Omnicare v. NCS Healthcare: A Critical Appraisal

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When can a public company acquisition be subject to an absolute lock-up? Is the lack of an effective “fiduciary out”—in the absence of any separate defect of due care or loyalty—itself a violation of the fiduciary obligations of the seller’s board of directors? In the spring of 2003, the Delaware Supreme Court addressed questions like these in Omnicare v. NCS Healthcare. As this article will discuss, most observers of Delaware corporate law have found that the answers provided by Omnicare were at least unexpected and, at the extreme, “bad law, bad economics, and bad policy.”

Indeed, Omnicare is a controversial opinion even from a structural perspective since it was decided by a 3-2 vote and each of the dissenting justices wrote separate dissenting opinions. Unlike many jurisdictions, the Delaware Supreme Court is famously averse to non-unanimous opinions and its justices have issued separate opinions, on average, for only three percent of reported cases each year. To borrow a phrase from Professor Skeel, Delaware Supreme Court jurisprudence has been characterized by a “unanimity norm.” Corporate lawyers will recall another controversial case prior to Omnicare—Smith v. Van Gorkom—which was also decided by a 3-2 split vote.

However, it would be a mistake to think that Omnicare is a “close case.” If that were so, one might have expected the Delaware high court to compromise and issue a unanimous opinion. Rather, both Chief Justice Veasey and Justice Steele “strongly believe[d] that the majority opinion was wrong-headed” and that the “decision represents an intellectual disagreement whether there can ever be an absolute lock-up under the circumstances of that case.” Consequently, Omnicare is a difficult case for both the practitioner and the

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3. The majority opinion was authored by Justice Holland, who was joined by Justices Walsh and Berger. Chief Justice Veasey wrote a dissenting opinion, which was joined by Justice Steele, who is the current Chief Justice. In addition, Justice Steele authored a separate dissenting opinion.
5. See David A. Skeel, Jr., The Unanimity Norm in Delaware Corporate Law, 83 VA. L. REV. 127, 127 (1997).
legal academic. Currently, it is not only unclear whether Omnicare is a normatively "good" rule, but also whether the current understanding of the rule and rationale in Omnicare will continue to be "good" law. Although there is currently little case law interpreting Omnicare, at least one Chancery case, which will be discussed below, has taken a narrow view of the holding.\(^8\) The real meaning of Omnicare likely lies somewhere between the Chief Justice's dissent, which hopes that the decision will be "interpreted narrowly and will be seen as *sui generis,*"\(^9\) and the majority's insistence that the holding is compelled by the "unremitting"\(^10\) fiduciary duties of a director. In all likelihood, the "real" meaning will only become clear upon further litigation of similar issues in the Delaware courts.

This Article will focus on Omnicare itself and the voluminous critical commentary which has grown out of the case. Part II reviews the facts of the case and the holdings of the court. Part III considers the legal rationale that drives the Omnicare holding. Finally, Part IV concludes by briefly summarizing the possible impact of the case in shaping Delaware corporate law.

II. A "PERFECT STORM"\(^11\) OF CIRCUMSTANCES?: THE FACTS AND HOLDINGS OF OMNICARE

As the preceding discussion has indicated, it is currently unclear whether the Delaware courts will apply the Omnicare holdings broadly or narrowly. As a result, any discussion of the case requires a careful explication of the unique facts which were before the court. This section begins with a recitation of the facts and circumstances as recognized by the court and then proceeds to state the rulings made by the court. Notably, however, the facts of Omnicare are uncontroversial in the sense that both the majority and dissenting opinions accept the findings made by Vice Chancellor Lamb in the Court of Chancery.\(^12\) Moreover, the opinion notes that "[t]he parties are in substantial agreement regarding the operative facts."\(^13\)

A. Factual Background

NCS Healthcare was a publicly traded Delaware corporation and a "leading

\(^10\) Id. at 938.
\(^11\) Veasey, *supra* note 7, at 172.
\(^12\) As this Article will discuss below, some commentators have suggested that the Justices in the majority seem to harbor doubts regarding the Vice Chancellor’s findings, particularly with regard to the sufficiency of process due care. Nonetheless, the high court would probably have needed to find something akin to "clear error" in order to overturn such factual conclusions. As a result, perhaps, there is no attempt by the high court in Omnicare to disturb the factual conclusions of the Court of Chancery.
\(^13\) Omnicare, 818 A.2d at 920.
independent provider of pharmacy services” to long-term care institutions, nursing homes, and similar facilities. Equity ownership of NCS was represented by two classes of common stock: Class A (18,461,599 shares outstanding) and Class B (5,255,210 shares outstanding). The only meaningful distinction between Class A and Class B were the voting rights, which granted Class A one vote per share and Class B ten votes per share. Jon H. Outcalt was chairman of the board of directors and owned 202,063 shares of Class A stock and 3,476,086 shares of Class B stock. Kevin B. Shaw was President, CEO, and a director of NCS. At the time of this decision, Shaw controlled 28,905 shares of Class A stock and 1,141,134 shares of Class B stock. As a result, public stockholders owned 80% of the value of NCS at the time of the decision. However, Outcalt and Shaw each held a substantial equity interest in the company and retained clear control over NCS via their “heavy voting” Class B shares. In total, Outcalt and Shaw controlled more than 65% of the voting power of NCS stock.

Changes in the timing and level of reimbursements by government and third-party providers began to roil NCS’s market in 1999, and the company found itself in significant economic difficulties. By early 2001, NCS was in default on some $350 million in debt, including $206 million in senior bank debt and $102 million in convertible debentures. NCS was economically insolvent, but it is unclear if the company was also insolvent as a legal matter.

As early as February 2000, NCS retained outside financial advisors to explore possible strategic solutions to the company’s problems. An initial “shop” of the company to over fifty different entities resulted in only one indication of interest that valued the company at substantially less than face value of outstanding NCS debt. Meanwhile, NCS’s financial performance continued to deteriorate and an “Ad Hoc Committee” of debt-holders was formed to advance their interests in the company.

In the summer of 2001, NCS began discussions regarding a possible acquisition by Omnicare that continued through October of that year. During this time, Omnicare made several proposals but steadfastly refused to consider any deal that did not involve a Section 363 bankruptcy sale. Omnicare’s proposals would have provided only a small recovery to NCS debt-holders and
nothing to stockholders. In addition, discovery revealed that Omnicare had engaged in what the company referred to as an “NCS Blitz” designed to lure away NCS customers on numerous occasions, including during the July and August negotiations. After discussions broke down in October of 2001, Omnicare continued to pursue a sale of NCS’s assets in bankruptcy via secret discussions with a representative of the Ad Hoc Committee.

By early 2002 NCS’s operating results had shown some improvement, and the company began to entertain hope that it would be possible to secure some recovery for NCS shareholders. During the spring, the board formed an independent committee of directors (which excluded Outcalt and Shaw) and retained financial and legal counsel. The special committee was charged with finding a strategic transaction for the troubled company. Genesis, another player in the pharmaceutical industry, had been contacted by the Ad Hoc Committee in January of 2002 and had expressed some interest in NCS. Notably, Genesis had previously lost a bidding war to Omnicare in a separate transaction. Genesis quickly made clear that it was determined not to act as a “stalking horse” to Omnicare a second time.

Genesis began negotiations with the independent committee in May of 2002 and by late June had advanced a proposal that would provide nearly a full recovery to NCS debt-holders (no provision was made for accrued interest on the NCS Notes) and $20 million in value for NCS stockholders. At this point, Genesis insisted that NCS execute an exclusivity agreement in order for negotiations to continue. Genesis argued that agreement was necessary in light of the expenses being incurred during the negotiations and voiced the legitimate concern that it would be used as a “stalking horse” to encourage other bidders. The independent committee considered and approved the exclusivity agreement, and NCS executed the agreement in July of 2002. During the month of July, the independent committee and the Ad Hoc Committee continued to negotiate with Genesis for better terms.

By late July, Omnicare began to suspect that NCS was negotiating a transaction with one of its competitors. Omnicare faxed an attractive proposal to NCS that included retirement of NCS’s senior and subordinated debt at par
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plus accrued interest and a payment of $3 per share to NCS stockholders. However, the proposal was expressly conditioned on negotiating a merger agreement, obtaining third party consents, and completing due diligence. Omnicare refused to drop the due diligence condition despite being warned by a representative of the Ad Hoc Committee that it made the proposal significantly less attractive.36

Despite the exclusivity agreement, the independent committee met on July 26th to consider the new proposal from Omnicare.37 The committee concluded that Omnicare’s past bankruptcy proposals and unwillingness to structure a merger38 made the due diligence condition of the current proposal a significant risk.39 In addition, the committee concluded that there was a real danger that Genesis would simply abandon negotiations if NCS were to commence open discussions with Omnicare. As a result, the committee recommended using the Omnicare offer as leverage to secure better terms from Genesis.40

Confronted with NCS’s request to increase its offer, Genesis responded on July 27th with a substantially improved proposal, which included a full retirement of the NCS debt (including accrued interest) and an 80% increase in the payout to NCS stockholders (providing 1/10 of a share of Genesis for each share of NCS).41 In exchange, Genesis demanded that NCS approve the transaction no later than midnight the following day, July 28th.42

On July 28th, both the independent committee and the full NCS board scheduled meetings to consider the proposal.43 The independent committee met first. It determined that Genesis was likely sincere in establishing the midnight deadline, unanimously approved the transaction, and recommended it to the full board. Next, the full board considered the transaction and heard advice from its legal and financial advisors. The board concluded that “balancing the potential loss of the Genesis deal against the uncertainty of Omnicare’s letter, results in the conclusion that the only reasonable alternative for the Board of Directors is to approve the Genesis transaction.”44

The merger agreement approved by the NCS board included a “force the vote” provision, as authorized by §251(c) of Delaware General Corporation Law (“DGCL”), which required that NCS submit the merger to the NCS stockholders regardless of whether the board continued to recommend the

36. Id.
37. Id.
38. That is, Omnicare had been determined to pursue an asset purchase in the bankruptcy context rather than a merger.
39. Omnicare, 818 A.2d at 924.
40. Id.
41. Id.
42. Id. at 925.
43. Id.
44. Id.
merger.\textsuperscript{45} In addition, the merger proposal required that Outcalt and Shaw execute voting agreements, in their capacity as shareholders, in which they agreed to vote all of their shares for the merger and granted Genesis an irrevocable proxy to vote their shares in favor of the merger agreement.\textsuperscript{46} Genesis also required that NCS be a party to these voting agreements. Moreover, the voting agreements specified that they were specifically enforceable by Genesis.\textsuperscript{47} The NCS board was advised by its legal counsel that as a result of these agreements NCS would be prevented from engaging in any alternative or superior transaction in the future.\textsuperscript{48} That is, the merger agreement provided no “fiduciary out” that would allow the NCS board to torpedo the interlocking “force the vote” provision and the Outcalt/Shaw voting agreements that covered over 65% of the voting power in NCS common stock.

On July 29th, hours after the NCS/Genesis transaction was executed, Omnicare faxed a letter to NCS restating its conditional proposal.\textsuperscript{49} On August 8th, Omnicare launched a tender offer for NCS’s shares at $3.50 per share and expressed a desire to discuss the terms of the offer with NCS. Nonetheless, Omnicare continued to condition its proposal on a satisfactory completion of a due diligence investigation.\textsuperscript{50} During August and September, the independent committee and the full NCS board met to determine whether it was permissible for NCS to consider the Omnicare offer under the terms of the NCS/Genesis merger agreement.\textsuperscript{51} On September 10th, NCS requested and received a waiver from Genesis to allow NCS to enter into discussions with Omnicare without violating the merger agreement.\textsuperscript{52}

Finally, on October 6th, Omnicare withdrew all of the conditional aspects of its proposal and made an irrevocable offer to acquire all outstanding Class A and Class B shares at $3.50 per share in cash.\textsuperscript{53} As a result, the board of NCS withdrew its recommendation for the Genesis transaction.\textsuperscript{54} Nonetheless, the combination of the “force the vote” provision and the voting agreements would have rendered Omnicare’s efforts utterly moot in the absence of judicial intervention.

B. Holdings of the Omnicare Court

Faced with these facts, the majority opinion in \textit{Omnicare} made several
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relevant holdings. First, the Delaware Supreme Court held that the appropriate standard of review was “enhanced judicial scrutiny,” or the well-known *Unocal* standard.\(^ {55}\) Traditionally, the *Unocal* standard has been held to apply to a board’s decision to utilize defensive devices that raise the “omnipresent specter” of a conflict of interest (such as board entrenchment or hostility to an offer which does not provide special benefits to corporate insiders).\(^ {56}\) Here, however, the majority opinion indicated, with some imprecision, that *Unocal* might be triggered “whenever a board adopts defensive devices to protect a merger agreement.”\(^ {57}\)

Next, the majority opinion clarified the application of the *Unocal* standard of review.\(^ {58}\) As modified by *Unitrin*, that test requires that “if the board of directors’ collective defensive responses are not draconian (preclusive or coercive) and are ‘within a “range of reasonableness,” a court must not substitute its judgment for the board’s judgment.’ ”\(^ {59}\) Here, the majority opinion clearly holds that a response that is preclusive or coercive falls squarely within the realm of “draconian.”\(^ {60}\) Further, the court held that any defensive action must first pass this threshold inquiry into preclusiveness and coerciveness before it may be judged for reasonableness.\(^ {61}\) Thus, “in applying enhanced judicial scrutiny to defensive devices designed to protect a merger agreement, a court must first determine that those measures are not preclusive or coercive before its focus shifts to the ‘range of reasonableness’ in making a proportionality determination.”\(^ {62}\) Here, the court held that the “force the vote provision” in combination with the voting agreements and the lack of a fiduciary out resulted in a deal lock-up that rendered the devices “*both* preclusive and coercive.”\(^ {63}\)

Finally, the court held that the deal lock-up was also invalid on the alternate grounds that the merger agreement provided no effective fiduciary out.\(^ {64}\) It is this final holding that has generated the greatest controversy around the *Omnicare* decision. Regardless of any other circumstances, the majority opinion flatly states that “the NCS board did not have the authority to accede to the Genesis demand for an absolute ‘lock-up.’”\(^ {65}\) Regardless of the dire solvency concerns at NCS, the “board had no authority to execute a merger agreement that subsequently prevented it from effectively discharging its

\(^{55}\) Id. at 928 (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985)).

\(^{56}\) Omnicare, 818 A.2d at 929 (citing Unocal, 493 A.2d at 954).

\(^{57}\) Id. at 930.

\(^{58}\) See id. at 931-34.

\(^{59}\) Id. at 931 (citing Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1388 (Del. 1995)).

\(^{60}\) Id. at 932 (citing Unitrin, 651 A.2d at 1387).

\(^{61}\) Id. at 932 (citing Unitrin, 651 A.2d at 1367).

\(^{62}\) Id. at 932.

\(^{63}\) Id. at 935.

\(^{64}\) Id. at 936.

\(^{65}\) Id. at 938.
ongoing fiduciary responsibilities." In order to discharge the "unremitting" fiduciary duties of a director, the "NCS board was required to contract for an effective fiduciary out clause to exercise its continuing fiduciary responsibilities to the minority stockholders." Thus, *Omnicare* appears to require that any such business combination transaction include a fully functional fiduciary out even when the deal has been approved by an independent committee and a majority of the common stock votes have been committed to the transaction.

III. CRITICAL ANALYSIS: DOCTRINES, RATIONALES, AND IMPLICATIONS OF *Omnicare*

The *Omnicare* decision has proven controversial both for the "rule" that the court announced (i.e., a board of directors may not accede to a merger agreement which is subject to an absolute lock-up) and for the legal analysis that the majority opinion employed to reach this result. This section will examine the legal doctrines, rationales, and implications of *Omnicare*. However, it begins with a brief consideration of the recent Court of Chancery decision in *Orman v. Cullman*.68

A. Orman v. Cullman: The Court of Chancery Discusses Omnicare

In *Orman*, the Delaware Chancery Court was confronted with a merger transaction between two tobacco companies, Swedish Match AB and General Cigar Holdings, Inc.69 Swedish Match sought to purchase a significant equity stake in General Cigar, but control of the latter company would remain with the founding Cullman family.70 Much like in *Omnicare*, the Cullmans maintained control over General Cigar even after the company went public via "their exclusive power over the Company's Class B common stock, which is entitled to ten votes per share."71

In order to prevent General Cigar from "shopping" the company to alternate purchasers, Swedish Match negotiated a voting agreement with the Cullmans that would prevent the family from selling their shares and required that the Cullmans vote against any alternative transaction during a one year period.72 As a result, any alternative transaction would be impossible during the specified period. Notably, however, the merger agreement in *Orman* differed from

66. *Id.*
67. *Id.* at 939.
69. *Id.* at *1.
70. *Id.*
71. *Id.* at *3.
72. *Id.* at *7.*
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Omnicare in that it required the approval of the Class A public shareholders.\(^\text{73}\) According to the court, "the merger could not proceed without approval by a 'majority of the minority.'"\(^\text{74}\)

Despite these significant distinctions, it is worthwhile to consider the court’s discussion of Omnicare's applicability to a shareholder challenge to the voting agreement. The Court of Chancery wrote that Omnicare, [has] no application here because in both cases [referring to Omnicare and Paramount Communications v. QVC Network\(^\text{75}\)] the challenged action was the directors’ entering into a contract in their capacity as directors. The Cullmans entered into the voting agreement as shareholders. Nothing in the voting agreement prevented the Cullmans from exercising their duties as officers and directors. For example, the Cullmans could have voted, as directors, to withdraw their recommendation that the public shareholders approve the merger. This factual distinction from Paramount and Omnicare is meaningful.\(^\text{76}\)

Here, the Chancery Court has focused on a convenient distinction between conduct that is appropriate for an individual in her capacity as a shareholder as opposed to her capacity as a company director.

Unfortunately, this "meaningful" factual distinction is patently counterfactual. The Omnicare voting agreements provided that "Outcalt and Shaw were acting in their capacity as NCS stockholders in executing the agreements, not in their capacity as NCS directors or officers."\(^\text{77}\) Moreover, neither the Court of Chancery nor the Delaware Supreme Court voiced any criticism of this assertion. Rather, the majority opinion in Omnicare simply states that "Outcalt and Shaw, in their capacity as NCS stockholders, entered into voting agreements with Genesis."\(^\text{78}\) Indeed, the Omnicare voting agreements had no impact on the ability of Outcalt and Shaw to "withdraw their recommendation that the public shareholders approve the merger."\(^\text{79}\) The NCS board withdrew its recommendation for the NCS/Genesis merger agreement on October 21, 2002.\(^\text{80}\)

As discussed in Part I, the real import of Omnicare will only become clear as the Delaware courts apply the case in alternate factual situations. In Orman, the above discussion indicates that the Chancery Court was either unfamiliar with the facts of Omnicare or, perhaps, overly eager to follow Chief Justice Veasey's suggestion that the case be treated as "sui generis."\(^\text{81}\) As a result, it is worth considering the possibility that the Delaware courts will sharply limit the

\(^{73}\) See id. at *3.
\(^{74}\) Id. at *14.
\(^{75}\) Paramount Comm'ns, Inc. v. QVC Network, 637 A.2d 34 (Del. 1994).
\(^{76}\) Orman, 2004 Del. Ch. LEXIS 150, at *21.
\(^{77}\) Omnicare v. NCS Healthcare, 818 A.2d 914, 926 (Del. 2003).
\(^{78}\) Id.
\(^{79}\) Orman, 2004 Del. Ch. LEXIS 150, at *21.
\(^{80}\) Omnicare, 818 A.2d at 927.
\(^{81}\) Id. at 946.
future application of Omnicare regardless of the "unremitting" reasoning of the majority opinion. Moreover, with the departure of both Chief Justice Veasey and Justice Walsh, it is unclear how much support the current Delaware Supreme Court will accord to litigators relying on Omnicare.

B. Respecting the Law-Equity Divide

In a recent address at the UCLA School of Law, Vice Chancellor Strine outlined a number of criticisms of the Omnicare holding.82 Most centrally, Strine criticized the Omnicare majority for announcing a "per se" rule that seems to exceed the court's traditional equitable authority and trends into quasi-legislative lawmaking.

The Strine critique begins by recognizing the traditional "law-equity" divide in Delaware corporation law.83 At least as a theoretical matter, it is well accepted that the Delaware courts will consider questions of director and corporate action through the dual rubric of law and equity.84 As an initial matter, for example, the court must determine whether an action was lawful in the sense that it was authorized (or not prohibited) by statute and within the realm of behavior contemplated by the corporate charter and other relevant governing documents.85 In all but the most egregious cases, the action will satisfy this standard of lawfulness. Instead, most fiduciary litigation focuses on the second question, which asks if this otherwise lawful action should be enjoined by the court because it is inequitable in the circumstances before the court.86

Indeed, this law-equity distinction is often described by the Delaware courts

83. Id. at 29.
84. See, e.g., William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., Function Over Form: A Reassessment of Standards of Review in Delaware, 56 BUS. LAW. 1287, 1289 (2001), reprinted in 26 DEL. J. CORP. L. 859 (2001) [hereinafter Function Over Form]. William T. Allen formerly served as Chancellor of the Delaware Court of Chancery and is currently the Director of the New York University Center for Law & Business. Jack B. Jacobs served as Vice Chancellor of the Delaware Court of Chancery for many years and is currently a Justice on the Delaware Supreme Court. Leo E. Strine, Jr. is Vice Chancellor of the Delaware Court of Chancery. Function Over Form notes that:
85. Id. at 861.
86. Strine, supra note 82, at 29-30.
as an equitable authority to scrutinize corporate action that is enabled by statute. In the words of retired Chief Justice Veasey:

State incorporation statutes are largely enabling acts that provide directors and stockholders with considerable latitude for private ordering, consistent with investor protection. Delaware decisional law also contemplates a large role for the courts on a case-by-case basis in applying the directors’ fiduciary duties of loyalty, care and good faith.\(^\text{87}\)

The Strine critique also notes the seminal importance of *Schnell v. Chris-Craft Industries*.\(^\text{88}\) In that case, Justice Herrmann’s opinion articulated “the dual roles of law and equity”\(^\text{89}\) by announcing that “inequitable action does not become permissible simply because it is legally possible.”\(^\text{90}\)

Building on this basic logic, which describes the role of the Delaware judiciary in corporate cases as an equitable assessor of actions otherwise “enabled” by legislative statute, the Strine critique argues that equitable review implies certain restraints on the role of the judiciary:

There exists an implicit, but I think unmistakable, corollary to the rule of *Schnell*. To wit, if the General Assembly has declared certain acts lawful, presumably there must be circumstances in which those acts would be equitable (otherwise why permit the acts at all). Fidelity to the corollary requires the judiciary to eschew the formulation of per se rules in equity. To declare, for example, that directors may never do X and Y, when X and Y are clearly authorized by the DGCL, is to undermine the genius of the Delaware way, by narrowing the freedom of action our statute affords to directors. Only when a court could say that the directors were taking actions X and Y for an improper purpose (such as the desire to enrich themselves at the expense of the corporation) could the court intrude by using its equitable powers.\(^\text{91}\)

Thus, Vice Chancellor Strine argues that equity was developed as a tool to constrain otherwise legal actions that are tainted by some “improper purpose.”

During his address, Strine traced the increasingly sophisticated and complex treatment of such “improper purposes” in the Delaware courts.\(^\text{92}\) The classic improper purpose involves acts inspired by personal self-interest and self-dealing, which are recognized as duty of loyalty violations.\(^\text{93}\) Then, with the 1985 case of *Smith v. Van Gorkom*,\(^\text{94}\) the Delaware Supreme Court made it clear that acts of “fiduciary sloppiness”\(^\text{95}\) would also be subject to equitable review.\(^\text{96}\) Finally, Strine notes that *Unocal*\(^\text{97}\) and its progeny signaled that the

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\(^{88}\) Strine, *supra* note 82, at 28 (analyzing Schnell v. Chris-Craft Indus., 285 A.2d 437 (Del. 1971)).

\(^{89}\) Id. at 30.

\(^{90}\) Schnell, 285 A.2d at 439.

\(^{91}\) Strine, *supra* note 82, at 30.

\(^{92}\) Id. at 31.

\(^{93}\) Id. at 34.

\(^{94}\) Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

\(^{95}\) Strine, *supra* note 82, at 31.

\(^{96}\) While this level of “sloppiness” is generally referred to as “gross negligence” by the Delaware
Delaware courts would apply more stringent standards of equitable review to the defensive measures taken by a board of directors confronted by a takeover bid.  

How, then, does Omnicare fit into this model of equitable review? The Strine critique applies most powerfully to the final holding of the majority opinion, which appears to invalidate any "absolute lock-up" (or, the lack of an "effective fiduciary out" which is functionally identical in this context). According to the Omnicare court, "[t]he defensive measures that protected the merger transaction are unenforceable not only because they are preclusive and coercive but, alternatively, they are unenforceable because they are invalid as they operate in this case." The court quickly made clear that "as they operate in this case" did not refer to any specter of a loyalty or due care violation, but simply to the lock-up itself: "We hold that the NCS board did not have authority to accede to the Genesis demand for an absolute 'lock-up.'"

Essentially, according to Strine, with this holding the court ignored its equitable obligations to identify those facts particular to this case that made the otherwise lawful action untenable. In his words, "[t]his reasoning renders indistinct the line between law and equity by announcing that legally authorized action is, in any conceivable circumstance, somehow invalid." According to Strine, the court enunciated what amounts to a "per se" rule of equity which tramples on the domain of the legislature. As a result, the judiciary may be responsible for deterring behavior—otherwise authorized by the popularly elected legislature—that presumably is not inequitable at all. That is, 

Imagine a seller that has conducted a full market search for buyers for a year. In the last round, the seller is down to three bidders, who have completed due diligence and engaged in a few weeks of preliminary competition. To extract the very last nickel from the bidders' pockets, the seller, which has a majority stockholder who has agreed to share the control premium ratably with the minority, indicates that final bids will be due in a week and that the high bidder will get an


98. Strine, supra note 82, at 33 ("The Supreme Court therefore tightened the screws on corporate boards, by ratcheting up the judicial review standard from the lax test of bare rationality, to the stricter form of reasonableness review used to review actions by other fiduciaries, such as trustees.").  


100. Id. at 938.  

101. Strine, supra note 82, at 45.  

102. Id. at 46:  
For the judiciary to decide that in all possible circumstances, particular legally authorized acts are forbidden, is for the judiciary to place itself clearly on the law side of the law-equity divide. But our legitimacy to place ourselves on this side of the divide, not as interpreters of statutes passed by our General Assembly, but as makers of common law supplements to the DGCL is highly questionable.
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"absolutely locked up" deal including a force-the-vote provision, a voting agreement from the majority stockholder, and no fiduciary out. Under the strict reasoning of Omnicare, that action would be invalid, yet it is difficult to see why such an agreement would be inequitable.\(^\text{103}\)

This is the crux of the Strine critique. Strine has crafted a very powerful condemnation of the Omnicare per se rule forbidding lock-ups if one accepts that, in some situations, an absolute "lock-up" can be employed in a manner that is both consistent with Delaware's statutory framework and equitable to the parties. If that is indeed true, then the court inappropriately allowed itself to condemn the lock-up without indicating the particular actions that made this lock-up inequitable. As a result, a rule seems to appear by fiat from the high court rather than an equitable supplement to the framework crafted by the Delaware legislature.

On the other hand, it is worth recalling retired Chief Justice Veasey's assertion that Omnicare "represents an intellectual disagreement whether there can ever be an absolute lock-up under the circumstances of the case."\(^\text{104}\) That is, if one believes that absolute lock-ups involving a majority shareholder are always inequitable, then this rule remains a violation of the form of equitable jurisprudence\(^\text{105}\) but is far less troubling because we would expect equitable review to reach substantially the same result as the per se rule in most every case.\(^\text{106}\)

One potential ground for this inequity would be the "preclusive" or "coercive" nature of the Omnicare lock-up. This Article will examine below the court's finding that the NCS/Genesis merger arrangement violated the Unocal standard of review. First, however, it will briefly discuss two possible "pretextual" motivations for the court's holding in Omnicare that emerge as a subtext to the majority opinion.

C. Pretext: Suspicions of a Due Care Violation?

In a case such as Omnicare, where there are sharp dissenting opinions and widespread disagreements among critics regarding the strength of the rationale employed, it is reasonable to ask whether the court was motivated by pretextual issues. That is, one may wonder if the court sought to assemble an ex post legal

\(^{103}\) Id. at 45-46.

\(^{104}\) Veasey, supra note 7, at 172.

\(^{105}\) Strine might argue that, while the Court may craft more or less restrictive tests for whether action is equitable, remaining faithful to the law-equity divide requires that the court refuse "to enact, in equity, a per se rule equivalent to a statutory ban." Strine, supra note 82, at 38.

\(^{106}\) Thus, Omnicare would be similar to the decision in Mentor Graphics v. Quickturn, 721 A.2d 1281 (Del. 1998). In that case, the Delaware Supreme Court announced a per se ban on the use of "slow hand" poison pills. Strine, supra note 82, at 39. Nonetheless, as Strine notes, the decision can be viewed as "not very problematic" because "the equitable justification for a slow hand of any but the smallest length [is] hard to perceive, resting solely on the proposition that no new board could be trusted to act with proper care and fidelity." Id. at 41.
rationale to justify a conclusion that the Justices felt was compelled by issues that they could not legitimately treat.

Vice Chancellor Strine has suggested that the chronology and opinions in *Omnicare* hint at such a possibility. Following the decision of the Court of Chancery on November 22, 2002,107 "a rapid appeal ensued" and the Supreme Court issued an order on December 10, 2002 to reverse the lower court’s opinion and enjoin the NCS-Genesis merger.108 Strine argues that,

What went on between the date of the Court's order on December 10, 2002 and the issuance of the final opinion on April 4, 2003 is known only to the Justices, of course. But from the eventual opinions in the case, one surmises that the majority for reversal was anxious to find a way to conclude that the NCS board had been guilty of a breach of [the] duty of due care in the sense of having proceed[ed] without adequately informing itself of material facts. But there was no principled way for the majority to overturn Vice Chancellor Lamb's express findings of fact to the contrary.109

Indeed, it is evident from the tone of the majority opinion in *Omnicare* that the Justices were deeply suspicious of Vice Chancellor Lamb's finding that the NCS board had fully met its duty of procedural due care.

For example, the court notes that the independent search committee "retained the same legal and financial counsel as the NCS board" and that the "entire four member NCS board, however, retained authority to approve any transaction."110 Later, the court writes that "[a]fter listening to a summary of the merger terms, the board then resolved that the merger agreement and the transactions contemplated thereby were advisable and fair and in the best interests of all the NCS stakeholders."111

In the same paragraph, the court notes that the "Court of Chancery held that it was not a per se breach of fiduciary duty that the NCS board never read the NCS/Genesis merger agreement word for word."112 This statement is particularly curious, not only because it indicates the majority's hostility to the process employed by the NCS board, but also because it implies that, in the opinion of the court, satisfying the duty of care would, at a minimum, require a "word for word" reading of the merger documents. Normally, independent corporate directors are businesspeople and "generalists" familiar with running companies.113 It is unclear why such behavior would violate either the explicit

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108. Strine, *supra* note 82, at 44.
109. *Id.*
111. *Id.* at 925.
112. *Id.*
113. In *Omnicare*, for example, the two independent directors were Boake A. Sells (a graduate of Harvard Business School and formerly the Chairman and CEO of Revco Drugstores in Cleveland, Ohio) and Richard L. Osborne (a full-time professor at the Weatherhead School of Management at Case Western Reserve University). *See id.* at 919.
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“gross negligence” or implied “negligence” due care standard in Delaware.114 Given that merger documents are usually highly technical and heavily lawyered, it hardly seems “sloppy” for a board of directors working in a compressed time frame to rely on the interpretation of experienced legal and financial counsel.

Throughout the Omnicare opinion there are similar indications of the court’s hostility to the procedural due care exercised by the NCS board of directors. Professor Stephen Bainbridge has noted that the Supreme Court “snidely ‘assumed arguendo’ that the target’s board of directors ‘exercised due care when it: . . . executed a merger agreement that was summarized but never completely read’ by the board.”115 While it is evident that the Omnicare majority disagreed with Vice Chancellor Lamb’s factual conclusions, there is no way of knowing how important this subtext was to the holding in the case. More importantly, it is unclear whether this suspicious dicta will be relevant to subsequent interpretations of the case.

D. Pretext: Hostility to Control Via “Heavy Voting” Class B Shares?

In addition to the majority’s concerns over the issue of procedural due care, there are subtle indications that the court was troubled by NCS’s corporate structure. As previously noted, NCS was 80% “owned” by Class A public shareholders, but Outcalt and Shaw maintained absolute voting control (approximately 65%) over the company via their super-charged Class B shares, which carried ten votes per share.

There is no indication, either in the opinion or in Delaware corporate law, that such an arrangement is illegal or impermissible. However, in discussing the Court of Chancery’s Unocal analysis, the Omnicare opinion states that the lower court “did find as a fact, however, that NCS’s public stockholders (who owned 80% of NCS and overwhelmingly supported Omnicare’s offer) will be forced to accept the Genesis merger because of the structural defenses approved by the NCS board.”116 The court went on to stress that “the record reflects that any stockholder vote would have been robbed of its effectiveness by the impermissible coercion that predetermined the outcome of the merger without regard to the merits . . . .”117

Professors Ronald Gilson and Jeffery Gordon, recognizing this language in the opinion, have argued that,

One way to understand Omnicare . . . is as an inchoate effort to deal with the troubling mismatch between control rights and cash flow rights that emerges from

114. See Strine, supra note 82.
117. Id. at 936.
dual class capital structures. From this perspective, because the controlling
shareholders in Omnicare could not have sold control other than through a
corporate-level transaction like a merger (their voting control disappeared if they
sold their shares), the NCS independent directors were conflicted about whether
they should block the controlling shareholders' efforts to impose a control
transaction. [A] "true" majority shareholder might legitimately have received
greater deference from the board. Moreover, the mismatch between voting
rights and cash flow rights is particularly problematic because the insolvency risk of
the controlled corporation means that the payoffs from the two transactional
alternatives could well have been evaluated differently by the public shareholders
(who are diversified and therefore risk neutral) and the controllers (who are
undiversified and therefore risk averse).\textsuperscript{118}

One can speculate that the court may have granted different treatment to a
controlling shareholder who held 65% of both the vote and the value of the
company rather than 65% of the vote and only 20% of the value. At a
minimum, this factual distinction could prove to be a useful device for litigators
seeking to distinguish future cases from Omnicare. If the Delaware courts take
a narrow view of the holding, in many cases it would be relatively easy to argue
that the new facts do not present the same degree of vote-value disparity that
the court noted in Omnicare.\textsuperscript{119}

E. Unocal Analysis: Application and Implications

As a result of its aggressive per se condemnation of absolute lock-ups, the
Omnicare opinion is unusual among fiduciary analyses from the Delaware
courts. Normally, the most significant tension in the legal analysis of corporate
or director action revolves around a court's selection of a standard of review
and the application of that standard to the facts before it. However, as the prior
discussion indicates, the Omnicare opinion significantly changes that tension.
By declaring that the mere fact of an absolute lock-up (or lack of an effective
fiduciary out) was itself untenable, the Omnicare court seems to turn the entire
process of selecting and applying the appropriate standard of review into an
elaborate charade.

Nonetheless, the court determined that the "tripartite defensive measures—
the Section 251(c) ['force the vote'] provision, the voting agreements, and the
absence of an effective fiduciary out clause"\textsuperscript{120} violated the Unocal standard of
review independent of the per se rule that the court enunciated regarding
absolute lock-ups. If the Delaware courts choose to interpret Omnicare
narrowly, it is reasonable to conclude that it is this latter analysis, rather than

\textsuperscript{118} Ronald J. Gilson & Jeffery N. Gordon, \textit{Doctrines and Markets: Controlling Controlling

\textsuperscript{119} Of course, this type of argument would require a sympathetic judicial ear. Despite the
rumblings noted in the opinion, the Omnicare court never explicitly acknowledged the issue of vote-
value disparity as a concern.

\textsuperscript{120} Omnicare, 818 A.2d at 936.
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the per se rule, that will have the most significance in future cases.

As previously noted, the Delaware Supreme Court declined to disturb the Court of Chancery’s finding that the business judgment rule applied to the NCS board’s decision to merge with Genesis (rather than applying the more stringent Revlon standard). The plaintiffs had argued that Revlon should apply, despite the lack of a “change of control,” because NCS had initiated a “bidding process seeking to maximize short-term stockholder value.” In any case, the Vice Chancellor concluded that the directors’ actions would have met the Revlon requirements—had they been applicable—since the directors had sought to achieve the highest and best transaction that was reasonably available. As a result, the Delaware Supreme Court recognized that this issue was “not outcome determinative” and left the issue undisturbed by “assum[ing] arguendo that the business judgment rule applied.”

This Article will focus on the court’s analysis of the tripartite lock-up elements, which the opinion loosely refers to as “deal protection devices” and “defensive devices.” The court’s analysis begins by accepting the Court of Chancery’s determination that “enhanced scrutiny” should apply to the tripartite measures because of their defensive character. At least one scholar has argued that the court’s application of enhanced scrutiny in this context “rests on an infirm doctrinal foundation.” Professor Griffith argues that Unocal does not “provide appropriate support for the rule in Omnicare.”

Griffith notes that Unocal involved a hostile takeover attempt, unlike the friendly transaction pursued by NCS, and thus raised the specter of improper entrenchment on the part of the board. According to Griffith, “[e]ntrenchment was not a possibility [for the NCS board]. The company would either be sold, or it would drift toward bankruptcy, either of which would displace incumbent management.” Thus, it was inappropriate for the court to apply enhanced scrutiny by equating mere “deal protection devices” with “defensive devices,” as the Omnicare opinion does. That is, while deal protection devices are clearly designed to “defend” the negotiated merger from alternative deals, these devices do not raise the same policy rationales regarding board entrenchment in the face of a hostile bid that are a central concern with

121. Id. at 929.
122. Id.
123. Id.
124. Id.
125. Id. at 930.
126. That is, the Court would apply the Unocal “reasonableness” test as supplemented by the proportionality review of Unitrin.
127. Griffith, supra note 2, at 587.
128. Id.
129. Id. at 588.
130. Id.
131. Id. at 588-89.
“defensive devices” such as a poison pill.

Moreover, Griffith attacks the court’s suggestion that Paramount Communications, Inc. v. Time, Inc. approved an application by the Court of Chancery of “a Unocal analysis to each of the structural devices contained in the original merger agreement between Time and Warner.” Rather, Griffith argues that the Court of Chancery “analyzed those provisions only in terms of Revlon duties and the change-of-control paradigm. . . . [T]he chancery opinion applied Unocal to the restructuring of the Time-Warner transaction as a whole.” Thus, it is not clear that prior Delaware case law supported the review of the tripartite deal protection devices in Omnicare under the enhanced scrutiny standard.

Omnicare seems to indicate that the adoption of any mechanism that may be viewed as “defensive” or “protective” or aimed at warding off competing transactions may trigger Unocal enhanced scrutiny regardless of facts that indicate good faith execution of the board’s duties or the lack of indications of self-dealing or entrenchment problems. As one commentary has argued,

[t]his decision [Omnicare] illustrates the difficulty in predicting the level of, as well as the result of, judicial scrutiny in the control transaction area. [In the context of a poison pill,] Corporate advisers will be hard pressed to assure target boards that they can adopt a second rights plan in the middle of a contest with any degree of confidence.

Next, this Article will turn to the court’s application of enhanced scrutiny to the facts of the case. The Unocal/Unitrin enhanced scrutiny test may be summarized as follows: First, the board members must demonstrate “that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed.” Next, the board members must demonstrate that their defensive response was “reasonable in relation to the threat posed.” Unitrin amplified this second prong of the inquiry to indicate that the board’s response must fall “within a range of reasonable responses” and not be draconian in the sense of being “preclusive” or “coercive.” As previously noted, the Omnicare opinion has further refined the Unitrin analysis by specifying that the question of preclusiveness or coerciveness is a threshold inquiry which must be satisfied prior to considering the “reasonableness” of the board’s action.

Applying the first prong, the court noted that the “threat identified by the NCS board was the possibility of losing the Genesis offer and being left with

134. Griffith, supra note 2, at 590.
137. Id.
no comparable alternative transaction."\textsuperscript{140} More critically, the Omnicare court found that, in regards to the second prong, the tripartite deal protections were "both preclusive and coercive."\textsuperscript{141} The court stated that a "response is 'preclusive' if it deprives stockholders of the right to receive all tender offers or precludes a bidder from seeking control by fundamentally restricting proxy contests or otherwise."\textsuperscript{142} Accordingly, the court reasoned that the merger arrangement was preclusive because "[a]lthough the minority stockholders were not forced to vote for the Genesis merger, they were required to accept it because it was a \textit{fait accompli}."\textsuperscript{143}

The Omnicare rationale for a finding of preclusiveness is not consonant with prior holdings of the court or even the definition of preclusiveness cited in the opinion. Notably, the tripartite devices did not deprive the minority stockholders of the right to receive any tender offers or bids whatsoever. Indeed, the NCS shareholders did receive the later tender offer from Omnicare and were free to vote on the offer.

It is true that the vote of the Class A shares could not, as a practical matter, prevent the consummation of the NCS/Genesis merger. However, there was never a point at which the vote of the "minority" shareholders could ever have trumped the 65% voting power of Outcalt and Shaw’s combined Class A and Class B shareholdings. This determinative voting power was not the result of the voting agreements or any of the other deal protection devices but rather the corporate control structure of NCS.

Finally, it is not clear that the NCS/Genesis transaction would have prevented Omnicare from seeking control of the combined post-merger entity. In \textit{Time}, the court noted with approval that "the revised agreement and its accompanying safety devices did not preclude Paramount from making an offer for the combined Time-Warner company."\textsuperscript{144} It is not clear why the same rationale would not apply in these circumstances. Thus, Omnicare appears to significantly broaden the definition of preclusiveness.

Similarly, the finding of coerciveness in Omnicare does not correspond well with the rationale cited by the court. The majority opinion notes that "a response is 'coercive' if it is aimed at forcing upon stockholders a management-sponsored alternative to a hostile offer."\textsuperscript{145} Once again, the court reasoned that the NCS/Genesis merger was presented to the stockholders as a "\textit{fait accompli}" and, thus, was coercive because "any stockholder vote would have been robbed of its effectiveness by the impermissible coercion that

\textsuperscript{140}. Id. at 935.
\textsuperscript{141}. Id.
\textsuperscript{142}. Id.
\textsuperscript{143}. Id. at 936.
\textsuperscript{144}. Paramount Comm’ns, Inc. v. Time Inc., 571 A.2d 1140, 1155 (Del. 1989).
\textsuperscript{145}. Omnicare, 818 A.2d at 935.
predetermined the outcome of the merger without regard to the merits of the Genesis transaction at the time the vote was scheduled to be taken.”

However, once again, the public shareholders were clearly not denied their ability to approve or disapprove the transaction by virtue of the voting agreements or any of the deal protections devices. The Class A shareholders were denied that ability from the moment that they purchased shares in NCS because Outcalt and Shaw maintained voting control via their heavy-voting Class B shares. Indeed, the NCS/Genesis transaction might have been viewed as a paradigmatic example of shareholder democracy since it was contingent not on board action but rather on the casting of a majority of the common stock votes by fully informed stockholders. Nonetheless, the majority’s insistence that the merger arrangements were coercive because they did not allow the transaction to be evaluated at the time the vote was scheduled to be taken is puzzling and warrants further consideration.

Why is it coercive of the shareholder franchise if the controlling shareholders effectively cast their votes in advance of other shareholders? It is true that this “advance voting” was enabled and cemented into a certainty by the voting agreements in Omnicare. However, the voting agreements were mere voluntary contractual instruments that had no force over any of the public shareholders. Essentially, the voting agreements allowed Outcalt and Shaw—in their capacity as shareholders—to trade what they personally owned (i.e., control of NCS) in exchange for a firm commitment by NCS to purchase the company.

Moreover, if it is essential to equity that shareholders make the final determination of how to cast their votes at the time of the vote rather than through some precommitment device, then this is hardly a unique situation. If that is indeed the concern of the Omnicare court, then it would seem that the validity of all manner of voting agreements, voting trusts, and other private contractual relationships should be more closely scrutinized. Essentially, the Omnicare rationale seems to indicate that shareholders, or at least controlling shareholders, should be equitably estopped from bargaining away their right to cast their votes according to their convictions before the time that the actual vote is to be held.

However, the Omnicare opinion offers no guidance on this curious issue of coerciveness and advance voting. One may surmise that the court did not intend to suggest that voting agreements and similar devices are in danger of losing their legal status under Delaware law. Rather, the court seems to be making an oblique reference to its continuing hostility to precommitment strategies. Just as with the Omnicare per se rule against absolute lock-ups, the court is simply

146. *Id.* at 936.

unwilling to countenance any device that may interfere with a board’s “ongoing” discharge of its fiduciary duties. Oddly enough, then, it appears that the private voting rights of Outcalt and Shaw, as shareholders, are to be lumped in with the powers of the board of directors for the purposes of such a precommitment inquiry.

Is the Omnicare court correct to interpret precommitment devices as a clear evil? While the court insists that it is preserving the ability of the board “to discharge its fiduciary duties at all times,” it would seem obvious that it is taking away something valuable as well. What equitable rationale justifies denying the directors of a Delaware corporation the ability to commit themselves to a particular course of action when that action is carefully and selflessly considered, exchanged for valuable consideration, and within the realm of behavior contemplated by applicable statutes? As Professor Bainbridge has asked, “why should a board of directors have an ongoing fiduciary duty to constantly reevaluate its decision?”

Having considered the relevant case law, including Omnicare, Bainbridge argues that, as of yet, there is no satisfying answer to this question:

In sum, no Delaware case has yet cogently explained why its case law takes a “rather dim view” of board self-disablement. No Delaware case has yet cogently distinguished the self-disablement effected by bond indentures, no shop clauses, employment agreements, fair price shark repellents, nonredeemable standard pills, and their ilk from the self-disablement effected by no shops or no hand pills. Nor has any Delaware case explained why it is that individuals may freely disable themselves from pursuing certain courses of conduct, but that boards may not.

F. Normative Evaluations of the Omnicare Rationale

The foregoing analysis of Omnicare ultimately begs the question: are precommitment devices so inherently problematic that they should be prohibited? Is the Omnicare per se rule that bars the board of directors from engaging in any absolute lock-up lacking an effective fiduciary out a normatively “good” rule? That is, can one make accurate generalizations about the social utility of allowing or disallowing a board to engage in an absolute lock-up? Vice Chancellor Strine’s critique of Omnicare would seem to suggest that this sort of question exceeds the bounds of the judiciary’s realm of equitable review. Rather, this seems to be a complicated inquiry into social policy, which may involve balancing competing interests and engaging in a subtle cost-benefit analysis of various rules. It is elemental to our system of democratic government that such questions are, ideally, to be tackled by a popularly elected legislature rather than by the judiciary.

148. Omnicare, 818 A.2d at 938.
150. Id. at 26.
In any case, a thorough inquiry into the normative value of precommitment devices exceeds the scope of this Article. Instead, this Article will briefly note some cogent insights into the utility of the *Omnicare* bar on absolute lock-ups. As a preliminary matter, it is useful to translate the requirement of an “effective fiduciary out” into the plain language of financial economics: the fiduciary out transforms a “locked up” merger agreement into an option contract. According to a client memorandum from Wachtell, Lipton, Rosen & Katz, the *Omnicare* decision,

leaves little doubt that Delaware is now an option state—that is, a board of a Delaware corporation cannot agree to a merger agreement without a fiduciary out permitting it either to terminate the agreement if a superior proposal emerges or to be certain that the stockholders remain free to reject the original merger in that event.\(^\text{151}\)

Moreover, understanding the fiduciary out as an “option” is only half the story. According to an experienced practitioner,

[As any economist will tell you, an option has a price, and because such a target will not actually pay money to a buyer for the option the economic price for the option will be paid for by the target shareholders in the form of a lower initial deal price. Ironically, this option price will be predominately paid for by the majority stockholders whose ability to extract that extra price by promising a locked deal has arguably been taken away by Omnicare. Note that this “option discount” will be paid for by all targets with large voting blocks; in effect Omnicare . . . surcharge[s] all corporations with concentrated ownership with a price tax.]

As a basic matter, then, it seems clear that an *Omnicare*-style per se rule requiring a fiduciary out “option” must have a tangible economic cost. Of course, this observation does not clarify whether, on the whole, the social value of requiring such an option will generally outweigh its costs. All that is certain is that such a rule is not costless.

One must next ask whether an option rule tends to increase or decrease socially desirable ends. Quite obviously, this sort of question exceeds the ken of an attorney and belongs more properly to the social scientist trained in economics. Nonetheless, it is worth noting the insights generated by two recent articles.

Professor Wayne Hanewicz has suggested that “the effect of the *Omnicare* court’s rule arguably will enhance overall shareholder and corporate wealth.”\(^\text{153}\) The Hanewicz critique focuses on the differential risk preferences of the diversified public shareholder and the heavily-invested controlling shareholder. Quite clearly, “[t]he public is likely to be much less

\(^{151}\) David Marcus, *Holland’s Clarity is Others’ Confusion*, CORP. CENT. ALERT, May 2003, at 12-13 (quoting a Wachtell, Lipton Rosen & Katz client memorandum).


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risk averse\textsuperscript{154} than Outcalt and Shaw because the public is, or easily can become, well diversified.\textsuperscript{155}

As a result, Hanewicz reasons that “public stockholders are willing to risk the possibility that pursuing the riskier bidding war strategy will not pay off in NCS’s particular case so long as, on average and over time, the strategy pays off for enough other companies in their investment portfolio.”\textsuperscript{156} Viewed from this perspective, the \textit{Omnicare} court’s focus on the timing of the controlling shareholder vote seems to make more sense:

At the time of the shareholder meeting, the bidding war has already occurred (or failed to occur), and Outcalt and Shaw and the public stockholders will face only a decision\textsuperscript{157} on which they are much more likely to agree: which offer on the table (assuming there is more than one) is better.\textsuperscript{158}

Essentially, these observations lead Hanewicz to conclude that the \textit{Omnicare} option rule serves the beneficial function of removing the comparative risk preference of controlling shareholders in an absolute lock-up, and, thus, it incentivizes the board of directors to pursue a riskier strategy with higher potential returns that more closely match the risk preferences of non-controlling shareholders.\textsuperscript{159}

Stated differently, the Hanewicz critique seems to describe a significant tax on the preferences of controlling shareholders in order to supplement the preferences of minority shareholders. It is unclear what the consequences of such a tax would be on the corporate form. For example, one might imagine that it would add significant negative considerations to the calculations of the owners of family-run businesses and other private ventures who wish to tap into the capital markets via an IPO but do not wish to surrender control of the firm.

On the other hand, Professor Griffith arrives at the diametrically opposing conclusion: “Unfortunately, in settling on its bright line rule against transactional certainty, the \textit{[Omnicare]} majority did not choose a rule that is likely to maximize the welfare of target shareholders.”\textsuperscript{160} Griffith evaluates the strategic value of a precommitment option through a number of game theory simulations, and concludes that precommitment offers the target board a valuable tool in the complex dance of merger negotiations taking place in the

\textsuperscript{154} Alternatively, one might say that the public shareholder is able to eliminate non-systematic risk through market diversification.
\textsuperscript{155} Hanewicz, \textit{supra} note 153, at 544.
\textsuperscript{156} Id. at 546.
\textsuperscript{157} Of course, this generously assumes that the shareholder vote will occur in the absence of a bidding war. Given the facts of \textit{Omnicare}, it seems entirely plausible that a failed bidding war would have resulted in finally delivering Omnicare the opportunity to sift through the remains of NCS in a Section 363 bankruptcy sale of assets.
\textsuperscript{158} Hanewicz, \textit{supra} note 153, at 546.
\textsuperscript{159} Id. at 546-49.
\textsuperscript{160} Griffith, \textit{supra} note 2, at 622.
context of incomplete information. According to Griffith,
Commitments enhance the ability of parties to convey information to other players
and, in doing so, to alter their behavior. Without the ability to hold to a
predetermined course of action, a player does not have the same credibility in
communicating its intentions to other participants and, as a result, will also have
less opportunity to influence their behavior. Generals burn bridges behind them in
order to signal to the enemy that they will not retreat. In doing so, they imperil
themselves should retreat become necessary, but the commitment itself—the
intractable promise not to retreat—may alter the enemy’s will to fight.

Thus, Griffith suggests that the mere ability to engage in a binding
commitment may afford a target board valuable negotiating leverage which is
eviscerated by the *Omnicare* per se option rule.

In addition, Griffith notes the corollary of our earlier observation that an
option is not costless: “Certainty itself has value.” Just as a fiduciary out
“option” must be paid for through a lower bid price, a target board may include
certainty in a deal as a valuable commodity that will increase the value of a
deal. In sum, Griffith argues that,

> [T]he majority opinion in *Omnicare* appears to take the commodity-value of
certainty away from target boards. Worse still, the loss of the ability to trade
certainty also eliminates the ability of target boards to follow precommitment
strategies and credibly convey their intentions in negotiation. . . . [T]his is likely to
lead to sub-optimal outcomes. To generalize slightly, the *Omnicare* decision takes
away the ability of targets to control the merger process and drives up transaction
costs by eliminating valuable negotiating alternatives. One ought not to be surprised
if, as a result, target companies on the whole sell for less.

**IV. CONCLUSION**

Above all, there can be no doubt that *Omnicare* is a controversial decision.
Indeed, the case has inspired such divergent interpretations that it is not
possible to predict whether *Omnicare*, at one extreme, embodies a coming
revolution in Delaware corporate law or, at the other extreme, is merely a
passing aberration that will have little long-term impact.

In the short-term, it is possible to distill several credible conclusions: First,
*Omnicare*’s strange dicta on the duty of care and its broad application of the
*Unitrin* inquiry into preclusiveness and coerciveness will inject more
uncertainty (and thus higher transaction costs) into the process of negotiating
business combinations. In an era where directors are increasingly (and
justifiably) sensitive to issues of personal liability, *Omnicare* may result in
“over-deterrence” and a lessening of desirable risk-taking. Similarly, *Omnicare*
will deter all but the boldest corporate practitioners from utilizing absolute

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161. *Id.* at 611-12.
162. *Id.* at 612.
163. *Id.* at 614.
164. *Id.* at 615.
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lock-ups (and acquirers will significantly discount the possibility that the Delaware courts will respect an absolute lock-up upon litigation). More abstractly, Omnicare raises troubling and vague questions about the hostility of the Delaware courts to precommitment strategies. If Omnicare is applied broadly, it would be reasonable to expect some level of legislative intervention, much like the addition of Section 102(b)(7) to the DGCL following the Van Gorkom decision.