Genesis X

IN THE SUPREME COURT OF THE STATE OF DELAWARE

OMNICARE, INC., Plaintiff-Below Appellant, v. NCS HEALTHCARE, INC., JON H. OUTCALT, KEVIN B. SHAW, BOAKE A. SELLS, RICHARD L. OSBORNE, GENESIS HEALTH VENTURES, INC., and GENEVA SUB, INC., Defendants-Below Appellees.	)	No. 605, 2002 Appeal From Memorandum Opinions and Orders Dated October 25 & 29, 2002 Of The Court of Chancery Of The State Of Delaware In And For New Castle County In Civil Action No. 19800

APPELLANT'S REPLY BRIEF

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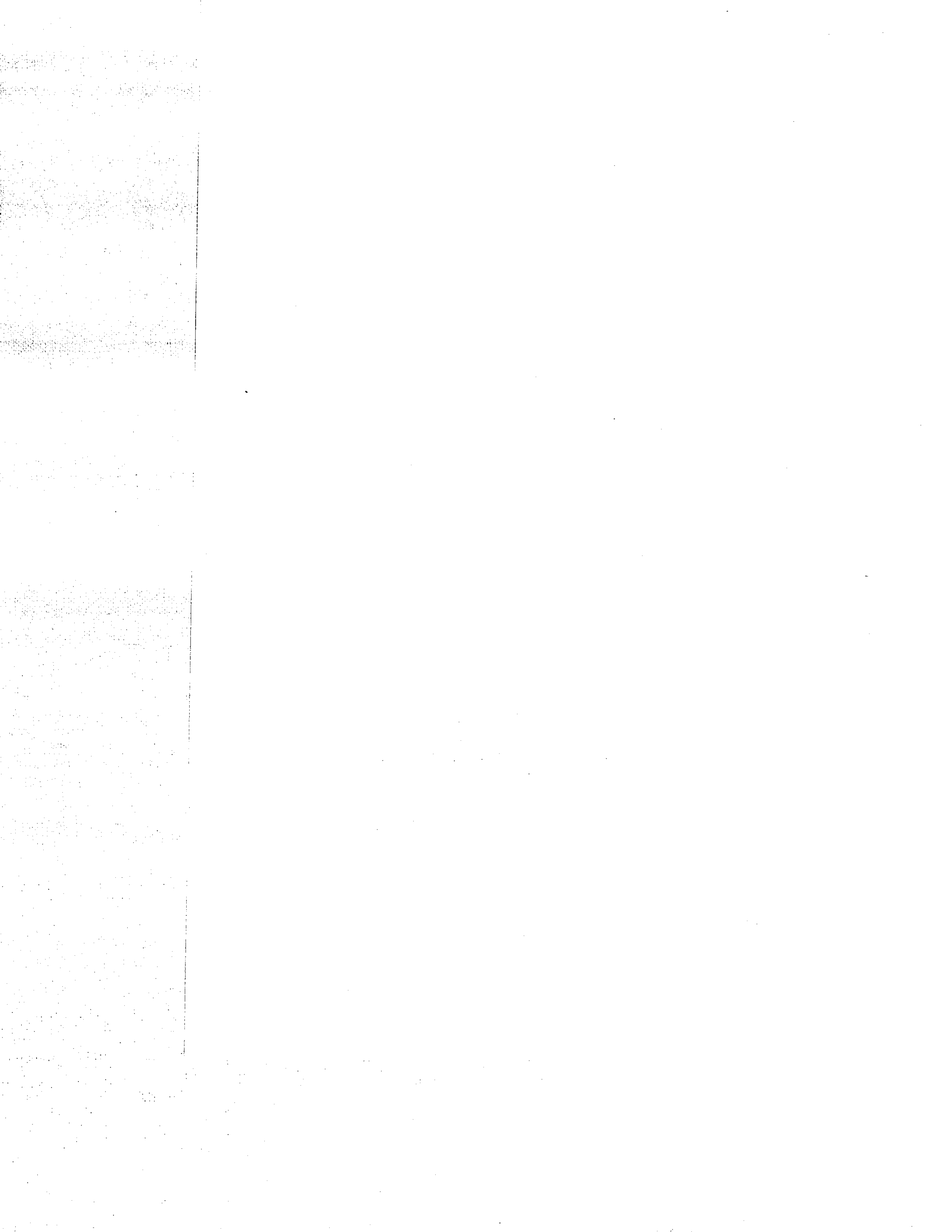

ARGUMENT

I. THE TRIAL COURT ERRED BY DENYING STANDING

Defendants devote the bulk of their briefs to refuting arguments that Omnicare has not even raised on this appeal. For example, Omnicare has not argued here that it has standing to pursue breach of fiduciary duty claims based solely on its status as a "bidder." While Omnicare's bidder status alone ought to confer standing to challenge the NCS board's adoption of draconian defensive devices designed to defeat Omnicare's superior offer,[1] Omnicare is also a stockholder of NCS. Its standing, therefore, derives from its status as a stockholder-bidder asserting individual claims. No reasonable reading of Omnicare's opening brief can lead to the conclusion that Omnicare's standing arguments rest even substantially, much less solely, on the concept of bidder standing.

Moreover, Omnicare does not dispute that under existing law, a plaintiff must be a stockholder to assert claims against corporate directors for

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[1] The Court of Chancery has observed, with apparent disdain for the hyper-technicality of such a rule, that a "bidder's standing ... has remained putatively tethered, if only by a bare thread, to its status as a stockholder." *In re Gaylord Container Corp. S'holders Litig.*, 747 A.2d 71, 77 n.7 (Del. Ch. 1999). In *Gaylord*, the Court of Chancery explained that sound policy favors a rule that affords standing to bidders, regardless of whether they are stockholders:

> There are very sound practical, value-enhancing reasons for the case law according bidders standing, even though the practice of according *bidders standing as stockholders* leads to a certain amount of undeniable doctrinal incoherence.... There are also very sound doctrinal reasons for recognizing that defensive measures primarily affect stockholders as prospective sellers and bidders (regardless of stockholder status) as prospective buyers, and enabling each to bring individual actions to protect their legitimate interests in being able to deal with each other without improper (*i.e.*, not fiduciarily compliant) interference by corporate boards. Such a reality-based approach seems to have little downside and is a more straightforward manner in which to address cases implicating *Unocal*.

Id. at n.14 (emphasis in original) (citing J. Travis Laster, *The Line Item Veto and* Unocal: *Can a Bidder Qua Bidder Pursue Unocal Claims Against a Target Corporation's Board of Directors?*, 53 BUS. LAW. 767 (1998)).

breach of fiduciary duty. As noted, Omnicare is an NCS stockholder. The NCS directors owe and have breached fiduciary duties to Omnicare by virtue of conduct both before and after Omnicare became a stockholder. As a result of those breaches, Omnicare has suffered unique, individual (non-derivative) injury and should have standing to seek relief for that injury.

A. Section 327 Of The General Corporation Law Has No Applicability To Omnicare's Individual Claims

Where Omnicare and Defendants most significantly part ways is with respect to (1) the trial court's conclusion that the derivative suit standing principles of Section 327 of the DGCL are equally applicable to Omnicare's individual claims and (2) the unprecedented fashion in which the trial court applied those principles to bar Omnicare's claims. As shown in Omnicare's opening brief, the stringent standing requirements of Section 327 have no applicability to non-derivative claims for breach of fiduciary duty. Despite their attempts to distinguish this Court's opinion in *Alabama By-Products Corp. v. Cede & Co.*, 657 A.2d 254 (Del. 1995), Defendants cannot evade this Court's unambiguous holding that "procedural requirements of standing developed to control derivative actions have *no relevance to individual shareholder suits claiming a private wrong.*" *Alabama By-Products*, 657 A.2d at 266 (quoting *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1188 (Del. 1988)) (emphasis added); *see also Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 117 (Del. 2002) (holding that contemporaneous ownership principles of Section 327 do not extend to an individual books and records action under 8 *Del. C.* § 327).

A stockholder's standing to pursue *individual* claims for breach of fiduciary duty cannot be determined by rote application of the uniquely restrictive provisions of Section 327, but instead depends upon satisfaction of traditional principles of standing and whether, as a matter of substantive law, a fiduciary duty is owed to the plaintiff and such a duty has been breached. While apparently recognizing that Omnicare's stake in the controversy is far from that of a "mere intermeddler," making it a proper plaintiff under traditional standing principles, the trial court denied standing on the ground that Omnicare was owed no duties prior to its acquisition of NCS stock. The trial court failed to appreciate, however, that Omnicare has suffered substantial, individual injury resulting from the NCS directors' breaches of fiduciary duty. It also failed to appreciate, and in fact made no mention of, the fact that Omnicare has alleged wrongful conduct that took place after it became a stockholder.

The very case upon which Defendants and the trial court rely for the untenable proposition that the contemporaneous ownership requirement imposed by Section 327 in derivative actions applies equally to individual claims

expressly recognizes to the contrary. In *Brown v. Automated Marketing Systems, Inc.*, 1982 WL 8782 (Del. Ch.), the Court of Chancery quoted at length from the Nebraska Supreme Court's decision in *Home Fire Insurance Company v. Barber*, 93 N.W. 1024 (Neb. 1903), where it was observed that the applicability of the contemporaneous ownership requirement turns of the nature of the stockholders' injury. Specifically, the court observed that lack of contemporaneous ownership does not bar individual stockholder claims alleging special injury:

> If [a stockholder's] interest is trifling, and the injury therefore of no consequence, he cannot sue to compel righting of wrongs to the corporation. (Citations omitted). Hence there is obvious reason for holding that one who held no stock at the time of the mismanagement ought not to be allowed to sue, *unless the mismanagement or its effects continue and are injurious to him, or it affects him specially and peculiarly in some other manner.*

Brown, 1982 WL 8782, at * 2 (quoting *Home Fire*, 93 N.W. at 1029) (emphasis added).

There can be no doubt that Omnicare, as a stockholder-bidder, has suffered special injury as a result of the NCS board's unrelenting efforts to thwart its bid. It ought to have standing to rectify that injury. Indeed, the trial court implicitly recognized that claims alleging individual injury stand on different footing than derivative claims when it held that Omnicare could pursue claims alleging individual injury to its voting rights. (Standing Op. 18-21). Given the obvious preclusive effect of the lock-ups approved by the NCS board on the ability of the NCS stockholders to decline the Genesis merger by voting against it, Omnicare's breach of fiduciary and statutory duty claims implicate the stockholder franchise (an individual stockholder right) no less than the voting right claims for which Omnicare was found to have standing.[2]

B. Omnicare Has Standing To Pursue Claims Challenging Conduct That Occurred After It Became A Stockholder

The trial court paid no heed to Omnicare's claims challenging conduct of the NCS directors that occurred while Omnicare was a stockholder. The Second Amended Complaint alleges that the NCS directors have continued

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[2] Defendants do not contest the trial court's holding that Omnicare has standing to assert its claim that the Voting Agreements violate the NCS Charter.

to thwart Omnicare's bid, which itself postdated Omnicare's acquisition of NCS shares, that they have completely abdicated their statutory duties under 8 *Del. C.* § 141(a), and that they have steadfastly refused to recommend Omnicare's admittedly superior offer and retract unenforceable lock-up provisions that are still preventing the NCS stockholders from accepting that offer. (A414, A423-25, A427-29). All that has taken place since Omnicare became a stockholder.

Defendants deny none of this; nor could they. Their only response is the tactical (and incorrect) assertion that Omnicare purportedly never raised a "continuing wrong" theory in the lower court and, therefore, should be precluded from pointing out to this Court what the trial court overlooked -- that the Second Amended Complaint challenges a host of actions that postdate Omnicare's acquisition of shares. Defendants' tactic fails on two counts.

First, the "continuing wrong" concept is one that derives from the precedent that surrounds the application of the contemporaneous ownership requirement of Section 327. As explained in Omnicare's opening brief, that concept is relevant here simply to show that even where Section 327 is applicable, the Courts of this State have consistently recognized that the contemporaneous ownership restriction should not disqualify a stockholder from challenging a pattern of director misconduct merely because it began prior to the stockholder's acquisition of shares. Here, of course, Omnicare's claims are individual, not derivative, and neither Section 327 nor the attending theory of "continuing wrong" applies. Omnicare should have standing to pursue its individual claims without reference to the uniquely stringent requirements of Section 327. The trial court, however, found Section 327 to be applicable. Given that intervening finding, Omnicare cannot now be precluded from arguing in the alternative that the same conduct giving rise to its individual claims would constitute a "continuing wrong" if those claims were derivative.

Second, Omnicare's answering brief at the trial level summarized each of Omnicare's breach of fiduciary and statutory duty claims and described specifically those wrongs that occurred *after* Omnicare became a stockholder. (AR5-6).[3] The specific legal issues on the motion to dismiss were framed, of course, by the Defendants, and Omnicare's answering brief was understandably focused on the non-applicability of Section 327 and the derivative standing cases cited by Defendants. Indeed, when it became clear during oral argument that the trial court would apply Section 327 and had

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[3] Omnicare has filed contemporaneously herewith a Supplemental Appendix. Citations to items in the Supplemental Appendix are in the form "AR___".

mistakenly assumed that all of Omnicare's claims involved wrongs that occurred prior to Omnicare's acquisition of stock, counsel pointed out that Omnicare should have standing, at the very least, to pursue those claims involving "continuing wrongs." (AR138-40). It cannot be said, therefore, that Omnicare's allegations of post-acquisition wrongs were not fairly before the trial court.

What Defendants really want, it would appear, is to deny Omnicare an opportunity to respond to the trial court's unprecedented holding that Section 327 precludes a stockholder from challenging not only conduct that occurred before the stockholder's acquisition of shares, but also all post-acquisition conduct in any way "arising out of" pre-acquisition events. (Standing Op. at 11). Even in the derivative context, where the more stringent standing requirements of Section 327 are applicable, a plaintiff has standing to challenge wrongs that occurred after the plaintiff's acquisition of stock, as evidenced by the "continuing wrong" exception. *See, e.g., Saito*, 806 A.2d at 117. But even assuming, for the sake of argument, that a sweeping "arising out of" standard might be appropriate in the derivative context in order to deter strike suits, such a standard should by no means be applied to individual claims, which by their very nature involve "special harm" to the stockholder that is independent of any harm to the corporation.

C. The Cases Upon Which Defendants Rely Are Inapposite

None of the cases cited by Defendants support the proposition that Omnicare should be denied standing to pursue its individual claims for breach of fiduciary duty. For example, the present case differs markedly from *Brown v. Automated Marketing Sys., Inc.*, 1982 WL 8782 (Del. Ch.), upon which both the trial court and Defendants heavily rely. First, the Court of Chancery in *Brown* assumed, without explanation, that the plaintiff's claims were derivative in nature and that the special standing requirements of 8 *Del. C.* § 327 were directly applicable. Nothing in that case suggests, as Defendants and the trial court contend, that the *Brown* court intended to apply Section 327 to individual claims for breach of fiduciary duty or that it believed Section 327 to be an extension of "general equitable principles" applicable to all breach of fiduciary duty claims. Indeed, in the passage from *Brown* cited by the trial court, the court explained that Section 327 is an extension of general principles "with regard to the standing of a shareholder to sue for *corporate wrongs*" – *i.e.* derivative claims. *See Brown*, 1982 WL 8782, at *2 (quoting *Home Fire*, 93 N.W. at 1029, which addressed the circumstances in which a stockholder would have standing to "sue to compel righting of wrongs *to the corporation*") (emphasis added).

But even assuming that *Brown* can be read as authority for the odd proposition that Section 327 applies to all shareholder suits, both derivative

and individual, it is inapposite here to support Defendants' remarkable claim that a stockholder cannot challenge acts of faithlessness that arise after it became a stockholder. While *Brown* did involve claims challenging a merger that had been publicly announced prior to the plaintiff's acquisition of stock, the Court of Chancery found that the plaintiff had not alleged continuing wrongs because she challenged the merger solely on the basis of improper purpose and inadequate price. *Id.* at *2. *Brown* did not involve a situation where, as here, the board, after announcement of the merger, acted in violation of its fiduciary duties to thwart a superior bid by a third party. The plaintiff did not allege discrete breaches of duty that occurred after she purchased her shares, and she did not allege that the board had completely abdicated its statutory and fiduciary obligations to consider superior offers. *Brown*, therefore, is inapposite.

Defendants' reliance on *U-H Acquisition Co. v. Barbo* is similarly unavailing. In that case, the Court of Chancery held that plaintiffs' breach of fiduciary duty claims were derivative and that their voting rights claims were individual. *U-H Acquisition Co. v. Barbo*, 1994 WL 34688, at *4 (Del. Ch.). The court held that neither plaintiff had standing to pursue either category of claims. One plaintiff was solely a tender offeror who did not even own units. *Id.* at *5. The other was an assignee of units, but had not been admitted as a substitute limited partner and, therefore, was owed no fiduciary duties and had no right to vote. *Id.* Omnicare, in contrast, is indisputably a stockholder of NCS. The corporate law contains no requirement that a stockholder be "admitted" to the corporation before fiduciary duties are owed.

The other cases upon which Defendants rely fare no better. The bulk of those cases involved derivative claims and corporate -- not individual -- wrongs. None of them denied standing to a stockholder who had suffered special injury resulting from breaches of fiduciary duty merely because that injury was related to circumstances that occurred prior to the time the plaintiff became a stockholder. For example, the trial court relied exclusively upon *IM2 Merchandising & Manufacturing, Inc. v. Tirex Corp.*, 2000 WL 1664168 (Del. Ch.), for the proposition that the contemporaneous ownership requirement has been "vigorously enforced through recent time" with respect to individual claims. (Standing Op. at 11). That case, however, involved *derivative* claims. *Id.* at *6. One plaintiff lacked standing because it no longer owned shares and, thus, could not satisfy the "continuous ownership" requirement of Section 327. *Id.* The other plaintiff was found to have no standing, by reason of Section 327, to attack breaches of duty that allegedly occurred *before* he became a stockholder. *Id.* Although he also alleged breaches of duty that occurred after he became a stockholder, those claims were dismissed for failure to plead demand excusal as required by Chancery Court Rule 23.1 -- not on the basis of standing. *See id.*

The United States Supreme Court's decision in *Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R. Co.*, 417 U.S. 703 (1974), is likewise inapposite. That case involved a claim brought by the corporation itself and held, by analogy to *derivative suit* standing principles and veil piercing concepts, that *the corporation* was barred from prosecuting claims of prior mismanagement because ownership of the corporation had changed since the time of the actions and injuries allegedly caused by that mismanagement. The Supreme Court was careful to note that the then-current majority stockholder did "not assert that it has sustained any injury at all. Nor does it appear that the alleged acts of prior mismanagement have had any continuing effect on the corporations involved...." *Id.* at 711.

Nor do the cases arising in the disclosure context suggest that Omnicare should be denied standing here. *See Sanders v. Devine*, 1997 WL 599539, at *5 (Del. Ch.) (holding that plaintiff had not stated a breach of fiduciary duty claim for fraudulent inducement to purchase his shares because no fiduciary duty was owed to him at the time the prospectus was issued); *Thorpe v. CERBCO, Inc.*, 1993 WL 35967, at *3 (Del. Ch.) (holding that plaintiffs had not been harmed by alleged disclosure violations, and therefore had no standing, because they were not stockholders at the time of the disclosures or at the time of the vote with respect to which the disclosures were made).

In sum, the trial court avoided any meaningful assessment of the nature of Omnicare's individual claims for breach of fiduciary and statutory duties. It engaged in no analysis of the unique injury suffered by Omnicare and it overlooked the fact that much of Defendants' wrongful conduct occurred *after* Omnicare became a stockholder. Omnicare was an NCS stockholder when it filed suit, remains so today, and, as a stockholder-bidder seeking to acquire NCS, has suffered an individual injury separate and distinct from NCS and all its other stockholders. The trial court erred in denying standing.

II. THE VOTING AGREEMENTS VIOLATE THE NCS CHARTER

A. The Issues Presented Are Subject To De Novo Review

The NCS Defendants and Defendants Outcalt and Shaw concede that Omnicare's appeal of the trial court's summary judgment decision is subject to *de novo* review by this Court. (NCS Br. at 22;[4] Outcalt/Shaw Br. at 19[5]). Genesis suggests that a more exacting standard of review should be applied to the "factual findings" of the trial court but concedes that review of the questions of law raised by Omnicare's appeal are subject to *de novo* review. (Genesis Br. at 15-16[6]). Since only the latter, *i.e.,* questions of law relating to the construction of NCS's corporate charter, are raised by the instant appeal, *de novo* review applies. *E.g., Waggoner v. Laster*, 581 A.2d 1127 (Del. 1990).

B. The Purported Transfer Of Any Interest In The Class B Shares Is Prohibited By Section 7(a) Of The NCS Charter, Regardless Of Whether Section 7(d) Was Triggered

Significantly, Defendants do not seriously contest -- nor could they -- that if the Voting Agreements effected the transfer of *any interest* in the Class B shares, they violated Section 7(a) of the NCS Charter and are, therefore, null and void -- regardless of whether or not they purported to transfer a sufficiently "substantial" interest in the shares to trigger the conversion provisions of Section 7(d) under the test adopted by the trial court.[7] As noted in

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[4] References to the "NCS Br. at __" are to the referenced page(s) of the Answering Brief of Defendants-Below/Appellees NCS HealthCare, Inc., Richard L. Osborne and Boake A. Sells (the "NCS Defendants").

[5] References to the "Outcalt/Shaw Br. at __" are to the referenced page(s) of the Joint Answering Brief of Defendants-Below/Appellees Jon H. Outcalt and Kevin B. Shaw.

[6] References to the "Genesis Br. at __" are to the referenced page(s) of the Answering Brief of Defendants-Below/Appellees Genesis HealthVentures, Inc. and Geneva Sub, Inc. (collectively, "Genesis").

[7] Genesis's suggests that the trial court's conclusion that the automatic conversion provisions of Section 7(d) are triggered by the transfer of an interest "represent[ing] a substantial part of the total ownership interests" associated with the Class B shares somehow operates to narrow the scope of the blanket prohibition in Section 7(a) on the transfer of "***any*** interest" in those shares. (*See* Genesis Br. at 34). That nonsensical contention is wrong. The trial court specifically noted the different language in the two subsections, concluding that

Omnicare's opening brief, this is, in essence, how the court construed the stockholder agreement at issue in *Garrett v. Brown*, 1986 WL 6708 (Del. Ch.), *aff'd*, 511 A.2d 1044 (Del. 1986) (TABLE), a case on which both the trial court and Defendants place heavy reliance. (*See* the discussion of *Garrett* at pp.13-14, *infra*.) The NCS Defendants' claim that Omnicare "did not raise this specific contention in ... the Second Amended Complaint" (NCS Br. at 30) is not accurate. Paragraphs 59 and 60 of the Second Amended Complaint specifically allege that the Voting Agreements violate Section 7(a) (A426), and Paragraph 62 states that "Omnicare is entitled to a judgment declaring that Messrs. Outcalt and Shaw's grant of irrevocable proxies with respect to, and conveyance of interests ... in, their respective Class B shares ***violates Section 7 of the NCS Charter....***" (A427) (emphasis added); *see also* A431 ("Wherefore" Clause ¶ a).

Indeed, the wording of Section 7(d) of the NCS Charter underscores that any attempted transfer prohibited under Section 7(a) is ineffective when it refers to such a transfer as a "***purported*** transfer." The use of the word "purported" necessarily implies that the attempt to effect such a transfer is ineffective.

C. The Voting Agreements Purport To Transfer A Substantial Interest In -- Indeed, Beneficial Ownership Of -- The Class B Shares To Genesis

Defendants' argument that the irrevocable proxies and agreements to vote given to Genesis did not effect a transfer of "any interest" because they were "for a limited time and limited to a particular transaction" ignores both the terms of the Voting Agreements and the practical realities of the situation. That argument depends primarily on the absurd proposition, embraced by the trial court, that Outcalt and Shaw have done nothing more than enable Genesis to do them the favor of performing the ministerial act of casting their votes for them. That proposition, however, ignores the substantial powers that Outcalt and Shaw have actually granted to Genesis. Genesis does not simply have the ministerial role of casting votes that Outcalt and Shaw have previously decided. Indeed, Defendants' cases point up how substantial an interest is transferred by the grant of an irrevocable proxy. *See Brady v. Mexican Gulf Sulphur Co.*, 88 A.2d 300, 303 (Del. Ch. 1952) (describing irrevocable proxy as "*irretrievably redelegat[ing]* [the] discretionary duties" of voting trustees, who

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Section 7(a) prohibits the transfer of "any interest," but that Section 7(d), in contrast, does not "operate in the case of the transfer of a minor or unimportant 'interest.'" (S.J. Op. at 10-11).

would "*completely divest themselves of voting power* by executing an irrevocable proxy") (emphasis added).

Genesis's irrevocable proxy includes the power to vote the Class B shares "in accordance with the provisions of Section 2(b)" of the Voting Agreements. Section 2(b) covers the right to vote the shares on an extraordinarily broad range of matters. Taken together, Sections 2(b) and 2(c) give Genesis the ability to vote Outcalt's and Shaw's shares on virtually any issue, as well as the discretion to determine whether those votes should be cast at all. Thus, for example, it is Genesis who will decide whether a proposed action might, for example, be "reasonably expected" to "interfere with" the consummation of the Genesis merger agreement. (A130, 136).

Defendants contend that no transfer occurred because Outcalt and Shaw retained voting power for transactions and issues unrelated to the Genesis merger and because the right to dividends, the right to the merger consideration, and other economic rights associated with the shares remain with Outcalt and Shaw. But those "interests" supposedly retained by Outcalt and Shaw are nonexistent. The Genesis merger agreement not only obligates NCS to "conduct its operations in the ordinary course consistent with past practice" but also explicitly prohibits NCS from taking a broad range of specified actions that might otherwise require stockholder approval. (A89-93). As a result, there are no transactions or issues unrelated to the Genesis merger upon which Outcalt and Shaw could ever vote. Similarly, the merger agreement prohibits NCS from paying any further dividends or making any distribution on its common stock (A90), and, accordingly, Outcalt and Shaw have no remaining economic rights other than the right to receive the promised payment for their shares under the locked-up Genesis merger agreement. Indeed, that is the consideration they agreed to take in exchange for transferring voting rights and other interests to Genesis.

As discussed at length in Omnicare's opening brief, the Voting Agreements, which purported to transfer to Genesis both the power to vote (via the irrevocable proxies) and the power to direct the vote (via the agreements to vote) of Outcalt's and Shaw's Class B shares, would, if effectual, transfer far more than just "any interest" in the Class B shares. They would transfer "beneficial ownership," as defined in the NCS Charter, to Genesis. Genesis's reliance on the trial court's conclusion that Section 7(g), which defines "beneficial ownership," serves only the "limited purpose" of defining that term for purposes of Section 7(e), which the trial court identified as "the only place the phrase 'beneficial ownership' appears" in the NCS Charter, is misplaced. The trial court's unduly restrictive reading of the applicability of the definition of

"beneficial ownership" is inconsistent with, and would require the rewriting of, Section 7(g), which defines "beneficial ownership" "[f]or purposes of this Section 7" -- *i.e.,* the ***entirety*** of Section 7 (including Sections 7(a) and 7(d)) -- and not, as Defendants and the trial court would have it, solely for purposes of Section 7(e).

Moreover, Genesis's arguments regarding the implications of Section 7(e) (permitting registration of the shares in the name of the beneficial owner) are similarly misguided. Genesis, of course, cannot obtain beneficial ownership and have the shares registered in its name pursuant to Section 7(e) because Section 7(a) prohibits the transfer of beneficial ownership to Genesis and, as noted, renders the attempt to do so -- *i.e.*, the Voting Agreements -- null and void. Moreover, no one is arguing that Defendants ***intended*** to violate the NCS Charter by transferring a substantial interest in the Class B shares to Genesis or that they ***intended*** to transfer "beneficial ownership" under the NCS Charter when they did so. But the subjective intent of the parties in entering into the Voting Agreements is not at issue. What is at issue are the unambiguous terms of the ***NCS Charter***, and their application to the Voting Agreements. Given the evident purpose of Section 7 of the Charter, which is to prevent the transfer of the super-voting power of the Class B shares to anyone other than a Permitted Transferee, defining "beneficial ownership" in a manner broad enough to encompass the Voting Agreements here, makes perfect sense.

In short, Outcalt and Shaw have transferred their power to vote, and it is that voting power that is the fundamental indicia of ownership of the NCS Class B shares. That is why the NCS Charter defines "beneficial ownership" of the Class B shares as "possession of the power to vote or to direct the vote" of those shares. As shown above, contrary to Defendants' arguments, the agreements to vote and irrevocable proxies here are far from "limited," as they give Genesis complete control over Outcalt's and Shaw's votes on any conceivable issue. Indeed, it is difficult to imagine a more effective transfer of voting power -- and, thus, under the NCS Charter, beneficial ownership -- to Genesis.

As if mere repetition could make it so, Genesis repeatedly intones the mantra that the Voting Agreements did not transfer to Genesis any power to control the vote, which it maintains was merely exercised, and then retained, by Outcalt and Shaw. In fact, the irrevocable proxy granted to Genesis precludes and disables Outcalt and Shaw from exercising their voting power. This is graphically illustrated by the course of events subsequent to execution of the Voting Agreements. Specifically, as the trial court noted, the NCS board of directors -- including Outcalt and Shaw -- has since changed its recommendation

in light of Omnicare's superior offer and is now recommending *against* the Genesis merger. (SJ Op. at 3; AR139, 175). If Defendants were correct that Outcalt and Shaw have not irrevocably transferred to Genesis the power to vote their shares, they would remain free today to vote down the Genesis merger and accept Omnicare's offer. As it is, however, even if they wanted to (and they obviously do), under the terms of the Voting Agreements, Outcalt and Shaw no longer have the power to do so, because they have irrevocably granted to Genesis the right to cast their votes.

Moreover, the cases relied upon by Defendants for the proposition that an irrevocable proxy does not constitute the transfer of "any interest" in the underlying shares in fact establish just the opposite. For example, Genesis cites the 1933 decision of the Court of Chancery (adopting a master's report) in *In Re Chilson*, 168 A. 82, 86 (Del. Ch. 1933), for the proposition that only a "recognizable property or financial interest," and not "the bare voting power," can ever constitute any "interest" in shares of stock. But that badly misconstrues the decision. Contrary to Genesis's mischaracterization of *Chilson*, the case in fact expressly recognizes (as indeed it must) that voting power ***does*** constitute an "interest" in shares, but holds that in order to render a proxy irrevocable, like those at issue here, the person to whom it is transferred must ***also*** have a property or financial interest in the shares:[8]

> There is no such thing as an irrevocable proxy to vote stock not coupled with an ***interest in the stock*** itself ***other than the right to vote it.***

Id. at 85 (quoting *Luthy v. Ream*, 110 N.E. 376, 376 (Ill. 1915) (emphasis added).[9] This makes clear that (a) the right to vote the stock is "an interest in the stock itself," but (b) in order to support the ***irrevocable*** transfer of that power, the transferee must have some ***additional*** (financial or property) interest in the stock (or, under present law, in the corporation itself).[10] The prohibitions of Section

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8 Pursuant to a subsequent amendment to 8 *Del. C.* § 212(e), this requirement can now be satisfied by an interest in the corporation generally.

9 Notwithstanding that the decision actually contradicts Defendants' position, it should be noted that (a) the master in *Chilson* repeatedly made clear that he did "not hav[e] sufficient time in which to make an exhaustive investigation" of the case law, 168 A. at 85, and (b) the analysis cited by Defendants was *dicta*.

10 Elsewhere in its brief, Genesis actually acknowledges that "a 'transfer' must ... consist of some economic ***or voting element*** of the shares being 'transferred'

7(a) of the NCS Charter are not, of course, limited to the transfer of "any financial or property" interest in the Class B shares, but extend to "*any* interest therein" -- of any kind.

Defendants further contend that an agreement to vote can never amount to a transfer of an interest in shares of stock, relying primarily on *Garrett v. Brown*, 1986 WL 6708 (Del. Ch.), *aff'd*, 511 A.2d 1044 (Del. 1986) (TABLE). But *Garrett* held no such thing. *Garrett* involved a stockholders' agreement that contained (a) a broad prohibition on the transfer of certain shares or "any right, title or interest therein ...," (b) a separate purchase option provision triggered by certain prohibited transfers, and (c) a provision defining "transfer" as "a sale, assignment, hypothecation, encumbrance, bequest or other transfer, whether by operation of law or otherwise." The decision turned on the court's reading of those provisions as limiting the applicability of the ***purchase option provision*** to outright transfers of the shares by sale. The court concluded, however, that while ***non-sale*** transfers did not trigger the purchase option provision, they were nevertheless prohibited by the stockholders' agreement and there was therefore "recourse to the available equitable and legal remedies as to any non-sale transfers." *Id.* at *9.

The court in no way suggested or implied that a transfer of voting power could never constitute the transfer of "any interest" in shares of stock. It merely found, in conclusory fashion, that under the stockholders' agreement there at issue, certain unenumerated provisions relating to the manner in which one of the parties was to vote its stock did not constitute a "transfer." Here, the agreements to vote (and the irrevocable proxies) undoubtedly constituted the transfer of "an interest" in the Class B shares in violation of Section 7(a) of the NCS Charter, and Omnicare and the other public stockholders of NCS have, at an absolute minimum, recourse to their equitable and legal remedies with respect thereto, *i.e.*, they are entitled to a declaration that the purported transfers are null and void. Moreover, unlike the restrictive reading given by the *Garrett* court to the applicability of the purchase option provision at issue there, the trial court correctly recognized that the automatic conversion provisions of Section 7(d) of the NCS Charter are "broad enough to encompass actual share transfers as well as other situations in which *some interest in those shares* although less than full legal or equitable ownership is transferred." (SJ Op. at 10-11) (emphasis added).

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from the stockholder and received by Genesis." (Genesis Br. at 19) (emphasis added). Notwithstanding Genesis's contention that "[t]he Voting Agreements do not do that" (*id.*), that, of course, is exactly what they do.

That the *Garrett* decision was specific to the particular provisions of the stockholder agreement and voting arrangements at issue in that case, and that it generally makes perfect sense to interpret the transfer of "any interest" in shares of stock to encompass a transfer of the power to vote or to direct the vote -- including, *inter alia*, by the grant of a proxy -- is driven home in emphatic fashion by the definition of "transfer" contained in the Voting Agreements themselves. Section 2(a) of the Voting Agreements prohibits Outcalt and Shaw from "[t]ransfer[ing] (or agree[ing] to transfer) any of his Shares owned of record or beneficially by him." The Agreements expressly provide that such prohibited transfers of the Class B shares shall include:

> the direct or indirect assignment, sale, transfer, tender, pledge, hypothecation, or the grant, creation or suffrage of a lien or encumbrance in or upon, or the gift, placement in trust, or the constructive sale or other disposition of such security (including transfers by testamentary or intestate succession or otherwise by operation of law) ***or any*** right, title or ***interest therein (including but not limited to any right or power to vote to which the holder thereof may be entitled, whether such right or power is granted by proxy or otherwise)*** ....

(A129) (emphasis added).[11]

Similarly, while Outcalt and Shaw point to the representation they made in the Voting Agreements that they had "full legal power, authority and right to vote all of the Shares then owned of record or beneficially" by them as evidence that Genesis has no independent power to vote their Class B shares (Outcalt/Shaw Br. at 25), those representations actually lend further support to Omnicare's position. Clearly, they are the product of Genesis requiring that Outcalt and Shaw, in effect, represent and warrant that they were in a position to transfer the voting power to Genesis unencumbered.

Finally, the trial court's conclusion that the restrictions on the ***subsequent*** transfer of Outcalt's and Shaw's Class B shares contained in Section 2(a) of the Voting Agreements "can hardly be thought to constitute a transfer of

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[11] The NCS Charter does not define "any interest" in the Class B shares; nor does it define "transfer" other than to indicate that any transfer, "whether by sale, assignment, gift, bequest, appointment or otherwise," of ***any*** interest in the Class B shares is prohibited. (A28).

those shares" (SJ Op. at 6 n.5) misses the point. That provision was intended, when taken together with Sections 2(b) and 2(c) of the Voting Agreements, to shore up the effective transfer of the shares to Genesis by ensuring that ***after entering into the Voting Agreements***, Outcalt and Shaw would be disabled from transferring or purporting to transfer either physical possession of, or any other substantial ownership interest in, the shares to anyone else.

D. The Voting Agreements Triggered The Automatic Conversion Provisions Of Section 7(d)

Defendants' continued insistence that physical transfer of the Class B shares is necessary to trigger the conversion provisions of Section 7(d) (*e.g.,* Genesis Br. at 33-35; NCS Br. at 10, 30-31) flies in the face of the trial court's holding, which they otherwise embrace. The trial court held that the automatic conversion provisions of Section 7(d) are "broad enough to encompass actual share transfers ***as well as other situations in which some interest in those shares although less than full legal or equitable ownership is transferred.***" Accordingly, the trial court concluded, those conversion provisions are triggered where "the interest transferred ... represent[s] a substantial part of the total ownership interests associated with the shares in question." (SJ Op. at 10-11) (emphasis added). As demonstrated in the preceding sections and in Omnicare's opening brief, the Voting Agreements purported to transfer the requisite "substantial interest" to trigger Section 7(d). Indeed, those agreements purported to transfer "beneficial ownership" in the Class B shares to Genesis. Given the attempt to afford Genesis complete control over Outcalt and Shaw's votes on almost every conceivable issue, it cannot be seriously disputed that the interest purportedly granted to Genesis was substantial.

E. Section 7(c)(5) Of The NCS Charter Is An Exception That Proves The Rule, Not An Exception That Exempts The Voting Agreements From Section 7(a)

1. Section 7(c)(5) Of The NCS Charter Would Be Meaningless If No Proxy Could Ever Constitute A Violation Of Section 7(a)

While Defendants argue that Section 7(c)(5) exempts the irrevocable proxies given to Genesis from the proscriptions of Section 7(a), in fact, the existence of Section 7(c)(5) conclusively refutes one of Defendants' primary (albeit most attenuated) arguments, to wit, that the giving of a proxy -- *any* proxy -- does not and cannot constitute the "transfer of any interest" in the Class B shares. If that were the case, what possible reason could there be for including Section 7(c)(5) in the NCS Charter? It would be superfluous.

Moreover, in repeatedly mischaracterizing the scope of the exception afforded by Section 7(c)(5) as somehow applicable to *any* proxy, Genesis leaves out the critical phrase "in connection with a solicitation of proxies subject to the provisions of Section 14 of the Securities Exchange Act of 1934." The inclusion of this qualifier, which obviously circumscribes the universe of proxies that "shall not be deemed to constitute the transfer of an interest in the shares of Class B Common Stock," necessarily implies that the giving of any ***other*** type of proxy -- including the ***irrevocable*** proxies given to Genesis in the Voting Agreements -- ***shall*** constitute "the transfer of an interest" in the Class B shares, in violation of Section 7(a).

Thus, contrary to Defendants' argument, Section 7(c)(5) demonstrates that Omnicare's construction of the NCS Charter is correct, for there would be no need to impose an exception to the transfer restriction and automatic conversion provisions for the solicitation of proxies under Section 14 of the Exchange Act if the granting of a proxy did not otherwise constitute a transfer of an interest in the shares. Because basic rules of contract construction require that all terms of the agreement be given effect, if possible, Defendants' interpretation must be rejected. *See, e.g., Elliot Assocs., L.P. v. Avatex Corp.*, 715 A.2d 843, 854 (Del. 1998) ("It is well established that a court interpreting any contractual provision, including preferred stock provisions, must give effect to all terms of the instrument, must read the instrument as a whole, and, if possible, reconcile all the provisions of the instrument.").

2. Section 7(c)(5) Of The NCS Charter Does Not Exempt The Irrevocable Proxies From Section 7(a)

While Defendants argue that Section 7(c)(5) authorizes the giving of any kind of proxy by Class B stockholders (*see, e.g.,* Genesis Br. at 23-27), in fact, the plain language of that provision proves just the opposite. Only a limited category of proxies, not at issue here, is authorized under Section 7(a)(5), *i.e.,* those given "in connection with a solicitation of proxies subject to the provisions of Section 14 of the Securities Exchange Act of 1934." Because the irrevocable proxies given to Genesis by Outcalt and Shaw in the Voting Agreements were most decidedly *not* given in connection with any Section 14 proxy solicitation, Section 7(c)(5) is, by its terms, simply inapplicable. Defendants' arguments to the contrary do not hold water.

First, Defendants' construction of Section 7(c)(5) as authorizing the giving of ***any*** proxy would require this Court to engage in the wholesale rewriting of that provision. On Defendants' view of the world, Section 7(c)(5) would have to be revised as follows:

> [t]he 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 (or any successor provision thereof) and the rules and regulations promulgated thereunder~~ shall not be deemed to constitute the transfer of an interest in the shares of Class B Common Stock which are the subject of such proxy.

Such a reading can obviously not be squared with the fundamental principles of contract interpretation that: (1) all provisions of the contract must be given meaning, *see Elliot Assocs.*, 715 A.2d at 854; (2) the court will not interpret a contract in a manner such that its terms are mere "surplusage," *see, e.g.*, *Sonitrol Holding Co. v. Marceau Inv.*, 607 A.2d 1177, 1183 (Del. 1992); and (3) "it is not the proper role of a court to rewrite ... a written agreement." *Cincinnati SMSA Ltd. P'ship. v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 992 (Del. 1998).

Second, in response to Omnicare's argument that because the Class B shares are not registered under Section 12 of the Exchange Act, the solicitation by Genesis of proxies with respect to those shares was not a Section 14 solicitation, Defendants advance the facile argument that if Omnicare were correct, no solicitation of the Class B shares could ***ever*** be deemed to be "in connection with" a Section 14 solicitation. Unless Section 7(c)(5) of the NCS Charter is read to apply to the irrevocable proxies given to Genesis in the Voting Agreements, Defendants argue, that section would be rendered meaningless.

But the import of Section 7(c)(5)'s plain language, and the reason for the exception it affords, is obvious. When NCS solicits proxies in connection with its annual meeting, Outcalt and Shaw should be -- and, by virtue of Section 7(c)(5), are -- permitted to give their proxies in connection with such a solicitation without effecting an impermissible transfer and converting their Class B shares into Class A shares. Indeed, as Genesis itself points out, Class B shares can be, and are, solicited (by NCS) "in connection with" a solicitation under Section 14 every time NCS has a meeting of stockholders. (Genesis Br. at 28) ("[T]he Class B stockholders have repeatedly been invited to grant and undoubtedly have granted proxies to vote their B shares at prior NCS stockholders meetings"). In such circumstances, there is no change of control of NCS. As is apparent from the plain language of Section 7(c)(5), it is precisely in order to permit Outcalt and Shaw to give their proxies in connection with NCS annual meetings and other routine votes in connection with which the public stockholders' proxies are solicited under Section 14 that Section 7(a)(5) exists at all.

Both the Defendants and the trial court seek to circumvent the fact that the Class B shares are not registered pursuant to Section 12, and that

Section 7(c)(5) therefore does not apply to the giving of proxies "in connection with" a solicitation of proxies from Class B stockholders by Genesis, by concluding that the irrevocable proxies given to Genesis were given "in connection with" the later-in-time solicitation ***by NCS*** of proxies from all NCS stockholders pursuant to the Genesis merger agreement, a solicitation which had not even begun at the time Outcalt and Shaw entered into the Voting Agreements.[12]

Moreover, as Defendants pointed out below, Genesis would never have entered into the Genesis merger agreement -- and there would thus have been no solicitation at all under Section 14 of Exchange Act -- unless Outcalt and Shaw gave their irrevocable proxies to Genesis. Thus, properly viewed, the irrevocable proxies given to Genesis in the Voting Agreements, far from having been given "in connection with" an eventual (though as yet uncommenced) Section 14 solicitation by NCS of all NCS stockholders, were in fact a condition precedent to the contemplated Section 14 solicitation.[13]

Defendants are dismissive of the fact that in the Voting Agreements, Outcalt and Shaw purported to give their irrevocable proxies to Genesis, not to NCS. But the ultimate solicitation of NCS stockholders on which Defendants premise their argument for the application of Section 7(c)(5) is a solicitation *by NCS*, in connection with which NCS stockholders give their proxies *to NCS* -- not to Genesis. The Voting Agreements, on the other hand, were solicited *by Genesis* and are intended to facilitate Genesis's efforts to acquire NCS. This is further evidence that the solicitation of Outcalt's and Shaw's irrevocable proxies was separate and distinct from -- and not "in connection with" -- the solicitation by NCS of the proxies of its Class A stockholders.

Finally, the federal securities law cases upon which Defendants rely to support their interpretation of the phrase "in connection with" are inapposite. As those cases illustrate, courts have interpreted the federal securities laws broadly in order to protect the public from, among other things, "deceptive

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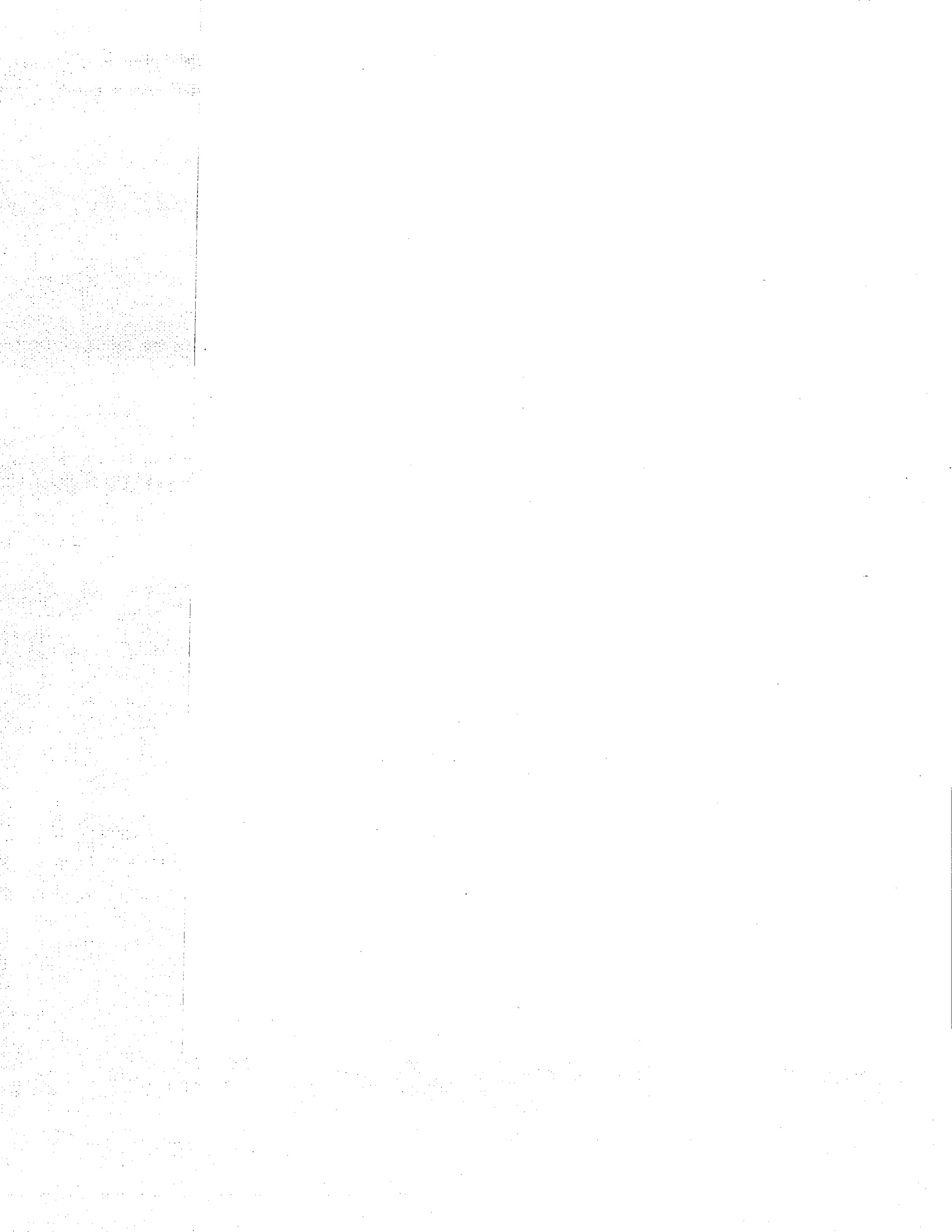
[12] The solicitation of proxies by NCS to approve the Genesis merger agreement commenced in early November, 2002.

[13] Outcalt's and Shaw's citation to the definition of "solicitation" in Rule 14a-1(1)(1) (Outcalt/Shaw Br. at 28-29) is superfluous. Omnicare does not dispute that Genesis "solicited" proxies from Outcalt and Shaw. The point is that those proxies were not solicited "in connection with the solicitation of proxies subject to Section 14" of the Exchange Act.

devices and contrivances in the purchase or sale of securities." *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971) (purpose of Section 10b-5 of the Exchange Act requires flexible reading of statute); *Securities & Exchange Comm'n. v. Okin*, 132 F.2d 784, 786 (2d Cir. 1943) (broad interpretation of securities laws necessary to further Congress's intended purpose, otherwise "an easy way would be open to circumvent the statute; one need only spread the misinformation adequately before beginning to solicit, and the [Securities and Exchange] Commission would be powerless to protect shareholders"). No such concerns are present in construing the NCS Charter.

The *Bankers Life* case did not interpret the phrase "in connection with" in the context of a proxy solicitation, but rather in the inapposite context of Rule 10b-5's prohibition of misstatements or omissions "in connection with the purchase or sale of any security." *See* 404 U.S. at 9. Moreover, Judge Learned Hand's analysis in *Okin*, cited by Genesis to support the conclusion that Genesis's solicitation of proxies from Outcalt and Shaw was "in connection with" NCS's later solicitation of proxies from the Class A stockholders, in fact supports the opposite conclusion. In *Okin*, which nowhere even mentions the term "in connection with," the court addressed the question of whether a letter sent by Okin to stockholders urging those stockholders not to sign any proxies for the company, and to revoke any proxies they had already signed, was subject to regulation by the SEC. *Okin*, 132 F.2d at 786. The court held that the letter came within the SEC's power because -- and only because -- ***Okin*** intended to follow it by actually soliciting proxies ***from the same group of stockholders***. *See id.* ("If the complaint had not alleged that the defendant intended to follow it up by actually soliciting proxies . . . we should indeed have great doubt whether it stated a cause of action."). To the extent that *Okin* has any applicability here, it serves only to illustrate the fallacy of Genesis's position. Here, as noted, it was ***Genesis*** that solicited proxies from ***Outcalt and Shaw***, with respect to their Class B shares, but it is ***NCS*** that is soliciting proxies from its other stockholders. Thus, even under the broad (albeit inapplicable) analysis in *Okin*, Genesis's solicitation of proxies from Outcalt and Shaw cannot be deemed to have been "in connection with" the later solicitation by NCS of the Class A stockholders.



CONCLUSION

For all the foregoing reasons, and the reasons set forth in its opening brief, Omnicare respectfully requests that the Memorandum Opinions from which Omnicare appeals, dated October 25 and 29, 2002, respectively, be reversed, that Counts II through V of the Second Amended Complaint be reinstated and that the Court of Chancery be instructed to enter an order declaring that the Voting Agreements violate Section 7(a) of the NCS Charter and are therefore void, and that the Class B shares of defendants Outcalt and Shaw have been irrevocably converted into Class A shares.

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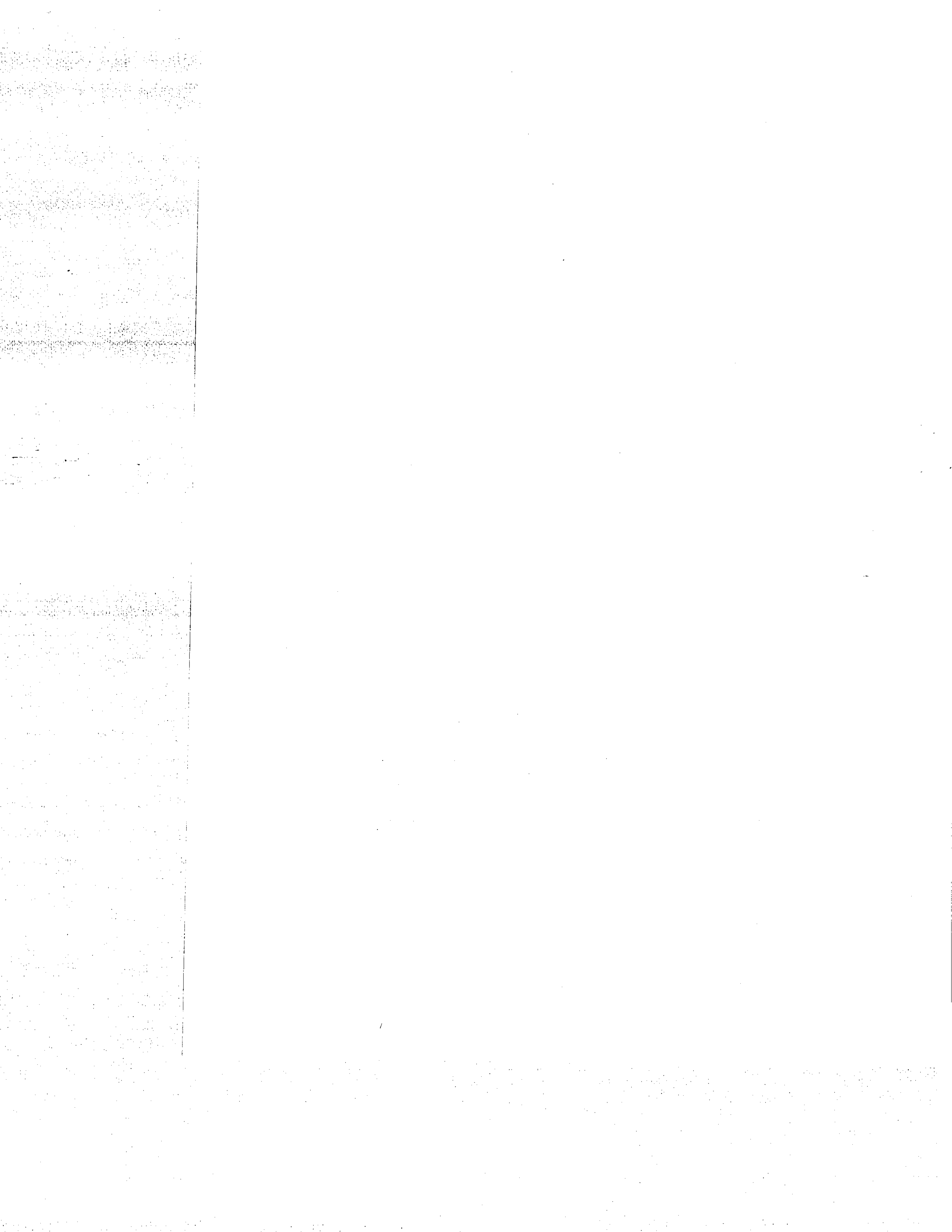

CERTIFICATE OF SERVICE

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