They Don’t Make ‘Em Like They Used To: When the 5th Amendment Plays Dodgeball With Juvenile Confessions
Krista M. Gieske ................................................................. 1

Merger Agreements Post-Omnicare, Inc. v. NCS Healthcare, Inc.: How the Delaware Supreme Court Pulled the Plug on “Mathematical Lock-Ups”
Jay H. Knight ...................................................................... 29

Does ERISA Impose on HMO’s a Duty to Disclose Physician Incentive Contracts?: An Examination of Circuit Splits
Michael Nitardy .................................................................... 59
THEY DON'T MAKE 'EM LIKE THEY USED TO: WHEN THE 5TH AMENDMENT PLAYS DODGEBALL WITH JUVENILE CONFESSIONS

by Krista M. Gieske*

I. INTRODUCTION
II. BACKGROUND LAW
   A. Kids in Court: Juvenile Protections in the United States Justice System
   B. Waiving at the Police: Voluntary Versus Coerced Confessions
   C. Get Out of Jail Free: The Writ of Habeas Corpus
III. STATEMENT OF FACTS AND HOLDING FOR HARDAWAY v. YOUNG
IV. ANALYSIS OF THE FEDERAL HARDAWAY DECISIONS
   A. The District Court Decision: Coercion It Is
   B. The Circuit Court Decision: Very Voluntary
   C. Voluntary or Coerced: A Close Call at the Finish Line?
V. A PSYCHOLOGICAL AND SOCIOLOGICAL PERSPECTIVE ON JUVENILE WAIVER OF FIFTH AMENDMENT RIGHTS
   A. Piaget's Ponderables and Other Psychological Principles
      1. Nature versus Nurture
      2. Piaget's Theory of Formal Operations
      3. Piaget and Hardaway Go Head to Head
   B. Putting a Sociological Wrench in the Works
      1. The Juvenile “Superpredator”
      2. Reality
      3. Society's Branding of Hardaway: Scarlet Letter or Justified Punishment?
   C. Caveat: Keeping Police Coercion in Check
   D. Beyond Hardaway
VI. CONCLUSION

* Krista M. Gieske is a J.D. candidate for 2005 at Salmon P. Chase College of Law, Northern Kentucky University. She earned a B.A. in English from Thomas More College in December 1999.

1 Hardaway v. Young, 302 F.3d 757 (7th Cir. 2002).
I. INTRODUCTION

The room was simple, plain. The walls were grey. There were no windows. Two overhead lamps drowned the room in a harsh fluorescent light. Fourteen-year-old Charlie sat on a wooden straight-backed chair. His body ached. He had been in that chair a long time. The two detectives stared back at him from across the wooden table. They repeated once again what they had told him when they first picked him up, and again when he was brought into this room— he was allowed to refuse to answer their questions, anything he did say they could use against him in court, he was allowed to have an attorney, and if he didn’t have money for one they would get him one. Yes, he understood all of that. They started questioning him again. He repeated that he was only hanging around the crime scene to watch the cops. Yes, he had seen the murder victim before. The victim was an elderly man who lived in his apartment building. No, he had never spoken to the victim before, at least he didn’t think so. No, the victim had never spoken to him. No, he did not know the victim was known to make racist remarks to minority residents. He never even talked to the guy. He didn’t know anything about any of it. No, he didn’t know exactly which apartment the victim lived in. Close to the entrance of the building? Yeah, sure. The detectives told him that they had some evidence that Charlie and the victim had argued before. They said it was common knowledge that the old man regularly accosted Charlie and his friends when they entered and exited the building, that the victim shouted derogatory names and racial slurs at him. The detectives spouted off a litany of examples. Charlie remained silent, wondering where his parents were and why he hadn’t seen them since he had arrived at the station.

Noting that Charlie was visibly upset, the detectives pressed on. They showed him graphic pictures depicting the murder scene. The victim had been brutally beaten in his apartment. The detectives informed Charlie that the autopsy revealed that the cause of death was acute blows to the skull with a blunt metal object. The perpetrator messed up the victim’s face pretty bad too... you could see that in the pictures as well. The questions were coming more quickly now, and Charlie’s head was swimming. He had worked hard to keep the tears back, but now they came, stinging and salty and warm running down his face. They kept asking him... they kept on and on and on. The pit in his stomach felt like it was on fire. His vision was blurred— he felt like it would explode. Finally something snapped. He hated that old jerk, he admitted. He hated him. He couldn’t take the old bigot ragging on him day after day. It was never going to stop. He had to stop it himself. He had no choice.

Was Charlie’s confession coerced by the police detectives? The United States Court of Appeals for the Seventh Circuit would probably have a tough

---

2 This fact pattern is a hypothetical situation, loosely based on several juvenile confession cases.
time with this hypothetical situation. The court would take into consideration all of the surrounding circumstances to decide the issue of whether the juvenile’s confession was voluntary. Charlie appeared to understand his constitutional rights, and he expressly said he understood them. That fact strongly suggests that Charlie comprehended the severity of his situation. It is not unfeasible to imagine an eighth grader comprehending such a situation. The police used tactics that may seem controversial to the average citizen, but did those methods go far enough to amount to coercion? Charlie was questioned for a long period of time under physically uncomfortable circumstances. His parents were not let into the room, though the facts do not indicate whether they were prevented from seeing Charlie or whether they did not try to visit him. The detectives showed the youth graphic pictures of the murder scene, and described the cause of death in detail. Also, Charlie did not have a friendly adult or an attorney present. All of this evinces that there were definite psychological tactics utilized here. Considering the totality of the circumstances, the United States Court of Appeals for the Seventh Circuit would probably not consider this confession coerced. However, this is mere speculation, considering that a few displaced facts or slight variations in the law from state to state could easily shift the result the other way. In the end, the court’s opinion would be heavily dependent on the specific facts contained in the record.

This casenote deals with a juvenile confession that shares some of the factors posited in the previous hypothetical. Part II provides background law relevant to the Seventh Circuit Court of Appeals case Hardaway v. Young. Part III sets out the facts and holding of the case. Part IV contrasts the opinion of the United States District Court for the Northern District of Illinois with the opinion rendered by the Seventh Circuit Court of Appeals, analyzing their conflicting views on the voluntariness of Hardaway’s confession. Part V considers the impact of individual psychology and changing social norms on the perception of the Fifth Amendment and coerced juvenile confessions. Part VI concludes with a brief summary of the issue and future implications of Hardaway v. Young.

3 See Hardaway v. Young, 302 F.3d 757, 768 (7th Cir. 2002) (holding that the Illinois courts’ determination that Hardaway’s confession was voluntary under the totality of the circumstances was not an unreasonable application of clearly established federal law).

4 Id.


7 302 F.3d 757 (7th Cir. 2002).

8 Id.
II. BACKGROUND

A. Kids in Court: Juvenile Protections in the United States Justice System

The juvenile justice system was established on July 1, 1899 in Chicago, Illinois with the enactment of a state statute entitled “An Act to Regulate the Treatment and Control of Dependent, Neglected, and Delinquent Children.”\footnote{9} Under the current juvenile court system, children are afforded higher protection than adults.\footnote{10} Most notable is the juvenile justice system’s focus on rehabilitation rather than punishment, its goal being to prevent the child from becoming a criminal.\footnote{11} The court’s actions often reflect a consideration of the needs and potential of the child, and include elements of law and social work in the outcome of proceedings in order to better rehabilitate the youth.\footnote{12} Also, the status of “delinquency” affords a juvenile offense a retributive label while not carrying the same weight in severity as a crime.\footnote{13} Furthermore, juvenile proceedings are considered non-criminal in nature and are less formal than adult criminal proceedings, placing more emphasis on protecting the interests of the child.\footnote{14} Finally, juveniles are not subjected to as serious or lengthy punishments as adults.\footnote{15}

Juveniles, however, lose some of these protections once they are tried as adults.\footnote{16} Transfer to the adult criminal justice system may be perfected through judicial waiver, legislative waiver, or at the prosecutor’s discretion.\footnote{17} Some factors that these bodies may consider in deciding whether to transfer a juvenile case to an adult criminal court include: age, present offense, past record, weapons used, severity of harm to victims, and gender.\footnote{18}

Upon transfer to the adult system, incriminating statements made by a juvenile at the time of arrest are protected by certain constitutional rights.\footnote{19} The Supreme Court has continually affirmed the principle that the United States Constitution provides certain protections relative to all confessions of crimes, regardless of the age of the confessor.\footnote{20} Furthermore, the Due Process Clause of

\footnote{9} Thomas A. Johnson, Introduction to the Juvenile Justice System 3 (1975).
\footnote{10} Id. at 9-13.
\footnote{11} Id. at 12-13.
\footnote{12} Id. at 12.
\footnote{13} Id.
\footnote{14} Id.
\footnote{15} Tracey M. Hodson, Note, The Effect of Race on the Decision to Try a Juvenile as an Adult, 20 J. Juv. L. 82, 82 (1999).
\footnote{16} Id.
\footnote{17} Id. at 84-86.
\footnote{18} Id. at 82.
\footnote{19} Id. at 87-88.
\footnote{20} In re Gault, 387 U.S. 1, 13 (1967) (stating: "neither the Fourteenth Amendment nor the Bill of Rights is for adults alone").
the Fourteenth Amendment makes it unlawful to use involuntary confessions resulting from coercive police conduct to obtain criminal convictions.21 Also applicable to coerced confessions, the Fifth Amendment affords all citizens the right to be free from compelled self-incrimination.22

The privilege against self-incrimination has had a long historical evolution.23 Over the centuries it developed into the fundamental right that was officially solidified into American jurisprudence by the framers of the Constitution and Bill of Rights.24 The underlying values served by this privilege include the personal dignity and integrity of all American citizens.25 These were the ideals that the Framers had in mind when codifying the right to be free from self-incrimination in the Fifth Amendment.26

The leading case on Fifth Amendment jurisprudence is Miranda v. Arizona.27 In this seminal case, the United States Supreme Court held that, before a suspect is interrogated by law enforcement officials, he must receive certain warnings regarding his privilege against self-incrimination (i.e., his right to remain silent) and his right to the presence and advice of an attorney.28 These Miranda warnings are only required if the suspect (1) is being interrogated and (2) is “in the custody” of law enforcement officials.29 Two purposes that are

---

21 U.S. CONST. amend. XIV, § 1.
22 U.S. CONST. amend. V.
23 Miranda v. Arizona, 384 U.S. 436, 458-59 (1966). This portion of the Miranda opinion quotes a number of ancient sources from which the privilege against self-incrimination is claimed to have its roots. Id. at 458-60. For example, a 17th century case involved an English anti-Stuart Leveller named John Lilburn who refused to take an oath that would, in essence, compel him to incriminate himself in judicial proceedings (by a court that was later abolished thanks to Lilburn’s protestations). Id at 459. Lilburn proclaimed: “[a]nother fundamental right I then contended for, was, that no man’s conscience ought to be racked by oaths imposed, to answer to questions concerning himself in matters criminal, or pretended to be so.” Id. at 459 (quoting WILLIAM HALLER & GODFREY DAViES, THE LEVELLER TRACTS 1647-1653, at 454 (1944)).
24 Miranda, 384 U.S. at 459-60.
25 Id.
26 Id.
28 Id. at 436.
29 Id. at 444. See also Stansbury v. California, 511 U.S. 318 (1994). In that case, the United States Supreme Court stated:

An officer’s obligation to administer Miranda warnings attaches... only where there has been such a restriction on a person’s freedom as to render him “in custody”... In determining whether an individual was in custody, a court must examine all of the circumstances surrounding the interrogation, but “the ultimate inquiry is simply whether there [was] a ‘formal arrest or restraint on freedom of movement’ of the degree associated with a formal arrest.”
purportedly served by these warnings are (1) increasing a suspect’s knowledge and (2) protecting a suspect’s right to be free from self-incrimination, a possible outcome of an involuntary confession.30

B. Waiving at the Police: Voluntary versus Coerced Confessions

If all of the Miranda requirements are met at the time of a confession, there must have been a valid waiver of Miranda rights by the confessor in order for the confession to escape being labeled as coerced.31 A valid waiver is one that is knowing, intelligent, and voluntary.32 If Miranda rights are not knowingly, intelligently, and voluntarily waived, then the confession will be considered coerced and completely inadmissible at trial.33 Courts have recognized that the voluntariness of juvenile confessions, in particular, is an issue that must be closely scrutinized.34

The totality of the circumstances approach appears to be the prevailing method utilized by courts across the nation to determine the voluntariness of confessions made by juvenile/minor suspects.35 Waiver of Miranda and Fifth Amendment rights are among the factors closely examined in this test.36 This

Id. at 322. (quoting California v. Beheler, 463 U.S. 1121, 1125 (1983); citing Oregon v. Mathiason, 429 U.S. 492, 495 (1977)).

30 See Miranda, 384 U.S. at 457-58.
32 Miranda, 384 U.S. at 444, 475. A confession is “knowing” if the suspect fully understands his Miranda rights and the consequences of waiving them. Moran, 475 U.S. at 421. A confession is “voluntary” if it is un-coerced by law enforcement officials, meaning that the confessor would have made the statements regardless of outside influences. Miranda, 384 U.S. at 462. Put another way, a voluntary confession is one that is a “product of free choice.” Id. at 457.
33 Cooper v. Griffin, 455 F.2d 1142, 1144 (5th Cir. 1972) (affirming that “any statement obtained in derogation of [Miranda] rights is inadmissible in a subsequent criminal prosecution”).
34 Hardaway v. Young, 302 F.3d 757, 762 (7th Cir. 2002). Compare Mlyniec, supra note 5, at 1873-74 (suggesting that “knowing, intelligent, and voluntary” waiver of rights by a juvenile is a “fluid” concept in light of child development research), and infra Part V.A. (generally standing for the proposition that, in light of certain child development research examined therein, juveniles are capable of knowing, intelligently, and voluntarily waiving their rights from a fairly early age), with Jane Rutherford, The End of Adolescence: Juvenile Justice Caught Between the Exorcist and a Clockwork Orange, 51 DePaul L. Rev. 715, 715 (2002) (citing neuroscientific data that “suggests that there are developmental differences in the [adolescent] brain’s biochemistry and anatomy that may limit [their] ability to perceive risks, control impulses, understand consequences, and control emotions”).

35 See, e.g., Fare v. Michael C., 442 U.S. 707, 725 (1979) (holding “[t]otality-of-the-circumstances approach is adequate to determine whether there has been a waiver even where interrogation of juveniles is involved”); Alverado v. Hickman, 316 F.3d 841, 848 (9th Cir. 2002) (noting “a criminal defendant’s age has long been a relevant factor in determining whether a confession or a waiver of a constitutional right was voluntary” and then proceeding to cite cases from other jurisdictions that utilized the totality of circumstances test to determine the voluntariness of juvenile confessions).
36 See infra note 39 and accompanying text.
totality of the circumstances approach was adopted in *Alvarado v. Hickman*, where the Ninth Circuit Court of Appeals examined the juvenile's "age, experience, education, background, and intelligence, and [inquired as to] whether he [had] the capacity to understand the warnings given him, the nature of his Fifth Amendment rights, and the consequences of waiving those rights." There seems to be a veritable consensus on these factors amongst jurisdictions, with surprisingly little variance.

C. Get Out of Jail Free: The Writ of Habeas Corpus

An involuntary confession that leads to a conviction may be grounds for issuance of a writ of habeas corpus. A writ of habeas corpus is a device used to bring a petitioner before a court to inquire into the legality of his confinement. The goal of such an action is to determine whether a defendant’s conviction comports with due process of the law. The Antiterrorism and Effective Death Penalty Act of 1996 governs the issuance of a writ of habeas corpus. The pertinent provisions state:

An application for a writ of habeas corpus on behalf of a person in custody pursuant to the judgment of a State court shall not be granted with respect to any claim that was adjudicated on the merits in State court proceedings unless the adjudication of the claim (1) resulted in a decision that was *contrary to, or involved an*

---

37 316 F.3d 841, 846 (9th Cir. 2002).
38 Id. at 854.
39 See, e.g., Gallegos v. Colorado, 370 U.S. 49, 55 (1962) (factors included age, long detention, failure to send for suspect’s parents, failure to bring suspect immediately before the judge of the Juvenile Court, and absence of a lawyer or friend); Haley v. Ohio, 332 U.S. 596, 600-01 (1948) (factors examined included age, hours and duration of questioning, absence of friend or counsel, and police attitude); *Alvarado*, 316 F.3d at 846-51 (factors included age, absence of prior criminal history, inexperience with police, duration of questioning, denial of presence of parents during interrogation, failure to advise of *Miranda* rights, and misleading statements by the detective); Gachot v. Stadler, 298 F.3d 414, 418-21 (5th Cir. 2002) (factors included age, absence of prior record, exposure to the justice system through family members, presence of friendly adult, and demonstrated comprehension of rights); United States v. Butler, No. 98-C-5625, 2002 U.S. Dist. LEXIS 11021, at *43-44 (N.D. Ill. June 19, 2002) (factors included age, interview setting, duration of interrogation, mood and mode of interrogation, absence of parent or attorney present, absence of youth officer at the beginning of questioning, and youth officer’s failure to aid when present).
41 Id. § 1.
42 Id.
44 Id.
The United States District Court for the Northern District of Illinois and the Seventh Circuit Court of Appeals used this habeas corpus test to determine whether the conviction of the defendant Hardaway comported with due process of law under the following facts.46

III. STATEMENT OF FACTS AND HOLDING FOR HARDAWAY v. YOUNG47

The case of Hardaway v. Young involved a 14-year-old defendant, Derrick Hardaway ("Hardaway"), who confessed to killing a fellow street gang member, 11-year-old Robert Sandifer ("Sandifer") and was subsequently convicted of first-degree murder.48 Hardaway and his 16-year-old brother were allegedly ordered by the leader of the gang to get rid of Sandifer after Sandifer garnered too much attention by shooting three teenagers.49 Police were alerted to Hardaway’s possible involvement in Sandifer’s murder when they received a call from a neighbor indicating that Hardaway was the last person seen with Sandifer only hours before his death.50

Police went to Hardaway’s home and awoke the sleeping suspect around 8:00 a.m. to take him to the police station.51 Hardaway’s father declined to accompany his son to the station, preferring instead to wait at home for the return of his older son.52

46 Hardaway v. Young, 162 F. Supp. 2d 1005, 1010-11 (N.D. Ill. 2001); Hardaway v. Young, 302 F.3d 757, 761-62 (7th Cir. 2002). In utilizing this habeas corpus test, the circuit and district courts concentrated on 28 U.S.C. § 2254(d)(1), the “unreasonable application of federal law” prong of the habeas test. Id. This was done because both courts concluded that the Illinois state courts performed the appropriate analysis, the totality of the circumstances test, to determine the voluntariness of Hardaway’s confession, and therefore habeas relief would only be proper if those lower courts unreasonably applied the totality of the circumstances test. Id.
47 302 F.3d 757 (7th Cir. 2002).
48 Id. at 759-60.
50 Hardaway, 302 F.3d at 760.
51 Id.
52 Id.
Hardaway initially stated that he last saw Sandifer three days before the murder. After detectives confirmed the neighbor's story, which placed Hardaway in Sandifer's company just hours before his death, they interviewed Hardaway a second time. It was during this second interrogation that Hardaway was read his Miranda rights. After learning of the neighbor's version of events, Hardaway admitted to being with Sandifer the night of his death, but claimed that Sandifer drove off with Hardaway's 16-year-old brother.

Hardaway was then left alone for six hours, visited only to be given lunch and to be questioned by police about minor details. Eventually, detectives returned to question Hardaway a third time and his Miranda rights were read again. A witness who personally knew Hardaway apparently placed him in the car with Sandifer and Hardaway's older brother, contradicting Hardaway's version of events. Upon seeing the witness at the station, a distraught Hardaway confessed that he did get into the car and he did witness his older brother shoot Sandifer.

Shortly thereafter, the Assistant State's Attorney and a youth officer arrived. The youth officer asked Hardaway if he needed help with anything, and after receiving a negative answer did not assist the juvenile for the rest of his detainment. The Assistant State's Attorney reiterated the Miranda warning to Hardaway, and had him relay the rights back to her in his own words, which he did without incident. It was at this time that Hardaway gave a formal statement confessing to the crime, first to the Assistant State's Attorney and then in the presence of a court reporter.

The findings of fact at trial included Hardaway's extensive prior criminal record. He had been arrested nineteen times in the previous two years on charges including robbery, attempted criminal sexual assault, unauthorized use of a weapon, and delivery of a controlled substance. As a result of these crimes, he had participated in the juvenile court system on several occasions. The trial court also found that not only had Hardaway never asked to see his parents for the duration of his questioning, but also that his parents failed to

---

53 Id.
54 Id.
55 Id.
56 Hardaway, 302 F.3d at 760.
57 Id.
58 Id.
59 Id.
60 Id.
61 Id. at 761.
62 Hardaway, 302 F.3d at 761.
63 Id.
64 Id.
65 Id.
66 Id.
67 Id.
come to the police station at all.\textsuperscript{68} Hardaway did not ask for an attorney either.\textsuperscript{69} His detention at the station lasted for approximately sixteen hours.\textsuperscript{70}

The Illinois trial court denied Hardaway's motion to suppress his court-reported confession, which was the key piece of evidence in his trial for first-degree murder.\textsuperscript{71} The court reasoned that his confession was voluntary based on the surrounding circumstances prevailing at the time it was made.\textsuperscript{72} The Illinois appellate court affirmed Hardaway's conviction and forty-five year jail sentence.\textsuperscript{73} The Supreme Court of Illinois denied review, and Hardaway applied for a petition for a writ of habeas corpus to the United States District Court for the Northern District of Illinois.\textsuperscript{74} The district court granted Hardaway's petition, holding that, under the totality of the circumstances approach, his confession was in fact coerced and, therefore, unconstitutional and inadmissible.\textsuperscript{75}

The State appealed the district court's decision.\textsuperscript{76} The Seventh Circuit Court of Appeals unanimously reversed, holding that the confession was voluntary and federal habeas relief was not proper.\textsuperscript{77} The court reasoned that the police did not use any particularly coercive tactics to extract the confession from Hardaway.\textsuperscript{78}

IV. ANALYSIS OF THE FEDERAL HARDWAY DECISIONS

One of the central issues in \textit{Hardaway} was whether or not 14-year-old Derrick Hardaway's confession at the police station was voluntary or coerced by law enforcement officials considering the totality of the circumstances prevailing at the time the confession was made.\textsuperscript{79} This issue was of vital importance because the confession was key in convicting the juvenile of first-degree

\textsuperscript{68} \textit{Hardaway}, 302 F.3d at 761.
\textsuperscript{69} \textit{id.}
\textsuperscript{70} \textit{id.} at 766.
\textsuperscript{71} \textit{Hardaway v. Young}, 162 F. Supp. 2d 1005, 1009-10 (N.D. Ill. 2001).
\textsuperscript{72} \textit{Hardaway v. Young}, 302 F.3d 757, 761 (7th Cir. 2002). The surrounding circumstances included the following facts: the police never prevented Hardaway and his parents from seeing each other, there was a youth officer present during Hardaway's last two confessions, the police did not threaten or abuse him, he did not seem to be too mentally challenged or handicapped in any way that would make him unable to understand his \textit{Miranda} rights, and he was familiar with the criminal justice system in light of his previous nineteen arrests. \textit{id.}
\textsuperscript{73} \textit{id.}
\textsuperscript{74} \textit{Hardaway}, 162 F. Supp. 2d at 1007.
\textsuperscript{75} \textit{id.} at 1016.
\textsuperscript{76} \textit{Hardaway}, 302 F.3d at 757.
\textsuperscript{77} \textit{id.} at 768.
\textsuperscript{78} \textit{id.} at 766-67 (stating "Hardaway was not intimidated, abused, or physically coerced in any way").
\textsuperscript{79} \textit{id.} at 763.
murder. In Hardaway's habeas proceedings, both the district court and the Seventh Circuit Court of Appeals utilized the totality of the circumstances test to determine the voluntariness of the juvenile's confession, reaching opposite conclusions on this issue. Although the circumstances surrounding Hardaway's confession could feasibly lend themselves toward either conclusion, the Seventh Circuit's opinion provides a more convincing analysis of the totality of the circumstances surrounding Hardaway's confession.

A. The District Court Decision: Coercion It Is

The main issue facing the United States District Court for the Northern District of Illinois was whether federal habeas relief was warranted because Hardaway's Fifth Amendment right to be free from compelled self-incrimination was violated by the trial court's use of his allegedly involuntary confession. The court first determined that Hardaway's petition met the threshold procedural requirements and Section 2254 standards. In addressing the involuntariness of the challenged statements, the court invoked the totality of the circumstances test. The court examined the following factors: Hardaway's age, absence of a friendly adult, prior experience with the criminal justice system, education, and the duration of the interrogation.

The Illinois state courts utilized the totality of the circumstances test as well. Because it deemed this to be the correct approach, the federal district court observed that Hardaway's habeas relief depended on there having been an unreasonable application of this test by the state courts. To that end, Hardaway claimed that his youth, the duration of the repeated interrogations, and the absence of a friendly adult were factors that pointed to the involuntariness of his statements under United States Supreme Court precedents.

The district court then examined a number of United States Supreme Court precedents. The first case examined was Haley v. Ohio, where a 15-year-old juvenile made a confession during a lengthy interrogation without a lawyer or a parent present. The court held that the admission of the confession was error under the circumstances.

---

80 Hardaway, 162 F. Supp. 2d at 1010.
81 Id. at 1017. See also Hardaway, 302 F.3d at 768.
82 See Hardaway v. Young, 302 F.3d 757 (7th Cir. 2002).
83 Hardaway, 162 F. Supp. 2d at 1010.
84 Id. The procedural requirements include (1) petitioner must have exhausted his state court remedies, and (2) petitioner must have avoided any fatal procedural defaults. Id. See supra note 45 and accompanying text for the two Section 2254 habeas petition standards.
85 Hardaway, 162 F. Supp. 2d at 1013.
86 Id.
87 Id. The district court noted that the Illinois state court examined circumstances such as age, duration of interrogation, previous experience with the criminal justice system, Hardaway's claimed comprehension of his Miranda rights, and the presence of a youth officer. Id.
88 Id.
89 Id.
90 Hardaway, 162 F. Supp. 2d at 1013-16.
91 332 U.S. 596 (1948).
old’s murder confession was found to be involuntary because it was extracted late at night, after five hours of interrogation, without the minor’s parents or an attorney present. In Haley, the Court rejected the prosecution’s argument that the suspect understood and waived his constitutional rights, denying that a 15-year-old boy in that position was even capable of fully understanding his rights without the aid of counsel. The second case examined was Gallegos v. Colorado, in which a 14-year-old boy’s assault and robbery confession (leading to his later charge of murder) was found to be involuntary because he was detained for five days without the presence of a friendly adult or legal counsel. Here the Court again stressed the youth’s inability to fully understand his rights or the consequences of his confession. The third case that the district court examined was In re Gault, an often-cited case holding a 15-year-old boy’s confession to making lewd calls was involuntary because law enforcement officials questioned him without a friendly adult or legal counsel present and entirely failed to inform the juvenile of his constitutional rights.

Applying the principles enumerated in these three cases, the district court concluded that the totality of the circumstances surrounding Hardaway’s confession warranted the finding that his statements were involuntary. The court noted that, for the first ten hours of his questioning, Hardaway did not have his parents, an attorney, or a youth officer present. The court stressed Hardaway’s age and the extreme length of his confinement for questioning. The court also expressed doubt as to whether Hardaway truly understood his constitutional rights. Thus, due to the circumstances surrounding the first portion of Hardaway’s detention, the district court concluded that his statements during this part of his detention were indeed involuntary.

The remaining issue was whether Hardaway’s statements during the latter six hours, while a youth officer was present, could be considered voluntary. A special consideration was included here due to the fact that the court found the previous statements to be involuntary. A statement made subsequent to an

---

92 Id. at 599-600.
93 Id. at 601.
95 Id. at 54-55.
96 Id.
97 387 U.S. 1 (1967).
98 Id. at 56. As previously mentioned, this landmark case was important because it affirmed the applicability of constitutional rights in judicial proceedings to juveniles as well as adults. See supra note 20.
100 Id.
101 Id.
102 Id.
103 Id.
104 Id.
105 Hardaway, 162 F. Supp. 2d at 1015-16.
involuntary statement could only be considered voluntary if there was a "break in the stream of events . . . sufficient to insulate the statement from the effect of all that went before." The sufficiency of a break in between statements could be determined by looking at the amount of time elapsed, whether the location of each questioning session changed, and whether interviewers changed. The district court concluded that the "taint" from Hardaway's earlier coerced confession had not dissipated by the time of his later confession, therefore making that confession involuntary as well. The amount of time that elapsed between his first "tainted" confession and the second was not very long, the location of the questioning sessions had not changed, and the same detective who had extracted the tainted confession from Hardaway was still present during his later confession. These surrounding circumstances all evidence the failure of the previous taint to dispel before the later confession was made. Under such circumstances, the court held that the subsequent statements were also "tainted" and thus involuntary.

The court further noted that the youth officer abdicated his role as a friendly adult. The officer was derelict in failing to counsel Hardaway as to his rights. He did not speak to Hardaway in private, nor did he attempt to make certain that Hardaway fully understood his rights. This failure to perform any affirmative actions to protect Hardaway's interests prevented the youth officer from satisfying the "friendly adult" requirement. Therefore, the mere presence of this youth officer did not suffice to render Hardaway's later confession voluntary. In sum, the district court found all of Hardaway's statements to be involuntary. The court chastised the State for Hardaway's 16-hour duration of questioning, the absence of a friendly adult or an attorney for most of the questioning, and the passive youth officer, reasoning that these surrounding circumstances compelled the conclusion that Hardaway's confession to murder was coerced and inadmissible. The district court thus granted Hardaway's writ of habeas corpus.

\[\text{Id. (quoting Clewis v. Texas, 386 U.S. 707, 710 (1967)).}\]
\[\text{Id. at 1016.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Hardaway, 162 F. Supp. 2d at 1016.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Hardaway, 162 F. Supp. 2d at 1017.}\]
\[\text{Id.}\]
\[\text{Id.}\]
B. *The Circuit Court Decision: Very Voluntary*

When the State appealed the district court’s decision, the Seventh Circuit Court of Appeals revisited the issue of whether federal habeas relief was proper for the alleged violation of Hardaway’s Fifth Amendment right to be free from compelled self-incrimination.\(^{120}\) The court of appeals also invoked the totality of the circumstances test, examining Hardaway’s age, experience, education, background, intelligence, and the circumstances regarding the confession.\(^{121}\) The court placed heavy emphasis on the need for “special caution” in determining the voluntariness of a juvenile’s confession, and acknowledged that the trial court and state appellate court properly recognized this need for special care.\(^{122}\)

The court of appeals then examined the trinity of cases from the United States Supreme Court – *Haley*, *Gallegos*, and *Gault* – upon which the district court relied as precedent supporting its conclusion that Hardaway’s confession was involuntary.\(^{123}\) It distinguished Hardaway’s case from *Haley* in that Hardaway’s parents were not kept away, Hardaway was not questioned around midnight, he was not held for three days like the suspect in *Haley*, and Hardaway received breaks in questioning whereas the suspect in *Haley* was questioned for five consecutive hours.\(^{124}\) Next, the court of appeals examined *Gallegos*, and found this case to be more on point.\(^{125}\) As previously stated, the 14-year-old suspect in *Gallegos* confessed to assault and robbery.\(^{126}\) This confession was elicited “immediately” after the suspect’s arrest.\(^{127}\) Shortly thereafter, the boy was detained in a juvenile hall for five days.\(^{128}\) During this period, he was not permitted any visitors, nor did he request to see his parents or an attorney.\(^{129}\) The juvenile signed a confession at the end of his five day detention.\(^{130}\) The court, while noting the absence of any prolonged questioning or fear tactics, nonetheless held the confession involuntary under the totality of the circumstances.\(^{131}\)

\(^{120}\) *Hardaway v. Young*, 302 F.3d 757, 762 (7th Cir. 2002).

\(^{121}\) *Id.*

\(^{122}\) *Id.*

\(^{123}\) *Id.* at 762-63.

\(^{124}\) *Id.*

\(^{125}\) *Id.* at 763.


\(^{127}\) *Id.*

\(^{128}\) *Id.*

\(^{129}\) *Id.*

\(^{130}\) *Id.*

\(^{131}\) *Id.* at 54. Here the court reasoned that:

[A] 14-year-old boy, no matter how sophisticated, is unlikely to have any conception of what will confront him when he is made accessible only to the police . . . . He
The Seventh Circuit Court of Appeals noted that, if *Gallegos* were its only measure, then indeed federal habeas relief would likely be proper in Hardaway's case. However, the court distinguished the reasoning in *Gallegos* by pointing out that later decisions, such as *Fare v. Michael C.*, signified that the mere absence of a friendly adult does not automatically render a juvenile confession involuntary. The United States Supreme Court found a 16-year-old's murder confession in *Fare* to be voluntary under the totality of the circumstances. Those circumstances included the defendant's prior criminal record, demonstrated intellectual capability (relevant to comprehension of rights), absence of police threats, intimidation, or trickery, and absence of a friendly adult.

The Seventh Circuit Court of Appeals then proceeded by rebutting what it viewed as the district court's three main factors indicating coercion: Hardaway's age, the *de facto* absence of a friendly adult, and the length and nature of the interrogation. Age was one factor on which heavy emphasis was placed. The court of appeals quoted a number of Illinois laws which treated children differently than adults, including laws prohibiting minors from marrying, smoking, driving, as well as laws imposing curfews on minors. The court acknowledged that the decision to waive *Miranda* rights and voluntarily confess was doubtless a difficult decision for a 14-year-old. The court, however, rejected Hardaway's interpretation of *Gallegos* as imposing a rule that a child under the age of sixteen was *per se* unable to waive his rights and voluntarily confess. Instead, the court reasoned that the *Fare* decision required that the totality of circumstances be examined, rather than allowing one factor to be dispositive of the voluntariness issue. Even the *Gallegos* decision utilized a totality of the circumstances test rather than letting age be solely dispositive of would have no way of knowing what the consequences of his confession were without the advice as to his rights – from someone concerned with securing him those rights.

*Id.*

132 Hardaway v. Young, 302 F.3d 757, 763 (7th Cir. 2002).
134 *Hardaway*, 302 F.3d at 763.
136 *Id.* The district court attempted to distinguish *Fare*, citing that "Hardaway was two years younger than the defendant in *Fare*, had no prior convictions and was subjected to over 10 hours of repeated interrogations." *Hardaway v. Young*, 162 F. Supp. 2d 1005, 1015 n.11 (N.D. Ill. 2001).
137 *Hardaway*, 302 F.3d at 763.
138 *Id.* at 763-64.
139 *Id.* at 764.
140 *Id.*
141 *Id.*
142 *Id.*
an involuntary confession. Another reason for rejecting Hardaway’s suggestion was that the Seventh Circuit Court of Appeals previously upheld the murder confession of another 14-year-old on habeas review in *Johnson v. Trigg.* So while youth was a factor to be closely scrutinized, it was not available as a catchall for involuntary confessions.

The second factor that the court examined was the absence of a friendly adult. Hardaway’s parents did not accompany him to the station, and he did not request an attorney. Although there was a youth officer present for the latter portion of Hardaway’s confession, the court of appeals agreed with the district court that the officer’s passive presence did not do much to guard Hardaway against undue police influence. The court stressed that a youth officer who acted merely as an observer did not fulfill the “friendly adult” requirement for purposes of the totality of the circumstances test. Though agreeing with the district court on this point, the Seventh Circuit Court of Appeals concluded that the absence of a friendly adult was also not dispositive! The reason for this was that “neither federal statutory nor constitutional law require[d] that a juvenile’s parents be notified prior to obtaining a confession.” Thus, the mere absence of an adult, by itself, similarly did not render the confession involuntary.

The third factor that the court examined was the duration of the interrogation. Hardaway was detained at the police station from 8:30 a.m. to midnight. During this time, Hardaway was interviewed intermittently, and left alone for a substantial portion of the total duration of his detention. Therefore, as the court of appeals noted, it was misleading for Hardaway to assert that he was interrogated for sixteen hours. The court also rejected Hardaway’s sleep deprivation assertion, citing the absence of a necessity to provide sleeping accommodations between the hours of 8:30 a.m. and 4:30 p.m. (4:30 p.m. being the time at which Hardaway first confessed), when most eighth graders would be

---

144 28 F.3d 639, 642 (7th Cir. 1994).
145 *Hardaway,* 302 F.3d at 765.
146 *Id.*
147 *Id.*
148 *Id.* (stating “Geraci [the youth officer] provided about as much assistance as a potted plant”).
149 *Id.* (citing *People v. McDaniel,* 762 N.E.2d 1086, 1097-98 (Ill. App. Ct. 2001), a case in which an Illinois appellate court reversed a conviction under state law where a youth officer took no interest in protecting the juvenile defendant’s welfare).
150 *Id.*
151 *Hardaway,* 302 F.3d at 765.
152 *Id.* at 765-66.
153 *Id.* at 766.
154 *Id.*
155 *Id.*
156 *Id.*
The court contrasted Hardaway's ninety minutes of interrogation prior to confession with the defendant's five hours of interrogation prior to confession in *Haley.* The court also noted that the police did not mistreat or abuse Hardaway in any way. Rather, the officers questioned Hardaway in an up-front manner, confronting him with truthful statements of two witnesses whose stories contradicted his own statements. These circumstances did not suggest that Hardaway's confession was coerced.

Another factor that was interrelated with the duration of Hardaway's detention was psychological pressure. The court noted that juveniles are more susceptible to such pressure, being less mature and resilient than adults. True, Hardaway may have experienced psychological pressure being scared, hungry, tired, and alone in a police station interrogation room. However, the court could not set aside the trial court's findings unless they were unreasonable, which the court of appeals did not hold. First, as previously stated, Hardaway was not subjected to any police abuse. He was not subjected to psychological tricks, and a photograph of him taken at the station did not show any signs of abuse. Second, Hardaway's extensive prior record evidenced his experience with the criminal justice system. As previously stated, he had been arrested nineteen times on various charges. He had appeared in juvenile court with appointed counsel seven times. Third, Hardaway demonstrated an understanding of his *Miranda* rights and the consequences of waiving them. Not only did he expressly claim to understand them, but he also relayed his rights in his own words to the Assistant State's Attorney without incident. This accurate recitation by Hardaway indicated that he had at least a basic comprehension of his rights. Furthermore, his intelligence test scores

---

157 *Hardaway,* 302 F.3d at 766.
158 Id.
159 Id. Here the court of appeals cited Woods v. Clusen, 794 F.2d 293, 297 (7th Cir. 1986), a case which granted a writ of habeas corpus to a 16-year-old suspect who was handcuffed, made to strip and wear jail clothes, questioned for lengthy periods of time without a break, showed graphic pictures of the murder scene, and to whom the officers misrepresented evidence that they allegedly had proving his guilt.
160 *Hardaway,* 302 F.3d at 766.
161 Id.
162 Id.
163 Id.
164 Id.
165 Id. at 766-67.
166 *Hardaway,* 302 F.3d at 767.
167 Id.
168 Id.
169 Id.
170 Id.
171 Id.
172 *Hardaway,* 302 F.3d at 767.
173 Id.
indicated that he had an IQ of ninety-five (average is one hundred\textsuperscript{174}) and an educational performance level of a sixth grader.\textsuperscript{175} Considering all of these factors, the court held that the duration of Hardaway's detention and any psychological pressure he may have been under did not render his confession involuntary.\textsuperscript{176}

In sum, the court of appeals concluded that the Illinois trial court's determination of the voluntariness of Hardaway's confession was not unreasonable in light of the totality of the circumstances.\textsuperscript{177} The court noted that the district court's wariness regarding Hardaway's youth, the absence of a friendly adult, and the duration of his interrogation were factors that worked against the voluntariness of his confession.\textsuperscript{178} However, the court accepted the Illinois trial court's findings, and reasoned that these surrounding circumstances\textsuperscript{179} compelled the conclusion that Hardaway's confession for murder was not coerced and was therefore admissible.\textsuperscript{180} The court of appeals accordingly reversed the district court's grant of Hardaway's writ of habeas corpus.\textsuperscript{181}

C. Voluntary or Coerced: A Close Call at the Finish Line?

One must concede that the totality of the circumstances test is somewhat subjective.\textsuperscript{182} In reality, it seems to be partially subjective and partially objective.\textsuperscript{183} The veritable consensus among various jurisdictions utilizing this test to determine the voluntariness of juvenile confessions supports the test's objectivity.\textsuperscript{184} However, some of these cases contain such a close mix of factors

\begin{itemize}
  \item \textsuperscript{174} American Mensa, \textit{IQ Facts}, at http://www.us.mensa.org/ttnscore.php.
  \item \textsuperscript{175} \textit{Hardaway}, 302 F.3d at 767.
  \item \textsuperscript{176} \textit{Id}.
  \item \textsuperscript{177} \textit{Id} at 768.
  \item \textsuperscript{178} \textit{Id} at 767.
  \item \textsuperscript{179} These circumstances, in sum, included "the lack of any apparent coercion by the police, Hardaway's recitation of his rights, his mental capacity, and his past experience with the criminal justice system." \textit{Id}. at 768.
  \item \textsuperscript{180} \textit{Id}.
  \item \textsuperscript{181} \textit{Hardaway}, 302 F.3d at 768.
  \item \textsuperscript{184} Mlyniec, \textit{supra} note 5, at 1901-02. Mlyniec provided an objective list of factors that he conceded "most courts focus on" when examining an interrogation and resultant confession, including:
    \begin{itemize}
      \item (1) age of the accused;
      \item (2) education of the accused;
    \end{itemize}
\end{itemize}
as to make the subjective will of the court the ultimate deciding factor. With a different panel of judges on a different day, perhaps Hardaway's confession would have been held involuntary. It is under very close factual circumstances that the results in these cases could easily go either way.

Hardaway was not such a case. Consider the procedural history. The Illinois trial court held the confession to be voluntary. The Illinois appellate court agreed that it was voluntary. The Supreme Court of Illinois denied review. The United States District Court for the Northern District of Illinois held that the confession was coerced. The Seventh Circuit Court of Appeals found the confession to be voluntary. The United States Supreme Court denied certiorari. Bottom line: it was not all that close. In this long line of exhausted appeals, the federal district court was the sole body to characterize the confession as coerced. The consensus amongst the remaining courts helps to dispel any gross imposition of subjectivity and reaffirms the Seventh Circuit Court of Appeals' decision upholding the voluntariness of Hardaway's confession.

(3) knowledge of the accused as to both the substance of the charge, if any has been filed, and the nature of his rights to consult with an attorney and remain silent;
(4) whether the accused is held incommunicado or allowed to consult with relatives, friends or an attorney;
(5) whether the accused was interrogated before or after formal charges had been filed;
(6) methods used in interrogation;
(7) length of interrogations;
(8) whether vel non the accused refused to voluntarily give statements on prior occasions; and
(9) whether the accused has repudiated an extra judicial statement at a later date.

Id. It should be noted, however, that Mlyniec immediately negated the adequacy of examination of these factors to determine a juvenile's capacity to knowingly and intelligently waive his rights. Id. See Lisa M. Krzewinski, Note, But I didn't do it: Protecting the Rights of Juveniles During Interrogation, 22 B.C. THIRD WORLD L.J. 355, 370-71 (2002).

See Monique Anne Gaylor, Note, Postcards From The Bench: Federal Habeas Review of Unarticulated State Court Decisions, 31 HOFSTRA L. REV. 1263, 1293 (2003) (pointing to the deference warranted under the 2254(d)(1) "unreasonable application" prong of the habeas test as a major factor in generating the court of appeals' "reluctant conclusion" in Hardaway's case).

See id.

Hardaway, 302 F.3d at 761.


People v. Hardaway, 731 N.E.2d 767 (Ill. 2000).


Hardaway, 302 F.3d at 768.


Hardaway, 162 F. Supp. 2d at 1017.

See Hardaway v. Young, 302 F.3d 757 (7th Cir. 2002).
The federal district court took a dual approach to analyzing Hardaway’s confessions, an approach not taken by the Seventh Circuit Court of Appeals.\textsuperscript{196} The district court initially looked at Hardaway’s statements during the first ten hours, while there was no friendly adult present to protect Hardaway’s interests.\textsuperscript{197} Concluding that these initial statements were involuntary and that the “taint” from these statements had not yet dissipated by the time there was a youth officer present, the district court found Hardaway’s later statements to be involuntary as well.\textsuperscript{198} The court of appeals, by contrast, attacked the district court’s analysis by taking a broader view of the circumstances surrounding the interrogation, and refusing to consider any one circumstance as dispositive.\textsuperscript{199} Which approach was more equitable here? Which approach was a more fair use of the totality of the circumstances test considering Hardaway’s young age? If one takes the totality of the circumstances to be just that – the \textit{totality} – it would appear that the court of appeals’ application of the test more genuinely serves the central theme of the test.\textsuperscript{200} Rather than separating the day into segments of time defined by the circumstances prevailing within each specific segment, the court of appeals analyzed the circumstances contained within the entire sixteen-hour duration and examined the possibility of an involuntary confession from that standpoint.\textsuperscript{201} If the totality of the circumstances test is to remain truly objective, or at least as objective as possible, then this overarching approach better avoids the possibility of any one factor swaying the subjective views of courts.\textsuperscript{202}

\section*{V. A Psychological and Sociological Perspective on Juvenile Waiver of Fifth Amendment Rights}

The Seventh Circuit Court of Appeals noted that the possible “psychological tension” surrounding Hardaway’s confession was not sufficient to render it involuntary.\textsuperscript{203} The narrow focus of this section offers a scientific perspective on why \textit{Hardaway v. Young} was correctly decided. First, it will examine psychology’s role in how a juvenile approaches a confession. Second, the impact of sociological influences will be considered.

\textsuperscript{196} Id. at 762-68.
\textsuperscript{197} \textit{Hardaway}, 162 F. Supp. 2d at 1015.
\textsuperscript{198} Id. at 1016.
\textsuperscript{199} \textit{Hardaway}, 302 F.3d at 763-68.
\textsuperscript{200} See \textit{Fare v. Michael C.}, 442 U.S. 707, 725-26 (1979) (stating “[t]he totality approach permits - indeed, it mandates - inquiry into all the circumstances surrounding the interrogation”). Id. at 725.
\textsuperscript{201} \textit{Hardaway}, 302 F.3d at 762-68.
\textsuperscript{202} See id.
\textsuperscript{203} Id. at 766-67.
A. Piaget's Ponderables and Other Psychological Principles

Developmental psychology involves the study of physical, intellectual, emotional, and social changes throughout a human being's life cycle.\(^\text{204}\) The psychology of adolescent development may shed some light on the inner workings of these young minds to aid in the differentiation between voluntary and coerced confessions.\(^\text{205}\)

1. Nature versus Nurture

Some psychologists believe that psychological development is primarily a function of an individual's genes.\(^\text{206}\) These are the nativists, following the "nature" side of the debate.\(^\text{207}\) Others believe that psychological development is largely a product of one's environment (home, school, community, culture).\(^\text{208}\) These are the empiricists, following the "nurture" side of the debate.\(^\text{209}\)

As previously mentioned, the totality of the circumstances approach to determining the voluntariness of juvenile confessions takes into consideration the suspect's age, experience, education, background, intelligence, and capacity to understand Miranda warnings and Fifth Amendment rights and the waiving of these rights.\(^\text{210}\) This test appears to walk the line between the nature and nurture theories of psychological development.\(^\text{211}\) A juvenile offender's age, intelligence, and capacity for understanding complex concepts would fall in line with the nature theory, as these factors are ultimately a function of genetics.\(^\text{212}\) A juvenile offender's experience, education, and background involve more nurture aspects, and are ultimately a function of an individual's environment.\(^\text{213}\) As a result, this test encompasses a wide range of psychological and physical factors.\(^\text{214}\)

\(^\text{204}\) YOUTH ON TRIAL: A DEVELOPMENTAL PERSPECTIVE ON JUVENILE JUSTICE 21 (Thomas Grisso & Robert G. Schwartz eds., 2000).

\(^\text{205}\) See infra Part V.A.1.

\(^\text{206}\) DAVID MOSHMAN, ADOLESCENT PSYCHOLOGICAL DEVELOPMENT: RATIONALITY, MORALITY, AND IDENTITY 3 (1999).

\(^\text{207}\) Id.

\(^\text{208}\) Id.

\(^\text{209}\) Id.

\(^\text{210}\) Alvarado v. Hickman, 316 F.3d 841, 854 (9th Cir. 2002).

\(^\text{211}\) See infra text accompanying note 212.

\(^\text{212}\) Hugh Miller, III, DNA Blueprints, Personhood, and Genetic Privacy, 8 HEALTH MATRIX 179, 204 (1998) (stating DNA structures may determine physical traits, such as sex and race, as well as many mental traits, such as IQ and emotional temperament). Cf. Maxwell J. Mehlman, The Law of Above Averages: Leveling the New Genetic Enhancement Playing Field, 85 IOWA L. REV. 517, 521 n.16 (2000) (citing studies of twins raised separately, the results of which suggest that traits such as personality and cognition are genetically influenced).

\(^\text{213}\) Miller, supra note 212, at 205.

\(^\text{214}\) See id.
The totality of the circumstances test survives mere common sense justification. From this brief psychological perspective, it appears to cover sufficient enough ground that the nativists and empiricists would be satisfied, at least in that their respective views would both have representation in the test. Therefore, at first blush, the Hardaway court and others that utilize this test appear to be employing the most equitable method to determine the voluntariness of juvenile confessions.

2. Piaget’s Theory of Formal Operations

Noted psychologist Jean Piaget theorized that, through childhood and adolescence, individuals’ psychological development reflects a maturation of rational cognitive abilities. He believed that by age nine or ten, children could perform acts involving sophisticated reasoning and understanding. Around age eleven, children begin to develop an even higher form of cognition, which Piaget called “formal operations,” centering around the active creation of reality from available behavioral choices. In other words, adolescents at this stage are able to independently generate possible outcomes in their own minds, and then act accordingly to create their own realities (instead of considering possibilities with respect to the confines of reality).

By analyzing the child’s perspective, one could say this “formal operations” stage is the point at which an individual begins to exert more sophisticated control over his choices. This suggests that juveniles at this stage do in fact have control over whether or not to confess to wrongful behavior, rather than fabricating a confession purely as some sort of negative stimulus response to police pressure.

3. Piaget and Hardaway Go Head to Head

The court in Hardaway examined the juvenile’s age, background, and past criminal record, and inquired as to whether he had the capacity to understand the Miranda warnings, the nature of his Fifth Amendment rights, and the

215 See supra note 210 and accompanying text.
216 The equitable nature of the totality of the circumstances test is bolstered by its inclusion of both genetic and environmental factors, since very few people today would attach any validity to a purely nativist or purely empiricist approach to behavior. See Mehlman, supra note 212, at 521 n.15.
217 Moshman, supra note 206, at 7.
218 Id. at 11.
219 Id. at 11-12.
220 Id.
221 Mlyniec, supra note 5, at 1880-83.
222 See id.
consequences of waiving those rights. In utilizing the totality of the circumstances test, the court concluded that Hardaway's confession was in fact voluntary.

It may be argued that Hardaway, left alone for many hours at the police station, having no family members around, having a useless youth officer present, and being subjected to numerous questioning sessions, confessed only because the police overcame the his will to withstand the constant underlying psychological pressure. In fact, the Seventh Circuit Court of Appeals expressed sympathy towards the juvenile offender, and off-handedly questioned the voluntariness of his confession. Nonetheless, the court specifically denounced any police utilization of "psychological tricks" and reversed the district court's grant of Hardaway's habeas corpus petition.

If one accepts the aforementioned psychological theories of development, then the surrounding circumstances in this case reinforce the court's decision. Hardaway lied to law enforcement officials three times before producing a truthful confession, and he only confessed when confronted with evidence that directly contravened his versions of the events. This does not suggest a na"ive child being forced down a path by police. On the contrary, it suggests that Hardaway was making a conscious, rationalized choice to keep the true facts concealed so as to avoid facing the repercussions of his actions. Even the duration of his detention supports this assertion, since Hardaway did not confess to the true version of events until many hours after his arrival at the station, long after the repeated relaying of his *Miranda* rights and his demonstrated comprehension of these rights.

---

223 Hardaway v. Young, 302 F.3d 757, 762-68 (7th Cir. 2002).
224 Id. at 768.
225 Id. at 766-67. See also *Miranda v. Arizona*, 384 U.S. 436, 448 (1966) (stressing that "the modern practice of in-custody interrogation is psychologically rather than physically oriented").
226 *Hardaway*, 302 F.3d at 766-67. The court stated:

[i]f we were a state appellate court, we might well find that on balance the psychological tension caused by leaving a boy of 14 alone in an interview room, hungry, scared, and tired, was enough to exclude the confession. But we may set aside the contrary findings of the Illinois trial and appellate courts only if their determination was unreasonable . . . [and] there are arguments [here] that pass the lenient test of "reasonableness" in favor of finding the confession voluntary.

227 Id. at 766-67.
228 Id. at 767-68.
229 Id. at 760.
230 *Id.*
231 Id. at 760-61.
juvenile’s will down by any type of verbal, physical, or psychological abuse, this reinforces the voluntariness of the confession once the truth was finally unearthed. Hardaway did not confess until the facts, corroborated by witnesses, gave him no other option. The truth, not the police, spurred his confession.

**B. Putting a Sociological Wrench in the Works**

Society is the ultimate judge of punishment, because it is the changing norms of society that dictate what is acceptable and unacceptable. Some say that changing societal attitudes towards juvenile offenders are partially and inaccurately fueled by modern media. This, it is argued, has resulted in an unjust increase in harsher punishments for juvenile offenders. Does the Hardaway case reflect such desensitization towards today’s youthful offenders?

1. The Juvenile “Superpredator”

With the increase of violent juvenile crime in the late 1980’s and early 1990’s, many believed that a more aggressive breed of juvenile offender (the “superpredator”) was on the rise. It was thought that violence was more of an accepted, integral part of the lives of this breed of juvenile delinquents. This perception prompted many states to change their laws dealing with transfer of juveniles to the adult criminal justice system, making it easier to try these “superpredators” as adults. An obvious consequence of these statutory amendments is that juveniles are susceptible to more severe and longer sentences once transferred to adult criminal court.

---

232 See supra Part III.
233 Hardaway, 302 F.3d at 760.
234 See id. at 768.
235 See generally Ronald J. Rychlak, Society’s Moral Right To Punish: A Further Exploration of the Denunciation Theory of Punishment, 65 Tul. L. Rev. 299 (1990) (discussing the denunciation theory of punishment, which justifies punishment “when the offender has violated the rules that society has used to define itself”).
237 Id.
239 Id.
240 Id. See also Moore, supra note 236, at 126 (insisting that the perception that violent juvenile crime is on the rise has “motivated the nation to ‘get tough’ on crime committed by juveniles”).
241 Hodson, supra note 15, at 82.
2. Reality

So are more extreme measures necessary to ward off this predicted wave of superpredator adolescents and teens? Contrary to popular belief, statistics compiled by the Federal Bureau of Investigation show that violent juvenile crime has progressively decreased every year from its peak in the mid 1990's to the present.242 Murder data, purported to be the most complete because it is a crime that is almost always reported, shows that juvenile arrests for murder have dropped 55% between 1996 and 2000, there being an estimated 1200 juvenile arrests for murder in the year 2000.243 Perhaps the continued decrease reflects that the states’ “toughening up” of their laws regarding juvenile transfer to adult criminal court has in fact had some deterrent effect not only upon the juveniles punished, but also upon their peers.244

Maybe society has been too harsh, too quick to judge this supposedly emerging trend of vicious juvenile violence. Although the data sources consulted often seem to take a positive tone when discussing these juvenile crime statistics, the remaining numbers still speak volumes.245 In the year 2000 alone, over 2.3 million juvenile arrests were made.246 Furthermore, this data reflects arrest numbers, not the number of crimes committed within each arrest.247 While it is true that this number is down from the over 2.4 million estimated number of juvenile arrests in 1999,248 the overtly high numbers still do not serve as grounds for celebration.249 Compare the aforementioned 1200 juvenile arrests for murder in the year 2000 to that same year’s arrest of 4500 juveniles for forcible rape, 26,800 for robbery, and 66,300 for aggravated assault.250 Property crimes committed by juveniles in the year 2000 accounted for an even larger number of the total arrests, including 95,800 for burglary, 363,500 for larceny-theft, 50,800 for motor vehicle theft, and 8,700 for arson.251

243 Id.
244 This hypothesis reflects the utilitarian theory of punishment, which centers around the effect of punishment on potential lawbreakers (including deterrence, rehabilitation, and incapacitation). Rychlak, supra note 235, at 308-14, 322-25.
245 This observation is based on the perception that the primary emphasis of the data is the percentage decrease rather than the actual remaining number of juvenile arrests. See Snyder, supra note 242.
246 Snyder, supra note 242.
247 Id.
248 Myths, supra note 238.
249 Id.
250 Snyder, supra note 242.
251 Id.
These numbers may be lower than in past years, but by no means do they reflect an acceptable decrease in crimes committed by juveniles. 252

3. Society's Branding of Hardaway: Scarlet Letter or Justified Punishment?

How do these statistics relate to 14-year-old Derrick Hardaway's confession and subsequent murder conviction? Considering the surrounding circumstances, Hardaway does appear to fit the "superpredator" mold. 253 He stood by and watched his brother put two bullets in the back of an 11-year-old fellow gang member's head. 254 He lied to police about it—three times. 255 He confessed only when it was obvious that he was caught in a bind. 256 It is similar to a child being caught with one hand in the cookie jar, only Hardaway was caught with one hand in a calculated murder plot. 257

There are some circumstances that support giving Hardaway a break. 258 He was supposedly ordered by the leader of his gang to conduct this inside hit, and his older brother, surely a trusted family member, accompanied him. 259 This situation appeared to be a classic example of the power of peer pressure. 260 On the other hand, gang membership does not readily lend itself to society's sympathies. 261 Hardaway made the choice to get involved with this gang, and more than likely it was an informed decision. 262 Referring back to the previously analyzed psychological models, he made the conscious decision to connect himself with a force that he had to have known was involved in unlawful undertakings. 263 Peer pressure as a justification for murder is definitely not a recognized social norm. 264

---


253 See supra Part V.B.1.


255 Hardaway v. Young, 302 F.3d 757, 760-61 (7th Cir. 2002).

256 Id. at 760.


259 Hardaway, 718 N.E.2d at 687-88.

260 See Mlyniec, supra note 5, at 1883.


262 See Hardaway, 718 N.E.2d at 685-88.

263 See supra Part V.A.2.

264 For a more in-depth analysis of social norms see Cass R. Sunstein, Social Norms and Social Roles, 96 COLUM. L. REV. 903 (1996).
C. Caveat: Keeping Police Coercion in Check

What must, of course, be kept in mind is the continued heightened judicial scrutiny applied to police procedures in handling juveniles, especially very young children. While juveniles should be held to their convictions if and when circumstances dictate, this is not to say that police should have free rein to exert even minimally coercive strategies to illicit juvenile confessions.

Certain safeguards may help guard against rampant police coercion. At the judicial level, the totality of the circumstances test seems to do a fair job in determining the level of coercion on a case-by-case basis. This, however, may not be enough. Steps should be taken "on the home front," that is, in the police station, where the confession usually occurs. In other words, it is up to individual police and state departments to make sure that increasingly negative societal views towards juveniles do not automatically color law enforcement officials' opinions and treatment of juveniles. This is a large-scale goal, impossible to tackle here, but one of the many open questions to be determined in the future.

D. Beyond Hardaway

Another open question has to do with just how low the "age of voluntary capacity" as far as confession and cognizant waiver of rights should go. Where should the line be drawn? This is a difficult and complex question that has to take into account many factors, including our ever-changing society, individual psychology, economics, current crime trends, etc. It is not a question that can be readily answered. Recent data shows that approximately 230,800 juveniles age 12 and under were arrested in 1999. While there is evidence that younger and younger juveniles are becoming the subjects of criminal arrest, there does not appear to be much empirical psychological or sociological research on this trend. The ability of these younger age groups to make conscious and rational decisions to waive Fifth Amendment rights and voluntarily confess thus leads courts into murky waters without enough scientific background to make steadfast determinations. Until more research is done, there can be no consistent or truly fair treatment of these younger juvenile offenders.

265 Hardaway v. Young, 302 F.3d 757, 762 (7th Cir. 2002).
267 See supra note 35 and accompanying text.
268 See Mlyniec, supra note 5, at 1910-11.
269 See id.
270 See id.
271 See Mlyniec, supra note 5, at 1894-1903.
272 Findings, supra note 252.
273 Id.
274 Id.
VI. CONCLUSION

As the foregoing analysis illustrates, coercion of juvenile confessions is a difficult issue to address. Courts closely scrutinize this issue when a confession plays a role in a juvenile’s conviction. The totality of the circumstances approach, clearly the majority, is the most equitable method currently available to discern the voluntariness of juvenile confessions. This method, combined with heightened judicial scrutiny, provides adequate insurance against the admission of coerced juvenile confessions.

The impact of our changing society may alter how the totality of the circumstances test is applied in the future. With children becoming increasingly enmeshed in criminal activity, society’s tolerance for the wayward behavior of these children may decrease as the violence of the crimes undertaken by younger age groups increases. Hopefully, courts will take psychological and sociological research into consideration in order to more efficiently promote the proper level of justice commensurate with the applicable circumstances surrounding these juvenile crimes.

275 Hardaway v. Young, 302 F.3d 757, 762 (7th Cir. 2002).
276 Contra Krzewinski, supra note 185, at 368-69. Krzewinski advocates total abandonment of the totality of the circumstances test. Id. Instead, she urges for an adoption of a per se rule which automatically excludes any statements made by juvenile suspects under the age of 16 who were not accompanied by an interested adult at the time of confession. Id. at 368. She notes that this rule would not be applicable to juveniles 16 and older. Id. at 369. Further, Krzewinski insists that the suspect’s Miranda rights must be understood by both the juvenile and the adult accompanying him or her. Id. The burden would be on the defense to prove that the juvenile’s statements were involuntary. Id.
277 See supra Part V.
278 See supra Part V.B.
MERGER AGREEMENTS POST-OMNICARE, INC. V. NCS HEALTHCARE, INC.: HOW THE DELAWARE SUPREME COURT PULLED THE PLUG ON "MATHEMATICAL LOCK-UPS"

by Jay H. Knight*

I. INTRODUCTION

II. BACKGROUND
   A. Deal Protection Provisions Generally
      1. Termination Fees
      2. No-Talk/No-Shop Provisions
      1. The Business Judgment Rule
      2. Enhanced Judicial Scrutiny

III. THE FACTUAL BACKGROUND OF OMNICARE, INC. V. NCS HEALTHCARE, INC.
   A. The Facts
      1. Genesis’ Initial Proposal
      2. Omnicare Re-enters the Race
      3. Genesis Improves Its Offer
      4. Specifics of the NCS/Genesis Merger Agreement
      5. Specifics of the Voting Agreements
      6. Omnicare’s Superior Proposal
      7. Omnicare and Stockholders of NCS File Suit
   B. The Majority Opinion
   C. The Dissenting Opinions

IV. ANALYSIS
   A. What was the Underlying Reasoning in Omnicare?
   B. Effects of the Omnicare Decision
      1. Termination Fees Revisited
      2. Renewed Interest in Stock Lock-ups
      3. What’s Left for Voting Agreements?

V. CONCLUSION

* Jay H. Knight is a J.D. candidate for 2005 at Salmon P. Chase College of Law, Northern Kentucky University. He earned a B.B.A. in Finance from Eastern Kentucky University in May 2000. Special thanks to Professor William K. Sjostrom, Jr. for his helpful insight into the world of mergers and acquisitions.
I. INTRODUCTION

In April 2003, the Delaware Supreme Court released a much anticipated decision delineating the extent to which public corporations may "lock-in" a merger agreement. In *Omnicare, Inc. v. NCS Healthcare, Inc.*\(^1\) the court expanded previous precedent when it invalidated a merger agreement that mathematically "locked-in" stockholder approval.\(^2\) The court held that when a force-the-vote provision is coupled with a voting agreement signed by owners of a majority of voting power, there must be an effective fiduciary out clause so that the board can discharge its fiduciary duties.\(^3\) Although it may take several years for the impact of *Omnicare* to be completely absorbed, this note attempts to make several predictions with respect to how the court's decision may affect practitioners.

Given the complexity of corporate merger agreements and deal protection provisions, Section II attempts to provide a useful background. The section discusses deal protection provisions with an emphasis on termination fees and no-shop provisions. Section III provides a chronologically written and detailed description of the facts of *Omnicare*, along with a synopsis of both the majority and dissenting opinions. Section IV then provides an analysis of *Omnicare*. Section IV is not meant to be a critique of the court's decision. Instead it is meant to provide some of the author's thoughts on how *Omnicare* may affect merger agreements in the future. Section V concludes this article.

II. BACKGROUND

A. Deal Protection Provisions Generally

When two companies choose to merge, or one decides to acquire another, there is time between the public announcement of the acquisition agreement and the closing of the deal.\(^4\) During this brief interim, third party bidders may make a premium offer for the target.\(^5\) Although a higher offer equates with more consideration given to the stockholders, both targets and acquirors may want to minimize interference from outside parties during the time between the merger

---
\(^1\) 818 A.2d 914 (Del. 2003).
\(^2\) Id.
\(^3\) Id. at 939.
\(^4\) See Sean J. Griffith, *Deal Protection Provisions In The Last Period of Play*, 71 FORDHAM L. REV. 1899, 1900 n.2 (2003). This delay may be caused by the need to obtain regulatory approval and stockholder approval. Del. Code Ann. tit. 8, § 251(c) (2003). Stockholder consent entails, for public companies, the preparation of a proxy statement and the solicitation of proxies in compliance with federal securities laws, and giving the stockholders due notice, at least twenty days, of a stockholder's meeting. Id.
\(^5\) Griffith, *supra* note 4, at 1900.
agreement and the stockholder vote. The acquiror will want assurance in the deal because of "significant sunk costs in the initial transaction, including the fees of legal and financial advisors, loan commitments, research and diligence costs, and perhaps most significantly, management time and foregone business opportunities." The target corporation may want to discourage an outside bidder because the proposed merger may present unique business opportunities that an outside bidder cannot match. Furthermore, if the acquiror is able to simply walk away from the deal, "the target may be left 'in play' without a suitable buyer." In order to minimize the risk of a third party intervening, merger agreements will often include deal protection provisions. The following sections will explain two of the most frequently used deal protection provisions, both of which were implemented in the merger agreement between Genesis and NCS Healthcare.

1. Termination Fees

A termination fee provision in the merger and acquisition arena is an agreement that, if the proposed transaction fails due to the fault of a party, the party at fault will pay a specified fee. Although there is no standardized amount, Delaware courts have consistently upheld termination fees amounting to

---

6 See id. at 1900.
7 Id.
8 Id. For example, in Paramount Communications, Inc. v. Time, Inc., 517 A.2d 1140 (Del. 1989), members of Time's outside directors feared that a merger with an entertainment company would divert Time's focus from news journalism and threaten the "Time Culture." Id. at 1143 n.4.
9 Recent case law in New York has restricted the ability of an acquiror from easily walking away from the deal. See In re IBP, Inc. S'holders Litig. v. Tyson Foods, Inc., 789 A.2d 14 (Del. Ch. 2001) (holding that Tyson Foods, Inc. (the acquiror) could not abandon its merger with IBP, Inc. because a downturn in the livestock market was not enough to qualify as a "material adverse effect"). Id. at 71.
10 Griffith, supra note 4, at 1901. A target is considered "in play" when the market knows that it is an acquisition candidate. Id. at 1901 n.5. In addition, the announcement of the merger agreement gives outside parties important information regarding the health of the target. Id.
11 Id. at 1901.
13 Also referred to as "bust-up" fees, "expense reimbursement provisions," or "break-up" fees. See Lou R. KLING & EILEEN NUGENT SIMON, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 13.05[2] (updated through Release 9, 1997). See generally Comment, Breaking-Up is Hard to Do: A Look at Braun v. Bell Atlantic and the Controversy over Termination Fees in Mergers and Acquisitions, 65 BROOK. L. REV. 585 (1999) (comparing a court's decision to review termination fees under the business judgment rule or under a liquidated damages rubric).
14 See KLING & SIMON, supra note 13, § 13.05[2] (discussing broadly how buyers and sellers can recoup some expenses).
2-4% of the deal value as reasonable and not coercive\textsuperscript{15} to stockholders.\textsuperscript{16} Termination fees are "designed to protect the transaction for the acquir[0]r, to make it more expensive for any third party to enter the bidding after an agreement has been announced, and to ensure the initial putative acquir[0]r that it will be appropriately compensated" if the deal were to deteriorate.\textsuperscript{17}

Historically, courts used the business judgment rule\textsuperscript{18} analysis to determine whether the fee was reasonable.\textsuperscript{19} Today most courts determine the reasonableness of a termination fee through a liquidated damages analysis.\textsuperscript{20} The following test is now followed by Delaware in determining whether the liquidated damage (i.e., termination fee) section of the merger agreement is valid:\textsuperscript{21}

\begin{enumerate}
\itemdamages that would result from a breach of the merger agreement must be uncertain or incapable of accurate calculation,"\textsuperscript{22} and
\itemThe termination fee must be a "reasonable forecast of actual damages" (i.e., not merely a penalty intended to punish the stockholders for not approving the merger).\textsuperscript{23}
\end{enumerate}

Thus, if the damages can not be calculated accurately and the termination fee is reasonable, this section of the agreement would be considered valid.\textsuperscript{24}

\textsuperscript{15} Brazen v. Bell Atl. Corp., 695 A.2d 43, 50 (Del. 1997). "Wrongful coercion that nullifies a stockholder vote may exist 'where the board or some other party takes actions which have the effect of causing the stockholders to vote in favor of the proposed transaction for some reason other than the merits of that transaction.'" \textit{Id}. Brazen involved a two-tiered $550 million termination fee. \textit{Id}. at 45. "First, either party would be required to pay $200 million if there were both a competing acquisition offer for that party and either (a) a failure to obtain stockholder approval, or (b) a termination of the agreement." \textit{Id}.


\textsuperscript{17} SIMON M. LORNE, ACQUISITIONS AND MERGERS: NEGOTIATED AND CONTESTED TRANSACTIONS § 2:23 (2003).

\textsuperscript{18} See discussion infra Part II.B.1.

\textsuperscript{19} See generally Brazen, 695 A.2d at 49-50 (ruling that a liquidated damages analysis should be used for termination fees).

\textsuperscript{20} \textit{Id}. This represents the anticipated loss by either party should the merger not occur. \textit{RESTATEMENT (SECOND) OF CONTRACTS} § 356 cmt. b (1981).

\textsuperscript{21} Brazen, 695 A.2d at 49-50.

\textsuperscript{22} \textit{Id}. at 48.

\textsuperscript{23} \textit{Id}.

\textsuperscript{24} \textit{Id}.
As a general rule, termination fees are upheld so long as the amount provided is not unreasonably high and stockholders are not coerced into voting in favor of the transaction because of the severity of the termination fee if they were to vote against it.\textsuperscript{25}

2. No-Talk/No-Shop Provisions

No-talk/no-shop provisions are another common technique employed to prevent third party bidders from intervening into negotiations between an acquiror and a target.\textsuperscript{26} An early step for two corporations when entering into negotiations is for the target to sign a “standstill” agreement, sometimes called an exclusivity agreement.\textsuperscript{27} The exclusivity agreement is a contract signed by the acquiror and target before the definitive merger agreement that restricts the ability of the target to negotiate with an outside party.\textsuperscript{28} It often provides that the target may negotiate with the acquiror for a specified period of time, typically two or three weeks.\textsuperscript{29} This agreement usually demands that the target will not, whether directly or indirectly: (1) solicit new proposals from any person other than the prospective acquiror, (2) provide any non-public information to an outside party, (3) entertain any proposal from an outside party, and (4) not disclose that negotiations between the prospective acquiror and the target are taking place.\textsuperscript{30} Because of the short two or three week duration, fiduciary out provisions are generally not included in this agreement.\textsuperscript{31}

When the acquiror and the target have agreed to sign a definitive merger agreement, often the acquiring company will want to include a provision in the agreement similar to the “standstill” agreement to prevent the acquiring company from being a “stalking horse”\textsuperscript{32} for other bidders.\textsuperscript{33} This provision is similar to the exclusivity agreement in that it prevents the target from engaging in discussions with third parties concerning an alternative acquisition.\textsuperscript{34}

The principal distinction between the “no-shop” provision contained within the merger agreement and the exclusivity agreement is the inclusion of a

\textsuperscript{25} See generally Coates & Subramanian, supra note 16, at 331-36 (discussing the trends in termination fees).
\textsuperscript{26} See LORNE, supra note 17, at § 2.24.
\textsuperscript{27} Negotiating Acquisitions of Public Companies, 10 U. MIAMI BUS. L. REV. 219, 221 (2002) [hereinafter Negotiating Acquisitions].
\textsuperscript{28} Id.
\textsuperscript{29} Id. at 229-30.
\textsuperscript{30} Id. at 273-74.
\textsuperscript{31} Id. at 231-32.
\textsuperscript{32} The term “stalking horse” refers to an acquiror’s initial bid which is then used by the target to attract higher offers. See In re Integrated Res., Inc., 147 B.R. 650, 661 (S.D.N.Y. 1992).
\textsuperscript{33} See Negotiating Acquisitions, supra note 27, at 219.
\textsuperscript{34} KLING & SIMON, supra note 13, at § 13.05[1].
"fiduciary out" clause. The latter allows the target to communicate with a third party if the target’s board determines that such discussions are required by its fiduciary duties to stockholders. In addition, the Delaware Court of Chancery has held that a target’s board must be fully informed before agreeing to a “no-shop” provision, otherwise it may breach its fiduciary duties by foreclosing on a better opportunity.

Typically, the “fiduciary out” clause authorizes the target board to speak with other bidders only if the board concludes “in good faith . . . based on the written advice of its outside legal counsel, that participating in such negotiations or discussions or furnishing such information is required in order to prevent the Board of Directors . . . from breaching its fiduciary duties to its stockholders . . .”


To decipher the complex reasoning of the court’s decision in Omnicare, Inc. v. NCS Healthcare, Inc., it is important to have a basic understanding of how Delaware reviews decisions by corporate boards of directors. This section will provide a concise look at the seminal cases that have molded judicial review of a board’s decision under Delaware corporate law.

1. The Business Judgment Rule

Stockholders who are displeased with the terms of the merger agreement may sue the board of directors claiming that the board violated its fiduciary duties. Prior to 1985, courts primarily applied the “business judgment” rule in determining whether or not the board of directors violated these duties. The business judgment rule is a “presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the

35 A fiduciary out clause has its basis in the restrictions placed on fiduciaries so that they are not induced into violating their duty to beneficiaries. RESTATEMENT (SECOND) OF CONTRACTS § 193 (1981). The section heading states: “A promise by a fiduciary to violate his fiduciary duty or a promise that tends to induce such a violation is unenforceable on grounds of public policy.” Id.
36 See KLING & SIMON, supra note 13, at § 13.05[1].
37 See Phelps Dodge Corp. v. McAllister, No. 17398, 1999 Del. Ch. LEXIS 202, at *3-4 (Del. Ch. Sept. 27, 1999) (ruling “even the decision not to negotiate . . . must be an informed one”).
38 ACE Ltd. v. Capital Re Corp., 747 A.2d 95, 98 (Del. Ch. 1999). This language is from a portion of a contract held valid in ACE Ltd. Id.
39 818 A.2d 914 (Del. 2003).
40 See DEL. CODE ANN. tit. 8, § 262 (2003). Displeased stockholders may also exercise appraisal rights. Id.
41 See discussion infra Part II.B.2.
42 FRANKLIN A. GEVURTZ, CORPORATION LAW § 7.2, at 654 (2000). Such a challenge might involve a duty of care or duty of loyalty claim. Id.
honest belief that the action taken was in the best interests of the company."43 Thus, the party attacking a board decision as uninformed must rebut the presumption that its business judgment was an informed one.44 Furthermore, the determination of whether a decision is informed hinges on whether the directors have educated themselves regarding all material information reasonably available to them prior to making their decision.45

The seminal case with regard to the application of the business judgment rule in the context of mergers and acquisitions is Smith v. Van Gorkom.46 The Van Gorkom court held that the directors of Trans Union breached their fiduciary duties to their stockholders "(1) by their failure to inform themselves of all information reasonably available to them . . . ; and (2) by their failure to disclose all material information such as a reasonable stockholder would consider important in deciding whether to approve the . . . offer."47

The business judgment rule is important to stockholder-plaintiffs because absent a showing of bad faith or uninformed decision-making, a court will not hold directors liable for their decisions, even poor decisions that adversely affect the corporation.48

2. Enhanced Judicial Scrutiny

The business judgment rule gives broad discretion to a company's board of directors in making decisions on behalf of the corporation.49 In the context of mergers and acquisitions, this discretion can become relatively complicated.50 When confronted with a possible change in corporate control, the board has an obligation to determine whether the offer is in the best interests of the corporation and its stockholders.51 In hostile takeovers, the board of directors may face numerous conflicts of interest, such as the possibility of losing their position on the board.52 In Unocal v. Mesa Petroleum Co.,53 the Delaware Supreme Court held:

Because of the omnipresent specter [in a takeover situation] that a board may be acting primarily in its own interests, rather than those

44 Id.
46 Id.
47 Id. at 893.
49 See supra notes 41-48 and accompanying text.
50 See infra notes 51-53.
51 Unocal, 493 A.2d at 955.
52 Id.
53 Id. at 946.
of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.\textsuperscript{54}

With this in mind, when a board might be tempted to further its own interests ahead of the interests of the stockholders, judicial scrutiny may be triggered.\textsuperscript{55}

Unocal formulated a two-part test for reviewing directors' decisions to employ takeover defenses before they would come within the ambit of the business judgment rule.\textsuperscript{56} First, the directors must show reasonable grounds for believing that a danger to corporate policy and effectiveness existed.\textsuperscript{57} Second, the defensive measures implemented must be reasonable in relation to the threat posed.\textsuperscript{58}

The Unocal test, unlike the business judgment rule, shifts the burden of proof to the directors to show a justification for their decision.\textsuperscript{59} In addition, because the defensive measure adopted must be "reasonable" in proportion to the perceived threat, courts use an objective inquiry when reviewing takeovers, unlike the more deferential presumption of the business judgment rule.\textsuperscript{60}

3. Heightened Level of Scrutiny Under Revlon v. MacAndrews & Forbes Holdings, Inc.\textsuperscript{61}

Delaware's final and most demanding standard resulted from a takeover bid for the cosmetics giant, Revlon, Inc.\textsuperscript{62} In Revlon, two companies were competing to acquire Revlon, Inc. – Pantry Pride (a hostile acquiror\textsuperscript{63}) and Forstmann (a "white knight")\textsuperscript{64}. In an attempt to ward off Pantry Pride (prior to signing any merger agreement), Revlon's board adopted a number of defensive

---

\textsuperscript{54} Id. at 954.

\textsuperscript{55} Id.

\textsuperscript{56} Id. at 955.

\textsuperscript{57} Unocal, 493 A.2d at 955. The first part of the Unocal test was first crafted in Cheff v. Mathes, 199 A.2d 548, 554-55 (Del. 1964).

\textsuperscript{58} Unocal, 493 A.2d at 955.

\textsuperscript{59} Id.

\textsuperscript{60} Id.


\textsuperscript{62} Id.

\textsuperscript{63} A "hostile acquiror," also known as a "corporate raider" or "unfriendly suitor" is an acquiror that "attempts to take control of a corporation, against its wishes, by buying its stock and replacing its management." BLACK'S LAW DICTIONARY 341 (7th ed. 1999).

\textsuperscript{64} A "white knight" is an acquiror preferred by the board "that rescues the target of an unfriendly corporate takeover, esp[ecially] by acquiring a controlling interest in the target corporation or by making a competing tender offer." BLACK'S LAW DICTIONARY 1591 (7th ed. 1999).

\textsuperscript{65} Revlon, 506 A.2d at 175-78.
tactics. These tactics included a stockholder rights ("poison pill") plan and a share repurchase plan.

Undeterred, Pantry Pride continued to incrementally increase its bid. In the end, Revlon signed a merger agreement with Forstmann that included several deal protection provisions. The Delaware Supreme Court first held that Revlon's defensive measures prior to the merger agreement were reasonable in relation to the threat posed under the Unocal analysis. Nevertheless, the court went on to hold that as Pantry Pride kept increasing its offer, "it became apparent to all that the break-up of the company was inevitable," and as such, "[t]he duty of the board had thus changed from the preservation of Revlon as a corporate entity" to that of "auctioneers charged with getting the best price for the stockholders at a sale of the company."

Over time, a board's duty to obtain the highest price for stockholders has become known as its Revlon duty. Circumstances which give rise to this heightened judicial scrutiny occur when (1) there is a change in the control of a corporation, (2) the corporation "initiates an active bidding process seeking to sell" the company, or (3) the "break up of the corporate entity is inevitable."

66 Id. at 177.
67 A "poison pill" is "[a] corporation's defense against an unwanted takeover bid whereby shareholders are granted the right to acquire equity or debt securities at a favorable price to increase the bidder's acquisition costs." BLACK'S LAW DICTIONARY 1177 (7th ed. 1999).
68 Revlon, 506 A.2d at 177. The court provided:

Under this plan, each Revlon shareholder would receive as a dividend one Note Purchase Right (the Rights) for each share of common stock, with the Rights entitling the holder to exchange one common share for a $65 principal Revlon note at 12% interest with a one-year maturity. The Rights would become effective whenever anyone acquired beneficial ownership of 20% or more of Revlon's shares, unless the purchaser acquired all the company's stock for cash at $65 or more per share. In addition, the Rights would not be available to the acquir[or]....

Id.
69 Id. The Revlon board voted to repurchase up to ten million of its nearly thirty million outstanding shares. Id.
70 Id. Pantry Pride's first cash tender offer on August 23, 1985 was "for any and all shares of Revlon at $47.50 per common share and $26.67 per preferred share ...." Id. By October 7, 1985, Pantry Pride was offering $56.25 for each common share. Id. at 178.
71 Id. The provisions included were a no-shop provision and an asset lock-up which gave Forstmann the right to purchase Revlon's VisionCare and National Health Laboratories divisions for $525 million, some $100-$175 million below the market value, if another acquiror obtained 40% of Revlon's outstanding shares. Id. at 178.
72 Id. at 181.
73 Id. at 182.
74 Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 928 (Del. 2003).
III. THE FACTUAL BACKGROUND OF
OMNICARE, INC. V. NCS HEALTHCARE, INC. 76

A. The Facts

NCS Healthcare, Inc., a Delaware corporation, was a "leading independent provider of pharmacy services to long-term care institutions including skilled nursing facilities, assisted living facilities and other institutional healthcare facilities." As a result of changes in timing and reimbursement levels by both government and third-party sources, market conditions began to worsen during the end of 1999. Consequently, NCS experienced financial difficulty, which led to a sharp decline in the value of its stock. In response to the company's instability, NCS creditors formed an ad hoc committee to protect their financial interests. After extensive investigation, NCS was unable to obtain any offers that would fully reimburse the creditors and supply some sort of compensation to the stockholders. In April 2001, NCS was in default on approximately $350 million in debt, including senior bank debt and notes outstanding under convertible subordinated debentures.

Around the summer of 2001, NCS contacted Omnicare, Inc. to discuss a possible transaction. After initial discussions, Omnicare proposed to acquire NCS in a bankruptcy sale for $225 million subject to completion of due diligence. After further negotiations, Omnicare eventually offered $270 million, but still intended to only go through with the deal in a bankruptcy sale. After careful consideration, NCS determined that the offer of $270 million was not adequate because it did not provide full recovery for the bondholders or any recovery for its stockholders.

76 Id. at 914.
77 Id. at 918.
78 Id. at 920.
79 Id. The publicly traded common stock of NCS dropped from $20 in January 1999 to $5 by the end of that same year. Id. at 920.
80 Omnicare, 818 A.2d at 921.
81 Id. at 920. In February 2000, NCS hired UBS Warburg, L.L.C. to look for strategic alternatives. Id. Over fifty different entities were contacted, but only one indication of interest surfaced for $190 million, substantially less than the outstanding notes. Id.
82 Id.
83 Id.
84 Id. at 919. Omnicare is an institutional pharmacy business incorporated in Delaware with its principal place of business in Covington, Kentucky. Id.
85 Id. at 921.
86 Omnicare, 818 A.2d at 921.
87 Id.
88 Id.
1. Genesis' Initial Proposal

In January 2002, after the failed negotiations with Omnicare, the ad hoc committee of creditors began discussions with Genesis.\(^9\) During these negotiations, NCS's operating performance began to improve and the NCS directors began to believe that its equity owners may receive some compensation after all.\(^9\) In June 2002, Genesis proposed:

(1) repayment of the NCS senior debt in full, (2) payment of par value for the Notes (without accrued interest) in the form of a combination of cash and Genesis stock, (3) payment to NCS stockholders in the form of $24 million in Genesis stock, plus (4) the assumption of additional liabilities to trade and other unsecured creditors.\(^9\)

This proposal would both repay NCS's senior debt and assume other liabilities to unsecured creditors while also providing for both the payment of the Notes and a stock-swap for the NCS stockholders.\(^9\)

At a June 26 meeting, Genesis, who had previously lost a bidding war with Omnicare,\(^9\) demanded that NCS agree to an exclusivity agreement.\(^9\) Along with an exclusivity agreement,\(^9\) Genesis also proposed that the merger agreement have a force-the-vote provision authorized under Section 251(c) of Delaware's corporation law\(^9\) requiring NCS to submit the agreement to a stockholder vote, even without the board's recommendation.\(^9\) It also included a provision (Voting Agreement) requiring two of the board members, Jon H. Outcalt\(^9\) and Kevin B. Shaw,\(^9\) who collectively owned more than 65% of the

---

\(^9\) Id. Genesis, a Pennsylvania corporation, has its principal place of business in Kennett Square, Pennsylvania. Id. at 919. Genesis provides healthcare and support services to the elderly. Id.

\(^9\) Id. at 922.

\(^9\) Id. at 923.

\(^9\) Omnicare, 818 A.2d at 923.

\(^9\) Id. at 921.

\(^9\) Id. at 924. This agreement precluded NCS from "engaging or participating in any discussions or negotiations with respect to a Competing Transaction or a proposal for one." Id.

\(^9\) Id. at 922-24.

\(^9\) DEL. CODE ANN. tit. 8, § 251(c) (2003) (providing that "[t]he terms of the agreement may require that the agreement be submitted to the stockholders whether or not the board of directors determines at any time subsequent to declaring its advisability that the agreement is no longer advisable and recommends that the stockholders reject it").

\(^9\) Omnicare, 818 A.2d at 923.

\(^9\) Id. at 918. John H. Outcalt was Chairman of the NCS board of directors. Id. The court observed:
shares outstanding, to vote their shares in favor of the transaction.\textsuperscript{100} In effect, the force-the-vote provision, together with the Voting Agreement, was an attempt to lock-in the merger agreement regardless of whether the board later rescinded its recommendation.\textsuperscript{101}

The exclusivity agreement was signed in early July and negotiations continued between NCS and Genesis regarding its proposed merger.\textsuperscript{102} This exclusivity agreement was authorized through July 31, 2002.\textsuperscript{103}

2. Omnicare Re-enters the Race

Toward the end of July 2002, Omnicare began suspecting that the run-up in the price of NCS's stock was attributed to NCS negotiating with Genesis or one of its other competitors.\textsuperscript{104} Omnicare believed this could potentially pose a competitive threat and began to reconsider NCS as a viable acquisition candidate.\textsuperscript{105}

Omnicare faxed NCS a letter on July 26, 2002 outlining a proposed acquisition.\textsuperscript{106} The proposal suggested an acquisition whereby "Omnicare would retire NCS's senior and subordinated debt at par plus accrued interest, and pay the NCS stockholders $3 cash for their shares" (emphasis added).\textsuperscript{107} Omnicare's offer was expressly conditioned on its completing due diligence.\textsuperscript{108}

The exclusivity agreement with Genesis notwithstanding, NCS officers met to consider the Omnicare proposal.\textsuperscript{109} They concluded that although the terms of the offer were better than that of Genesis, its due diligence requirement

\begin{itemize}
\item Outcalt owned 202,063 shares of NCS Class A common stock and 3,476,086 shares of Class B common stock.
\item NCS common stock consisted of Class A shares and Class B shares. The Class B shares were entitled to ten votes per share and the Class A shares were entitled to one vote per share.
\end{itemize}

\textit{Id.}\textsuperscript{99} at 919. Kevin B. Shaw was President, CEO, and director of NCS. The court noted: "Shaw owned 28,905 shares of NCS Class A common stock and 1,141,134 shares of Class B common stock." \textit{Id.}\textsuperscript{100} at 923.

\textit{Id.}\textsuperscript{101} at 923.

\textit{Id.}\textsuperscript{102} at 923.

\textit{Id.}\textsuperscript{103} at 923.

\textit{Id.}\textsuperscript{104} at 924.

\textit{Id.}\textsuperscript{105} at 924.

\textit{Id.}\textsuperscript{106} at 924.

\textit{Id.}\textsuperscript{107} at 924.

\textit{Id.}\textsuperscript{108} at 924.

\textit{Id.}\textsuperscript{109} at 924.
“substantially undercut its strength.” An independent committee of NCS concluded that discussions with Omnicare about its July 26 letter presented an unacceptable risk that Genesis would abandon merger discussions.

3. Genesis Improves Its Offer

After learning of Omnicare’s proposal, Genesis improved its offer on July 27 to include (1) paying off the defaulted notes in accordance with the terms of the indenture, (2) increasing by 80% the exchange ratio that NCS stockholders would receive and (3) lowering the proposed termination fee from $10 million to $6 million. In return for these better terms, however, Genesis stipulated that the transaction had to be approved by midnight the next day, July 28, and if that demand was not met Genesis would terminate discussions and withdraw its offer completely.

On July 28, both the independent committee and the NCS board met and concluded that Genesis was sincere in establishing the midnight deadline. The committee met first and voted unanimously to recommend the transaction to the board. The full board of directors for NCS met next, and after receiving advice from its legal and financial advisors, concluded that “balancing the potential loss of the Genesis deal against the uncertainty of Omnicare’s [revised] letter, resulted in the conclusion that the only reasonable alternative for the Board of Directors [was] to approve the Genesis transaction.” The merger agreement between NCS and Genesis was executed later that day.

4. Specifics of the NCS/Genesis Merger Agreement

The merger agreement between NCS and Genesis contained the following pertinent provisions:

- NCS stockholders would receive [one] share of Genesis common stock in exchange for every [ten] shares of NCS common stock held;

110 Id.
111 Id. The underlying fear of the target corporation in these situations is that market forces may view the failed transaction as being caused by weaknesses in the target corporation’s financial condition. Id. If this happens, lenders may be more reluctant to enter into long term contracts and the stockholders may begin to sell their shares in response. Id.
112 Id. at 924-25.
113 Id. at 925.
114 Omnicare, 818 A.2d at 925.
115 Id.
116 Id.
117 Id.
• NCS stockholders could exercise appraisal rights under 8 Del. C. § 262;
• NCS would redeem NCS’s Notes in accordance with their terms;
• NCS would submit the merger agreement to NCS stockholders regardless of whether the NCS board continued to recommend the merger;
• NCS would not enter into discussions with third parties concerning an alternative acquisition of NCS, or provide non-public information to such parties, unless (1) the third party provided an unsolicited, *bona fide* written proposal documenting the terms of the acquisition; (2) the NCS board believed in good faith that the proposal was or was likely to result in an acquisition on terms superior to those contemplated by the NCS/Genesis merger agreement; and (3) before providing non-public information to that third party, the third party would execute a confidentiality agreement at least as restrictive as the one in place between NCS and Genesis; and
• If the merger agreement were to be terminated, under certain circumstances NCS would be required to pay Genesis a $6 million termination fee and/or Genesis’s documented expenses, up to $5 million.\(^{118}\)

5. Specifics of the Voting Agreements

In conjunction with the merger agreement, Outcalt and Shaw consented to sign the voting agreements.\(^{119}\) These agreements provided, *inter alia*, that:

\(^{118}\) *Id.* at 925-26.

\(^{119}\) *Id.* Omnicare’s initial argument at the Court of Chancery was that these voting agreements violated a clause in NCS’s Certificate of Incorporation that prevented any person holding any shares of Class B Common Stock from transferring their shares to any person other than a “Permitted Transferee.” Omnicare v. NCS Healthcare, Inc., 825 A.2d 264, 268-69 (Del. Ch. 2002). The Chancery Court concluded that the voting agreement signed by Outcalt and Shaw did not transfer their ownership interest, but simply expressed their promise to vote those shares in a particular manner in an effort to induce Genesis to enter into a merger agreement with NCS. *Id.* at 271-72.
• Neither Outcalt nor Shaw would transfer their shares prior to the stockholder vote on the merger agreement;
• Outcalt and Shaw agreed to vote all of their shares in favor of the merger agreement; and
• Outcalt and Shaw granted to Genesis an irrevocable proxy to vote their shares in favor of the merger agreement.
• The voting agreement was specifically enforceable by Genesis.120

6. Omnicare’s Superior Proposal

The day following the execution of the merger agreement, Omnicare faxed to NCS a letter reiterating its $3.00 per share offer along with a draft merger agreement.121 Later that morning, Omnicare disclosed in a press release its proposal to acquire NCS.122

On August 1, 2002, Omnicare decided to increase its offer to the stockholders of NCS and announced that it intended to launch a tender offer for NCS’s shares at a price of $3.50 per share.123 That same day it filed a lawsuit seeking to enjoin the merger agreement between NCS and Genesis.124 After obtaining a waiver from Genesis,125 the NCS board met with Omnicare, which agreed to drop its due diligence clause thus “irrevocably commit[ing] itself to a transaction with NCS.”126 In light of Omnicare’s superior offer, the NCS board voted to withdraw its recommendation that NCS stockholders approve the NCS/Genesis merger agreement.127

---

120 Omnicare, 818 A.2d at 926.
121 Id. at 926-27.
122 Id. at 926.
123 Id. The $3.50 per share tender offer was more than twice the value that NCS would have received from the deal with Genesis. Id.
124 Id.
125 Id. at 926. The directors of NCS needed to obtain a waiver because they were unsure whether discussions with Omnicare would lead to a “Superior Proposal” as was required by the merger agreement before NCS could have discussions with third parties. See id. at 925-26.
126 Omnicare, 818 A.2d at 926.
127 Id.
7. Omnicare and Stockholders of NCS File Suit

Although the signed merger agreement between NCS and Genesis allowed NCS to talk to a third party if certain conditions were met, the effects of these talks would be moot since NCS and Genesis were assured of consummation.\footnote{Id. at 927.} The July 28 merger agreement used the force-the-vote provision combined with Outcalt and Shaw's voting agreements to mathematically lock-in Genesis' acquisition of NCS.\footnote{Id. at 928.} As a result, Omnicare and NCS stockholders commenced litigation seeking to enjoin the merger between NCS and Genesis.\footnote{Id. at 929.}

B. The Majority Opinion

The Delaware Supreme Court began its analysis by determining which standard of judicial review should apply to the NCS board's decision to merge with Genesis.\footnote{Id. at 930.} First, the court held that "Revlon duties had not been triggered because NCS did not start an active bidding process, and the NCS board 'abandoned' its efforts to sell the company when it entered into an exclusivity agreement with Genesis."\footnote{Id. at 930-31.} In the end, the court agreed with the Chancery Court's conclusion that the decision to merge should be analyzed under the business judgment rule.\footnote{Id. at 930.}

More importantly, after holding that the business judgment rule applied, the court went on to make a distinction between the decision to merge with Genesis and the decision by the board to adopt deal protection devices into the merger agreement.\footnote{Id. at 931.} As a consequence, the court held that the protection devices should not be analyzed under the business judgment rule, but rather the enhanced judicial scrutiny required under the \textit{Unocal} test.\footnote{Id. at 930.}

Under the \textit{Unocal} two-prong test, the court concluded the defensive devices drafted into the merger agreement failed to satisfy the second prong's...
"proportionality" test. Specifically, the court held that the NCS directors did not adopt reasonable protection devices because the combined effect of having a force-the-vote provision, stockholder voting agreements, and the absence of an effective fiduciary out clause were both "coercive" and "preclusive." The devices were "coercive" because the minority stockholders of NCS, even though not forced to vote for the Genesis merger, were required to accept it because it was "a fait accompli." The court next declared that an effective fiduciary out is required when a merger agreement has both a force-the-vote provision and a voting agreement signed by owners of a majority of voting power. It stated that when the majority of the corporation's voting shares are acting as a "cohesive group," the "minority stockholders must rely for protection solely on the fiduciary duties owed to them by the directors." The court reasoned that the board could not delegate its fiduciary duties to the stockholders to approve or disapprove of the merger agreement because the subsequent stockholder vote was moot given that a majority voting agreement had already been signed.

While the court acknowledged that Section 251(c) of the Delaware corporation law statute allows a stockholder vote regardless of whether the directors approve or disapprove of the merger agreement, it went on to add that the statute could not limit the directors' fiduciary duties "or prevent the [NCS] directors from carrying out their fiduciary duties under Delaware law." The court held that directors, even after a merger agreement has been announced, "have a continuing obligation to discharge their fiduciary responsibilities, as future circumstances develop . . . ."

136 Id. at 935. The second part of the Unocal test requires that the defensive responses adopted must be "reasonable in relation to the threat posed." Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).
137 Omnicare, 818 A.2d 933-35. A protection device "is 'coercive' if it is aimed at forcing upon stockholders a management-sponsored alternative to a hostile offer." Id. at 935. The court ruled 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." Id. In making the preceding statements, the court was paraphrasing its own findings from Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387 (Del. 1995). Id.
138 Id. at 936. "Fait accompli" is a French phrase meaning "a deed accomplished." BLACK'S LAW DICTIONARY 617 (7th ed. 1999).
139 Omnicare, 818 A.2d at 936-37.
140 Id. at 937 (quoting Paramount Communications, Inc. v. QVC Network Inc., 637 A.2d 34, 43 (Del. 1994)).
141 Compare Omnicare, 818 A.2d at 939 (holding that a majority voting agreement coupled with a force-the-vote provision that locks-in the merger agreement must have an effective fiduciary out clause) with Maple Leaf Foods Inc. v. Schneider Corp., 42 O.R.3d 177, 205 (Ontario Ct. App. 1998) (holding that the board of directors did not violate its fiduciary duties when the target corporation could not accept a higher offer because of a prior locked-in merger agreement).
142 DEL. CODE ANN. tit. 8, § 251(c) (2003).
143 Omnicare, 818 A.2d at 938.
144 Id. at 938.
held that NCS's board of directors violated their fiduciary responsibility by not including an effective fiduciary out provision in the merger agreement with Genesis.\textsuperscript{145}

C. The Dissenting Opinions

The two dissenting opinions,\textsuperscript{146} written by Chief Justice Norman Veasey and Justice Myron T. Steele, argued that the majority diverged from precedent and adopted the new rule, “[a] merger agreement entered into after a market search, before any prospect of a topping bid has emerged, which locks up stockholder approval and does not contain a ‘fiduciary out’ provision, is per se invalid when a later significant topping bid emerges.”\textsuperscript{147} The dissenters believed this new rule was an “unwise extension of existing precedent.”\textsuperscript{148}

First, the dissent argued that the decision by NCS to merge with Genesis must be viewed in “real-time” before the merger agreement was entered.\textsuperscript{149} They argued that lock-ups cannot be viewed in a vacuum.\textsuperscript{150} Instead, “[the] court should review the entire bidding process to determine whether the independent board’s actions permitted the directors to inform themselves of their available options and whether they act in good faith.”\textsuperscript{151} Since the NCS board fulfilled its duties of care, loyalty, and good faith by entering into the Genesis merger agreement, the dissent reasoned that the court should not \textit{ex post facto} analyze the board’s decision in light of a topping bid from Omnicare.\textsuperscript{152}

Secondly, the dissenters believed that the majority misapplied prior case law in its analysis of “coercive and preclusive” measures.\textsuperscript{153} Here, the dissent argued, “the deal protection measures were not adopted unilaterally by the board to fend off an existing hostile offer (as was the situation in \textit{Unitrin, Inc. v. American General Corp.}\textsuperscript{154}). They were adopted because Genesis – the ‘only game in town’ – would not save NCS, its creditors and its stockholders without these provisions.”\textsuperscript{155} The dissenters argued that the “draconian” measures in

\textsuperscript{145} \textit{Id.}
\textsuperscript{146} \textit{Id.} at 939-50. Chief Justice Veasey wrote a dissenting opinion with whom Justice Steele joined. \textit{Id.} at 939-46. Justice Steele wrote a separate dissenting opinion to elaborate on his central objections. \textit{Id.} at 946-50.
\textsuperscript{147} \textit{Id.} at 942.
\textsuperscript{148} \textit{Id.} at 943.
\textsuperscript{149} \textit{Omnicare}, 818 A.2d at 940.
\textsuperscript{150} \textit{Id.} at 941.
\textsuperscript{151} \textit{Id.}
\textsuperscript{152} \textit{Id.} at 946.
\textsuperscript{153} \textit{Id.} at 943-44.
\textsuperscript{154} 651 A.2d 1361, 1370 (Del. 1995).
\textsuperscript{155} \textit{Omnicare}, 818 A.2d at 943-44.
Unitrin 156 "dealt with unilateral board action . . . designed to fend off an existing hostile offer by American General." 157

The dissenters further opined that a bright-line test might deter bidders from engaging in negotiations if there must always be a fiduciary out clause. 158 In addition, the dissent argued that such a rule may reduce the number of wealth-enhancing transactions. 159 This is because, as the dissenters stated:

[A] lock-up permits a target board and a bidder to “exchange certainties.” Certainty itself has value. The acquir[or] may pay a higher price for the target if the acquir[or] is assured consummation of the transaction. The target company also benefits from the certainty of completing a transaction with a bidder because losing an acquir[or] creates the perception that a target is damaged goods, thus reducing its value. 160

With this in mind, the dissent suggested that in some instances, certainty is not only desired, but can also add value to the transaction. 161

Justice Steele, in his separate dissenting opinion, argued that the majority wrongfully applied the Unocal test and that the business judgment rule was the proper standard of judicial review when a board of directors’ decision is made that is free from self interest, made with due care and in good faith. 162 He continued by arguing that “Delaware corporate citizens now face the prospect that in every circumstance, boards must obtain the highest price, even if that requires breaching a contract entered into at a time when no one could have reasonably foreseen a truly ‘Superior Proposal.’” 163

IV. ANALYSIS

The principal purpose of this section is to delve into the Omnicare opinion and extract the underlying principles of why the court expanded existing precedent to invalidate the agreement between Genesis and NCS Healthcare.

156 Unitrin, 651 A.2d at 1370.
157 Omnicare, 818 A.2d at 944.
158 Id. at 946.
159 Id. at 942.
160 Id.
161 Id.
162 Id. at 946-47.
163 Omnicare, 818 A.2d at 948.
Furthermore, this section seeks to explore how mergers and acquisitions may be affected post-Omnicare.

A. What was the Underlying Reasoning in Omnicare?

It is clear that over the past several years there has been a consistent push in corporate America to hold boards of directors more accountable for their decisions. Within the past five years, stockholders have endured scandals at Enron, Worldcom, Global Crossing, HealthSouth, and Adelphia, just to name a few. In response to scandals such as these, Congress enacted the Sarbanes-Oxley Act which brought the federal government into the world of corporate governance law more than ever before. In addition to federal legislation, companies have been eager to reassure their investors of steps taken to prevent similar scandals. Likewise, the American Bar Association formed a task force to aid regulators and legislators in the development of corporate responsibility laws.

In light of these changes, it seems only natural that Omnicare was decided the way it was. Essentially, Omnicare affords another protection for stockholders. Stated broadly, Omnicare seeks to protect stockholder interest by preventing a board of directors from mathematically “locking in” a merger agreement. The combination of the merger agreement and signed voting agreement, and the absence of an effective fiduciary out clause mathematically locked in the deal so that the subsequent stockholder vote would be moot.

When analyzing the voting agreements, perhaps it is easier to say that Outcault and Shaw were not acting as stockholders when they signed the

---

164 See E. Norman Veasey, State-Federal Tension in Corporate Governance And The Professional Responsibilities of Advisors, 28 J. CORP. L. 441, 441-43 (2003). The author is the Chief Justice of the Delaware Supreme Court. Id.
165 Id.
167 Id. For a critical viewpoint on how the Sarbanes-Oxley Act has affected corporations since its enactment, see Peter J. Wallison, Blame Sarbanes-Oxley, WALL ST. J., Sept. 3, 2003, at A16.
168 See Veasey, supra note 164, at 442 (noting that corporations like General Motors have adopted a voluntary best practices code).
170 Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003). One sphere of stockholder protection pertains to the fiduciary duties of care and loyalty that the officers and directors owe to the corporation. G EvaRTZ, supra note 42, § 4. Specifically, they are “[a] duty to exercise care in avoiding harm to the corporation, and a duty of loyalty placing the corporation’s interests ahead of one’s own.” Id. at 273.
171 Omnicare, 818 A.2d at 938.
172 See id. at 936.
agreements, but as members of the board. Since Outcalt and Shaw were wearing their "director hats" when they signed the agreement instead of their "stockholder hats," the voting agreements would be scrutinized as a deal protection device rather than as an independent agreement not subject to enhanced scrutiny. According to the dissent, it is immaterial which "hat[s]" Outcalt and Shaw were wearing. The dissenters opined, "we believe this Court must respect the reasoned judgment of the board of directors and give effect to the wishes of the controlling stockholders." In other words, Outcalt and Shaw, as directors, should have been able to make a good faith, informed decision regarding a merger agreement with Genesis, and, at the same time, vote their shares in favor of the merger agreement as stockholders.

B. Effects of the Omnicare Decision

Prior to Omnicare, much of the focus in the law of mergers and acquisitions pertained to specific deal protection provisions and whether they violated a board's fiduciary duty. For example, courts analyzed how much a termination fee could be in relation to the deal or whether a stock lock-up granted in the merger agreement coupled with other protection devices was "draconian." The Omnicare decision certainly brings a renewed focus on the fiduciary out clause.

The majority opinion categorically holds that a combination of a merger agreement, majority stockholder voting agreement, and the absence of an effective fiduciary out clause is invalid per se. As the dissent points out, this

173 See id. at 942-43 (Veasey, C.J., dissenting). Chief Justice Veasey stressed the fact that Outcalt and Shaw were acting "as stockholders" when they irrevocably committed themselves to vote for the merger. Id.
174 See id. at 940.
175 See id.
176 Id. at 940.
177 See Omnicare, 818 A.2d at 940.
179 See Brazen, 694 A.2d at 47-50 (discussing the validity of a $550 million, two-tiered termination fee).
180 See QVC, 637 A.2d at 51 (holding that the no-shop provision in the merger agreement was contrary to the directors' fiduciary obligations).
181 See discussion infra Part IV.B.1-3.
182 Omnicare, 818 A.2d at 934-39.
is a bright-line, inflexible rule. The real question to be answered post-
*Omnicare* is what the decision means for mergers of the future.

Future merger agreements will certainly avoid the inclusion of these three provisions. However, the real issue is how much can two companies include in their agreement to add certainty to the deal. Are two out of three provisions acceptable? Maybe a voting agreement and merger agreement with an included fiduciary out clause will survive this new rule.

It is the author’s position of this article that the fiduciary out provision was determinative in the decision of *Omnicare*. As a foundation for its reasoning, the court stated, “[t]o the extent that a [merger] contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable.” In essence, it was not the merger agreement coupled with the voting agreement that was held invalid. Rather, it was the fact that when a better offer came along (*Omnicare* launching a tender offer), the directors had no way of fulfilling their duty to prevent the merger or, at the very least, letting the stockholders have a meaningful vote.

1. Termination Fees Revisited

Previous studies show that deal protection provisions are responsive to case law. In a 2000 article, John C. Coates and Guhan Subramanian perform regression analyses from a large sample of friendly mergers to determine how Delaware case law has shaped the use and effect of lock-ups. Of particular importance, Coates and Subramanian conclude that termination fees have been exceedingly responsive to case law. In fact, the analyses provide that since the court in *Brazen v. Bell Atlantic Corp.* decided to uphold a two-tiered

---

183 See *id.* at 950.
184 *Id.* at 934-39. The rule of adherence to judicial precedents is known as the doctrine of stare decisis. BLACK’S LAW DICTIONARY 1414 (7th ed. 1999). Stare decisis, Latin for “to stand by things decided,” is a “doctrine of precedent, under which it is necessary for a court to follow earlier judicial decisions when the same points arise again in litigation.” *Id.*
186 *Id.*
187 *Id.*
188 *Omnicare*, 818 A.2d at 936 (quoting Paramount Communication, Inc. v. QVC Network, Inc., 637 A.2d 34, 51 (Del. 1994)).
189 See discussion *supra* Part III.B.-IV.A.
190 *Omnicare*, 818 A.2d at 936.
192 *Id.* at 314-36.
193 *Id.* at 331.
termination fee of $550 million,\textsuperscript{195} breakup fee incidence increased from 33\% to 65\%.\textsuperscript{196}

What this means post-\textit{Omnicare} is that the use of termination fees in merger agreements will probably rise again.\textsuperscript{197} In \textit{Omnicare}, the termination fee between NCS Healthcare and Genesis was $6 million.\textsuperscript{198} That fee represented roughly 1.7\% of the $340 million deal value.\textsuperscript{199} Neither Genesis nor NCS Healthcare probably thought that having a termination fee was very useful since the combination of the merger agreement, voting agreement, and absence of an effective fiduciary out clause mathematically "locked-in" the merger.\textsuperscript{200} However, as it happened, the deal did not go through because of the court's decision to invalidate the merger agreement.\textsuperscript{201}

As previously mentioned, termination fees in the range of 2-4\% of the transaction value have consistently been upheld.\textsuperscript{202} Certainly, \textit{Omnicare} will give someone an argument for getting a larger percentage termination fee.\textsuperscript{203} If the court is not going to allow a "complete" lock-up prior to the required stockholder vote, then it would only seem reasonable to allow the potential acquiror more financial compensation in return for the increased risk that a possible third party bidder may interrupt the transaction with a higher offer.\textsuperscript{204}

\textsuperscript{195} \textit{Id}. The first part of the termination fee required either party to pay "$200 million if there were both a competing acquisition offer for that party and either (a) a failure to obtain stockholder approval, or (b) termination of the agreement." \textit{Id}. at 45. The second part of the termination fee required a payment of $350 million to the disappointed merger partner if a competing transaction were consummated within eighteen months of termination of the merger agreement. \textit{Id}.

\textsuperscript{196} Coates & Subramanian, supra note 16, at 331.

\textsuperscript{197} See \textit{id}. This would be due to the market's responsiveness to Delaware's case law. \textit{Id}.

\textsuperscript{198} Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 926 (Del. 2003).

\textsuperscript{199} Press Release, Genesis Health Ventures to Acquire NCS Healthcare, Transaction Creates Second Largest Institutional Pharmacy in the U.S. (July 29, 2002), at http://www.sec.gov/Archives/edgar/data/874265/000089882202000938/form425prreleasemay29.txt. The transaction value was estimated at $340 million dollars, net of the application of approximately $20 million in excess cash at NCS. \textit{Id}.

\textsuperscript{200} See discussion supra Part III.A.4.-B.

\textsuperscript{201} Omnicare, 818 A.2d at 936.


\textsuperscript{203} See discussion supra Part IV.B.1.

\textsuperscript{204} \textit{Id}.
Though it is impossible to predict what range of the termination fees the court will find reasonable post-Omnicare, analyzing past reaction by deal drafters to Delaware case law might provide some helpful insight. Before the Brazen decision in 1997, the average fee size was 2.8%. After Brazen, the likelihood that a breakup fee would be included in the deal rose by 52% while the average fee size rose from 2.8% to 3.2%. Assuming the reaction to Omnicare will be similar to that of Brazen, there is a substantial likelihood that the average termination fee post-Omnicare could be closer to 4% of the deal value. The author takes the position that in fairness to the added risk that is inflicted upon the acquiror now that the court has held an absolute lock-up invalid, the proper termination fee, although subject to the specific facts of the case, should be between 5-7% of the deal value. As a practical matter, acquiring companies choosing to merge post-Omnicare must factor into their merger agreement the possibility that their investment will never bear fruit. As the dissent correctly points out, “[c]ertainty itself has value.” Without that certainty, there will inevitably be more risk in the transaction. Basic finance dictates the trade-off between risk and return. When the acquiror must saddle more risk in the deal, it should be rewarded with a larger return if the transaction is not ultimately completed.

The liquidated damages analysis that courts typically employ in analyzing termination fees should not substantially restrict a slight increase in the percentage. So long as the termination fee is a reasonable forecast of actual damages and not merely coercive, courts should uphold the proposed termination fee.

2. Renewed Interest in Stock Lock-ups

In an ancillary agreement to the merger agreement, each merger partner may give the other the right to purchase a significant portion of its shares at the current market price (the stock “lock-up”) or the right to purchase certain

206 Id. at 335.
207 Id.
208 See discussion supra Part IV.B.1.
209 The 5-7% figure, although arbitrary, is an attempt to reflect the added risk that third party bidders will successfully intervene into a merger agreement.
210 See sources cited infra notes 211-14.
213 Id.
214 Id.
215 See sources cited supra notes 211-14. Courts should understand this basic economic fact and reflect that in their opinions.
valuable assets at a favorable price (the “crown jewels” lock-up, also known as the “asset” lock-up). After the court’s decision in Paramount Communications, Inc. v. QVC Network, Inc., the likelihood of a stock lock-up in a merger agreement was reduced by 41%. Before Paramount, stock lock-ups appeared in 19.6% of deals; after Paramount, stock lock-ups were found in 11.6% of deals.

The merger agreement in Paramount contained three defensive provisions: a “no shop” provision, a termination fee, and a stock option agreement (stock lock-up). The stock lock-up granted Viacom the option to purchase approximately 19.9% of Paramount’s outstanding shares. It also contained what the court called two “unusual” features “highly beneficial” to Viacom: (1) a provision allowing Viacom to pay for the optioned shares with a senior subordinated note instead of cash, and (2) the absence of any kind of cap on the option that would have prevented the option from reaching unreasonable levels. After finding that Revlon applied, the court invalidated the merger agreement holding the stock option to be “unreasonable” and “draconian.”

As previously stated, this ruling affected how practitioners use stock lock-ups. First, since the Paramount court focused on the absence of a cap, practitioners now cap their stock agreements. Second, although the standard of judicial review in Paramount was Revlon, risk averse practitioners “[worried] that the Delaware Supreme Court would view all stock lockups suspiciously, even outside of Revlon-land.” As a result, stock lock-up incidence declined.

Some good news for stock lock-ups came about in the case of In re IXC Communications, Inc. v. Cincinnati Bell, Inc. The IXC court upheld a stock option agreement permitting Cincinnati Bell to purchase 19.9% of IXC’s shares.

217 See James A. Fanto, Braking the Merger Momentum: Reforming Corporate Law Governing Mega-Mergers, 49 BUFF. L. REV. 249, 349 (2001) (arguing that mega-mergers are generally bad for stockholder wealth maximization and, as a result, the law should impose an enhanced standard of review regarding a board’s decision to merge).
219 Coates & Subramanian, supra note 16, at 329.
220 Id. at 329 n.65.
221 QVC, 637 A.2d at 39.
222 Id. The major exchanges require a stockholder vote for stock option grants of 20% or greater. See Paul S. Bird & Richard G. Thorpe, Selected Issues in Documenting Deals: Lock-ups, Deal Protection and Social Issues, 1085 PLI/CorP 245, 256 (1998). Therefore, stock lock-ups usually are capped at 19.9% so that stockholder approval is not required. Id.
223 QVC, 637 A.2d at 39.
224 Id. at 51.
227 Id.
228 See source cited supra note 213.
of common stock for $52.25 per share, with a profit cap of $26.25 million. This provided some reassurance for the corporate world that as long as a stock lock-up has a reasonable cap and is not coupled with "unusual" features, courts will likely uphold the agreement.

As discussed above, Omnicare is likely to inject a renewed interest into stock option agreements (stock lock-ups) primarily because corporations that choose to merge will not be able to assure themselves of completing the deal. Thus, there will be an incentive to implement deal protection devices that courts have analyzed and upheld. Acquirors who want to walk to the edge of Omnicare's cliff without falling over will be grabbing for protection devices that fend off potential third party bidders, yet still allow for the target's board to exercise its fiduciary duties.

3. What's Left for Voting Agreements?

The Omnicare court held that when a merger agreement has a force-the-vote provision operating in concert with a signed majority voting agreement there must be an effective fiduciary out clause in the agreement so that the board can discharge its fiduciary duties on a continuing basis. This bright-line test logically will lead future practitioners to ask, "What about minority voting agreements?" In trying to answer this question, perhaps it would be helpful to analyze previous Delaware cases that have addressed voting agreements directly and indirectly.

In addition to analyzing stock lock-up agreements, the court in In re IXC Communications, Inc. v. Cincinnati Bell, Inc. considered vote-buying arrangements. In IXC, Cincinnati Bell made a side deal with IXC's largest stockholder, General Electric Pension Trust ("GEPT"), whereby "GEPT agreed to support the merger on condition that [Cincinnati Bell] purchase one-half of its IXC holdings for $50 per share." In concluding that the voting agreement did not disenfranchise other stockholders, the Court of Chancery stated that "an . . . independent majority of IXC's shareholders (owning nearly 60% of all IXC shares) may still freely vote for or against the merger, based on their own perceived best interests, and ultimately defeat the merger, if they desire." In addition, the court made it a point to find that the voting agreement was not, in

230 Id. at *33-34.
231 Id.
233 See discussion supra Part IV.B.1-3.
234 See Coates & Subramanian, supra note 16, at 312-36 (providing a thorough analysis on how case law has affected lock-up incidence in merger agreements).
235 Omnicare, 818 A.2d at 939.
236 See IXC, 1999 Del. Ch. LEXIS 210, at *21-25.
237 Id. at *7.
238 Id. at *23.
fact, "locked up" by an absolute majority of the votes required for the merger.\footnote{Id. at *23-24.} Furthermore, Vice Chancellor Myron T. Steele wrote:

[The plaintiffs] can only say that the GEPT deal "almost completely lock[s] up the vote – thus giving stockholders scant power to defeat the Merger . . ." (emphasis added). "Almost locked up" does not mean "locked up," and "scant power" may mean less power, but it decidedly does not mean "no power."\footnote{Id. at *24.}

With this in mind, it is evident that the absence of a complete lock-up impacted the opinion of the court.\footnote{Id.}

In contrast with IXC, \textit{Ace Limited v. Capital Re Corp.}\footnote{Ace Ltd. v. Capital Re Corp., 747 A.2d 95 (Del. Ch. 1999).} took a different approach to the position of minority voting agreements.\footnote{Id.} In \textit{Ace Limited}, the acquiring company fused 12.3\% ownership of the target’s stock with stockholder voting agreements amounting to another 35.5\%.\footnote{Id. at 97.} The court stated in dicta that this amount, nearly 48\%, gave the acquiror, as a "virtual certainty, the votes to consummate the merger even if a materially more valuable transaction became available" (emphasis added).\footnote{Id. at 98.}

While IXC seems to permit voting agreements so long as a majority is not disenfranchised, \textit{Ace Limited} appears to scrutinize minority voting agreements that, for all practical purposes, assure that stockholder approval is "virtually certain."\footnote{Id. at 97.} In retrospect, it appears that the majority in \textit{Omnicare} most likely would agree with the analysis in \textit{Ace Limited}.\footnote{See discussion supra Part III.B.} As evidence of this assertion, Vice Chancellor Strine wrote in \textit{Ace Limited} the foundation for the holding in \textit{Omnicare}.\footnote{See Ace Ltd., 747 A.2d at 108.} He stated in dicta, "[a]s a practical matter, it might therefore be possible to construct a plausible argument that a no-escape merger agreement that locks up the necessary votes constitutes an unreasonable preclusive and coercive defensive obstacle within the meaning of \textit{Unocal}."\footnote{Id.} This "plausible" argument became law when \textit{Omnicare} held that the deal protection provisions at issue were both preclusive and coercive.\footnote{See Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 934-39 (Del. 2003).}
Due to the critical language in *Ace Limited*, risk averse practitioners may wish to avoid having their clients' deals invalidated and, instead, opt for a smaller, but still meaningful, percentage of the minority vote.\(^{251}\) It seems likely that courts in the future will scrutinize voting agreements as preclusive and coercive so long as the voting agreements coupled with a force-the-vote provision in the merger agreement essentially make stockholder approval "virtually certain."\(^{252}\)

V. CONCLUSION

As Chief Justice Veasey in his dissent wrote, "[n]arrowly stated, this new rule is a judicially-created 'third rail' that now becomes one of the given 'rules of the game,' to be taken into account by the negotiators and drafters of merger agreements."\(^{253}\) In light of this "third rail," *Omnicare* will likely increase the use of termination fees and stock lock-ups as protection devices.\(^{254}\) Furthermore, *Omnicare* provides a strong argument for the corporate market that, given the increased risk that the merger will not win approval, termination fee size should increase as well.\(^{255}\) In addition, practitioners who couple a merger agreement with a voting agreement may wish to make certain that the voting agreement is not so close to the mathematically certain threshold of 51% that a subsequent stockholder approval is "virtually certain."\(^{256}\)

It will be interesting to see the aftermath of *Omnicare*’s impact in corporate law. Chief Justice Veasey wrote in his dissent that he hoped the majority’s holding would be interpreted narrowly.\(^{257}\) To further add confusion with respect to whether *Omnicare* will be limited to its facts or broadly interpreted, one of the majority Justices, Justice Walsh, retired from the Delaware Supreme Court and was replaced by Justice Jack B. Jacobs.\(^{258}\) Perhaps with this structural change in Delaware’s Supreme Court and given *Omnicare*’s narrow 3-2 decision, Chief Justice Veasey’s recommendation of a narrow interpretation may be followed by the court when applying *Omnicare* in the future.\(^{259}\)

The decision in *Omnicare*, although straight-forward in its holding, may prove slippery in its application because of the numerous questions that the

\(^{251}\) See sources cited supra notes 242-49.

\(^{252}\) See discussion supra Parts III.B.-IV.B.

\(^{253}\) *Omnicare*, 818 A.2d at 943.

\(^{254}\) See discussion supra Part IV.B.1-3.

\(^{255}\) See discussion supra Part IV.B.1.

\(^{256}\) See discussion supra Part IV.B.1-3.

\(^{257}\) *Omnicare*, 818 A.2d at 946.


\(^{259}\) *Omnicare*, 818 A.2d at 943.
decision leaves unanswered.\textsuperscript{260} At the end of the day, practitioners will still have to lay out all the options for their clients and let them decide how much risk they are willing to bear – on one side, the risk that a future court could invalidate the merger agreement; and on the other, the risk that a third party bidder will intervene and capture the target.

\textsuperscript{260} See discussion \textit{supra} Part IV.
DOES ERISA IMPOSE ON HMOs A DUTY TO DISCLOSE PHYSICIAN INCENTIVE CONTRACTS?: AN EXAMINATION OF CIRCUIT SPLITS

by Michael Nitardy*

I. INTRODUCTION

Strong emotions permeate every healthcare issue. Because these issues are so vital to our personal and collective well-being, visceral reactions to common problems often dominate the debate. The patient-physician relationship represents just one such area. The addition of the specter of managed care to that sacred relationship has engendered considerable controversy. Consider the following hypothetical situation.1

A person goes to work for an employer who provides a health care benefit plan to its employees. The person enrolls in the plan. The person receives a handbook from the managed care company that administers the employer’s health care plan. In the book, the person finds the policies of the plan, including the policies on referrals. The person also reads that the managed care company does its best to provide high quality care while keeping costs low. The book mentions that sometimes, financial structures might exist that serve gate-keeping

* Michael Nitardy is a J.D. candidate for 2005 at Salmon P. Chase College of Law, Northern Kentucky University. He earned a B.B.A. in Finance from Marshall University in May 1996.

1 This hypothetical situation is based, with embellishment, on Shea v. Esensten, 107 F.3d 625 (8th Cir. 1997).
functions that can only be bypassed if the physician believes it to be necessary. Also in the book, the person finds a “network” sponsored physician. The person contacts that physician and makes an appointment.

At the appointment, the patient mentions that he has been experiencing shortness of breath and that his family has a history of heart disease. The physician does a thorough check-up and makes the clinical decision that a referral to a cardiologist is not necessary at the present. The patient worries because he knows that his dad died of a heart attack at a young age. The patient goes back to the physician and presses the point. The physician continues to assert that no referral is necessary, considering other health factors and the patient’s age. The patient says to the physician that he knows from his managed care handbook that he cannot see a cardiologist without the physician’s referral. The patient indicates he is willing to pay for the visit on his own. The physician still will not refer the patient. Shortly thereafter, the patient suffers the same fate as his father and dies from cardiac arrest.

The surviving spouse brings a malpractice suit against the physician. Knowing the managed care company has deep pockets, and perhaps feeling the company has some liability in the matter as well, the spouse also names the managed care company as a defendant. The spouse brings the suit in state court. At this point, the managed care company, through a federal regulatory scheme, moves the case to federal court. As a result, the spouse needs a cause of action against the managed care company in federal court. She amends the claim to allege that under that same federal scheme, the managed care company owed a fiduciary duty to the members of the plan. She states the company breached that duty by not disclosing to the member the existence of a financial structure to ration care that pays a bonus to the member’s physician if a certain goal of less referrals to cardiologists is met.

Three United States Circuit Courts of Appeal have heard claims on the issue of whether, under the Employee Retirement Income Security Act (ERISA), Health Maintenance Organizations (HMOs) have a fiduciary duty to disclose to their beneficiaries the existence of contracts to limit or ration care. Only one circuit has held a duty to disclose exists. The other two circuits, while using differing reasoning and under vastly different facts than outlined above, held that no duty exists to disclose such an incentive plan.

This note examines how each circuit reached its decision. The note further explores which appears to be the best approach in light of recent Supreme Court opinions touching on peripheral issues.

2 Third, Fifth, and Eighth Circuit Courts of Appeals.
4 Shea, 107 F.3d at 628-29.
5 Ehlmann, 198 F.3d at 555; Horvath, 333 F.3d at 462-63.
The note begins with a background of the federal regulatory scheme and the context in which these claims arise. The note then moves to the facts of each of the three circuit opinions. Finally, an analysis of each opinion is provided, followed by a proposal for eliminating such claims from the federal court system.

II. BACKGROUND

Congress passed the Employee Retirement Income Security Act (ERISA) in 1974. Congress intended the Act to keep employee benefit claims, such as retirement and pension plans, more structured and secure. However, employee health plans also fall under ERISA's expansive definition of employee benefit plans. At the time of ERISA's origination, the managed care world in no way resembled what we have today.

Because ERISA is primarily concerned with pensions and retirement funds, fiduciary duties and fiduciary care are extremely vital. Under ERISA, the

---


To the uninitiated, it may seem anomalous that the federal legislation regulating pensions and profit-sharing plans ("employee retirement income") should also cover employer-provided fringe benefit programs. In many respects, these are quite different arrangements. Pensions and profit-sharing plans defer wage income into the future. In contrast, fringe benefit programs typically provide current emoluments such as medical insurance or disability coverage. Nevertheless, for reasons of policy and politics, ERISA regulates both retirement income programs and most fringe benefit arrangements, but regulates them quite differently. ERISA governs pension and profit-sharing plans extensively and in detail, while ERISA's regulation of fringe benefits is more limited.

9 Id. See June M. Sullivan, The Doctor Won't See You Now: ERISA Permits HMOs to Give Doctors Financial Incentives to Limit Health Care, 77 N.D. L. REV. 267, 267-75 (2001) (discussing how over the last twenty-five years most people have moved from fee-for-service payment, where a physician was incentivized to provide more care, to a system where physicians are paid a set amount per patient, and are incentivized to limit care).
10 See Rush Prudential v. Moran, 536 U.S. 355, 364 (2002) (stating that in order to protect "the establishment, operation, and administration" of employee benefit plans, ERISA sets 'minimum
pertinent statutory provisions stipulate that plan administrators are deemed fiduciaries for the plan’s beneficiaries. 11 Congress intended the fiduciary relationship under ERISA to follow the common law of trusts. 12 Under that law, loyalty to the beneficiary is paramount. 13 Under ERISA, anyone who has discretionary authority over the operation of a plan is deemed a fiduciary because plan administrators are charged with making decisions that affect beneficiaries’ availability with respect to, and ultimately payment of, benefits. 14

ERISA contains a broad preemption provision. 16 The provision stipulates that any state law that “relates” to any ERISA designated plan is preempted by federal law. 17 The provision was intended to keep laws affecting ERISA plans more uniform and stable. 18 The stable regulatory environment is a benefit to large companies who have employee benefit plans all around the United States,

Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.

Id. at 224-25 (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y.1928)).

12 See Pegram v. Herdrich, 530 U.S. 211 (2000), for the Court’s discussion of Congress’ intent that the common law of trusts to apply to ERISA. The Court opined:

Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.

Id. at 224-25 (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y.1928)).
encompassing several different jurisdictions. The preemption provision has been likened to a “shield” for many defendants to hide behind, especially in the health care realm.

The rise of the managed care organization closely approximated the implementation of ERISA. Congress promoted Health Maintenance Organizations (HMOs) as a feasible means of providing quality health care while stemming rising health care expenditures. The tension between the provision of quality care and the curbs on rising costs caused some to wonder if medicine was becoming primarily a business. Legally speaking, the existence of managed care companies gave patients another potential defendant in malpractice claims.

Since ERISA’s preemption provision allows removal to federal court, many plaintiffs choose to sue managed care companies for breach of fiduciary duty under ERISA. In 1997, in Shea v. Esensten, the Eighth Circuit Court of Appeals held that the non-disclosure of financial incentives to limit care was a breach of fiduciary duty on the part of the managed care organization. Underlying the court’s rationale was the fact that disclosure is mandated for HMO forms of subsidized medical care, such as Medicare and Medicaid. Furthermore, a few states have also enacted legislation that commands such disclosures.

Despite these precedents, the duty to disclose financial incentives has not been universally accepted. For example, in Ehlmann v. Kaiser Found. Health

---

19 Id. (concluding that Mrs. Shea’s claim was properly removed to federal court). “The outcome of Mrs. Shea’s lawsuit would clearly affect how Seagate’s ERISA-regulated benefit plan is administered, and if similar cases are brought in state courts across the country, ERISA plan administrators will inevitably be forced to tailor their plan disclosures to meet each state’s unique requirements.” Id.
21 See Armitage, supra note 7, at 341-48; Sullivan, supra note 9, at 297-99.
23 Sullivan, supra note 9, at 297-99.
24 Cf. Armitage, supra note 7, at 341. The author analogized the struggle between HMOs and physicians on one side and patients on the other to a “constant game of tug-of-war.” Id.
27 107 F.3d 625 (8th Cir. 1997).
28 Id. at 628-29.
30 See Johnson, supra note 26, at 1639-40 (discussing states that have rules requiring disclosure). See also Wendy Silver, Note, The Inadequacy of State Legislative Responses to ERISA Preemption of Managed Care Liability, 78 N.Y.U. L. Rev. 845, 846-47 (noting the states who have also passed “managed care liability laws”). See id. for a discussion on such laws and their effectiveness.
31 See Horvath v. Keystone Health Plan E., Inc., 333 F.3d 450, 462 n.9 (3d Cir. 2003) (noting the several district courts who have declined to find that a duty to disclose incentive structures exists).
Plan, the Fifth Circuit Court of Appeals held that there was no broad duty to disclose the existence of financial incentives to limit care absent a specific request. In that same year, in the somewhat similar case of Pegram v. Herdrich, the United States Supreme Court held that the existence of a financial structure containing incentives to limit care was not a breach of fiduciary duty. In Pegram, the Court held that Congress did not foresee mixed eligibility and treatment decisions as fiduciary decisions. Furthermore, the Court expressed an unwillingness to impose burdens on these managed care organizations that Congress had so readily encouraged. In a footnote, however, the Court opined that because the administration of the plan was not a mixed eligibility and treatment decision, it could still possibly be subject to claims of breach of fiduciary duty for failure to disclose important information. Unfortunately, the Court did not expound on this possibility any further.

---

34 Id. at 223-26.
35 Id.
36 Id. at 233-34. The Court stated:

The fact is that for over 27 years the Congress of the United States has promoted the formation of HMO practices. The Health Maintenance Organization Act of 1973, 87 Stat. 914, 42 U.S.C. § 300e et seq., allowed the formation of HMOs that assume financial risks for the provision of health-care services, and Congress has amended the Act several times, most recently in 1996. See 110 Stat. 1976, 42 U.S.C. § 300e (1994 ed., Supp. III). If Congress wishes to restrict its approval of HMO practice to certain preferred forms, it may choose to do so. But the Federal Judiciary would be acting contrary to the congressional policy of allowing HMO organizations if it were to entertain an ERISA fiduciary claim portending wholesale attacks on existing HMOs solely because of their structure, untethered to claims of concrete harm.

37 Id. at 223-26.
38 Id. at 228 n.8. In an important footnote, the court opined:

Although we are not presented with the issue here, it could be argued that Carle [(the HMO)] is a fiduciary insofar as it has discretionary authority to administer the plan, and so it is obligated to disclose characteristics of the plan and of those who provide services to the plan, if that information affects beneficiaries’ material interests. See, e.g., Glaziers and Glassworkers Union Local No. 252 Annuity Fund v. Newbridge Securities, Inc., 93 F.3d 1171, 1179-1181 (CA3 1996) (discussing the disclosure obligations of an ERISA
Although the *Pegram* decision indicated that the structure of physician incentives to limit care could not be held to be a breach of fiduciary duty, the decision clearly left unresolved the question of whether the failure to disclose the structure itself could be considered a breach of fiduciary duty. Because the issue was not before the Court, it was not decided. However, dicta contained in the Court's opinion is instructive. The Court seemed to indicate that certain actions properly belonged in state courts.

What would be the value to the plan participant of having this kind of ERISA fiduciary action? It would simply apply the law already available in state courts and federal diversity actions today, and the formulaic addition of an allegation of financial incentive would do nothing but bring the same claim into a federal court under federal-question jurisdiction. It is true that in States that do not allow malpractice actions against HMOs the fiduciary claim would offer a plaintiff a further defendant to be sued for direct liability, and in some cases the HMO might have a deeper pocket than the physician. But we have seen enough to know that ERISA was not enacted out of concern that physicians were too poor to be sued, or in order to federalize malpractice litigation in the name of fiduciary duty for any other reason. It is difficult, in fact, to find any advantage to participants across the board, except that allowing them to bring malpractice actions in the guise of federal fiduciary breach claims against HMOs would make them eligible for awards of attorney's fees if they won. See 29

---

39 *Pegram*, 530 U.S. at 228.
40 *See supra* note 38 and accompanying text (stating how a claim might remain open).
41 *Id.* (explaining how the claim could have been argued can give insight as to how the Court might see the matter in the future).
42 *Id.*
43 *Pegram*, 530 U.S. at 235-36.
U.S.C. § 1132(g)(1). But, again, we can be fairly sure that Congress did not create fiduciary obligations out of concern that state plaintiffs were not suing often enough, or were paying too much in legal fees.\textsuperscript{44}

These remarks provide a somewhat veiled admonition against suits involving HMO defendants that are initiated merely to achieve a higher pecuniary gain for the plaintiffs.\textsuperscript{45} The Court indicated its disapproval of state plaintiffs using ERISA as a springboard from which to pursue fiduciary claims in federal court when such plaintiffs have an adequate remedy in bringing suit in state courts against physicians themselves.\textsuperscript{46}

Although the Court used this line of reasoning in determining a different question\textsuperscript{47} than the duty to disclose physician incentives under ERISA, the dicta can still be instructive in that it indicates some of the Court's sentiments towards litigation in an ERISA fiduciary context.\textsuperscript{48} Along with this development, in \textit{Rush Prudential v. Moran}, the Supreme Court provided hope to state laws seeking to regulate insurance.\textsuperscript{49} The Court held that an Illinois law providing for review of HMO benefits denials was not preempted by ERISA.\textsuperscript{50}

\textsuperscript{44} \textit{Id.}

\textsuperscript{45} \textit{Id.}

\textsuperscript{46} \textit{Id.}

\textsuperscript{47} \textit{Id.} at 214. The Court noted:

The question in this case is whether treatment decisions made by a health maintenance organization, acting through its physician employees, are fiduciary acts within the meaning of the Employee Retirement Income Security Act of 1974 (ERISA), 88 Stat. 832, as amended, 29 U.S.C. § 1001 et seq. (1994 ed. and Supp. III). We hold that they are not.

\textit{Id.}

\textsuperscript{48} See \textit{supra} note 38 and accompanying text (giving some insight as to how a successful claim might be argued).


\textsuperscript{50} \textit{Id.}
III. FACTS OF THE CIRCUIT SPLIT DECISIONS

A. Shea v. Esensten

While traveling on business, Patrick Shea experienced chest pain and needed to be hospitalized. Upon his return home, Shea visited his family doctor. The family doctor was on the list of approved physicians for Shea’s employer-sponsored health plan. Shea explained his symptoms, which included dizziness, muscle tingling, and shortness of breath. Shea also explained his family’s history of heart problems. The doctor told Shea that he was too young to be referred to a cardiologist. Under Shea’s policy, he needed a written referral from his primary care physician to see such a specialist. Shea, who was unaware that his doctor had a financial incentive to limit referrals to cardiologists, expressed that he was willing to pay for the cost of referral himself. The doctor responded by assuring him that his symptoms and age did not necessitate such a referral. A few months later, Shea died from heart failure.

Dianne Shea, as Mr. Shea’s surviving spouse, brought claims against both the physician and Medica (the administrator for the employer-sponsored health plan) for malpractice and fraudulent non-disclosure. Under ERISA’s preemption doctrine, the case was removed to federal court. In federal court, Mrs. Shea amended her complaint to state that Medica had breached its fiduciary duty to disclose the existence of the financial incentive to limit care. Mrs. Shea claimed this was a breach because, as a fiduciary, Medica owed a duty to its plan members to disclose all material information affecting the care of beneficiaries. The district court dismissed the claim stating that the financial incentive in the contract was not a material fact requiring disclosure. The Eighth Circuit Court
of Appeals reversed. The court found that the existence of the incentive to limit referrals was indeed a material fact. The court further stated that as a fiduciary, the managed care organization owed a duty to its beneficiaries to reveal such material facts so that patients could make informed decisions relating to their health care. Writ of certiorari to the United States Supreme Court was denied.

B. Ehlmann v. Kaiser Foundation Health Plan of Texas

In 1997, Mary Ellen Ehlmann, on behalf of herself and other health plan members, brought a claim against Kaiser Foundation Health Plan of Texas for breach of fiduciary duty for failure to disclose physician incentive contracts to limit care. There was no patient injury alleged in the complaint. In bringing the claim, Ehlmann attempted to gain class action status. Specifically, Ehlmann sought an injunction to require Kaiser to “modify its member handbooks and/or physician directories to fully disclose to all plan members the bonus arrangements between the HMOs and their contracting physicians.” The district court granted Kaiser’s motion to dismiss Ehlmann’s claim.

The Fifth Circuit Court of Appeals affirmed. Relying on the text of ERISA, as well as its legislative history, the court determined that nowhere in the language could a broad duty to disclose be found. Applying principles of statutory construction, the court further refused to read a duty of disclosure into ERISA. At the same time, however, the court distinguished its findings from the Eighth Circuit’s decision in Shea. The Fifth Circuit Court of Appeals found that the Eighth Circuit failed to examine the statutory language when the Eighth Circuit determined that a duty existed in Shea. The Fifth Circuit also distinguished Ehlmann based on the existence of an actual injury in Shea.

68 Id.
69 Shea, 107 F.3d at 628.
70 Id.
73 Id. at 553-54.
74 Id. at 554.
75 Id.
76 Id.
77 Id.
78 Ehlmann, 198 F.3d at 555-56.
79 Id.
80 Id.
81 Id.
82 Id.
83 Id. at 556.
84 Ehlmann, 198 F.3d at 556.
85 Id.
C. Horvath v. Keystone Health Plan East, Inc.\textsuperscript{86}

In January 2000, Donna Horvath, a benefits administrator for a law firm,\textsuperscript{87} brought claims for fraudulent non-disclosure against the company from which she received her health care.\textsuperscript{88} Like the plaintiff in \textit{Ehlmann}, a trip to her physician’s office did not prompt the claim.\textsuperscript{89} Rather, she initiated the claim after her discovery of the existence of financial incentives to limit care.\textsuperscript{90} Like Ms. Ehlmann, Horvath also attempted to gain class action certification.\textsuperscript{91} Again, the case was decided in federal court.\textsuperscript{92}

The district court dispensed Horvath’s claim on a motion for summary judgment.\textsuperscript{93} The court found no duty to disclose.\textsuperscript{94} The Third Circuit Court of Appeals upheld the district court.\textsuperscript{95} The appellate court found that there was no duty to disclose the existence of financial incentives to limit care unless specific exceptions were met.\textsuperscript{96} The court commented that, in this instance, because there was no actual injury alleged,\textsuperscript{97} disclosure was not necessary.\textsuperscript{98} The court stated that “absent a request for such information by Horvath, absent circumstances which put Keystone on notice that Horvath needed such information to prevent her from making a harmful decision with respect to her healthcare coverage, and absent any evidence that Horvath was harmed” because the information on financial incentives was not disclosed to her, a duty to disclose could not be imposed.\textsuperscript{99}

IV. ANALYSIS

When comparing these three cases from the Eighth, Fifth, and Third circuits, several striking differences in the courts’ analysis of whether a duty to disclose

\textsuperscript{86} Horvath v. Keystone Health Plan E., Inc., 333 F.3d 450 (3d Cir. 2003).
\textsuperscript{87} Id. at 452.
\textsuperscript{88} Id.
\textsuperscript{89} Id. at 453.
\textsuperscript{90} Id.
\textsuperscript{91} Id.
\textsuperscript{92} Horvath, 333 F.3d at 453.
\textsuperscript{93} Id. at 454.
\textsuperscript{94} Id.
\textsuperscript{95} Id. at 462-63.
\textsuperscript{96} Id.
\textsuperscript{97} Id. at 463.
\textsuperscript{98} Horvath, 333 F.3d at 463.
\textsuperscript{99} Id.
financial incentives to ration care under ERISA become readily apparent.100 First of all, *Shea* is the only case of the three that actually involved a visit to a physician.101 Unfortunately, *Shea* also involved a negative patient outcome.102 This striking difference cannot be ignored.103 In fact, the courts in both *Ehlmann*104 and *Horvath*105 stated that *Shea* is distinguishable on the basis of that one fact.106 In this context, it is clear that a patient with an actual injury that may have been caused or at least worsened by the lack of disclosure may have fared better in both *Ehlmann* and *Horvath*.107 In addition to the tremendous differences in plaintiffs among these three cases, each appellate court also used different methods to determine whether or not a duty to disclose physician incentive contracts existed.108 As a result, with such an extreme set of facts in the case of *Shea*,109 one might conclude that both *Shea* and *Ehlmann* were correctly decided in the pre-*Pegram*110 and pre-*Moran*111 world where federal preemption of state law claims was a major obstacle to plaintiffs' attempts to hold someone accountable. However, post-*Pegram* and post-*Moran*, *Shea* and other attempts by courts to create or expand a duty to disclose may not be necessary.112 What follows is an analysis of the three circuit cases and what they add to the overall picture of fiduciary duty to disclose physician incentives under ERISA.


101 *Shea*, 107 F.3d at 626.

102 Id.

103 See *Ehlmann*, 198 F.3d at 556; *Horvath*, 333 F.3d at 462-63.

104 *Ehlmann*, 198 F.3d at 556.

105 *Horvath*, 333 F.3d at 462-63.

106 See *Ehlmann*, 198 F.3d at 556; *Horvath*, 333 F.3d at 462.

107 *Ehlmann*, 198 F.3d at 556 (declining to address the duty to disclose physician incentive plans when faced with "a specific injury from a plan member or given some other special circumstance"); *Horvath*, 333 F.3d at 462-63 (expressly stating, in footnote 11, that physician incentives prompting inadequate medical treatment and resulting in injury to an HMO patient may serve as grounds for relief in a state court malpractice action).

108 See *Shea* v. *Esensten*, 107 F.3d 625, 628-29 (8th Cir. 1997); *Ehlmann*, 198 F.3d at 554-56; *Horvath*, 333 F.3d at 460-63.

109 *Shea*, 107 F.3d at 626-27.

110 See *Pegram* v. *Herdrich*, 530 U.S. 211 (2000). See also Richard D. Leigh, Comment, *Physician Incentives and ERISA Fiduciary Liability After Pegram v. Herdrich: What Solutions Are Available to HMO Patients Harmed by Non-Disclosure of Incentive Compensation Schemes?*, 106 DICK. L. REV. 415, 461 (2001) (stating: "[t]hus, while the participant who is harmed by non-disclosure of physician incentives may have an ERISA cause of action even after *Pegram*, if the participant's claim alleges breach of the common-law duty to disclose material information, ERISA pre-emption, and the consequent limitation of available remedies, may be avoidable"). Id.


112 Leigh, supra note 110, at 461.
A. Materiality

Shea's strength lies in the court's determination that the physician incentive to limit care is a material fact that must be disclosed to the patient. In Shea, by finding that the existence of the incentive to limit referrals to cardiologists was a material fact that should have been disclosed, the court tacitly agreed with the proposition that had Mr. Shea known of the existence of the incentive to limit care, he might have proceeded differently in the pursuit of his health care.

According to the court:

[from the patient's point of view, a financial incentive scheme put in place to influence a treating doctor's referral practices when the patient needs specialized care is certainly a material piece of information. This kind of patient necessarily relies on the doctor's advice about treatment options, and the patient must know whether the advice is influenced by self serving financial considerations created by the health insurance provider.]

Here the court stressed that a patient, as a layman unfamiliar with more advanced medical treatment options, relies on his doctor's advice and may fail to make informed choices if ignorant of possible financial incentives prompting his doctor to discourage or refuse referrals to specialists.

Although one can disagree as to whether the incentive structure truly influenced the physician to put "self serving financial considerations" ahead of

There is little factual support, however, for the argument that HMO physician incentives actually cause physicians to compromise the health care of their patients. In the unlikely event that a physician should sacrifice his patient's health for his own pecuniary gain, the physician almost certainly will expose himself to a malpractice claim, thereby offsetting any pecuniary gain with higher malpractice insurance rates.

Id.
the well-being of the patient being treated, the basic idea is valid.\textsuperscript{119} The idea is that a patient must have all of the necessary facts at his disposal in order to make the best decision possible.\textsuperscript{120} In Mr. Shea's situation, it was clear he did not have all of the facts necessary to make the best decision for himself.\textsuperscript{121} Unfortunately, unlike Mr. Shea's physician or HMO, we have the ability to make that determination with the benefit of hindsight.\textsuperscript{122} We know how the story ends.\textsuperscript{123} Under \textit{Shea}, the problem becomes whether a physician should always assume the worst-case scenario when making a referral decision.\textsuperscript{124} If there is no blanket requirement for disclosure, are all parties at the mercy of what is deemed to be a "material fact" by a court?\textsuperscript{125}

Under \textit{Shea}'s logic, in future physician encounters, if the decision not to refer is made, should a red flag then go up in the patient's chart that prompts a phone call or postcard from the HMO detailing the incentive contract under which the physician is operating?\textsuperscript{126} We can point to Mr. Shea's tragic example and clearly state that disclosure should have been made.\textsuperscript{127} But one can only speculate as to how many such tragedies actually transpire each year.\textsuperscript{128} The issue is further complicated by disagreement amongst patients and courts as to the definition of "materiality" and the practical consequences of unnecessary disclosure.\textsuperscript{129} Analytically, the conflict seems to be over whether disclosure

\begin{footnotesize}
\begin{itemize}
  \item[\textsuperscript{119}] Shea, 107 F.3d at 628-29.
  \item[\textsuperscript{120}] Id.
  \item[\textsuperscript{121}] Id. at 626-29.
  \item[\textsuperscript{122}] Id. at 626-27.
  \item[\textsuperscript{123}] Id.
  \item[\textsuperscript{124}] See Mark A. Hall, \textit{The Theory and Practice of Disclosing HMO Physician Incentives}, 65 LAW \& CONTEMP. PROBS. 207, 211 (2002) (asserting that "[m]andating disclosure unnecessarily, either when it would occur naturally or when the information is not actually relevant to consumers' decisions, could impose several costs beyond the trivial costs of releasing the information").
  \item[\textsuperscript{125}] This problem can be intensified by the different legal theories that plaintiffs use to impose liability. See Hall, \textit{supra} note 124, at 214-16 (explaining the various types of legal theories, such as tort, fraud, fiduciary, or lack of informed consent, and their ramifications on the average physician's practice).
  \item[\textsuperscript{126}] See generally Hall, \textit{supra} note 124, at 214-22 (discussing the types of disclosure and their practical applications in the real world, including the two types of mandated disclosure: liability and regulatory).
  \item[\textsuperscript{127}] Shea, 107 F.3d at 626-29.
  \item[\textsuperscript{128}] Indeed, because of the problem of possibly not knowing what contracts are at play, this figure may not be discernable. See Leigh, \textit{supra} note 110, at 458 (discussing how difficult it would be in a doctor's practice to implement disclosure, given the large number and various types of contracts under which each physician is obligated in today's world).
  \item[\textsuperscript{129}] See Hall, \textit{supra} note 124, at 211. The author states:

\begin{quote}
Cluttering consumer information with irrelevant and distracting detail makes it more difficult to focus on the information consumers find truly important, which detracts from the ultimate economic goal of disclosure. Also, because governmental mandates tend to be uniform and
\end{quote}
\end{itemize}
\end{footnotesize}
should be mandated in order to protect patients from harm or in order to provide injured patients with an avenue for relief. 130

At the time of the court's decision in *Shea*, 131 the United States Supreme Court had not decided either *Pegram* 132 or *Moran*. 133 The Eighth Circuit Court of Appeals could have been laboring under the idea that a plaintiff faced with such a shocking array of facts should have a way to vindicate her claims in the courts, notwithstanding the deference federal courts were affording defendants regarding preemption. 134 Indeed, preemption is what caused Mrs. Shea to amend her initial complaint. 135 In light of the possible preemption context, *Shea* appears more palatable. 136 However, the Supreme Court's opinions in both *Pegram* 137 and *Moran* 138 may make *Shea* unnecessary. 139

If difficult to modify, they may lock into place a form or content of disclosure that is suboptimal. A government mandate runs the risk of delivering the wrong type or quantity of information, in the wrong format, and at the wrong time. Therefore, further reflection is needed to establish more firmly the justification for mandatory disclosure laws.

Id.

130 See Hall, *supra* note 124, at 210-22 (explaining the different purposes for disclosure, ranging from protection from physician or HMO liability to proper patient education of the economic burdens on the health care system imposed by mandatory disclosure).

131 *Shea*, 107 F.3d at 628-29.


135 *Shea*, 107 F.3d at 627.


137 *Pegram*, 530 U.S. at 231.

138 *Moran*, 536 U.S. at 387.

139 See Leigh, *supra* note 110, at 460 (stating "while *Pegram* undoubtedly has closed one door to recovery, it appears to have opened another door that previously had been closed, at least in some jurisdictions: the state law negligence action against the HMO"). See also Hall, *supra* note 20, at 705 (stating "*Moran* represents further erosion of the oft-quoted doctrine that ERISA represents a complete insulation of MCOs from accountability for their decisions"). The author also states:

Under the recently-announced *Moran* decision, state laws providing for independent review of MCOs' administrative denials of coverage were denominated the "regulation of insurance" for purposes of ERISA's savings clause. However, unlike an independent review, direct regulation of physician financial incentives might be seen to affect the content of an ERISA plan, and thus "relate to" an employee benefit plan for purposes of preemption analysis.
B. **Statutory Construction**

Not only were the facts in *Ehlmann* vastly different from those in *Shea*, the Fifth Circuit also approached the question in a strikingly different fashion.\(^{140}\) Where the *Shea* court focused on materiality,\(^ {141}\) the *Ehlmann* court focused instead on the statutory construction of the fiduciary and disclosure provisions in ERISA,\(^ {142}\) noting:

>[that Congress and DOL [(Department of Labor)]] were so capable of enumerating disclosure requirements when they wanted to means that the absence of one regarding physician compensation plans was probably intentional. This fact, along with the general principle of statutory construction that more specific provisions in a statute govern over those generally worded, counsels against judicial intervention to add a disclosure requirement to those already provided. As the Sixth Circuit stated, “[i]t would be strange indeed if ERISA’s fiduciary standards could be used to imply a duty to disclose information that ERISA’s detailed disclosure provisions do not require to be disclosed.”\(^ {143}\)

Thus, the court invoked canons of statutory construction to discourage the implementation of disclosure requirements where Congress did not impose such a duty in ERISA’s comprehensive disclosure provisions.\(^ {144}\)

*Ehlmann* argued that Congress’ enunciation of the fiduciary and disclosure provisions occurred before the current health care crisis arose.\(^ {145}\) *Ehlmann* further argued that Congress, when enacting ERISA, could not have foreseen the current state of relationships in the managed care world.\(^ {146}\) Given that fact, the broad reading of the duty that *Ehlmann* espoused was actually in keeping with

---

*Id.* at 715-16.


\(^{141}\) *Shea v. Esensten*, 107 F.3d 625, 628-29 (8th Cir. 1997).

\(^{142}\) *Ehlmann*, 198 F.3d. at 554-56.

\(^{143}\) *Id.* at 555.

\(^{144}\) *Id.*

\(^{145}\) *Id.* at 555 n.3.

\(^{146}\) *Id.*
Congress' intent to protect the interest of employees under ERISA.\textsuperscript{147} It is hard to deny that many changes have indeed taken place since Congress originally enacted ERISA.\textsuperscript{148} The problem for the \textit{Ehlmann} court appeared to be the broad nature of the duty that Ehlmann wished to establish.\textsuperscript{149} The court was unwilling to play the role of a judicial legislature and declare that a broad duty existed in the absence of any clear evidence of congressional intent.\textsuperscript{150} The question remains, what would have been the court's finding had the request not been as broad, or had Ehlmann suffered specific injury as a result of a failure to disclose?\textsuperscript{151} The court refused to give any hints: "We do not pass on what sort of disclosure, if any, that Section 404 might require given a specific inquiry from a plan member or given some other special circumstance."\textsuperscript{152}

Like the Eighth Circuit in \textit{Shea},\textsuperscript{153} the Fifth Circuit in \textit{Ehlmann} made its decision in the pre-\textit{Pegram} world.\textsuperscript{154} Given the facts confronting the court in \textit{Ehlmann},\textsuperscript{155} it is highly unlikely that the United States Supreme Court's analysis in \textit{Pegram} would have affected the conclusion reached by the Fifth Circuit.\textsuperscript{156} In fact, the \textit{Ehlmann} decision is arguably bolstered by both \textit{Pegram}\textsuperscript{157} and \textit{Moran}.

\begin{footnotesize}
\begin{itemize}
\item\textsuperscript{147} \textit{Id.} at 555.
\item\textsuperscript{148} See \textit{Leigh}, supra note 110, at 419–34 (discussing the healthcare insurance industry and its various changes, including movement from fee-for-service to managed forms of payment). See also \textit{Sullivan}, supra note 9, at 267-75 (discussing the same progression from fee-based service to capitation).
\item\textsuperscript{149} \textit{Ehlmann}, 198 F.3d at 554-56.
\item\textsuperscript{150} \textit{Id.} at 555. \textit{But see} \textit{Johnson}, supra note 26, at 1653 stating:

The "specific trumps the general" canon is a "warning against applying a general provision when doing so would undermine limitations created by a more specific provision" and thus frustrate congressional intentions. This canon is merely a "rule of thumb," however, and should not apply if there is evidence of contrary legislative intent or policy. Given the fact that disclosure is the "core of a fiduciary's responsibilities" under the common law of trusts, ERISA's incorporation of trust law indicates that Congress did not intend ERISA's specifically enumerated disclosure obligations to be an exhaustive list.

\textit{Id.}
\item\textsuperscript{151} \textit{Ehlmann}, 198 F.3d at 556.
\item\textsuperscript{152} \textit{Id.}
\item\textsuperscript{153} \textit{Shea} v. \textit{Esensten}, 107 F.3d 625, 626-29 (8th Cir. 1997).
\item\textsuperscript{154} \textit{Ehlmann}, 198 F.3d at 552-57.
\item\textsuperscript{155} \textit{Id.}
\item\textsuperscript{156} \textit{Pegram} v. \textit{Herdrich}, 530 U.S. 211 (2000).
\item\textsuperscript{157} \textit{Id.}
\item\textsuperscript{158} \textit{Rush Prudential} v. \textit{Moran}, 536 U.S. 355 (2002).
\end{itemize}
\end{footnotesize}
C. Case Law Synthesis

The Third Circuit Court of Appeals faced a very similar case to that of Ehlmann in Horvath. Unlike both Shea and Ehlmann, however, Horvath was decided in the post-Pegram and post-Moran world. In addition, the Horvath court faced a question that dealt with a broad disclosure of HMO incentives already being made, and whether that broad disclosure gave rise to a duty to make more specific disclosures describing the particular incentives to ration care.

Whereas the analysis of the Shea and Ehlmann courts rested primarily on what constituted a "material fact" and statutory construction, the Horvath court tackled the same issue by reasoning through several of its own opinions on related matters.

The Third Circuit examined the district court's analysis by first turning to its own decision in Bixler. In Bixler, a case dealing with death benefits, the Third Circuit held that an individual claim for breach of fiduciary duty under ERISA could proceed. The court further found that the plaintiff's "requests for information, coupled with the fiduciary's understanding of her status and situation, imposed a duty to accurately convey all information relevant to her circumstances."

160 Shea v. Esensten, 107 F.3d 625 (8th Cir. 1997).
163 Moran, 536 U.S. at 355.
164 Horvath, 333 F.3d at 453 (3d Cir. 2003). The court stated:

Specificially, she [(Ms. Horvath)] received a letter from Keystone disclosing its practice of attempting to "[c]ontrol the increase of health care costs through negotiated agreements with health care providers, doctors, hospitals, pharmacy, and ancillary providers," as well as a Doctor and Hospital Directory that included a description of the physician compensation plan. Horvath also received literature, the Keystone Health Plan East Member Handbook and the September 1999 Letter to Benefits Administrator, which provided that she could request additional information regarding physician compensation. She concedes she never made any effort to do so.

Id.

165 Shea, 107 F.3d at 628-29.
167 Id. at 461.
169 Horvath, 333 F.3d at 461 (citing Bixler, 12 F.3d at 1300).
Next, the court moved to *Glaziers*, a case dealing with the disclosure of a money-manager’s resignation under suspicious circumstances. The plaintiffs in *Glaziers* transferred their money to the departing broker’s new firm. After the broker stole a large amount of money from them, the plaintiffs filed suit against the old firm. In examining their decision in *Glaziers*, the Third Circuit Court of Appeals concluded that:

> [I)n certain circumstances, the knowledge of the fiduciary may give rise to such a duty even in the absence of a specific request by the beneficiary because “absent such information, the beneficiary may have no reason to suspect that it should make inquiry into what may appear to be a routine matter.”

Thus, this decision allowed beneficiaries to gain some ground in pursuit of claims for breach of fiduciary duty even when they did not request the information at issue, though such headway was limited by the court’s inclusion of the phrase “in certain circumstances.”

Finally, the *Horvath* court also discussed *Jordan*, a case dealing with the irrevocability of retirement fund beneficiary designation. In *Jordan*, the court “applied the definition of materiality . . . to a claim for failure to disclose under [ERISA] § 404.” The court concluded that “such a failure [to disclose] was material if ‘there is a substantial likelihood that it would mislead a reasonable employee in making an adequately informed retirement decision.’”

Understanding the appellate courts’ findings in these prior cases is critical to understanding the holding of *Horvath*. The court of appeals found that the district court was correct in concluding *Horvath* failed to state any issues of material fact for which she could receive a remedy because:

---

170 *Glaziers & Glassworkers Union Local No. 252 Annuity Fund v. Newbridge Sec., Inc.*, 93 F.3d 1171 (3d Cir. 1996).
171 *Id.* at 1175-76.
172 *Id.* at 1177.
173 *Id.*
174 *Id.* at 1181.
176 *Id.*
178 *Id.* at 1007.
179 *Horvath*, 333 F.3d at 461.
180 *Id.* (quoting *Jordan*, 116 F.3d at 1015).
181 *See Horvath*, 333 F.3d at 461-63 (noting the court’s line of reasoning).
[S]he failed to request the information Keystone offered to make available[,] ... there was no set of circumstances pursuant to which Keystone should have known that such information was necessary to prevent Horvath from making a harmful decision regarding her healthcare coverage, ... and ... she failed to explain how the information at issue was material in light of the fact that her employer offers no other options for healthcare coverage....

Thus the court employed and combined its own prior decisions to impose limitations on claims for breach of fiduciary duty for failure to disclose incentives to limit care.\textsuperscript{182}

In other words, the appellate court agreed completely with the district court’s analysis and with its application of the appellate court’s prior decisions.\textsuperscript{183} After agreeing with the district court’s analysis below, the court stated that in addition to the district court’s reasoning, “Horvath’s claim is indistinguishable from the one rejected by the Fifth Circuit Court of Appeals in \textit{Ehlmann v. Kaiser}, where it declined to add physicians’ reimbursement plans to the list of specific disclosure requirements already included in ERISA by Congress.”\textsuperscript{184} The \textit{Horvath} court mentioned \textit{Shea} in stating: “to the extent that our conclusion is inconsistent with the position taken by the Eighth Circuit Court of Appeals in \textit{Shea v. Esensten}, we are not bound by \textit{Shea}.”\textsuperscript{185}

By merely reciting the wisdom of its own precedent, the court’s holding in \textit{Horvath} is essentially a compilation of the other three holdings as applied to the managed care/incentive to limit care context.\textsuperscript{186} Because of this, the holding appears to make sense, but over-reaches in trying to encompass areas that are

\textsuperscript{182} \textit{Id.} at 462.
\textsuperscript{183} \textit{Id.}
\textsuperscript{184} \textit{Id.}
\textsuperscript{185} \textit{Id.} (citation omitted).
\textsuperscript{186} \textit{Id.} (citation omitted).
\textsuperscript{187} \textit{Horvath}, 333 F.3d at 462-63. The court stated:

\textit{[W]e hold that ERISA imposes no duty on Keystone to disclose information regarding its physician incentives absent a request for such information by Horvath, absent circumstances which put Keystone on notice that Horvath needed such information to prevent her from making a harmful decision with respect to her healthcare coverage, and absent any evidence that Horvath was harmed as a result of not having such information disclosed to her.}

\textit{Id.}
consistent with the Third Circuit’s prior opinions as it relates to both materiality and to a duty to disclose when the fiduciary is on notice that the absence of such disclosure could injure the beneficiary.\textsuperscript{188} Certainly, the court was correct in its reasoning and in the line of logic it drew from the prior decisions.\textsuperscript{189} The problem is, those cases can be distinguished by the fact that they relate to information disclosure as applied to payment of death benefits,\textsuperscript{190} disclosure of the resignation of a money manager under questionable circumstances,\textsuperscript{191} and disclosure as to the irrevocability of a retirement plan designation.\textsuperscript{192} These instances are generally characterized by a more extensive passage of time as compared to the immediacy of medical decision-making.\textsuperscript{193} In addition, in the context of retirement plans and death benefits, the remedy of money is identical to what is at issue.\textsuperscript{194} This is in stark contrast to where a patient’s very life is at stake.\textsuperscript{195} Given the range of emotions covering health care today,\textsuperscript{196} the court’s holding seems less harsh than it would have in simply stating “No duty to disclose unless information is requested.”\textsuperscript{197} The reality of the application of the holding, however, may be as if that is all that was ever stated in the decision.\textsuperscript{198} The reason is that in application, the final two segments of the holding will either be extremely difficult and costly to administer or simply too little too late.\textsuperscript{199} The portion stating “absent circumstances which put Keystone on notice that Horvath needed such information to prevent her from making a harmful decision with respect to her healthcare coverage”\textsuperscript{200} raises many questions all by itself, not to mention the fact that its vagueness lends it to much litigation.\textsuperscript{201}

\textsuperscript{188} See Horvath v. Keystone Health Plan E., Inc., No. CIV.A.00-0416, 2002 WL 265023, at *4 (E.D. Pa. Feb. 22, 2002) (stating “[w]hile not speaking specifically to the disclosure of physician incentives, the Third Circuit has developed a body of law with respect to an ERISA fiduciary’s obligation of disclosure”). It appears that even though none of the prior cases individually spoke to the “disclosure of physician incentives,” somehow, collectively, they can. Id.

\textsuperscript{189} See Horvath, 333 F.3d at 461-63 (noting the court’s line of reasoning).

\textsuperscript{190} Bixler v. Cent. Pa. Teamsters Health & Welfare Fund, 12 F.3d 1292 (3d Cir. 1993).

\textsuperscript{191} Glaziers & Glassworkers Union Local No. 252 Annuity Fund v. Newbridge Sec., Inc., 93 F.3d 1171 (3d Cir. 1996).


\textsuperscript{193} Consider the differences between the facts in Shea v. Esensten, 107 F.3d 625, 626-27 (8th Cir. 1997), involving a deceased husband, and the facts in Glaziers, 93 F.3d at 1175-77, involving disgruntled pension holders.

\textsuperscript{194} See supra note 195.

\textsuperscript{195} Id.

\textsuperscript{196} See Portzline, supra note 134, at 402-04 (implying how emotions might have affected the court in Shea).

\textsuperscript{197} Id.

\textsuperscript{198} See Hall, supra note 124, at 210-11, 215-17 (discussing the difficulties in the actual process of disclosure, as well as inherent obstacles in the system of disclosure).

\textsuperscript{199} Id.


\textsuperscript{201} Cf. Hall, supra note 124, at 210-11 (referenced in note 192 supra). Hall’s article examined a number of problems inherent in making disclosure of financial incentives mandatory. Id. In light
What constitutes an HMO being put on notice? Will HMOs have to track every patient file the day of every visit in order to be on notice? Or better yet, would the HMOs simply organize themselves in a way to never constructively be on notice about anything, thus avoiding the duty to disclose? The decision decidedly raises many more questions than it answers.

In addition to the second part of the court's holding, the final segment of its holding which states that a duty to disclose will not be implied by ERISA absent evidence the plan beneficiary "was harmed as a result of not having such information disclosed" could be devastating. What type of harm must be shown? Must the plaintiffs wait until their loved ones have died of heart failure before an adequate harm is shown? Or will a seemingly benign harm of "sleepless nights and anxiety" fit the bill? After a harm has been suffered, the plaintiff should be able to recover for that harm anyway, without having to rely on a breach of fiduciary duty claim for non-disclosure of a material fact.

The court states in a footnote:

We note, however, that our ruling in no way leaves plan members, who have suffered harm, without a remedy. The Supreme Court's decision in Pegram would in no way preclude a claim by an HMO patient that the existence of financial incentives caused inadequate medical care to be provided, resulting in injury to the patient. "Treatment" or "quality of care" decisions are not preempted by ERISA and therefore could be brought as a state court medical malpractice action.

of his observations, the imposition of mandatory disclosure would further complicate an already disjointed health care system. Id.

See supra note 200.


Leonard J. Nelson III, Helling v. Carey Revisited: Physician Liability in the Age of Managed Care, 25 SEATTLE U. L. REV. 775, 810-11 (2002) (proposing that, in order for a patient to recover damages, they "would have to establish some actual harm as a result of the influence of the financial incentives. Ordinarily, this harm would consist of the loss of a chance of an improved condition because of the denial of access to a particular treatment or diagnostic procedure").

Shea v. Esensten, 107 F.3d 625 (8th Cir. 1997).

See Nelson, supra note 209.

Horvath, 333 F.3d at 463 n.11.

Id.
This dicta thus points plaintiffs who have suffered a harm to another avenue of relief, away from federal court decisions imposing limits on ERISA suits. Such plaintiffs may pursue state court medical malpractice actions.

As a result, the court may have been better served had the holding only read “No duty to disclose unless requested by beneficiary.” Although this conclusion might seem harsh to patients, it is evident that foreclosing this avenue of litigation will not deny aggrieved plaintiffs opportunities for recovery elsewhere.

In addition to the previously mentioned problems presented by the court’s synthesis of prior holdings is the conundrum presented by the wording of the holding itself. Proper grammatical reading leads one to believe that all elements of the holding must be satisfied in order for a duty to be attributed to an HMO. Such a reading, however, seems to fly in the face of the court’s own reasoning throughout its entire examination of the district court’s decision. In fact, if the proper grammatical line of thinking were to carry the day, the court would be stating that even if a patient requested information, the HMO would still have to be on notice of such a need that an absence of information could prove detrimental, and even then an injury must occur. It seems very illogical to think the court would examine Glaziers and its holding that some circumstances present occasions for disclosure even absent requests for such disclosures, and then hold that regardless of its own precedent, a request must always be made.

D. Proposal

After scrutinizing the three circuit opinions, it appears that though none are perfect. Ehlmann applied the best reasoning in light of the statutory structure of ERISA. Although the human loss in Shea carries great weight, a broad duty to
disclose cannot be implied absent the specific intent of Congress.\textsuperscript{224} In \textit{Ehlmann}\textsuperscript{225} and \textit{Horvath},\textsuperscript{226} absent powerful word-smithing and statutory slight of hand, the point seems to be that the plaintiffs suffered no cognizable harm and no specific request for the information was ever made.\textsuperscript{227} The facts before the courts simply were not compelling enough to read into the statutory structure a duty that Congress decided not to expressly spell out.\textsuperscript{228} It is natural to see injuries and feel a strong desire to see them remedied.\textsuperscript{229} The history of jurisprudence demonstrates that courts will find ways to provide remedies for aggrieved plaintiffs even when there appears to be no current relief available.\textsuperscript{230} In light of \textit{Pegram}, it is clear that HMOs have been given broad leeway to run their operations, as they should in a country seeking to strike a balance between both the quality and quantity of health care provided.\textsuperscript{231} The Court in \textit{Pegram} better served this balance in manifesting its unwillingness to declare financial incentives designed to ration care as a breach of the HMO's fiduciary duty.\textsuperscript{232} Instead, the Court declared mixed decisions of eligibility and treatment to be non-fiduciary in nature.\textsuperscript{233} As a result, because these decisions are "mixed" and not envisioned by Congress as worthy of inclusion in the ERISA scheme,\textsuperscript{234} these decisions may escape preemption under ERISA.\textsuperscript{235} Added to \textit{Pegram}'s ramifications is the fallout from \textit{Moran} and the potential for more state involvement in the process of examining HMO policies.\textsuperscript{236} The consequence of this is that plaintiffs may be able to seek redress in state court without worrying about losing their claims in federal court.\textsuperscript{237} With this in mind, courts can face the cases in front of them based on their own state law.\textsuperscript{238} Legislatures in each

\textsuperscript{224} \textit{Id.} at 556. \textit{But see} Sullivan, \textit{supra} note 9, at 306 (stating "[I]t is highly unlikely that Congress ever envisioned ERISA to negatively impact HMO beneficiaries. It is doubtful that Congress intended ERISA to put HMO beneficiaries in a worse position than they would have been if ERISA had not been made law").

\textsuperscript{225} \textit{Ehlmann}, 198 F.3d at 556.

\textsuperscript{226} \textit{Horvath}, 333 F.3d at 461.

\textsuperscript{227} \textit{See Ehlmann}, 198 F.3d at 552-56; \textit{Horvath}, 333 F.3d at 460-63.

\textsuperscript{228} \textit{See supra} text accompanying note 143.

\textsuperscript{229} \textit{See Portzline, supra} note 134, at 402-04 (implying how courts can find results based on emotions and perhaps based on results of other cases).

\textsuperscript{230} \textit{Id.}


\textsuperscript{232} \textit{Id.} at 231.

\textsuperscript{233} \textit{Id.} at 229-31.

\textsuperscript{234} \textit{Id.} at 231.

\textsuperscript{235} \textit{See supra} note 110.

\textsuperscript{236} \textit{See supra} note 139 (discussing ramifications of \textit{Pegram} and possible implications for state actions).

\textsuperscript{237} \textit{Id.}

\textsuperscript{238} \textit{Id. But see} Zelinsky, \textit{supra} note 8, at 464 (discussing the pitfalls of the "deemer" clause, which limits the states' encroachment into employer health plans). There are clearly limits to what states can do in the way of regulation. \textit{Id.} The author states:
state will be free to determine what causes of action or guidelines they want followed in cases involving physician incentive structures, medical malpractice, denial of care, etc.\textsuperscript{239} As a result, claims such as those in \textit{Ehlmann} and \textit{Horvath} become unnecessarily burdensome to the court system and only result in increasing the overall cost of healthcare.\textsuperscript{240} Because of this, either one of two things should happen. Either the Supreme Court should take the next case like this that comes out of a circuit court of appeals and declare that under ERISA, absent a specific request, no duty to disclose physician incentives exists. In the likely event that this will not occur, Congress should amend ERISA to state that no fiduciary duty exists to disclose physician incentive structures on either the physician or the HMO, absent a specific request from a beneficiary. In the meantime, patients should recognize the strong and necessary role that insurance plays in modern health care, and as a result, always ask a multitude of questions of both their physicians and their insurers.\textsuperscript{241}

V. CONCLUSION

The issue of whether ERISA imposes a duty on HMO fiduciaries to disclose to their beneficiaries the existence of an incentive contract to limit care depends largely on whether the goal of imposing such a duty is to limit patient harm or to

\textit{Id.} \textsuperscript{239} See supra note 139 (discussing ramifications of \textit{Pegram} and possible implications for state actions).

\textsuperscript{240} See Hall, supra note 124, at 210-11.

\textsuperscript{241} See Kurfirst, supra note 118, at 26-27 (arguing that “forcing physicians to discuss financial incentives may lead to confusion, distrust and greater inefficiency,” but if the patient has questions, they should certainly ask them).
provide a means of recovery when a harm occurs. Because the nature of patient care continues to change, and because the managed care companies are providing more and more disclosure, the goal should be to provide an avenue for relief if an injury occurs. As a result, in light of the onslaught against preemption in recent Supreme Court jurisprudence, no duty to disclose financial incentives should be attributed to HMOs absent a specific request from beneficiaries.

---

242 See supra note 148.
243 See Hall, supra note 124, at 222 (commenting on how the disclosure atmosphere has changed from the managed care side). The author explains:

As recently as early 1998, it was reported that virtually no health plans were disclosing physician incentives. ... [M]ost national health plans now routinely disclose in general terms how they pay their physicians. Thus, discussion has quickly shifted from whether disclosure should occur to how, when, and what should be disclosed, and by whom.

Id.
244 See supra Part IV.A-D (explaining the difficulty in providing disclosure before an injury occurred and how recovery may now be easier).
246 See supra Part IV.A-D (analyzing the split decisions, and demonstrating that, given the current atmosphere in state litigation, aggrieved plaintiffs are likely to have a recourse against HMOs).