Genesis

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

OMNICARE, INC., Plaintiff, v. NCS HEALTHCARE, INC., JON H. OUTCALT, KEVIN B. SHAW, BOAKE A. SELLS, RICHARD L. OSBOURNE, GENESIS HEALTH VENTURES, INC., and GENEVA SUB, INC. Defendants.	)	C.A. No. 19800

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MEMORANDUM OF DEFENDANTS GENESIS HEALTH VENTURES, INC. AND GENEVA SUB, INC. IN OPPOSITION TO PLAINTIFF'S MOTION TO QUASH SUBPOENAS AND IN SUPPORT OF THEIR MOTIONS FOR COMMISSIONS

Defendants Genesis Health Ventures, Inc. and Geneva Sub, Inc. (jointly, "Genesis") submit this memorandum (i) in opposition to the Motion to Quash Subpoenas filed by plaintiff Omnicare, Inc. ("Omnicare") and (ii) in support of Genesis' Motions for Commissions of certain financial institutions that are providing financing for Omnicare's proposed acquisition of defendant NCS Healthcare, Inc. ("NCS").

1. Omnicare argues that the subpoenas (which have already been served) should be quashed and the motions for commissions for the same and other financial institutions should not be granted for two reasons. First, Omnicare argues that the discovery sought is not relevant to any issue in this lawsuit because, as Omnicare claims, its proposal for acquiring NCS was not

formally conditioned on financing when it was first made on July 26, 2002, and is not so conditioned now.[1] Second, Omnicare argues that the discovery, if relevant, should be precluded because, according to Omnicare, it "has already produced all non-privileged documents relating to its lenders' consent with respect to the financing of Omnicare's proposed acquisition of NCS."[2] Both arguments advanced by Omnicare are wrong.

2. As to Omnicare's first contention, the discovery sought from the institutions financing Omnicare's offer is relevant for several reasons, including the fact that Omnicare conditioned its July 26 and July 28 proposals on the completion of due diligence and the negotiation of a "mutually acceptable merger agreement."[3] One of the reasons NCS entered into the Merger Agreement with Genesis, instead of recommencing due diligence and negotiations with Omnicare, was a concern about Omnicare's ability and intention to consummate its proposal.[4] More specifically, Omnicare's "due diligence" condition may have been necessitated by the concerns or demands of its lenders and may have been a disguised financing condition, allowing Omnicare to refuse to proceed on due diligence grounds if it were unable to obtain the consent of its lenders.

3. In addition, the subject matter of the discovery sought from the financial institutions is substantially the same as that sought from and produced by Omnicare, which itself

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1 Plaintiff's Memorandum Of Law In Support Of Motion To Quash And In Opposition To The Motions Of Genesis And Geneva Sub For Commissions ("PM at __"), at p.2 and ¶¶ 14-15.

2 Id. at p.1 and ¶¶ 7, 8, 23.

3 The text of Omnicare's July 26 and July 28 letters to NCS are set forth on pages 20 through 22 of Omnicare's Offer to Purchase, filed as Exhibit (a)(1)(A) to Omnicare's Tender Offer Statement Pursuant to Section 14(d)(1) of the Securities Exchange Act of 1934 (the "Offer to Purchase") (attached at Tab 1).

4 NCS Healthcare, Inc. Tender Offer Recommendation Statement on Schedule 14D-9, filed August 20, 2002 ("NCS Schedule 14D-9"), at 8-12 (attached at Tab 2).

never refused to produce the information on the basis that the information was "irrelevant." Any third party who may have relevant information is subject to being subpoenaed for that information. Indeed, most of the requests relate to facts alleged in Omnicare's Amended Complaint (and still alleged in Omnicare's proposed Second Amended Complaint).

4. Omnicare's second contention, that it has already produced the documents being sought from the financial institutions, is also wrong. Most basically, the financial institutions may have responsive documents which are no longer or never were in Omnicare's possession and, consequently, were not and could not be produced by Omnicare. Omnicare has produced only a small class of documents relating to its own communications with the lenders.

Nature Of The Factual Disputes At Issue
And Relevance Of The Documents Requested

5. In its First Amended Complaint, Omnicare claims that the directors of NCS breached their fiduciary duty when they approved the transaction with Genesis on July 28,[5] the only known available transaction which, after more than two years of searching,[6] provided any value to the NCS shareholders. The evidence in this case will demonstrate that during that two year period, NCS did not receive even a single acquisition proposal that provided any value to the NCS shareholders, much less a definitive contract ready to be signed.[7] Every prior proposal or indication of interest, including the proposals from Omnicare, offered only to pay some portion of the defaulted debt of NCS.[8]

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5 First Amended Complaint (D.I. 7) at ¶¶ 4, 11-12, 35-36, 62-67.

6 NCS Schedule 14D-9 at 4-7.

7 See, e.g., id. at 7.

8 Id.

6. On the afternoon of July 26, literally on the planned eve of the execution of the Merger Agreement by and among NCS and Genesis, Omnicare suddenly and without explanation, after five months of absolutely no communications with NCS, sent a letter to NCS indicating that Omnicare was interested in commencing negotiations with NCS about a potential merger in which the NCS shareholders might receive $3 per share in cash (which assumed, of course, the satisfactory resolution of Omnicare's due diligence conditions and the negotiation of a "mutually acceptable merger agreement").[9]

7. Prior to this letter of July 26, Omnicare never indicated to NCS any interest in pursuing a transaction that would provide any value to the NCS shareholders.[10] Rather, Omnicare's prior interest in NCS consisted of difficult negotiations with NCS for over a month about the terms of a confidentiality agreement, followed by nine months negotiating with an Ad Hoc Committee of NCS creditors about a proposed bankruptcy filing by NCS in which Omnicare would acquire the assets of NCS at a price that would pay all of NCS's bank debt, some portion of its debt to noteholders, and provide nothing to NCS' shareholders.[11]

8. Omnicare's July 26 letter revealed that Omnicare's offer was subject to contingencies. First, Omnicare stated that its proposal was conditioned upon conducting due diligence, even though NCS had, during the autumn of 2001, provided extensive due diligence to Omnicare.[12] (Omnicare also inexplicably complained in that letter that NCS had not previously

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9 Id. at 8.

10 Id. at 9.

11 Id. at 5-7.

12 Contrast July 26 Letter at 1 (Offer to Purchase at 20) with NCS Schedule 14D-9 at 8-9.

accorded Omnicare any "meaningful" due diligence.[13]) Second, the acquisition proposal was conditioned upon "the negotiation and execution of a mutually acceptable merger agreement,"[14] a proposed form of which Omnicare did not even enclose with its letter.

9. After NCS received the July 26 letter from Omnicare, the letter was sent to Genesis, and NCS used the Omnicare letter as leverage to extract an improved offer from Genesis.[15] However, before improving its offer, Genesis indicated that its offer was a "take it or leave it" proposition that must be accepted by midnight Sunday, July 28, or Genesis would terminate further negotiations.[16] From Genesis' perspective, its negotiations with NCS already had been lengthy, delayed in part by negotiations with the NCS debtholders. Genesis had been on the verge of executing an agreement that was the best offer that both the creditors and the shareholders had received after a long and exhaustive search. Genesis determined it was not willing to enhance its offer and still face further delay. Consequently, Genesis conditioned its' enhanced offer on the execution of the Merger Agreement and Voting Agreements by midnight, Sunday, July 28, 2002.

10. As a result, the issue which the Board of Directors of NCS (the "NCS Board") faced on July 28 was whether to lose or jeopardize its definitive transaction with Genesis in order to recommence due diligence and negotiations with Omnicare. For a number of reasons, which are set forth in the NCS Schedule 14D-9, the NCS Board and NCS' two largest (and controlling) shareholders made a reasoned business decision not to lose the Genesis proposal

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13 Id.

14 July 26 Letter at 1 (Offer to Purchase at 20).

15 NCS Schedule 14D-9 at 8.

16 Id.

simply in order to conduct due diligence and negotiations with Omnicare.[17] It is this decision which Omnicare contends was a breach of fiduciary duty.

11. One issue facing the NCS Board was whether a definitive agreement could ever be reached with Omnicare, and, if so, when. One obvious concern in this regard was the due diligence condition in Omnicare's July 26 letter. According to NCS' Schedule 14D-9, this due diligence condition concerned the NCS Board for two reasons. First, the NCS Board was wary of Omnicare's professed need for due diligence, in light of Omnicare's previous access to due diligence and its inexplicable assertion that it had not previously been able to obtain "meaningful" due diligence.[18] This created an obvious concern for the NCS Board that Omnicare was using the due diligence condition as a pretext to enable Omnicare to retreat from its offer if it decided to do so for other reasons. Second, the NCS Board had the typical concern that even due diligence conducted in good faith might abort the proposal.[19]

12. In its Amended Complaint, and in its public statements, Omnicare has taken the position that the NCS Board did not have legitimate concerns either about Omnicare's good faith or its willingness or ability to consummate the transaction it proposed.[20] Undoubtedly, Omnicare will rely upon the current status of its offer in an effort to persuade this Court to that view. However, it is the status of Omnicare's offer on July 26, not the current status of Omnicare's offer, that is the relevant consideration.

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17 NCS Schedule 14D-9 at 8-12.

18 Id. at 9 ("the fact that Omnicare continued to condition its proposal on satisfactory completion of due diligence, notwithstanding that Omnicare had previously performed due diligence").

19 Id. ("the highly conditional nature of the Omnicare indication of interest, which remained subject to due diligence and other as yet unknown conditions to be included in the definitive documentation relating to the transaction").

20 First Amended Complaint (D.I. 7) at ¶¶ 64-65.

13. The discovery from the financial institutions may show, at a minimum, that Omnicare did not have financing for its proposal on July 26. Indeed, it may be that under Omnicare's line of credit, Omnicare could not proceed with the July 26 proposal without the consent of the lenders on the line of credit, regardless of whether the line of credit was used as the funding source for the offer, and that Omnicare lacked that authorization on July 26. Moreover, Defendants want to discover whether the lenders had "due diligence" concerns of their own with respect to the July 26 offer, which might have complicated any due diligence and negotiations with NCS. For these reasons, the status of Omnicare's financing as of July 26, and whether Omnicare had the consents it needed to even proceed with the offer, are relevant.

14. Omnicare makes two arguments on this point. First, Omnicare contends that discovery from its lenders cannot possibly lead to admissible evidence because the offer contained in its July 26 letter was not conditioned upon financing, and because its subsequent tender offer expressly states that it is not conditioned on financing.[21] However, this contention is wrong for several reasons. While it is technically true that the offer contained in the July 26 letter was not expressly conditioned on financing, the letter in fact made no mention of financing whatsoever. The letter was simply silent on the subject. Also, the letter was silent about what conditions or terms Omnicare might have demanded or required, based upon the then state of its financing or consents, in the merger agreement Omnicare proposed to negotiate with NCS. Moreover, even if the July 26 letter had expressly stated that financing was not a condition, the status of Omnicare's financing, and whether it had any consents that might have been necessary to proceed with the transaction, had obvious significance both to the reasons behind the due

[21] PM at p.1 and ¶¶ 15-16.

diligence requirement and what due diligence might be necessary to obtain financing or consents.

15. Second, Omnicare contends that facts about its proposal are irrelevant because the only facts that matter are what was known by the NCS directors at the time they made their decision.[22] Genesis does not necessarily disagree with Omnicare's proposition as a matter of principle. But it would be fundamentally unfair and undermine the integrity of the factfinding process to permit Omnicare to claim that the NCS Board was wrong to have concerns about Omnicare's ability or intention to consummate its proposal, while at the same time permit Omnicare to conceal information which might show that on July 26 Omnicare lacked the financing to consummate a merger with NCS, the consents needed to proceed with such a merger, or both.

16. Omnicare cites the Court's opinion in Atlantic Research Corp. v. Clabir Corp. for the proposition that discovery from an offeror/plaintiffs' financing sources should be denied because "the validity of [the directors' decision at issue] has to rise or fall on what the directors knew and considered at the time they [took the action in question], and should not be considered on the basis of what they did not know and what they did not consider."[23] However, the Court's ruling in Atlantic Research is, in fact, contrary to the proposition for which Omnicare cites it. The discovery in question was ordered precisely because, as here, the party opposing the discovery sought to challenge the reasonableness of the directors' decision.[24] In words equally

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22 PM at p.1 and ¶¶ 19-21.

23 C.A. No. 3783, 1987 WL 758584, at *1, Jacobs, V.C. (Del. Ch. Feb. 10, 1987) (attached as Exhibit Q to Omnicare's motion).

24 Id. at *2.

applicable here, the Court ordered "that the subpoenas should be allowed to issue," and stated as follows:

> [T]here is a relevance of the information that is being sought. . . . If Clabir were to attack the reasonableness of the board's decision at the trial on the basis that the directors' perceptions of Clabir's intention were objectively incorrect, then Atlantic would be entitled to test what Clabir's true intentions were; that is to say, Atlantic would be entitled to test the validity or the truth of what Clabir has claimed that it intentions were by way of rebuttal.
>
> If the banks have documents or other evidence bearing on what Clabir's intentions were, then on that basis, conditional and contingent as it may be, it would be relevant at least in the sense that that term is used under Rule 26.[25]

As the quoted language makes clear, the Court found the information to be relevant because of the possibility that Clabir might attack the reasonableness of the directors' decision. In this case, where Omnicare has already made such accusations, such discovery is all the more relevant.

17. The discovery sought from the financiers is relevant for another, independent reason. In its Amended Complaint and public disclosures, Omnicare makes numerous factual assertions to create the impression that it was ardently pursuing NCS during the months preceding its July 26 offer, and was being rebuffed by the NCS directors.[26] In reality, NCS did not receive a single communication from Omnicare in the five months from February 2002 to

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25 Id.

26 See, e.g., First Amended Complaint (D.I. 7) at ¶¶ 23-27.

July 26, 2002.[27] Rather, Omnicare was attempting to negotiate with the Ad Hoc Committee of NCS's creditors the terms of a purchase of NCS's assets in bankruptcy.[28]

18. According to Omnicare's Offer to Purchase, the last offer made by Omnicare to the Ad Hoc Committee was in March 2002, and involved an asset purchase in bankruptcy that would have paid NCS's bank debt in full, a portion of the debt due to the NCS noteholders and absolutely nothing to the NCS shareholders.[29] When the Ad Hoc Committee communicated this proposal to NCS, NCS responded, as it had previously indicated to Omnicare, that NCS was searching for a transaction that would provide some value to its shareholders.[30] In any event, according to Omnicare, the Ad Hoc Committee responded to Omnicare's March asset purchase proposal with a redrafted asset purchase agreement on May 22, 2002.[31]

19. Omnicare states in its 14D-1 that it found this revised agreement to be unacceptable.[32] However, both Omnicare's 14D-1 and its document production are largely silent about what occurred between Omnicare's receipt of this "unacceptable" counterproposal on May 22 and its July 26 letter to NCS. The ball, so to speak, was in Omnicare's court, but no further offer was forthcoming from Omnicare. All of which leads to the question of whether, after

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27 NCS Schedule 14D-9, at 8 ("NCS had not received any communications directly from Omnicare since February 2002"), 9 ("after the absence of any communication from Omnicare for a period of several months").

28 Offer to Purchase, at 18-19 (describing Omnicare's negotiations with the Ad Hoc Committee in the November 2001 to March 2002 time period).

29 Id. at 19.

30 NCS Schedule 14D-9 at 7 ("Still believing that a bankruptcy was not the appropriate method of maximizing value to all NCS stakeholders, and that promising alternatives were developing, NCS indicated to the Ad Hoc Noteholder Committee that it was not interested in this proposal and would not participate in the Ad Hoc Noteholder Committee's bankruptcy sale discussions with Omnicare.").

31 Offer to Purchase at 19.

32 Id.

negotiating for nearly a year with either NCS or the Ad Hoc Committee (or both), Omnicare was (i) in active pursuit of NCS, finally willing to propose a transaction that would offer value to the NCS shareholders, and was being rebuffed by an NCS board determined to consummate an inferior transaction, or (ii) standing pat, refusing to budge from proposals that offered nothing for the NCS shareholders? The documents produced by Omnicare are largely silent on what was occurring during this period.

20. Omnicare's financial institutions may or may not have information about what was occurring during this period, as well as information about other aspects of Omnicare's prior year of due diligence and negotiations concerning NCS. In addition, discovery may reveal discussions or communications between Omnicare and these financial institutions about their consenting to or financing of Omnicare's earlier proposals to acquire the assets of NCS in bankruptcy.

21. Stated another way, the discovery sought goes to the same subject matters as the discovery sought from Omnicare. Omnicare did not (nor could it in good faith) refuse to produce responsive documents on relevancy grounds, because those requests were directed (as are these) to allegations in Omnicare's complaints. These financial institutions may have similar documents or information, and the discovery from the financial institutions is no less appropriate than that discovery from Omnicare.

22. Omnicare's penultimate argument, that discovery should not be had because it is duplicative of discovery Omnicare has already produced in this litigation,[33] is specious, ignoring as it does several well-settled principles of Delaware law. First, the scope of permissible

[33] PM at p.2 and ¶ 23.

discovery under Court of Chancery Rule 26(b) is broad, and a party is afforded substantial latitude in the discovery it may seek.[34] Second, the Court of Chancery Rules expressly contemplate that some duplicative discovery may occur in a given case,[35] and the mere possibility of some duplication (even assuming, arguendo, such would be the case here) is not a proper basis upon which to deny discovery.[36] Third, a litigant is not required to accept at face value a party's bare assertions that the discovery sought is entirely duplicative, and has the right to test the "truth, accuracy and completeness" of a party's discovery responses, and may do so by seeking discovery from non-parties.[37] It is not a proper basis for objecting to such discovery that there is a risk of duplication.

23. Discovery requests directed to one party are not improper merely because another party has produced documents responsive to similar requests, even where both parties might be expected to have the same documents. Moreover, in this situation, the financial institutions may have documents that were internally generated, either about the July 26 letter or about the prior negotiations and due diligence conducted by Omnicare, especially if Omnicare had been in

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[34] Gioia v. Texas Air Corp., C.A. No. 9500, 1988 Del. Ch. LEXIS 30, at *11, Allen, C. (Del. Ch. Mar. 3, 1988) ("[I]n the usual instance, so long as the test of Rule 26(b) is satisfied, it is not appropriate for the court to make judgments concerning whether plaintiffs really (in the court's judgment) need the discovery or not.") (attached at Tab 3).

[35] See Ch. R. 26(b)(1) ("unreasonably cumulative or duplicative") (emphasis added); Cleveland v. Cleveland, C.A. No. 7880, 1985 Del. Ch. LEXIS 428, at *5, Hartnett, V.C. (Del. Ch. June 25, 1985) ("In order to serve the policy of promoting the broadest possible discovery, duplicative discovery methods are permitted.") (attached at Tab 4).

[36] Van de Walle v. Unimation, Inc., C.A. No. 7046, 1984 Del. Ch. LEXIS 575, at *5, Hartnett, V.C. (Del. Ch. Oct. 15, 1984) ("Courts will usually only forbid such duplication where the objecting party has shown with particularity that the discovery is in fact fully duplicative and is meant merely to harass the interrogated party.") (attached at Tab 5).

[37] Fitzgerald v. Cantor, C.A. No. 16297, 1998 Del. Ch. LEXIS 194, at *3, Steele, V.C. (Del. Ch. Oct. 23, 1998) (attached at Tab 6). See also Shapiro v. Nu-West, Inc., C.A. No. 15442, 1998 Del. Ch. LEXIS 190, at *15, Steele, V.C. (Del. Ch. Oct. 1, 1998) (a party is not required to accept another party's pleadings or discovery at face value, "and should have the opportunity to test [their] veracity.") (attached at Tab 7).

discussions or communications with those institutions about its earlier asset purchase proposals. And they may have documents in their possession that are no longer in the possession of Omnicare.

24. Finally, contrary to the assertions in its motion (express and implied),[38] Omnicare has not produced the documents even between itself and the financial institutions, which are part of what Genesis seeks. Omnicare artfully and carefully limited its production of documents to those relating to a single consent executed by only some of the financial institutions after July 26. If Omnicare had communications with these financial institutions about its earlier offers or negotiations, it appears that those documents were not produced by Omnicare. But whether produced by Omnicare or not, Genesis is entitled to obtain from those financial institutions whatever documents or information they may have on the discovery subjects to which Omnicare itself already has responded.

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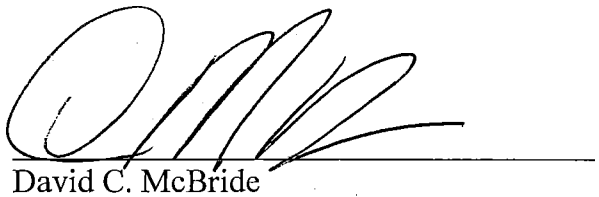
[38] See, e.g., PM at p.2 and ¶ 23.

In conclusion, the discovery sought from the financial institutions is relevant, or at a minimum, reasonably calculated to lead to the discovery of admissible evidence with respect to the very factual matters that Omnicare has put into issue, and thus should be permitted. Omnicare's motion to quash the subpoenas should be denied and Genesis' motions for commissions should be granted.

Respectfully submitted,



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