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OMNICARE OF "QUESTIONABLE CONTINUED VITALITY"?: DELAWARE CHANCERY COURT REJECTS APPLICATION OF CONTROVERSIAL CASE IN CONTEXT OF SAME-DAY STOCKHOLDER VOTE TO APPROVE MERGER

On June 27, 2008, the Delaware Court of Chancery in *Optima International of Miami, Inc. v. WCI Steel, Inc.*[1] refused to enjoin a merger approved by the WCI board of directors and adopted later that same day by its majority stockholders acting by written consent. Pursuant to the merger agreement, the acquiring company, OAO Severstal, had the right to terminate the agreement if stockholder approval was not obtained within 24 hours following signing. In ruling that the board's action in obtaining nearly immediate stockholder approval did not impermissibly "lock up" the deal in violation of the Delaware Supreme Court's controversial ruling in *Omnicare v. NCS Healthcare, Inc.*,[2] Vice Chancellor Lamb stated from the bench that "it's really not my place to note this, but *Omnicare* is of questionable continued vitality."

Background

WCI is a troubled steel company owned by 28 stockholders, two of whom control a majority of the outstanding voting power. In the months leading up to the signing of the merger agreement with Severstal, severe liquidity problems put WCI under great pressure either to complete a sale transaction or to face the prospect of a bankruptcy liquidation. Accordingly, WCI retained CIBC and, later, Moelis as its financial advisor to investigate the feasibility of a sale of the company. The bankers initially solicited 22 potential buyers, but by April 2008, the number of bidders had been reduced to two: Severstal and Optima International of Miami, Inc.

[1] C.A. No. 3833-VCL (Del. Ch. June 27, 2008) (TRANSCRIPT). There is no opinion in this case; due to the time sensitive nature of the proceeding, Vice Chancellor Lamb ruled from the bench.
[2] 818 A.2d 914 (Del. 2003).

WCI's sale process was complicated by the fact that it was operating under a collective bargaining agreement with the United Steelworkers Union which purported to give the Union a veto right over any change-of-control transaction. WCI "inherited" this collective bargaining agreement as a result of a prior restructuring. Therefore, as pressure mounted to compete a deal, the WCI board was quite aware that it must obtain the Union's imprimatur in order to consummate a sale.

Seeking to gain an advantage in the bidding process, each of Severstal and Optima approached the Union to solicit its exclusive support for its bid. The Union decided to support Severstal and, as a result, Severstal submitted the only bid in the amount of $101 million. Rather than accepting this bid, the WCI board contacted Optima to offer to help it try to strike a deal with the Union and to persuade it to make a competing offer. Although Optima submitted a bid of $150 million, subsequent negotiations among Optima, the Union and WCI proved fruitless.

In the meantime, Severstal increased its bid to $136 million. In response, on May 15th Optima sent a letter to WCI stockholders, probably in violation of its standstill agreement with WCI, offering to buy their shares and suggesting that it might be willing to pay a substantial premium. The next day, the WCI board let Severstal know that it would be willing to bless a transaction with Severstal if Severstal agreed either (1) not to require immediate stockholder consent, but allow for a 20-day period prior to a stockholders meeting, following the signing of a merger agreement or (2) to raise its bid. Severstal rejected the first alternative but raised its bid to $140 million, conditioned on the board's acting immediately to approve the deal and to obtain stockholder authorization. The board accepted Severstal's sweetened offer later in the day on May 16th, a merger agreement was signed and, "within minutes", the two majority stockholders signed written consents, thereby providing the requisite stockholder approval of the transaction.

Optima's Omnicare Argument

Optima sought to enjoin the Severstal transaction, arguing that the WCI board violated its duties under *Omnicare* by seeking and obtaining stockholder approval immediately after the board approved the merger agreement with Severstal rather than contacting Optima and seeking to keep the bidding process alive. In one of its most controversial decisions in recent memory, the Delaware Supreme Court (overturning the Chancery Court) ruled in *Omnicare* that the NCS HealthCare board had breached its fiduciary duties by allowing NCS to be acquired by Genesis Health Ventures pursuant to a merger agreement that virtually locked up the deal. Specifically, (i) the merger agreement provided that the stockholders meeting to vote on the proposed merger would be held regardless of whether the NCS board withdrew its recommendation in favor of the merger, and (ii) the two majority stockholders of NCS entered into a voting agreement with Genesis under which they irrevocably agreed to vote in favor of the merger at that meeting. The Court ruled that because the arrangements with Genesis rendered an alternative deal "mathematically impossible", the deal protection measures were designed to "coerce" the consummation of the transaction and "preclude" the consideration of a superior transaction by NCS stockholders and, therefore, violated the principles of *Unocal.*[3]

[3] *Unocal Corp. v. Mesa Petroleum Co*., 493 A.2d 946 (Del. 1985).

The *Omnicare* ruling came as a surprise to practitioners who believed that majority stockholders could, in effect, decide to cut off a bidding process by approving a transaction, and was roundly criticized. In fact, an unusually strong dissent admonished the majority that "situations will arise where business realities demand a lockup so that wealth-enhancing transactions may go forward." Practitioners have sought ways around *Omnicare* every since, and the Delaware Court of Chancery on at least one occasion has blessed a majority stockholder lockup agreement that did not go as far as the one employed in *Omnicare*.[4]

Analogizing to *Omnicare*, Optima argued that the WCI board's agreement to seek stockholder approval less than 24 hours after the signing of the merger agreement, and to allow Severstal to walk from the deal if such approval was not obtained, was an impermissible lockup which violated *Omnicare*.[5] Vice Chancellor Lamb disagreed, stating that "a stockholder vote is not like the lockup in *Omnicare*. … [The] stockholder vote here was part of an executed contract that the board recommended after deciding it was better for stockholders to take Severstal's lower-but-more-certain bid than Optima's higher-but-more-risky bid." Indicating its sensitivity to the fact that WCI (like NCS Healthcare) had severe liquidity problems and that it was completely unclear whether Optima would be able to consummate the transaction due to the Union's opposition, the Vice Chancellor concluded that "the stockholder vote, 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. And I don't see how the board's agreement to proceed as it did could result in a finding of a breach of fiduciary duty."[6]

Conclusion

The *Optima* decision indicates that, the *Omnicare* decision notwithstanding, there does come a point in time when a board of directors and the majority stockholders are allowed to act definitively to sign up and consummate a deal that is, in the board's judgment, in the best interests of the stockholders of the company. It is indeed encouraging, particularly in light of *Omnicare*, that the *Optima* Court was prepared to uphold board action approving a transaction where "a clear majority [of the stockholders] were in favor of the board acting in

[4] *See Orman v. Cullman*, CA No. 18039 (Del. Ch. 2004), where the Delaware Court of Chancery ruled that a majority stockholder could enter into a lockup agreement with an acquirer which prohibited the majority stockholder from selling its shares to a third party, or voting in favor of an alternative transaction, for a period of 18 months following the termination of the merger agreement with the acquirer. This lockup was deemed not to be either "coercive" or "preclusive" (in violation of *Unocal*) because (i) the target board was allowed to withdraw its recommendation and the stockholders were permitted to vote against the proposed merger and terminate the merger agreement and (ii) a third party was not precluded from (eventually) going forward with a proposal for an alternative transaction.

[5] Optima also argued, citing *In Re Topps Company Shareholders Litigation*, C.A. Nos. 2998-VCS, 2786-VCS (Del. Ch. 2007), that WCI's board breached its fiduciary duty by refusing to release Optima from its standstill agreement in order to allow Optima to pursue a transaction to directly acquire a debt and equity position in WCI held by a hedge fund. The Court quickly disposed of this argument, stating that "the transaction that Optima was proposing to pursue was one that *threatened* rather than was *protective* of the interests of all the stockholders of the company." (Emphasis added.) For a discussion of the *Topps* decision, see our previous Client Alert entitled "*Topps & Lear: Delaware Chancery Court Continues Recent Trend of Delaying Stockholders' Meetings Due to Inadequate Proxy Disclosures*," September 10, 2007.

[6] The Court also refused to accept Optima's contention that the WCI Board breached its *Revlon* duties in agreeing to a transaction with Severstal rather than continuing to negotiate with Optima, which actually had a higher (though more conditional) bid on the table. *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). Vice Chancellor Lamb concluded that "[t]he board, from what I can see, exercised a very thorough judgment, weighed all the risks associated with the different offers then available and concluded as it did that it was the appropriate judgment to make to approve the merger. In this regard, Optima's bid still lacked union support and Optima had not identified any alternative deal structure that did not entail undue risks." The Vice Chancellor then made his role clear, declaring "I don't substitute my judgment for that of the board or my business judgment for the board's judgment. My job is to look at what the directors did and determine whether the actions they took are within a range of reasonableness. And I have little doubt that they were."

such a way as to be sure not to lose the Severstal bid." In fact, the position adopted by Vice Chancellor Lamb is reminiscent of the practical approach advocated by the dissenting justices in *Omnicare*, who recognized the value of deal-protection devices by writing that "[a] lockup permits a target board and a bidder to 'exchange certainties.' Certainty itself has value."

While the *Optima* decision demonstrates that the Delaware Chancery Court remains pre-disposed to limiting the applicability of *Omnicare,* the specific *Optima* ruling will generally only be applicable to closely held corporations whose charter documents permit stockholders to act by majority written consent.[7] Even in the case of a publicly-traded, SEC-registered corporation with a majority stockholder whose charter documents permit that stockholder to act by written consent, *Optima* will be of limited utility because the SEC's proxy rules require the filing and clearance of an information statement, followed by a 20-calendar day waiting period, before corporate action authorized by a majority written consent of stockholders (where consents from the minority stockholders have not been solicited) may be taken. Presumably in these situations, until the Delaware courts take further action to limit or overturn *Omnicare*, the effectiveness of majority stockholder lockups will continue to be limited. However, given the consistent criticism of *Omnicare* since the time of its release, it is likely only a matter of time before the Delaware Supreme Court is presented with the appropriate set of facts that will permit it to modify or overturn the decision.

[7] Under Section 228 of the Delaware General Corporation Law, stockholders of a Delaware corporation may act by majority written consent, in lieu of a meeting, *unless* the certificate of incorporation provides otherwise.

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