Optima is Optimal: Sidestepping *Omnicare* in Private Company M&A Transactions

By Alexander B. Johnson and Roberto Zapata[1]

The general controversy surrounding the Delaware Supreme Court's decision in *Omnicare, Inc. v. NCS Healthcare, Inc.*[2] and the implications thereof are well-known to M&A practitioners. Although *Omnicare* has been the subject of extensive discourse and commentary, one less focused-upon concern involves the extent to which parties may effect an expeditious signing and closing of a private company merger. The concern arose from the seemingly *Omnicare*-mandated contingency of a meaningful stockholder vote or fiduciary out termination right. Practitioners have attempted to address this concern in the context of private company M&A transactions to varying degrees of effectiveness through several structuring alternatives ranging from less effective minor distinctions to the more generally implemented alternative of providing for a termination right in the event written consents are not received during a short post-signing window.

In 2008, the Delaware Court of Chancery provided guidance on the permissibility of utilizing written consents to expedite the signing and closing of private merger transactions in its notable bench ruling in *Optima International of Miami, Inc. v. WCI Steel, Inc.*[3] In addition to suggesting that the Court is inclined to narrow the application of *Omnicare*, Vice Chancellor Lamb's ruling shed light on the permissible mechanics for implementing an expeditious signing and closing, thereby removing some of the ambiguity concerning whether one of the alternatives for doing so would pass judicial muster in Delaware.

Setting the Stage: *Omnicare*

As has been recounted numerous times, *Omnicare* involved a merger agreement between NCS Healthcare, Inc. ("NCS") and Genesis Health Ventures, Inc. ("Genesis"). The merger agreement was entered into after an extensive sales process and included the following principal terms which, taken together, were the focus of the decision:

- voting agreements with NCS's two largest stockholders agreeing to vote their shares in favor of the merger agreement, which votes were sufficient to adopt the merger agreement;
- a "force-the-vote" provision, pursuant to which NCS was required to submit the merger agreement to a vote of NCS stockholders regardless of whether the NCS board continued to recommend the merger; and
- no fiduciary out termination right.

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[2] 818 A.2d 914 (Del. 2003).

[3] C.A. No. 3833, Lamb, V.C. (Del. Ch. June 27, 2008) (Transcript).

Soon after NCS executed the merger agreement, Omnicare, Inc. ("Omnicare") submitted a superior proposal to NCS, prompting the NCS board to withdraw its recommendation of the NCS/Genesis merger.

Although Omnicare's proposal was superior, the terms of the NCS/Genesis merger agreement effectively guaranteed that such merger would take place since, as mentioned above, (i) the NCS board was required to submit the proposed NCS/Genesis merger agreement to a vote of the NCS stockholders and (ii) the voting agreements executed by NCS's two largest stockholders, whose holdings in NCS constituted the requisite majority, guaranteed that their shares would be voted for the NCS/Genesis merger irrespective of a change in the NCS board's recommendation.

The Delaware Supreme Court, in a much criticized 3-2 decision, refused to enforce the merger agreement and found that the NCS board breached its fiduciary duties to the minority stockholders of NCS. According to the *Omnicare* court, the principal failing of the NCS board was that, due to the combination of the force-the-vote provision, the fully locked-up vote and the lack of a fiduciary out termination right to accept a superior proposal, neither the board nor the stockholders had the ability to accept a superior proposal following the execution of the merger agreement, thereby rendering the consummation of the transaction a *fait accompli*.

Private Deal Implications of *Omnicare* and Controlling Stockholder Transactions

While directors of private companies generally have the same fiduciary duties as those of public company directors, private companies are often able to act more quickly and efficiently than public companies, particularly in connection with the sale of the company given the typically more concentrated stockholder base of private companies and the lack of public company disclosure and related requirements. For example, in structuring a private transaction involving a controlling stockholder and a large number of unaffiliated or unsupportive stockholders (such that a stock purchase executed by 100% of the target stockholders would not be feasible), a merger with a controlling stockholder vote at or near signing was generally perceived as a relatively straightforward exercise. In the wake of *Omnicare*, however, it became apparent that structuring such transactions required careful consideration.

Following *Omnicare*, a few structuring alternatives quickly emerged, most of which attempted, but did not necessarily properly accomplish, balancing private company practice with *Omnicare* compliance. The general theme in each of these alternatives centered around attempting to find a technical distinction from *Omnicare* and/or there being a meaningful "out" prior to the stockholder vote, while simultaneously accelerating the timing of the vote as much as possible.

It is important to note, however, that *Omnicare* is not the only issue that should be considered in determining whether and how to expedite the signing and closing of a private company merger transaction. If *Revlon* duties apply to the transaction,[1] the target board will

[1] Generally speaking, other than in circumstances where controlling stockholder(s) have effectively ceded to the board control of the sales process on behalf of the stockholders, traditional *Revlon* duties typically should not apply in a sale led by a controlling stockholder, with the applicability of such duties being dependent on the particular facts and circumstances of the transaction. *See, e.g., McMullin v. Beran*, 765 A.2d 910 (Del. 2000), and *In re*

need to consider whether it is appropriate in light of the particular facts and circumstances to expedite the signing and closing of the transaction and, if so, how to do so in a reasonable manner that satisfies its *Revlon* duties.[2] In particular, it will have to assess the fairness of the bid (and thus whether it has obtained the best transaction reasonably available)[3] and whether an expedited signing and closing is consistent with that determination.

Private Company Lock-Up Alternatives

As noted above, following *Omnicare* a few structuring alternatives emerged for expediting the signing and closing of a private company merger transaction. Some structuring alternatives included (i) using irrevocable or revocable proxies, sometimes with a merger agreement termination right and/or termination fee payable in the event of non-delivery or revocation within a short time period, (ii) having post-signing written consents with a merger agreement termination right and/or termination fee payable in the event of failure to obtain consents within a short time period, (iii) inclusion of a fiduciary out termination right, with a termination fee payable if exercised, and (v) in most cases, some requirement that the vote (whether through proxy or written consent delivery) be obtained within a few days of signing the merger agreement.

Of these alternatives, the written consent approach has generally been the most used, in light of both practical and legal considerations relative to some of the other above-mentioned structures. The general approach is as follows:

- after the target board approves, and the parties sign, the merger agreement, target stockholders holding the required vote promptly deliver written consents to approve the transaction;
- the merger agreement sometimes contains a covenant that the target company will use its best efforts to obtain the written consent of its stockholders;
- the merger agreement sometimes contains a fiduciary out termination right which expires upon receipt of the target company stockholder vote;[4] and

CompuCom Sys. Inc. Shareholders Litigation, C.A. No. 499-N, 2005 Del. Ch. LEXIS 145 (Del. Ch. Sept. 29, 2005).

[2] The recent decision by the Delaware Supreme Court in *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235 (Del. 2009), could play an important role in determining the remedy (or lack thereof) in the event that a target's board of directors breaches its *Revlon* duties in connection with an expeditious signing and closing of a private company merger transaction. If the board is disinterested and independent with respect to the transaction at issue, did not breach its duty of loyalty (*e.g.,* by failing to act in good faith) in connection with the transaction, and may only have breached its duty of care by failing to fulfill its *Revlon* duties, a plaintiff challenging the transaction after the closing of the merger may be left with no remedy if the target corporation's certificate of incorporation contains a provision authorized by Section 102(b)(7) of the General Corporation Law of the State of Delaware ("DGCL").

[3] *See, e.g., Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286-87 (Del. 1989).

[4] Although some transactions have included both a fiduciary out termination right and a termination right for failure to obtain consents so as to have additional distinguishing factors from *Omnicare*, practitioners should consider the importance of doing so. For example, in a transaction where a board is otherwise comfortable as to its discharge of its fiduciary duties and assessment of the fairness of the transaction, such that it has no concerns with an expedited signing and closing approach, practitioners should consider whether bargaining for another "out" in

- the merger agreement generally (although not always) calls for the payment of a termination fee from target to buyer if (i) consents are not delivered within a prescribed time period (usually a few days) or (ii) the target exercises any fiduciary out termination right it may have. In some instances, such a trigger event would lead to the payment of a "mini" fee, with a full break-up fee payable if a transaction is subsequently consummated within a tail period.

The basic premise of this approach (and some of the others) is that, because consents representing the requisite vote have yet to be delivered, the vote has not been irrevocably committed to or delivered at the time the target board has approved the transaction. Although this may only be for a moment in time, because the vote will almost certainly be delivered immediately after execution of the merger agreement, the argument is that this should be sufficient to distinguish this scenario from *Omnicare*.[5]

A further premise of this approach is that it generally is acceptable for any "outs" in a merger agreement to expire upon obtaining the stockholder vote, such that the board's fiduciary duties in respect of alternative transactions are discharged at such point.[6] In this context, although the vote is obtained by means of a written consent, the same concept should apply, thereby allowing an ability to terminate prior to delivery of the consent, but not thereafter.

Under such approach, a buyer's deal certainty concerns are addressed by making clear that, in the event such vote is not received promptly (sometimes as short as 24 hours, or even less), it may terminate the agreement and possibly receive a termination fee. One concern with this approach, however, has been focused on this very short time period between signing and obtaining the stockholder vote – namely, whether it is a sufficient amount of time to allow for an informed vote, as well as whether such termination right is anything other than illusory in light of such timing. The court in *Optima*, however, recently confirmed its acceptance of a similar structure and time period.

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the form of a fiduciary out termination right could be interpreted as a signal that the board determined that such a right was needed to discharge its fiduciary duties, notwithstanding the aforementioned determination that it independently satisfied such duties and the arguably illusory nature of such a termination right in light of the likely limited time period during which such right could be exercised.

[5] Other variations of this approach are sometimes used to provide the buyer with more deal certainty. For example, the buyer may request that the consents be delivered either to the buyer's or the target's legal counsel to be held in escrow pending the closing. Given technical concerns under Section 251 of the DGCL with respect to stockholders approving a final agreement or there arguably being an uninformed vote, a target may resist that request. The buyer may also seek to obtain additional comfort by receiving a letter from the stockholders that they intend to deliver their consents within the designated time period after execution of the merger agreement and have no present intent to refrain from doing so. By contrast, a contractual agreement to deliver the consents would raise concerns under *Omnicare*.

[6] *Cf. In re Mobile Communications Corp. of Am., Inc.*, 1991 Del. Ch. LEXIS 4, at *20-21 (Del. Ch. Jan. 7, 1991) (finding that target corporation had no contractual obligation, following stockholder approval, to consider alternative transactions).

Enter *Optima*

In *Optima*, the Delaware Court of Chancery noted that *Omnicare* is of "questionable continued vitality"[7] and refused to enjoin a merger agreement between WCI Steel, Inc. ("WCI") and Severstal Warren Acquisition Corp. ("Severstal"). The merger agreement required that WCI deliver written consent of the stockholders within 24 hours of the board's approval of the merger agreement. Optima International of Miami, Inc. ("Optima"), having submitted a bid that was $14 million more than Severstal's offer, alleged that the merger agreement's restrictive provisions and short time frame constituted the functional equivalent of the locked-up, preclusive deal structures that were invalidated by *Omnicare*.

In holding that the structure did not implicate *Omnicare*, Vice Chancellor Lamb, ruling from the bench, noted that the stockholder consent was delivered after the board decided that it was "better for stockholders to take Severstal's lower-but-more-certain bid than Optima's higher-but-more-risky bid."[8] The board's decision was made after consideration by the board of the company's "severe liquidity problems" and the fact that it was completely unclear whether Optima would be able to consummate the transaction. Therefore, the stockholder consent, "although quickly taken, was simply the next step in the transaction as contemplated by the statute. Nothing in the DGCL requires any particular period of time between a board's authorization of a merger agreement and the necessary stockholder vote."[9]

Vice Chancellor Lamb also determined that WCI directors satisfied their *Revlon* duties despite agreeing to a structure that contemplated a brief time period between signing and delivery of the stockholder vote. The Court found that the WCI directors undertook "a deliberative, informed and reasoned process in making their decision" and that their decision, when considered in the context of all the circumstances, was reasonable.[10] Thus, while the Court found that this transaction did not implicate *Omnicare*, it is important to note that a board might still not satisfy its *Revlon* duties were it to agree to a structure such as this if the circumstances do not support the reasonableness of the decision.

Additional Considerations

While M&A practitioners are increasingly comfortable using formulations similar to those in *Optima*, it is important to keep in mind that there is no "one size fits all" approach. Indeed, *Revlon* duties may still apply and a target's compliance with its fiduciary duties is likely going to be more closely scrutinized in a transaction involving an expeditious signing and

[7] *Optima*, C.A. No. 3833, at 127. Since 2001, other cases have also whittled away at the holding in *Omnicare*. In *Orman v. Cullman*, the majority Class B stockholders entered into a voting agreement (i) not to sell their shares and (ii) to vote their shares against any alternative acquisition proposal for 18 months following any termination of the merger agreement. Ultimately, the court approved the agreement, finding that the merger "could not proceed without approval by a majority of the minority" and thus sufficiently differed from *Omnicare*. Specifically, "the deal protection devices at issue were not tantamount to a *fait accompli*, the public stockholders were free to reject the proposed deal, even though, permissibly, their vote may have been influenced by the existence of the deal protection measures." *Orman v. Cullman*, 2004 Del. Ch. LEXIS 150, at *7 (Del. Ch. Oct. 20, 2004).

[8] *Optima*, C.A. No. 3833, at 127.

[9] *Id.*

[10] *Id*. at 131.

closing. Moreover, not every structuring consideration is addressed in *Optima* and the Delaware Supreme Court's decision in *Omnicare* is still valid law.

Practical considerations and variations on these alternatives also continue to apply notwithstanding *Optima*. For example, notwithstanding the language in *Optima* that "[n]othing in the DGCL requires any particular period of time between a board's authorization of a merger agreement and the necessary stockholder vote," there remains an equitable and fiduciary duty consideration as to whether the target *should* allow for some time to pass. Moreover, even though the *Optima* structure appears to be legally permissible, buyers may still have practical concerns in light of their expectations that there should be no outs in a private company transaction. For example, even with a termination right and break-up fee as compensation for failure to obtain consents promptly, a buyer's potential concern that the target stockholders not deliver the consents is not eliminated altogether. From a target's perspective, however, it might be difficult for the target board to relent to a buyer's demands in such circumstances, particularly if there was concern that the target's board had not fulfilled its *Revlon* duties.

Conclusion

While in the wake of *Omnicare* practitioners were concerned about expediting the closing of private company merger transactions, *Optima* now provides a roadmap for effecting an expeditious signing and closing in the appropriate circumstances through the use of written consents. Cases such as *Optima* also serve as a reminder that, even though a transaction may not involve public companies, many of the same principles of Delaware law – such as the applicability of *Revlon* duties or even disclosure obligations in connection with appraisal rights[11] and/or Section 228 of the DGCL[12] – continue to apply and should not be forgotten.

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