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

STOCKHOLDER PLAINTIFFS' REPLY MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION FOR SUMMARY JUDGMENT

CHIMICLES & TIKELLIS, LLP
One Rodney Square
Wilmington, DE 19801
(302) 656-2500

ROSENTHAL, MONHAIT, GROSS
& GODDESS, P.A.
919 North Market Street, Suite 1401
P.O. Box 1070
Wilmington, DE 19899-1070
(302) 656-4433

Plaintiffs' Co-Liaison Counsel

OF COUNSEL:

LOWEY DANNENBERG BEMPORAD
& SELINGER, P.C.
The Gateway, 11th Floor
One North Lexington Avenue
White Plains, NY 10601-1714
(914) 997-0500

BEATIE AND OSBORN LLP
521 Fifth Avenue, 34th Floor
New York, NY 10175
(212) 888-9000

Plaintiffs' Co-Lead Counsel

October 22, 2002

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PRELIMINARY STATEMENT

The Stockholder Plaintiffs submit this Reply Memorandum of Law in support of their motion for summary judgment declaring that the July 28, 2002 Voting Agreements, entered into by director defendants Outcalt and Shaw with defendant Genesis, automatically converted defendant Outcalt and Shaw's shares of NCS Class B common stock, having 10 votes per share, into shares of NCS Class A common stock having one vote per share.[1/] This issue is central to the rights of the parties, as it will determine whether Genesis, through the Voting Agreements, controls 65% or 20% of the voting power in NCS.

Defendants do not dispute the basic premises set forth in plaintiffs' Opening Briefs: (a) under Section 7(a) of Section IV of the NCS amended and restated certificate of incorporation (the "NCS Certificate"),[2/] Outcalt and Shaw may not "transfer" their Class B shares or "any interest therein" to anyone other than a "Permitted Transferee," whether "by sale, assignment, gift, bequest, appointment or otherwise;" (b) Genesis is not a "Permitted Transferee (id.);" (c) the NCS Certificate defines "beneficial ownership" to include "the power to vote or to direct

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1/ Omnicare and the Stockholder Plaintiffs filed motions for summary judgment, dated September 30, 2002 and October 2, 2002, respectively.

2/ A copy of the NCS Certificate is attached as Exhibit C to the Omnicare motion for summary judgment.

the vote or to dispose of or direct the disposition of the shares of Class B common stock" (id. §7(g)); and (d) pursuant to Section 7(d) of the Certificate, Class B shares are "automatically" converted into Class A shares in the event of any "purported transfer" of the shares to a person or entity other than a Permitted Transferee.

Rather, defendants premise their opposition to plaintiffs' motions on (a) the fact that Section 7(d), the automatic conversion provision, does not specifically include the words "or interest;" (b) Section 7(c)(5) of the NCS Certificate, which permits "the giving of a proxy in connection with a solicitation of proxies subject to the provisions of Section 14 of the Securities Exchange Act of 1934;" and (c) the argument that applicable principles of contractual and charter interpretation preclude the grant of summary judgment.

Each of defendants' arguments fails on examination of the language of the NCS Certificate and the undisputed facts. First, defendants' strained interpretation of the interrelated subsections of Section 7 of Article IV of the NCS Certificate -- that the absence of the words "or interest" from Section 7(d) means the broad transfer of rights to Genesis in the Voting Agreements did not cause conversion of the Class B shares to Class A shares -- would negate Sections 7(a) and 7(g) of the NCS Certificate and render Section 7(c)(5) superfluous. Corporate

charters, like other contracts, are interpreted to give meaning to all of their terms.

Second, Section 7(c)(5) -- the proxy "exception" -- is inapplicable to the rights transferred by Outcalt and Shaw to Genesis in the Voting Agreements because the transfer of broad rights to Genesis was not effected "in connection with a solicitation of proxies subject to the provisions of Section 14 of the" Exchange Act.

Finally, there is no legal or equitable principle that precludes enforcing the conversion provisions of Section 7(d) of the NCS Certificate. Indeed, any other result would encourage the controlling stockholders of publicly held corporations to seek ways of circumventing charter restrictions designed to protect the public stockholders from a change of control at a price that is a fraction of the true value of the public shares. Neither public policy nor equitable considerations warrant such a result.

As the applicable facts are readily determinable on this motion, summary judgment should be granted to plaintiffs declaring that the Class B shares owned by defendants Outcalt and Shaw have been converted into Class A shares.

ARGUMENT

A. The Transfer of "Interest[s]" to Genesis Caused an Automatic Conversion of the Class B Shares

Defendants concede that, pursuant to Section 2 of each of the July 28, 2002 Voting Agreements, Outcalt and Shaw (a) gave Genesis "an irrevocable proxy, coupled with an interest" to vote their respective Class B shares (§2(b); and (c) committed not to alienate their shares prior to consummation of the proposed Genesis Merger (id. §§1(b), 2(a)).[3/]

Moreover, through the Voting Agreements, Outcalt and Shaw have "transfer[ed]" "beneficial ownership" of their shares to Genesis, as that term is defined in Section 7(g) of the NCS Certificate. That provision expressly provides: "For purposes of this Section 7, 'beneficial ownership' shall mean possession of the power to vote or to direct the vote ... of the shares of Class B Common Stock".

[3/] Outcalt's agreement did not come cheaply. Although Outcalt claims in his Brief (at 8 n.1) that he was not promised any additional compensation for signing his Voting Agreement, that assertion is contradicted by Genesis' admission in its Brief (at 34) that Outcalt has been promised a four-year consulting deal worth $700,000. And in its Form S-4, Genesis details other substantial payments and perks -- including consideration for a Board seat and designation as a "Founder," another paid position -- that Outcalt will be given by Genesis. The contemplated payments have never been aggregated by defendants, but appear to total more than $1,350,000 for just Outcalt -- a substantial sum for a transaction worth less than $42 million on the date it was announced (and worth substantially less today as a result of a material decline in the price of Genesis shares). See Form S-4, at 66 (Exhibit B to Omnicare's opening Memorandum of Law in support of its motion for summary judgment).

In view of the structure of the Genesis Merger Agreement and the Voting Agreements, Outcalt and Shaw have effectively transferred all of their meaningful ownership interests in the Class B shares (other than physical possession of the Class B certificates) to Genesis.[4/] As noted in Omnicare's Opening Brief (at 14 and n.12), under the terms of the Genesis Merger Agreement and the Voting Agreements, NCS is prohibited from paying any further dividends; making any adjustments or reclassifications on its capital stock; or changing its Certificate or by-laws. Accordingly, for Outcalt and Shaw -- as well as the NCS public stockholders -- there will be no further dividends, corporate transactions or stockholder votes before the Genesis Merger Agreement is "approved" and thereafter. See Genesis Merger Agreement §5.3 (Omnicare Ex. A).

The cumulative result of the provisions of Section 2 of the Voting Agreements and Section 5.3 of the Genesis Merger Agreement was to transfer to Genesis the primary interest in the super-voting Class B shares possessed by Outcalt and Shaw, the voting power itself. Consequently, Outcalt and Shaw transferred all meaningful indicia of ownership in, and rights to, their Class B shares. Indeed, because the super-voting right is the only

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[4/] The Voting Agreements are appended to the Form 8-K filed by NCS with the SEC on July 29, 2002, and are attached as Exhibits to Exhibit A to Omnicare's Opening Memorandum of Law in support of its motion for summary judgment.

difference between the Class B and Class A shares (see NCS Certificate, Art. IV, §2(f)), the transfer of the rights from Outcalt and Shaw to Genesis is the practical equivalent of an outright transfer of the shares themselves -- and resulted in automatic conversion of the Class B shares to Class A shares. See NCS Certificate §7(d).[5/]

Defendants appear to concede that the giving of a proxy with respect to the Class B shares, without an applicable exception, would result in a "transfer" of an "interest" in such shares and an automatic conversion of the shares into Class A shares. Indeed, they must so concede, otherwise the "proxy" exception in Section 7(c)(5) of the NCS Certificate, upon which all defendants are relying (see, e.g., Genesis Br. at 17-21), is totally superfluous. Moreover, under defendants' strained interpretation of Section 7(d), the terms "interest" and "or otherwise" in Section 7(a) would be rendered meaningless and there would be no consequences whatsoever from the "transfer" of the "beneficial

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5/ NCS claims that no "transfer of shares" is effective without delivery, citing the Delaware UCC, 6 Del. C. §§8-104, 8-301 (NCS Br. at 14). It misreads the statute however, which provides that "a person acquires a security or an interest therein," by means including either delivery under Delaware UCC §8-301 or acquisition of a security entitlement in the shares (§8-104(b)). Here, the Voting Agreements contain both restrictions on transfer (Sec. 2(a)) that negate the otherwise inherent attribution of ownership allowing unfettered power to sell or transfer shares, and also grant an irrevocable proxy "coupled with an interest" (Sec. 2(c)) to the President and Secretary of Genesis. Accordingly, physical delivery is not required here for a transfer of shares to have occurred.

ownership" (i.e., Section 7(g) "interests") to Genesis in the Voting Agreements.[6/] This is contrary to settled principles of contract interpretation mandating a construction that, as defendants acknowledge (e.g., Genesis Br. 14) harmonizes the various provisions of the corporate charter and "gives effect to all contract provisions." Elliott Associates v. Avatex Corp., 715 A.2d 843, 851 (Del. 1998), citing Sonitrol Holding Co. v. Marceau Investissements, 607 A.2d 1177, 1184 (Del. 1992); Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392, 395 (Del. 1996).

This conclusion is confirmed by two of the principal authorities upon which defendants rely. In Elliott Associates V. Avatex Corp. 715 A. 2d 843 (Del. 1998), the Supreme Court reversed the Chancery Court's ruling that preferred stockholders were not entitled to a separate vote on a proposed corporate restructuring, holding that the Chancery Court had failed to take into consideration the fact that the inclusion in the charter of the term "consolidation" would have been rendered surplusage if no separate vote were allowed. Here, the strained

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[6/] Haft v. Haft, 671 A.2d 413 (Del. Ch. 1995) and Eliason v. Englehart, 733 A.2d 944 (Del. 1999), cited by NCS (NCS Br. at 13) for the proposition that there has been no transfer of interests, are inapposite. Each merely addresses the irrevocability of a specific proxy. Moreover, defendants' citation to Haft ignores Chancellor Allen's recognition that Delaware Law has "tended to discourage and distrust the separation of the shareholder ... from the right to vote the stock" and that Delaware courts have long recognized "a rather clear rule against sale of a corporate vote unattached to the sale of the underlying stock." Haft, 671 A.2d at 423 (citations omitted).

construction offered by defendants would render meaningless all of Section 7(c)(5) and central portions of Sections 7(a); 7(d); and 7(g) of Article IV of the NCS Certificate.

In Garrett v. Brown, C.A. Nos. 8423, 8427 1986 LEXIS 516 (Del. Ch. June 13, 1986), aff'd, 511 A.2d 1244 (1986) (Genesis Br. at 14, 16 and 17), then Vice Chancellor Berger declined to conclude that a stockholders' agreement had resulted in a transfer of the shares because, unlike here, "the Stockholders' Agreement does not in any way limit the stockholders' freedom to vote their shares as they see fit." LEXIS *30. As the Voting Agreements indisputably do limit the freedom of Outcalt and Shaw to vote their shares "as they see fit," Garrett compels a finding that a "transfer" under §7(d) has occurred and that the Class B shares were converted to Class A shares.[7/]

B. Section 7(c)(5) of the NCS Charter -- the "Proxy" Exception -- is Inapplicable

Section 7(c)(5) of the NCS Certificate permits Shaw and Outcalt to "giv[e] a proxy in connection with a solicitation of

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7/ Defendants, Genesis in particular, argue that Outcalt and Shaw's shares will be voted in accordance with their wishes so the Voting Agreements do not limit their freedom to vote their shares as they please. In addition to the express language of the Voting Agreements, the short answer to this argument is that if Outcalt and Shaw changed their minds about endorsing the Genesis merger before the shareholder vote, their shares will not be voted according to their wishes. Indeed, it appears that, in their directorial capacities, Outcalt and Shaw have changed their minds because NCS' Board of Directors has withdrawn its recommendation that shareholders vote for the Genesis merger. See Exhibit A hereto.

proxies subject to the provisions of Section 14 of the Securities Exchange Act of 1934" without converting the Class B shares to Class A shares (emphasis added). The provisions of Section 14 of the Exchange Act, however, are applicable only to a solicitation of proxies with respect to securities "registered pursuant to section 12" of the Exchange Act. See 15 U.S.C. §78n(a) (1997). As defendants acknowledge, the Class B Common Stock is not a class of securities registered pursuant to Section 12 of the Exchange Act.

Outcalt and Shaw's grant to Genesis of irrevocable proxies through the Voting Agreements was not done "in connection with" a proxy solicitation, as no such solicitation was in progress at the time nor, to this date, has been commenced. Thus, defendants are reduced to arguing that the proxy grants of July 28, 2002 were effected in connection with the solicitation of proxies by NCS from all of its stockholders that will take place at some date in the future. That strains the operative language of Section 7(c)(5) beyond reasonable bounds. Accordingly, Section 7(c)(5) of the NCS Certificate is inapplicable and the Class B shares owned by Outcalt and Shaw have been automatically converted to Class A shares. See NCS Certificate §7(d).

C. The Issues of Textual Interpretation May Be Resolved As A Matter Of Law

Defendants do not dispute that a dual common stock structure, such as that in effect at NCS, while lawful, is used

by corporations to deter unwanted takeovers. Lacos Land Co. v. Arden Group, Inc., 517 A.2d 271, 275 (Del. Ch. 1986). In fact, there are few, if any, takeover defenses more likely to be successful than dual class capitalization. Joel Seligman, Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy, 54 Geo. Wash. L. Rev. 687 (1987). As a result of its effectiveness, however, a dual class voting structure, such as that of NCS, has "the potential for mischief and harm to the majority of shareholders who are left with a minority of the voting power," and is "unfair to shareholders whose share prices may be reduced ... by the loss of potential takeover premiums...." Id. at 721, 724.

To curb the potential for such harm, the drafters of the NCS Certificate severely limited the range of persons to whom "interest[s]" in NCS Class B common stock can be transferred. As set forth above, several limitations contained in Section 7 of Article IV of the NCS Certificate preclude the transfer of an interest in the Class B stock to defendant Genesis or any assignment of the 10 to 1 voting rights of Class B stock as contemplated in the Voting Agreements.[8/] And, by operation of

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[8/] NCS' reference to Section 7(i) of the NCS Certificate is puzzling (NCS Br. at 16) as that provision confirms that the drafters of the NCS Certificate desired to narrowly limit the circumstances under which the Class B shares could be transferred. Section 7(i) allows the Board to suspend the restriction on transfer provisions applicable to the Class B (continued...)

Section 7(d) of the NCS Certificate, the Class B shares owned by Outcalt and Shaw were "automatically" converted to Class A shares when Genesis acquired the "interest" in those shares on July 28, 2002 -- the date of the Voting Agreements.[9/]

As defendants acknowledge, the same rules of interpretation that govern statutes, contracts and other written instruments also apply to corporate charters, Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392, 395 (Del. 1996), and a certificate of incorporation is viewed as a contract among shareholders as to which general rules of contract interpretation apply, Waggoner v. Laster, 581 A.2d 1127, 1134 (Del. 1990) (citations omitted). See also Elliott Associates, L.P. v. Avatex Corp., 715 A.2d 843, 853 (Del. 1998) (construing corporate charter "because there is no ambiguity").

[8/] (...continued)
shares in the event of a liquidity crisis at NCS. However, the Board may only act prospectively, not backdate its approval to transfers predating the Board's suspension of the restrictions. See §7(i). The reason for this limitation is obvious: to protect the public stockholders of NCS from an unauthorized transfer of the Class B shares or the incidents of ownership -- as occurred here.

[9/] Nor is there any unfairness in the result. Genesis successfully bargained for a $6 million break-up fee -- an incredible 15% of the equity value of the transaction. Moreover, as Genesis points out in its Brief (at 34), the NCS Class B stockholders, Outcalt and Shaw, will be handsomely rewarded if Omnicare's $3.50 per share buyout proposal prevails. What Genesis really wants is to disregard the content and intent of the NCS Certificate so that it can purchase NCS at a below market price -- which neither longstanding principles of equity nor the applicable case law authorizes.

Accordingly, the plain, unambiguous meaning and import of the limitations on transfer of NCS Class B stock are readily capable of determination by this Court as a matter of law. Gilbert v. El Paso Co., 575 A.2d 1131, 1141-42 (Del. 1990); Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1141 (Del. 1989); Klair v. Reese, 531 A.2d 219, 222 (Del. 1987).[10] The Stockholder Plaintiffs and Omnicare have established that no genuine issue of material fact exists with respect to this dispute and that the moving parties are entitled to summary judgment as a matter of law. Accordingly, plaintiffs' motions for summary judgment should be granted. Del. Ch. Ct. R. 56(c); Gilbert v. El Paso Co., 575 A.2d 1131 (Del. 1990).[11]

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[10] Defendants assert discovery is warranted where the interpretation of language is ambiguous (see, e.g., NCS Br. at 18, 19) and cite Harrah's Entertainment v. JCC Holding, 802 A.2d 294 (Del. Ch. May 31, 2002) for that proposition. Here, however, there is no ambiguity and, as recognized by Vice Chancellor Strine in Harrah's, "merely because the thoughts of the party litigants may differ relating to the meaning of stated language does not in itself establish in a legal sense that the language is ambiguous." Id. at 309. See also Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392, 395 (Del. 1996) ("'A contract is not rendered ambiguous simply because the parties do not agree upon its proper construction.'" (Quotation omitted.)).

[11] The authorities cited by defendants on this issue are either supportive of plaintiffs' position or easily distinguishable. See, e.g., Gotham Partners, LP v. Hallwood Realty Partners, L.P., C.A. No. 15754, 2000 WL 147663 (Del. Ch. Sept. 27, 2000) (NCS Br. at 19) (contrary to defendants' citation, court granted motion for summary judgment); In re Dairy Mart Convenience Stores, Inc., C.A. No. 14713, 1999 WL 350473 (Del. Ch. May 24, 1999) (NCS Br. at 20) (cross-motions for summary judgment denied when factual disputes existed as to several defendants' individual

(continued...)

None of the authorities cited by defendants alter the conclusion that summary judgment is appropriate here. For example, Genesis cites SI Management L.P. v. Wininger, 707 A.2 37 (Del. 1998) (Genesis Br. at 14) for the proposition that any ambiguity in the NCS Certificate must be construed to "protect the rights of" Outcalt and Shaw, at the expense of the NCS public stockholders. To the contrary, however, in SI Management, the concept was employed to protect the rights of the limited partner investors, not the General Partner -- whose position was akin to that of Outcalt and Shaw. Id. at 43.

Defendant Genesis also asserts that Delaware courts consistently construe anti-transfer clauses narrowly and give effect to them only where no "reasonable doubt may exist" as to whether "non-sale transfers" are covered (Genesis Br. at 14-15). In fact, none of Genesis' authorities so state. Rather, they turn on the particular facts of the cases at issue.

Moreover, those decisions are either supportive of plaintiffs' position or inapplicable. For example, in Mitchell Assoc. v. Mitchell, Del. Ch., C.A. No. 6064, Del. Ch. LEXIS 562 (Dec. 5, 1980) (Genesis Br. at 15), then Vice Chancellor Hartnett granted summary judgment to plaintiffs, noting that "the weight

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11/ (...continued)
understanding of the facts surrounding a transaction's structure, their respective motivations and ultimate fairness of transaction).

of authority supports restraints on alienation of corporate stock provided they are reasonable" and finding that the decedents' estate had improperly transferred stock in violation of a shareholders' agreement. Id. at *7, 10-13. In Star Cellular Telephone Co. Inc. v. Baton Rouge CGSA, Inc., C.A. No. 12507, 1993 Del. Ch. LEXIS 158, Jacobs, V.C. (July 30, 1993)(Genesis Br. at 15), the Court held that a "merger" of a general partner of a limited partnership into a newly formed corporate entity was not a "transfer or assignment" under the limited partnership agreement because it created no material change in content or operation of the general partner, was purely formal, had no adverse affect upon the limited partners of the limited partnership and was not an "assignment" under 6 Del. C. §17-705. That is certainly not true here, where defendants are attempting to transfer voting control from Outcalt and Shaw to Genesis. See also Clark v. Kelly, Del. Ch., C.A. No. 16780, 1999 Del. Ch. LEXIS 148, Jacobs, V.C. (June 24, 1999) (Genesis Br. at 15) (no transfer of stock found where purported transferee, a widow, had always legally owned 50% of stock held by trust in which she and her late husband were sole beneficiaries); Shields v. Shields, 498 A.2d 161 (Del. Ch. 1985) (corporate-level stock for stock merger in closely held corporation did not constitute share transfer triggering right of first refusal among existing shareholders).

CONCLUSION

The undisputed facts entitle plaintiffs to an Order declaring that the NCS Class B common shares held by defendants Outcalt and Shaw were converted into Class A shares by virtue of Article IV, Section 7(d) of the NCS Certificate.

CHIMICLES & TIKELLIS, LLP
One Rodney Square
Wilmington, DE 19801
(302) 656-2500

ROSENTHAL, MONHAIT, GROSS
& GODDESS, P.A.

By: _____
919 North Market Street, Suite 1401
P.O. Box 1070
Wilmington, DE 19899-1070
(302) 656-4433

Co-Liaison Counsel for Plaintiffs

OF COUNSEL:

LOWEY DANNENBERG BEMPORAD
& SELINGER, P.C.
The Gateway, 11th Floor
One North Lexington Avenue
White Plains, NY 10601-1714
(914) 997-0500

BEATIE AND OSBORN LLP
521 Fifth Avenue, 34th Floor
New York, NY 10175
(212) 888-9000

Co-Lead Counsel for Plaintiffs