they adopt in response are reasonable in light of a threat to corporate policy and effectiveness posed by a takeover. Ivanhoe, 535 A.2d at 1341, citing Unocal, 493 A.2d at 954. Defensive measures adopted by a board must be reasonable in light of the circumstances and in proportion to the nature of the threat to the corporation. Unitrin, 651 A.2d at 1373. No such threat appeared here; hence, the Directors' decisions are not judged by this standard. Nevertheless, the deal protection measures Plaintiffs object to, including the July 1, 2002 Exclusivity Agreement with Genesis and Messrs. Outcalt and Shaw's Voting Agreements, were adopted in good faith and upon reasonable investigation. The Court should accord them the protection of the business judgment rule. Unitrin, 651 A.2d at 1374-75.

Although Messrs. Outcalt and Shaw dispute that the the heightened standard of Unocal/Unitrin is applicable here, even that standard acknowledges:

> [T]he board may under appropriate circumstances consider the inadequacy of the bid, the nature and timing of the offer, questions of illegality, the impact on constituencies other than stockholders, the risk of nonconsummation, and the basic stockholder interests at stake, including the past actions of the bidder and its affiliates in other takeover contests.

Ivanhoe, 535 A.2d at 1341-1342. In this case, the Directors did take these factors into consideration -- and an analysis of the considerations facing the NCS Board demonstrates that the Directors' decision to proceed with the Genesis merger, in the face of Omnicare's conditional proposal, was indeed reasonable and supports the "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Unocal, 493 A.2d at 954, quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

2. The Deal Protection Provisions Were Appropriate To The Circumstances.

The exclusivity arrangement with Genesis was not a defensive measure enacted to foreclose other bids, but, rather, a reasonable inducement to Genesis to engage in negotiations. The NCS directors confronted a situation manifestly distinguishable from that in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), where the board of a target corporation responded to a hostile offer by courting another buyer and engaging in multiple tactics to frustrate acquisition by the first. Here, the NCS Board had heard ***nothing*** from Omnicare for months. (Pollack 64-65, 71) (discussing the history of Omnicare's dealings with NCS). Entering into an exclusivity arrangement and the other subsequent agreements, which taken together served to protect the Genesis deal, was a reasonable course of action on the part of the NCS Directors to permit the only viable transaction to go forward.

The Plaintiffs' conclusory statement that the agreements entered into by the NCS Board were "draconian" defensive mechanisms is unsupported by the law and the record. In Rand v. Western Airlines, 1994 Del. Ch. LEXIS 26 at *18 (February 25, 1994 Del. Ch) (Ex. F hereto), the defendant airline negotiated with several possible acquirers, went through several rounds of failed negotiations and eventually determined to negotiate with the only interested suitor, Delta, pursuant to a lock-up agreement. Although the court noted that such agreements warranted careful scrutiny, in that case the Court held that they were appropriate in that to promote achieving the best value for the stockholders. Both Western and Delta sought assurances of certainty in the negotiations and, like NCS here, "Western gained a substantial benefit for its stockholders by keeping the only party expressing any interest at the table while achieving its own assurances that the transaction would be consummated." Id. at *20.

The threat the NCS Directors responded to in this case was an "opportunity loss" that would deprive the stockholders of an opportunity to consider a superior offer. See Unitrin, 651 A.2d at 1384. NCS faced the imminent loss of the Genesis transaction, superior to the Omnicare proposal by virtue of its certainty and chose to protect the opportunity to present the stockholders with that deal by entering into the Exclusivity Agreement and various other protective provisions, and subsequent to the execution of the Merger Agreement, the Voting Agreements. (Outcalt 74-75). Actions that encourage the completion of a transaction, including voting agreements, are entirely acceptable under Delaware law. See In re IXC Communications, Inc. Shareholders Litigation, 1999 Del Ch. LEXIS 210 at *27 ("[T]he commitment to vote, disparaged as locked up or otherwise, has the objective of promoting the best interest of the community of shareholders by increasing the likelihood (though far short of a certainty) of approval of the merger.") (Ex. G hereto).

3. The Directors' Judgment Was In No Way Clouded By Personal Conflicts.

As Messrs. Outcalt and Shaw have pointed out above, their interests in the Merger Agreement were aligned with the other stockholders, given that their own substantial stock holdings would give them an incentive to maximize value for stockholders in any transaction. The Plaintiffs suggest that Mr. Outcalt somehow breached his fiduciary duties by failing to disclose his subsequent consulting agreement with Genesis to the members of the Special Committee of the NCS Board. However, the Special Committee had previously discussed Mr. Outcalt's consulting agreement. Despite Sells' memory lapse in his deposition, it is clear that Pollack discussed Mr. Outcalt's proposed arrangement with the Special Committee on July 28, prior to the vote on the Merger Agreement, and they were fully informed as to its terms. (Form S-4 at 40-41).

The compensation given to Mr. Outcalt is immaterial in any event, in comparison to his interest as a stockholder. Mr. Outcalt and Mr. Shaw both would have received a salary continuation if ***any*** entity, including Omnicare, acquired NCS. (Shaw 76; Binding Term Sheet § 1(a)). Mr. Outcalt was likewise entitled to a success fee in the event of any such acquisition. Plaintiffs need a reality check.[6] Plaintiffs' suggestion that Mr. Outcalt would somehow act to deprive himself of the additional $5 million dollars-plus potentially available to him as a stockholder under Omnicare's proposal in order to receive an additional $175,000 per year from Genesis for four years, plus benefits, is ludicrous. Plaintiffs likewise offer no support for their contention that Mr. Outcalt's proposed "founder" added anything and the record demonstrates Mr. Outcalt himself was not sure what the designation meant, if anything. (Outcalt 103).

---

6 The Plaintiffs' arguments invite the same skepticism exhibited by the court in IXC Communications, supra, where the court states:

> The plaintiffs' attempts to portray the board as somehow self-interested in a manner adverse to the IXC shareholders stretch the facts to a logical breaking point and fail to support their claims that the board breached its duty of loyalty. At least three members of the board, Messrs. Irwin, McKenzie and Swett, together hold at least 16.3% of IXC's outstanding shares. Plaintiff has not demonstrated how the rational economic self-interest of these large shareholders differs from all IXC shareholders, nor that they would receive anything more for their shares than even the numerically smallest IXC shareholder.

IXC Communications, 1999 Del. Ch. LEXIS 210 at *17-18. Here Messrs. Shaw and Outcalt will receive exactly the same price for their shares as any other stockholder. In IXC the plaintiffs suggested that the defendants explanations for their actions was to avoid duties imposed by Revlon. The court found it exceptionally improbable that the members of the board in the IXC case would have behaved in such a fashion:

> I simply cannot accept a scenario that suggests that such a twisted self interest could even exist; namely, so intense a desire to avoid an artifice of perceived legal duties (duties which in actuality this Court determines from the context, *after the fact)* that the directors would actively shirk their fiduciary obligations *and* in the process ignore their own economic self-interests. Plaintiffs need a serious reality check.

Id. at *19.

C. The Directors Met Their Duty Of Care By Obtaining The Best Price Available To NCS As Of July 28, 2002.

1. The Directors Did Not Have Competing Bids To Enable Them To Conduct An Auction.

Plaintiffs take the position that Omnicare's July 26 letter was a "bid," and the Directors' refusal to give it any credit prematurely curtailed an auction of the Company. In fact, the Omnicare letter was not a genuine bid, and it did not contain the terms necessary to allow the Directors to consider it together with Genesis' proffered merger. The July 26 letter had a significant due diligence out, despite Omnicare's substantial prior due diligence.[7] REDACTED

The timing of Omnicare's expression of interest was highly suspect, coming as it did after months of silence, as NCS was about to enter into an agreement with Genesis. REDACTED Under the circumstances, the Directors' duty to conduct an auction as articulated in Revlon v. MacAndrews & Forbes Holdings, Inc., supra, simply does not apply.[8] REDACTED Here, the Company and its advisors had explored a broad array of options for preserving the Company and managing its debt (Pollack 37, 48), marketing the Company for over two years with no bidders. (Pollack 115-116). It is simply not reasonable to suppose that

---

7 Any deficiencies in Omnicare's prior due diligence are directly attributable to Omnicare's refusal to enter into a confidentiality agreement that would have protected NCS proprietary information. See Statement of Facts, Section I.B., supra.

8 Even the Revlon court approved a number of the protective measures taken by the board in that case, stating:

> In that regard the board acted in good faith, and on an informed basis, with reasonable grounds to believe that there existed a harmful threat to the corporate enterprise. The adoption of a defensive measure, reasonable in relation to the threat posed, was proper and fully accorded with the powers, duties, and responsibilities conferred upon directors under our law.

Id. at 181, citing Unocal, 493 A.2d at 954.

the Directors could have taken a company for which there was almost no market and whipped-up a bidding frenzy for it out of thin air. The May 14, 2002 presentation by Brown Gibbons to the Special Committee of the NCS Board sets out the history of the attempts to restructure or sell the Company, and amply demonstrates the efforts that the Board and its advisors made to canvas the pool of possible partners in the industry. (Presentation to NHS HealthCare, Inc., May 14, 2002. (Pltfs. Ex. 24)).[9] Although the Board would have liked to conduct an auction, as demonstrated in the May 14, 2002 presentation, at the end of the day, none of the parties identified as bidders came to the block to bid. In light of the limiting circumstances, the Directors chose to focus all their efforts on consummating the single strategic combination that seemed viable.

In NCS' case, Revlon does not apply because an auction was impossible under the circumstances. Although the Directors, including the Special Committee and the financial advisors to the Special Committee, recognized that an auction would be an appropriate method to generate high value, they were simply unsuccessful in making such an auction occur. (Pollack 115-16). In Revlon the board faced a situation involving fierce bidding; in contrast NCS could not arrange to have two bidders. (Pollack 151-53). Genesis declined to participate in an auction, refusing to be the "stalking horse" to trigger such an auction and refusing even to discuss an acquisition except on an exclusive basis. (Hager 180). Omnicare was not a bidder either, failing even to come to the table until July 26, and then only via a letter freighted with conditions, most particularly a due diligence out which NCS creditors had advised Omnicare would make its

---

9 The Plaintiffs make much of the Brown Gibbons recommendation that the Company should conduct an auction. If anything, it supports the contention that the Directors were doing their best to get a good value by pursuing a strategy which, if successful, would result in a higher price. Nonetheless, having brought the auction horse to water, the Directors cannot be faulted for its failure to drink.

proposal unacceptable. REDACTED

In fact, as the record shows, the Directors were able to conduct the closest thing to an auction that was possible under the circumstances. They were able to parlay the July 26 proposal into a higher offer from Genesis for stockholders and noteholders (Hager 131-40; Outcalt 91-94). Subjectively, the Directors felt they had obtained the best deal available for their stockholders, as well the Noteholders and creditors. (Outcalt 82). Objectively, for the Directors to have breached their Exclusivity Agreement with Genesis by attempting to negotiate with Omnicare would have been a tremendous risk to the NCS' stockholders in the face of Genesis' stated intent to withdraw if that occurred. (July 28, 2002 Minutes, NCS 8265). Moreover, the law is clear that the Board was not obligated to sit about and wait for a possibly superior transaction. See Matador Capital Management v. BRC Holdings, Inc., 729 A.2d 280, 292 (Del. Ch. 1998)(the board had no duty to delay a transaction in order to allow a party that had not made firm offer to promote a bid); In re Anderson, Clayton Shareholders' Litigation, 519 A.2d 669, 676 (Del. Ch. 1986)("[D]irectors of a Delaware corporation have no duty to delay an otherwise appropriate transaction just because at the last minute a possible alternative arises that might, if it could be arranged, be more beneficial to the corporation or its shareholders then [sic] the transaction with which the corporation has been proceeding.").

A logical reading of the record is that Messrs. Outcalt and Shaw would be before this Court on a similar suit had they permitted the Genesis offer to get away, because there was ***absolutely no guarantee*** on July 26, 2002 that Omnicare really would pay $3.00 per share -- or even $1.60 per share -- once Genesis was out of the picture.[10] In any event, even under the rigorous scrutiny of Revlon, the law only required a ***reasonable*** decision on the part of the Directors, not a perfect one. See Golden Cycle LLC v. Allan, 1998 Del. Ch. LEXIS 237 at *42 (December 10, 1998 Del. Ch.) (Ex. H hereto).

2. Even Had The Directors Been Able To Do So, The Circumstances Of This Case Did Not Require Them To Conduct An Auction.

The Merger Agreement between NCS and Genesis involves a stock for stock exchange. In such a case, the Delaware Supreme Court has stated that courts need not evaluate the transaction in light of Revlon. See Arnold v. Society for Savings, supra. The court in Arnold sets forth the circumstances in which the court will substantively evaluate the conduct of the directors in seeking the highest price for the company, as follows:

> The Court need not apply enhanced scrutiny under the circumstances of this case. The directors of a corporation "have the obligation of acting reasonably to seek the transaction offering the best value reasonably available to the stockholders." in at least the following three scenarios: (1) "when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company,"; (2) "where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company,"; or (3) when approval of a transaction results in a "sale or change of control,". In the latter situation,

10 Another logical possible outcome for NCS, had it pursued the course of action that Plaintiffs suggest was a suit by Genesis for breach of the Exclusivity Agreement, as happened to the target corporation in Ace Limited v. Capital Re Corp., 747 A.3d 95 (Del. Ch. 1999), cited by the Plaintiffs for the proposition that the NCS Directors' defensive measures were excessive. In Ace the target corporation's directors assessed a competing offer and judged that it represented a significant enough increase in value to negotiate with the second suitor. Here, the Plaintiffs are asking this Court to presume: (1) that the NCS Directors had no discretion to assess the viability and value of the second proposal and reject it accordingly, and (2) that the Directors should immediately have pursued the second proposal at the risk of suit by its first negotiating partner. Ace does not require such a conclusion.

> ***there is no "sale or change in control" when "'control of both [companies] remains in a large, fluid, changeable and changing market.'".***

Id. (citations omitted; emphasis added). As demonstrated above, the "active auction" analysis does not apply since the NCS Directors were unsuccessful in implementing an auction strategy and there is no evidence or argument here that the Company was being "broken up." The "sale of control" argument likewise does not apply because, as was the case in Arnold, the stock of NCS remains in a "large, fluid, changeable and changing market." But, in the final analysis, the Directors met their obligation to act reasonably by seeking "the transaction offering the best value reasonably available to the stockholders." Id. at 1289-90, quoting Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 43 (Del. 1994).

3. The Directors' Actions Were Reasonable Under The Circumstances At The Time They Made Their Decision.

As the Plaintiffs point out in their Memorandum, the parties had a history of dealing with one another, which put the NCS Directors in an excellent position to evaluate the Omnicare July 26 letter. The past history of negotiations with Omnicare -- offers that did not give ***any*** value to the equity holders and insistence on a bankruptcy sale that was detrimental to NCS' enterprise value – was sufficient to cast serious doubt on the value of Omnicare's proposal of July 26. (Shaw 33-35; REDACTED During the weekend of July 26 through July 28, 2002, the Directors faced a take-it-or-leave-it offer from Genesis. (Hager 149-50). The Genesis offer had to be signed by midnight on Sunday or the offer would be lost. (Hager 151, 192; Pollack 187, 196; July 28, 2002 Minutes (NCS 8263)).

The measure of the Directors' reasonableness is the information they had available to them at the time of their decision. See Thompson v. Enstar, 509 A. 2d 578, 582

(Del. Ch. 1984). At the time Omnicare suggested it would ***consider*** a $3.00 per share offer for NCS, the information the Directors had to rely on was that Genesis' firm offer of $1.60 per share, combined with full repayment of NCS' debt, was substantially better than Omnicare's illusory proposal to negotiate.

Plaintiffs make much of the language in the court's bench ruling in Phelps Dodge Corp. v. Cyprus Amax Minerals Co., 1999 WL 1054255 (Del. Ch.). In that instance the court stated:

> [E]ven the decision not to negotiate, in my opinion, must be an informed one. A target can refuse to negotiate under Time Warner, but it should be informed when making such refusal.
>
> The Board of Time, for example, may have refused in the exercise of its business judgment to negotiate with Paramount, but its refusal was not claimed to be an uninformed one. That is, Time's board had not ex ante bargained away its right even to become informed about whether or not to negotiate.

Phelps Dodge, 1999 WL 1054255 at *1. It is clear in Phelps Dodge that the court was concerned about whether the board had sufficient information to make its decision, but the opinion provides no facts from which to infer that the case was analogous to the situation before this Court. In fact, the NCS Directors had ample basis upon which to assess the Omnicare proposal. Accordingly, it was a proper exercise of their business judgment to refuse to negotiate with Omnicare, as the Phelps Dodge opinion confirms.

Throughout the process the Directors considered the interests of the other stockholders, as well as their obligations to the Noteholders and creditors. Plaintiffs question whether or not the Directors in fact had a duty to the creditors of the Company, which they did throughout the period at issue. A company owes fiduciary duties to its creditors when it becomes insolvent. See, e.g., Geyer v. Ingersoll Publications Co., 621 A.2d 784, 787 (Del. Ch. 1992). Plaintiffs provide absolutely no evidence that the Company was anything but insolvent during the 2000 through 2002 period; indeed, the evidence is the Company remains insolvent to this day. In the period encompassing the Company's attempts to refinance, restructure or merge, the period of initial unsuccessful conversations with Omnicare, and the period of subsequent negotiations with Genesis, the Company had defaulted on its debts and was under intensive scrutiny from its creditors, placing it within the "zone of insolvency" under Delaware law. Id. at 789 ("Besides Delaware case law, the other factor upon which I rely in holding that the insolvency exception arises upon the fact of insolvency rather than the institution of statutory proceedings is the ordinary meaning of the word insolvency. An entity is insolvent when it is unable to pay its debts as they fall due in the usual course of business.").

The authority for the Directors' actions "derives from [their] fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source." Unocal, 492 A.2d at 954. The Plaintiffs seek to force a hindsight evaluation of the contemporaneous reasonableness of the July 28, 2002 NCS Board decision. This Court, like the court in Thompson v. Enstar, should decline to engage in such hindsight analysis. In Thompson, the board of directors contacted over 100 prospective buyers of the corporation and seriously evaluated numerous of them, but when the time came for the board's decision, there was only one offer on the table, which the board decided to accept. The Vice Chancellor found that, given the amount of information available to the Board ***on the day they made their decision***, their decision was reasonable, despite the possibility of another conditional offer, known only at the last minute, as well as a subsequent higher offer. See Thompson, 509 A.2d at 582. This Court should make the same decision. Under the circumstances, this Court may presume that the actions of the NCS Directors were in accordance with their duties of care and loyalty. See Ivanhoe, 535 A. 2d at 1341.

4. Plaintiffs' Arguments Regarding The Value Of Omnicare's Proposal Are Misleading.

In the instant case, as in Thompson, the fact that Omnicare finally made an unconditional, substantially higher, tender offer months after their last-minute invitation to the NCS Directors has no bearing on the July 28, 2002 decision of the Directors. Indeed, upon finally receiving an actual firm offer from Omnicare that exceeded the amount of the Genesis offer, the Directors accordingly withdrew their recommendation of the lower offer. (Shaw 91-94) (NCS HealthCare, Inc. October 22, 2002 Press Release (Pltfs. Ex. 46)). Plaintiffs seek to transform this action into damning *ex post facto* evidence of the inappropriateness of the earlier decision to enter into the Merger Agreement, but that argument is faulty. The fact remains that at the time the Directors made their decision regarding the Genesis agreement, it was their ***best and only option***. (Shaw 71-72). Indeed, given the history of Omnicare's dealings with the Company, it is unlikely that Omnicare would ever have offered a fair value for the Company absent the Genesis transaction.

The Plaintiffs now have the benefit of 20/20 hindsight, and rely heavily on it in their Memorandum. That defendant Boake Sells, also with the benefit of hindsight, now sees that $3.00 is more than $1.60 is simply an affirmation of the unremarkable proposition that had the Directors been able to get that amount for themselves and other stockholders, they would have preferred to do so. Merely because the Directors -- as stockholders themselves -- would have preferred to receive $3.00, does not mean their determination that they were unlikely to receive it was unreasonable.

Plaintiffs greatly misstate the nature of Omnicare's overtures to NCS. The Memorandum speaks of Omnicare's more valuable "offers" for NCS. However, all of Omnicare's initial proposals offered absolutely ***no*** value to the stockholders. See Statement of

Facts Sections I.A. through I.E. supra. Plaintiffs cannot reasonably be suggesting that the Directors should have considered such offers in comparison with an offer that gave stockholders value. Thus the only "offer" that Plaintiffs can compare to the Genesis merger proposal is the July 26 letter. That proposal was so conditional, however, as to warrant no comparison with the firm offer negotiated with Genesis. See Rand v. Western Airlines, 1994 Del. Ch. LEXIS 26 at *18 (the court characterized an offer early in negotiations, subject to numerous conditions and further negotiations, as not even an "offer" for the purposes of measuring the board of director's reasonableness in subsequently accepting a lower offer).

The Revlon court, and subsequent decisions relying upon the court's opinion, makes the point that an objectively higher dollar value offer is not necessarily a superior offer. Revlon, 506 A.2d at 184. In that case the court found it unreasonable for the directors to reject an immediate bid in favor of a slightly higher bid that was not immediately available. Had the NCS Directors taken that approach, they might be subject to censure. They did not, and therefore Plaintiffs' claims fail.

III. PLAINTIFFS CANNOT MARSHALL A PLAUSIBLE HARM ARGUMENT, PARTICULARLY IN LIGHT OF THE DETRIMENT TO NCS IN THE EVENT OF A FAILED MERGER.

In light of the numerous defects in Plaintiffs' claims regarding the Directors' conduct in choosing the Genesis offer over Omnicare's invitation to discuss a purchase, any arguments Plaintiffs may make concerning purported irreparable harm are of negligible weight. See Formosa Plastics, 504 A. 2d at 1088.

Plaintiffs argue that NCS will sustain irreparable harm in the lost opportunity to pursue a business combination with Omnicare and that such a loss is unquantifiable. However, as Messrs. Outcalt and Shaw have set forth in detail above, the so-called "lost opportunity" was entirely speculative, being subject to Omnicare's due diligence out and other conditions. If, however, Plaintiffs were to prevail, their argument with respect to the nature of the loss contradicts their argument as to the nature of the harm. In fact, if the Plaintiffs sustain any loss at all, they have a remedy in an appraisal action.

By contrast, NCS has a transaction awaiting consummation, a business to run and extensive debts to pay. The continuing existence of those debts has dogged NCS throughout the entire process, as amply set forth in the parties' memoranda. Delaying the merger further imperils NCS' operations as a going concern and is detrimental to its stock value.

CONCLUSION

WHEREFORE, for all of the foregoing reasons and pursuant to the authorities cited, defendants Jon H. Outcalt and Kevin B. Shaw respectfully request that the Court deny the Plaintiffs' Motion for Preliminary Injunction.

SQUIRE, SANDERS & DEMPSEY L.L.P.

Frances F. Goins

Frances Floriano Goins JEA
Thomas G. Kovach
4900 Key Tower
127 Public Square
Cleveland, OH 44114
(216) 479-8500

MORRIS, NICHOLS, ARSHT & TUNNELL

Jon E. Abramczyk

Jon E. Abramczyk
1201 North Market Street
Wilmington, DE 19899
(302) 658-9200

Attorneys for Jon H. Outcalt

SPIETH, BELL, McCURDY & NEWELL CO., L.P.A.

James R. Bright

James R. Bright JEA
Timothy G. Warner
2000 Huntington Building
Cleveland, OH 44115
(216) 696-4700

MORRIS, JAMES, HITCHENS & WILLIAMS L.L.P.

Elizabeth A. Brown

Edward M. McNally JEA
Michael A. Weidinger
Elizabeth A. Brown
222 Delaware Avenue, 10th Floor
Post Office Box 2306
Wilmington, DE 19899
(302) 888-6800

Attorneys for Defendant Kevin B. Shaw

November 10, 2002