Genesis 11.26.02 12:28

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

| | | |
|---|---|---|
| IN RE NCS HEALTHCARE, INC., | ) | Consolidated |
| SHAREHOLDERS LITIGATION. | ) | C.A. No. 19786 |

***MEMORANDUM OPINION AND ORDER***

**Submitted: November 14, 2002**
**Decided: November 22, 2002**
**Revised: November 25, 2002**

Joseph A. Rosenthal, Esquire, ROSENTHAL, MONHAIT, GROSS & GODDESS, P.A., Wilmington, Delaware; Robert J. Kriner, Jr., Esquire, CHIMICLES & TIKELLIS, LLP, Wilmington, Delaware; Richard B. Bemporad, Esquire, LOWEY DANNENBERG BEMPORAD & SELINGER, P.C., White Plains, New York; Daniel A. Osborn, Esquire, BEATIE AND OSBORN, LLP, New York, New York, *Attorneys for Plaintiffs*

Edward P. Welch, Esquire, Edward B. Micheletti, Esquire, Katherine J. Neikirk, Esquire, James A. Whitney, Esquire, SKADDEN ARPS SLATE MEAGHER & FLOM, LLP, Wilmington, Delaware; Mark A. Philips, Esquire, Megan L. Mehalko, Esquire, H. Jeffrey Schwartz, Esquire, BENESCH, FRIEDLANDER, COPLAN & ARONOFF LLP, Cleveland, Ohio; *Attorneys for Defendants NCS Healthcare, Inc., Boake A. Sells, and Richard L. Osbourne*

Jon E. Abramczyk, Esquire, MORRIS, NICHOLS, ARSHT & TUNNELL, Wilmington, Delaware; Frances Floriano Goins, Esquire, Thomas G. Kovach, Esquire, SQUIRES, SANDERS & DEMPSEY, LLP, Cleveland, Ohio; *Attorneys for Defendant John H. Outcalt*

Edward M. McNally, Esquire, Michael A. Weidinger, Esquire, Elizabeth A. Brown, Esquire, MORRIS, JAMES, HITCHENS & WILLIAMS, LLP, Wilmington, Delaware; James R. Bright, Esquire, Timothy G. Warner, Esquire, SPIETH, BELL, McCURDY & NEWELL CO., L.P.A., Cleveland, Ohio; *Attorneys for Defendant Kevin B. Shaw*

this was necessary because, due to NCS's precarious financial condition, it felt that fiduciary duties were owed to the enterprise as a whole rather than solely to NCS stockholders. Sells and Osborne were selected as the sole members of the committee, and given authority to consider and negotiate possible transactions for NCS. The entire NCS board, however, retained authority to approve any transaction. The Independent Committee retained the same legal and financial counsel as the NCS board.

The Independent Committee met for the first time on May 14, 2002. At that meeting Pollack suggested that NCS seek a "stalking-horse merger partner" to obtain the highest possible value in any transaction.[4] The Independent Committee agreed with the suggestion.

On May 16, 2002, Scott Berlin of Brown Gibbons, Glen Pollack and Boake Sells met with George Hager, CFO of Genesis, and Michael Walker, who was Genesis's CEO. At that meeting, Genesis made it clear that if it were going to engage in any negotiations with NCS, it would not do so as a "stalking horse."[5] As one of its advisors testified, "We didn't want to be someone who set forth a valuation for NCS which would only result in that valuation ... being publicly disclosed, and thereby creating an environment where Omnicare felt to maintain its

---

[4] Pollack Dep. at 166.

[5] Hager Dep. at 24.

Mencher saw the July 26 Omnicare letter and realized that, while its economic terms were attractive, the "due diligence" condition substantially undercut its strength. In an effort to get a better proposal from Omnicare, Mencher telephoned Gemunder and told him that Omnicare was unlikely to succeed in its bid unless it dropped the "due diligence outs." She explained this was the only way a bid at the last minute would be able to succeed. Gemunder considered Mencher's warning "very real," and followed up with his advisors. They, however, insisted that he retain the due diligence condition "to protect [him] from doing something foolish." Taking this advice to heart, Gemunder decided not to drop the due diligence condition.

Late in the afternoon of July 26, 2002, NCS representatives received voicemail messages from Omnicare asking to discuss the letter. The exclusivity agreement prevented NCS from returning those calls. In relevant part, that agreement precluded NCS from "engag[ing] or particpat[ing] in any discussions or negotiations with respect to a Competing Transaction or a proposal for one."[9] The July 26 letter from Omnicare certainly met the definition of a "Competing Transaction."

---

[9] Keener Aff. Ex. 27.

reasonable) decision to pursue a transaction with Genesis.[44] Certainly, the record does not reveal any important information that they overlooked in reaching the conclusion they did.

---

[43] *See* Osborne Dep. at 107-08.

[44] The following question was asked and answered at Osborne's deposition:

> Q. [By plaintiffs' attorney] In your role as a member of the special committee, did you think it was appropriate for NCS to enter into an exclusivity agreement with Genesis?
>
> A. [By NCS Director Osborne] We were in a situation where a promising opportunity was developing with Genesis. One that had the promise of substantial recovery for -- for creditors ..., and also the chance of a significant value for shareholders.
>
> The company continued to be circling insolvency. We had talked to 50-plus companies and none had resulted in a deal. We had OmniCare, who had repeatedly offered only bankruptcy and no recovery for shareholders.
>
> We were very mindful of our responsibility to all the stakeholders, but particularly given our perilous condition to the noteholders and senior debt. And of course in this case, because of the chance of recovery for shareholders, it was very clear to me that we should be extremely careful to nurture and preserve this opportunity given the circumstances.
>
> We had been given analyses that showed negative value, looking at it every possible way for the equity, and here we were going to have -- at NCS we were going to have a recovery.
>
> So I was very clear that signing that agreement in order -- and of course, they made it -- they were adamant that that would be required to move forward. It was very clear to me that I was doing my duty when we -- when I agreed to sign that agreement, [I was] crystal clear [it] was the right decision to make on behalf of the stakeholders.

Osborne Dep. at 107-08.

conditional expression of interest."[46] According to Osborne, this was a very clear decision.[47] Similarly, in discussing the risk of losing the Genesis bid, director and Independent Committee member Sells noted that, given NCS's past negotiations with Omnicare that had led only to Section 363 bankruptcy proposals, NCS simply could not assume that Omnicare's conditional proposal would be likely to result in an agreement superior to the Genesis offer.[48]

Mencher, the Noteholders' representative on the Ad Hoc Committee, also was skeptical about negotiating further with Omnicare and was concerned about the risks it would pose to the pending Genesis deal. She stated,

> Omnicare already had shown themselves as being unable to complete a transaction that people had agreed to; hence, I thought there was a huge amount of risk going back to Omnicare, because I was afraid it would chase Genesis away, and a bird in the hand is always worth more than two in the bush.[49]

---

[46] Osborne Dep. at 128. The overall quality of testimony given by the NCS directors is among the strongest this court has ever seen. All four NCS directors were deposed, and each deposition makes manifest the care and attention given to this project by every member of the board.

[47] *Id.* at 128-29.

[48] *See* Sells Dep., Ex. 2 at Tab 22 (Minutes of NCS board meeting on July 28, 2002 stated, "Mr. Sells ... emphasized that reliance on Omnicare's July 26 letter would not be reasonable in light of Omnicare's historic conduct in negotiations with [NCS]. 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").

[49] Mencher Dep. at 194.

*Co.*,[51] and that these defensive devices were impermissibly preclusive, coercive and unreasonable.[52] The court agrees that these aspects of the Genesis merger agreement require special scrutiny. Nevertheless, the plaintiffs have not succeeded in showing that the NCS board of directors acted unreasonably at the time it agreed to these provisions or that these provisions were improperly preclusive or coercive of stockholder action.

The *Unocal* doctrine is applied by Delaware courts to subject to an intermediate level of reasonableness scrutiny the actions taken by directors that are defensive in nature and have the effect of either coercing involuntary stockholder action or precluding voluntary stockholder action.[53] The reasonableness standard of *Unocal* and related cases[54] is designed, to address and reconcile potential conflicts that arise in merger or acquisition transactions between the directors' power to manage the affairs of the corporation and the stockholders' power to sell

---

[51] 493 A.2d 946 (Del. 1985). *See also Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1386-89 (Del. 1995).

[52] *See, e.g., Williams v. Geier*, 671 A.2d 1368, 1377 (Del. 1996) ("A *Unocal* analysis should be used only when a board unilaterally ... adopts defensive measures in reaction to a perceived threat").

[53] *Id.*

[54] *See Brazen v. Bell Atlantic Corp.*, 695 A.2d 43, 48 (Del. 1997) (applying reasonableness standard to review $550 million termination fee in merger agreement.)

or vote their shares.[55] Our courts have applied this standard to examine deal protection devices, even in non-*Revlon* situations.[56]

The plaintiffs point out that the combined effect of the "force the vote" provision in the merger agreement, authorized by Section 251(c) of the DGCL,[57] and the Outcalt and Shaw voting agreements virtually guarantees that the Genesis merger will be accomplished. The plaintiffs argue that these provisions cannot survive a reasonableness analysis because they were not adopted in response to any legitimate threat to corporate control or effectiveness and because they are preclusive of the stockholders' ability to accept the Omnicare offer.[58]

---

[55] *See* Leo E. Strine, Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 BUS. LAW. 919, 934 n.44 (2001) ("A closer reading of the cases suggests that the 'unilateral' question turns solely on whether the defensive measures were adopted without involvement by the stockholders," citing *Williams v. Geier*).

[56] *Ace Limited v. Capital Re Corp.*, 747 A.2d 95 (Del. Ch. 1999); *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999); *but see IXC*, 1999 WL 1009174 (according "business judgment" deference to defensive provisions in merger agreement, after careful and thorough review of reasonableness of entire board process leading to adoption of merger agreement).

[57] Section 251(c) was amended in 1998 to allow for the inclusion in a merger agreement of a term requiring that the agreement be put to a vote of stockholders whether or not their directors continue to recommend the transaction. Before this amendment, Section 251(c) was interpreted as precluding a stockholder vote if the board of directors, after approving the merger agreement but before the stockholder vote, decided no longer to recommend it. *See Van Gorkom*, 488 A.2d at 887-88. In this case, NCS is obliged to convene a meeting of its stockholders to vote on the Genesis merger agreement even though the NCS board of directors has withdrawn its recommendation in favor of that agreement.

[58] The plaintiffs also argue that the $6 million termination fee and the no-talk provisions in the merger agreement subject this transaction to a *Unocal* analysis. These were not devices that served to ultimately "lock up" the NCS/Genesis merger. Rather the acts that served to lock up this transaction were only the Section 251(c) provision in the merger agreement and the execution of voting agreements by Outcalt and Shaw.