IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

JUDY KELLY, HARRIETTE OWENS WALDRON, SCOTT SYMONS and MICHAEL PUTNICK,	)	
Plaintiffs,	)	C.A. No. 99C-09-265 WCC
v.	)	
MCKESSON HBOC, INC., MARK A. PULIDO, CHARLES W. MCCALL and RICHARD H. HAWKINS,	)	
Defendants.	)	

Submitted: October 18, 2001
Decided: January 17, 2002

O P I N I O N

Plaintiffs' Motion for Partial Summary Judgment. Denied.

Defendant McKesson HBOC, Inc.'s Motion to Dismiss. Denied.

Plaintiffs' Motion to Strike Exhibit A of Defendant McKesson HBOC, Inc.'s Opening Brief. Denied.

Defendant Mark A. Pulido's Motion to Dismiss. Granted.

Defendant Charles W. McCall's Motion to Dismiss. Granted.

Defendant Richard H. Hawkins's Motion to Dismiss. Granted.

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CARPENTER, J.

This is the Court's decision on Plaintiffs' motion for partial summary judgment, each of the Defendants' individual motions to dismiss, and Plaintiffs' motion to strike Exhibit A of Defendant McKesson HBOC, Inc.'s opening brief.

FACTS

On December 17, 1998, Judy Kelly, Harriette Owens Waldron, Scott Symons and Michael Putnick (collectively the "Plaintiffs") sold their businesses, KWS&P, Inc. and KWS&P/SFA, Inc., to McKesson Corporation ("McKesson")[1] by entering into an Agreement and Plan of Merger ("Merger Agreement"). This was designed to be a stock-for-stock merger, and in exchange for their businesses, the Plaintiffs were to receive $103.5 million in publicly registered McKesson common stock. The exact number of shares, to which the Plaintiffs were entitled, was determined by computing the average New York Stock Exchange ("NYSE") closing price of McKesson common stock for the ten (10) consecutive trading day period three days prior to closing.

[1] The Plaintiffs' businesses, which were sold to McKesson, focused on processing and marketing data for pharmaceutical manufacturers. The businesses assisted pharmaceutical manufacturers in selling their products to and through doctors and consumers by analyzing marketing data. Each Plaintiff owned 25% of KWS&P, Inc., while each Plaintiff owned 17.5 % of KWS&P/SFA, Inc. They collectively owned 70%. A fifth stockholder, not a party to this action, owned the remaining 30% interest in KWS&P/SFA, Inc.

On October 18, 1998, prior to the completion of the above merger, McKesson and HBO & Company ("HBOC") publicly announced that they had also agreed to a merger. On January 12, 1999, the McKesson/HBOC merger closed, and McKesson changed its name to McKesson HBOC, Inc. ("McKesson HBOC")[2] and HBOC became a wholly-owned subsidiary of the company.

On January 26, 1999, the Plaintiffs' businesses merged into wholly-owned subsidiaries of McKesson HBOC. Pursuant to the Merger Agreement, the Plaintiffs received a total of 998,336 McKesson HBOC shares plus 110,926 additional common stock shares, which were placed in escrow and reflected a stock value of $85.15 per share.

On April 28, 1999, three months after the Plaintiffs' merger closed, McKesson HBOC announced that there were irregularities in the accounting practices of HBOC, which were discovered after the McKesson HBOC merger. McKesson HBOC stated that it had improperly recognized revenue, and that it would have to restate its earnings. As a result of this disclosure, the McKesson HBOC stock plummeted to $32 per share.

On July 14, 1999, McKesson HBOC announced that the write-offs would be

[2] McKesson HBOC is a large pharmaceutical and medical-surgical supply management and health care information technology company.

larger than originally anticipated indicating they would total $327.4 million, consisting of $245.8 million for fiscal year ending March 31, 1999, and $48.4 million and $33.2 million, respectively, for fiscal years ending March 31, 1998 and March 31, 1997. The massive write-offs were attributed to revenue recognition of contingent sales, backdated contracts, unavailable products, non-Y2K compliant products, and subscription contracts and expense accruals.

The Plaintiffs brought suit against McKesson HBOC asserting that absent the accounting improprieties, the Plaintiffs would have received far more McKesson HBOC shares at closing in exchange for their businesses. The Plaintiffs also brought suit against several individuals: Defendant Mark A. Pulido ("Pulido"), who was President, CEO and director of McKesson and McKesson HBOC, Defendant Charles W. McCall ("McCall"), who was CEO of HBOC prior to the merger and Chairman of McKesson HBOC's Board when McKesson merged with HBOC, and Defendant Richard H. Hawkins ("Hawkins"), who was McKesson's Executive Vice President and CFO, (collectively, the "individual Defendants").[3]

In Count I, the Plaintiffs allege a breach of contract against McKesson HBOC based on representations, warranties, and obligations in the Merger Agreement. Specifically, the Plaintiffs allege that McKesson HBOC (1) misrepresented and failed

[3] McCall was terminated in June 1999, and Pulido and Hawkins resigned in July 1999.

to disclose material adverse facts concerning the financial results and accounting practices; (2) issued false and misleading financial and related statements in documents filed with the Securities and Exchange Commission ("SEC"); (3) failed to comply with federal securities laws and Generally Accepted Accounting Principles ("GAAP"); and (4) failed to advise the Plaintiffs, prior to the time their merger closed, of the material adverse changes in McKesson HBOC's finances. In Count II of the Complaint, the Plaintiffs allege that McKesson HBOC violated the implied covenant of good faith and fair dealing that accompanied the Merger Agreement. In Counts III and IV, the Plaintiffs assert that all the Defendants violated Section 11 and Section 12(a)(2) of the Securities Act of 1933 (the "Securities Act"). Lastly, in Count V, the Plaintiffs claim that the individual Defendants violated Section 15 of the Securities Act.

DISCUSSION

I. Plaintiffs' Motion for Partial Summary Judgment Defendant McKesson HBOC's Motion to Dismiss

While the Plaintiffs and McKesson HBOC respectively move for partial summary judgment and to dismiss, the Court will address these motions together under this section. Summary judgment will be granted when, in viewing the record in the light most favorable to the non-moving party, the movant has shown that no genuine issues of material fact exist, and that the movant is entitled to judgment as a

matter of law.[4] When a motion for summary judgment is supported by a showing that there are no material issues of fact, the burden shifts to a nonmoving party to demonstrate that there are material issues of fact.[5]

For a motion to dismiss for failure to state a claim upon which relief can be granted, all allegations in the complaint must be accepted as true.[6] In addition, such a motion will not be granted if the plaintiff may recover under any reasonably conceivable set of circumstances susceptible of proof under the complaint.[7]

A. Count I

In Count I, the Plaintiffs assert that McKesson HBOC breached express warranties and representations made in the Merger Agreement. Specifically, the Plaintiffs rely upon Paragraph 4.4 of the Merger Agreement, which stated:

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[4] Super. Ct. Civ. R. 56(c).

[5] *Moore v. Sizemore*, 405 A.2d 679 (1979).

[6] *Spence v. Funk*, 396 A.2d 967 (1978).

[7] *Id*.

> SEC Documents. Buyer has filed all reports, proxy statements, forms and other documents required to be filed by it with the Securities and Exchange Commission (the "SEC") since March 31, 1996 (the Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and Proxy Statements filed by Buyer since March 31, 1996 being hereinafter referred to as the "Buyer SEC Documents"). As of their respective dates, and giving effect to any amendments thereto, (a) the Buyer SEC Documents complied in all material respects with the applicable requirements of the federal securities Laws, including the applicable rules and regulations of the SEC promulgated thereunder, and (b) none of the Buyer SEC Documents when filed with the SEC contained any untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.[8]

The Plaintiffs argue that McKesson HBOC, who was McKesson's successor-in-interest, included false and misleading information in their SEC filings and failed to comply with the federal securities laws. The Plaintiffs also rely upon Paragraph 4.5 of the Merger Agreement which stated:

> Financial Statements. The financial statements of Buyer (including any notes and schedules thereto) included in the Buyer SEC Documents (the "Buyer Financial Statements") at the time filed or as subsequently amended by any Buyer SEC Document filed prior to the date hereof (a) complied as to form in all material respects with all applicable accounting requirements and with the published rules and regulations of the SEC with respect thereto, (b) were prepared in accordance with generally accepted accounting principles applied on a consistent basis (except in the case of unaudited statements, as permitted by Form 10-Q as filed with the SEC under the Exchange Act) during the

[8] Merger Agreement at ¶4.4.

> periods involved (except as may be indicated in the related notes and schedules thereto) and (c) fairly present, in all material respects, the consolidated financial position of Buyer and its consolidated Subsidiaries as of the dates thereof and the consolidated results of their operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to annual year-end audit adjustments which are not, individually or in the aggregate, material).[9]

The Plaintiffs assert that McKesson HBOC breached these warranties because its financial statements were inaccurately made, according to the SEC rules and regulations, and to GAAP, and were admittedly false. As such, the Plaintiffs move for partial summary judgment with respect to this Count.

McKesson HBOC asserts that there were no breaches under Paragraphs 4.4 and 4.5 because those paragraphs only apply to SEC filings and financial statements made by McKesson, not HBOC or McKesson HBOC. As such, the initial question is whether there was a breach of Paragraphs 4.4 and/or 4.5 of the Merger Agreement.

In analyzing Count I's legal sufficiency, it is important first not to lose sight that, while the underlying claims regarding misrepresentations and false statements lie in the complexities of securities and corporate law, the dispute alleged in this Count is a contractual one. Unfortunately, there is a tendency to merge these legal concepts, which causes confusion, and which complicates them far beyond the parties' intent to

[9] Merger Agreement at ¶4.5.

this contract. In its simplest terms, the Plaintiffs bargained for a full and accurate financial disclosure by the Defendant so that they could fairly evaluate the appropriateness of the agreed upon sale of their business, and to obtain the appropriate number of shares of McKesson to fully compensate them at the agreed upon price. The Defendants were expected to be candid, and to provide a full accounting of the agreed upon documentation, which in turn would result in their acquisition of the Plaintiffs' businesses. Obviously these contractual terms have been significantly distorted by the false documents supplied by HBOC and subsequently used by McKesson to file financial statements. While the actions of HBOC are critical to understanding what has occurred, it is important to recognize that the contract in dispute in this litigation only involves McKesson or McKesson HBOC, and it is the conduct of those companies as it relates to the Plaintiffs that will determine whether a breach of contract has occurred. In this vein, the Court makes the following initial general findings.

First, the Court rejects McKesson HBOC's argument that since there is no assertion that McKesson alone filed false or materially misleading documents, and they are the named parties to the contract, that the contract dispute of Count I should be dismissed. The Court will simply not allow McKesson to avoid liability by hiding behind a change in their name. The Plaintiffs' bargain under the Merger Agreement

was either with McKesson or McKesson HBOC, and the actions of either entity can form the basis of a breach of the contract.

Secondly, the Court will also not allow McKesson to avoid liability simply because they assert in the filings complained of by the Plaintiffs that they were not warranting the financial information provided by HBOC. While such action can be considered by a jury in assessing the knowledge of McKesson and McKesson HBOC officials, it does not provide an automatic immunity from liability.

Third, the Court also rejects the Plaintiffs suggestion that simply because the documentation provided by HBOC and utilized by McKesson was subsequently found to be false, that they have established their contractual claim found in Count I. As stated before, the contract dispute is between the Plaintiffs and McKesson or McKesson HBOC, and it is the actions and conduct of those entities that the Plaintiffs must establish violated the terms and conditions of the agreement. In other words, it is not at this junction an illogical assumption to surmise that McKesson may have been equally duped into believing the accuracy of the information provided by HBOC, and it will not be sufficient for the Plaintiffs to merely show that the documents were subsequently found to be false.

With these underlying principles as its guide, the Court finds there remains a dispute, unresolvable by either parties' motion, as to what may have been reasonably

known by McKesson, or McKesson HBOC, prior to the closure of Plaintiffs merger with McKesson, that would perhaps constitute a breach of the agreement. As such, the Court will provide the Plaintiffs an opportunity to fully explore these areas in discovery. It is clear that on November 27, 1998, a Joint Proxy Statement/Prospectus was issued by McKesson regarding its merger with HBOC. This Joint Proxy Statement/ Prospectus provided the summary financial data of McKesson and HBOC, separately, and the unaudited pro forma combined condensed consolidated financial data of McKesson and HBOC, jointly, for the years ending March 31, 1998 and March 31, 1997, as well as for the six months ending September 30, 1998. This Joint Proxy Statement/Prospectus was annexed to the Merger Agreement between McKesson and HBOC dated October 17, 1998, which included Section 3.1(f), entitled "Information Supplied," and stated in part:

> The Form S-4 and the Joint Proxy Statement will comply as to form in all material respects with the requirements of the Exchange Act and the rules and regulations thereunder, except that no representation or warranty is made by McKesson with respect to statements made or incorporated by reference therein based on information supplied by HBO specifically for inclusion or incorporation by reference in the Form S-4 or the Joint Proxy Statement.

In the Joint Proxy Statement/Prospectus, there were letters to the shareholders of both McKesson and HBOC. These letters encouraged the shareholders to read the Joint Proxy Statement/Prospectus and the McKesson/HBOC merger agreement.

On January 14, 1999, McKesson HBOC filed a Form 8-K with the SEC, which described the consideration McKesson paid for HBOC and indicated that HBOC had become a wholly-owned subsidiary of the company. It further stated that "[t]he financial statements required to be filed were previously reported in McKesson's Registration Statement on Form S-4 dated November 13, 1998, as amended by Amendment No. 1 thereto dated November 27, 1998 (No. 333-67299), which is incorporated herein by reference."[10] Furthermore, "[t]he unaudited combined condensed pro forma financial statements of McKesson and HBOC were previously reported in McKesson's Registration Statement on Form S-4 dated November 13, 1998, as amended by Amendment No. 1 thereto dated November 27, 1998 (No. 333-67299), which is incorporated herein by reference."[11]

These actions occurred prior to the January 26, 1999 closing with the Plaintiff and reasonably call into question the knowledge of McKesson or McKesson HBOC officials as to the accuracy of the information provided by HBOC. If McKesson or

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[10] McKesson HBOC's Form 8-K dated January 14, 1999 at Item 7(a).

[11] McKesson HBOC's Form 8-K dated January 14, 1999 at Item 7(b).

McKesson HBOC knew, or had any reason to believe that the information that they or HBOC were disclosing regarding their merger was false, misleading or materially omitted critical information, they had an obligation under the contract with the Plaintiffs to make a disclosure prior to the January 26, 1999 closing. In essence, this is the crux of the dispute now between the parties, and it does not appear from the arguments made in the briefing of these motions to have been adequately explored by the parties at this juncture in the litigation. Since factual issues remain in dispute, it would be inappropriate to grant the Plaintiffs' motion for partial summary judgment at this time.

Having addressed the fundamental arguments of Count I, the Court will briefly discuss the miscellaneous legal arguments that remain as to this count. First, McKesson HBOC argues that the Joint Proxy Statement/Prospectus was not included as a "Buyer SEC Document" defined in Paragraph 4.4 of the Merger Agreement. Under Paragraph 4.4, "Buyer SEC Documents" were defined as "the Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and Proxy Statements filed by Buyer since March 31, 1996." While the Joint Proxy Statement/Prospectus dated November 27, 1998 was jointly filed by McKesson and HBOC, the Court considers this document to be included in the Buyer SEC Documents mentioned in Paragraph 4.4 of the Merger Agreement. It fits the

definition provided in Paragraph 4.4 and was filed by McKesson HBOC, the legally remaining entity of McKesson.

In addition, McKesson HBOC argues that the January 14, 1999 Form 8-K was not a Buyer SEC Document under Paragraphs 4.4 or 4.5 because it was filed after the Merger Agreement of December 17, 1998. The Court finds that the language in Paragraph 4.4 does not limit the inclusion of the January 14, 1999 Form 8-K as a Buyer SEC Document. Article 4 of the Merger Agreement preludes with the following

> [i]n order to induce the Companies and the Shareholders to enter into this Agreement, Buyer and the Merger Subsidiaries, jointly and severally, hereby represent and warrant to the Companies and the Shareholders as of the date hereof and as of the Closing Date as follows.

Paragraph 4.4 then provides in part:

> SEC Documents. Buyer has filed all reports, proxy statements, forms and other documents required to be filed by it with the Securities and Exchange Commission (the "SEC") since March 31, 1996 (the Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and Proxy Statements filed by Buyer since March 31, 1996 being hereinafter referred to as the "Buyer SEC Documents"). As of their respective dates, and giving effect to any amendments thereto,...

The language "[a]s of their respective dates" in no way precludes a Form 8-K dated January 14, 1999 and there is no other limiting language that is date specific except March 31, 1996. In addition, the prelude to Paragraph 4.4 warrants the time frame

from December 17, 1998, "as of the date hereof" through the Closing Date, which was January 26, 1999.[12] Unless there is a clear specific limiting language in the Agreement, the Court will not exclude from consideration documents filed by the Defendant and referenced in the Merger Agreement. To do otherwise would give the Defendant the freedom to file documents knowingly containing false information after signing the agreement but before closing without any consequences. That obviously is not the intent of the parties nor will it be condoned by the Court. As such, the Plaintiffs are not precluded from using the Form 8-K as a Buyer SEC Document under Paragraph 4.4.

However, the Court finds that the language of Paragraph 4.5 warrants a different result. It provides in part:

> Financial Statements. The financial statements of Buyer (including any notes and schedules thereto) included in the Buyer SEC Documents (the "Buyer Financial Statements") at the time filed or as subsequently amended by any Buyer SEC Document filed prior to the date hereof . . .

The Court finds that based on Paragraph 4.5's language, the Plaintiffs would be precluded from arguing that the financial statements, contained in the January 14, 1999 Form 8-K, fit within the warranties of this paragraph. The limiting language of

[12] The Closing Date is defined in 1.6 of the Merger Agreement.

“filed prior to the date hereof” leads the Court to conclude that for some unexplained reason or by mere oversight the parties agreed to a different time standard in Paragraph 4.5 than they did in Paragraph 4.4. The use of this language, which differs from the prelude to Article 4, indicates that the parties agreed upon a more restrictive date for the financial statements within the Buyer SEC Documents. As such, to the extent that the Plaintiffs argue that McKesson HBOC violated Paragraph 4.5 the documentation relied upon by the Plaintiffs to support this assertion would had to have been filed prior to December 17, 1998.

McKesson HBOC relying upon the “bespeaks caution doctrine” also argues that the Joint Proxy Statement/Prospectus provides no basis for the Plaintiffs’ breach of contract claim because it provides material that was forward-looking and thus did not purport to relate misstatements of fact, which could give rise to a breach of Paragraphs 4.4 and 4.5 of the Merger Agreement. The Third Circuit examined this doctrine in *In re Donald J. Trump Casino Securities Litigation--Taj Mahal Litigation*.[13] It is premised upon the idea that if sufficient, cautionary statements are included in a prospectus, any alleged misrepresentations and omissions contained in the prospectus, may be nonactionable.[14] There, the Court explained:

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[13] 7 F.3d 357 (3rd Cir. 1993).

[14] *Id.* at 364(stating “[a]s we see it, “bespeaks caution” is essentially shorthand for the well-established principle that a statement or omission must be considered in context, so that

> [W]e can state as a general matter that, when an offering document's forecasts, opinions or projections are accompanied by meaningful cautionary statements, the forward-looking statements will not form the basis for a securities fraud claim if those statements did not affect the "total mix" of information the document provided investors. In other words, cautionary language, if sufficient, renders the alleged omissions or misrepresentations immaterial as a matter of law.
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> The bespeaks caution doctrine is, as an analytical matter, equally applicable to allegations of both affirmative misrepresentations and omissions concerning soft information. Whether the plaintiffs allege a document contains an affirmative prediction/opinion which is misleading or fails to include a forecast or prediction which failure is misleading, the cautionary statements included in the document may render the challenged predictive statements or opinions immaterial as a matter of law. Of course, a vague or blanket (boilerplate) disclaimer which merely warns the reader that the investment has risks will ordinarily be inadequate to prevent misinformation. To suffice, the cautionary statements must be substantive and tailored to the specific future projections, estimates or opinions in the prospectus which the plaintiffs challenge.[15]

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accompanying statements may render it immaterial as a matter of law.").

[15] *In re Donald J. Trump Casino Sec. Litig.,* 7 F.3d at 371-72.

In finding that the Plaintiffs failed to state an actionable claim, the Third Circuit reasoned that the prospectus truly "bespeaks caution" because, not only did the prospectus generally convey the riskiness of the investment, but its warnings and cautionary language directly addressed the substance of the statement the Plaintiffs challenged.[16]

[16] *Id*. at 372.

While the Court believes that the "bespeaks caution" doctrine is not necessarily limited to the alleged violations of federal securities laws, but, instead, may be applied to a breach of contract claim where the underlying misrepresentations relate to securities, it also finds that the "bespeaks caution" doctrine does not immunize the Joint Proxy Statement/Prospectus filed in this litigation from the breach of contract claim. The Court is persuaded by the Plaintiffs' argument that the alleged false and misleading information were not projections of future results, as the information required the restatement of revenue, concerned of the financial statements for the fiscal years ending March 31, 1997 and March 31, 1998 and the six month period ending September 30, 1998. At the time of the November 27, 1998 Joint Proxy Statement/Prospectus, the statements regarding the finances for those times were not futuristic or forward-looking. Moreover, the Third Circuit in *In re Donald J. Trump Casino Sec. Litig.*, *supra*, reasoned that the warnings and cautionary language was abundant, meaningful and tailored to directly address the substance of the statement the Plaintiffs challenged.[17] This was not the case here.

McKesson HBOC also argues that the claim regarding Paragraph 4.4 fails under

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[17] 7 F.3d at 369 (holding that the prospectus at issue in that case, contained "an abundance of warnings, and cautionary language, which bore directly on the prospective financial success of the Taj Mahal and the Partnerships ability to repay the bonds.").

the pre-existing duty rule.[18] They argue that this provision required McKesson to comply with the federal securities laws, which was already a pre-existing legal duty. As such, McKesson HBOC relying upon *Seidel v. Lee*[19] asserts that this claim should be dismissed.

[18] The pre-existing duty rule is a well-settled principle of law that states a contract cannot be based upon a duty which one is already legally obligated to perform. *See Seidel v. Lee*, 954 F. Supp. 810, 817 (D.Del. 1996)(citing Restatement (Second) of Contracts § § 73, 80(2)(1979); Calamari and Perillo, The Law of Contracts § 49(b)(West 1987)).

[19] 954 F. Supp. 810 (D.Del. 1996).

While recognizing the validity of the pre-existing duty rule, this Court, like the Delaware Supreme Court in *Rossdeutscher v. Viacom, Inc.,*[20] cannot reasonably construe the requirements of Paragraph 4.4 of the merger agreement as an attempt to seek enforcement of an agreement to comply with federal security laws. Clearly Paragraph 4.4(b) does not, and Paragraph 4.4(a) is a certification of the buyer that he has complied with those laws. The certification by the buyer is what is critical to the agreement and what is important to the Plaintiff's decision making process, not the requirement that he do so. As such, this rule is not applicable to the facts of this litigation.

In making the findings as to Count I, the Court believes it has addressed all the issues raised by the Defendant in its motion to dismiss. The Court has rejected these arguments, and the motion to dismiss at this junction in the litigation is hereby denied.

The remaining issues, as to Count I, arise from the Plaintiffs' motion for partial summary judgment. The motion itself is not very helpful in focusing the issues for the Court to consider, since it simply states in a conclusory form that there is no dispute of the existence of McKesson's representations and warranties and the breach by the company, so summary judgment is warranted. The Plaintiffs filed no opening brief in support of their motion, but simply allowed the Defendant in essence to create the

[20] 768 A.2d 8 (Del. 2001).

legal issues relating to summary judgment in their brief, and then responded in a reply brief. The Court has previously ruled that the factual issues of the case are not as straightforward and uncontroverted as claimed by the Plaintiffs, and that summary judgment is not warranted. Having made this finding it is at least arguable at this point in time that the remaining issues raised by the Defendant in its briefs opposing summary judgment are mooted and should not be addressed. However, in spite of this, to avoid further delay, this Court will address those issues it believes are ripe for decision.

According to sound Delaware law, a plaintiff must establish reliance as a prerequisite for a breach of warranty claim.[21] In *Bleacher v. Bristol-Myers Company,*[22] this Court held that "[t]he law is clear that in order for a defendant to be responsible for a breach of warranty, plaintiff must have known about the warranty and have relied upon it."[23] As further support for this holding, a federal district court in Illinois, interpreting Delaware law in a breach of corporate assets purchase contract, recently re-examined this issue, and held that the plaintiff in that action had to show

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[21] *Bleacher v. Bristol-Myers Company*, 163 A.2d 526, 528 (1960); *Loper v. Lingo*, 97 A. 585 (Del. Super. 1916); 1 Williston on Sales (Rev. Ed.), § 206.

[22] 163 A.2d 526 (Del. Super. 1960).

[23] *Bleacher* 163 A.2d at 528.

reliance to prevail on its breach of warranty claim as a matter of Delaware law.[24] To support its ruling, the *Middleby* court examined Delaware precedent on the reliance in breach of warranty claims, and noted that

[24] *The Middleby Corporation v. Hussmann Corporation*, No. 90C 2744, 1992 WL 220922, at *6 (N.D.Ill Aug. 27, 1992).

> [a]lthough Delaware case law is not replete with discussions of whether reliance is an essential element of a breach of warranty claim, several old--but apparently still viable--decisions answer the question in the affirmative. *See Harvard Industries, Inc. v. Wendel*, [Del. Ch.], 178 A.2d 486, 496 (1962) (requiring reliance but somewhat unclear whether referring to fraud or warranty claim); *Bleacher v. Bristol-Myers Co*., [Del. Super.], 163 A.2d 526, 528 (1960)("The law is clear that in order for a defendant to be responsible for a breach of warranty, plaintiff must have known about the warranty and have relied upon it"); *Loper v. Lingo*, [Del. Super.], 97 A 585, 586 (1916)(charging the jury that to find liability for breach of warranty in a horse sale, the jury must find "that at the time of the sale the horse was warranted by the defendant to be sound, and that the plaintiff relied upon such warranty").[25]

In the case at bar then, the Plaintiffs' reliance upon *Mowbray v. Waste Management Holdings, Inc*.[26] is erroneous. While the *Mowbray* court found that reliance was not an essential element in a breach of warranty claim, that Massachusetts court was interpreting Illinois law, and examined the issue under Illinois law.[27] As such, the *Mowbray* holding, in light of the clear Delaware case law, which requires reliance for a breach of warranty claim, is inapplicable.

McKesson HBOC asserts that the Plaintiffs and their expert advisors conducted

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[25] *Id*.

[26] 45 F.Supp.2d 132 (D. Mass. 1999).

[27] *Id.* at 135.

their own independent investigation of McKesson HBOC's financial stability by retaining Bear Stearns & Company as their financial advisor. They further assert that included in the Plaintiff's Bear Stearns financial team were senior members of that organization that had also worked with McKesson in connection with its merger with HBOC. While this Court believes that such advice and independent oversight was appropriate and important because of the financial stakes involved in the Plaintiffs' merger plans, it does raise factual issues as to what extent the Plaintiffs relied upon the documentation filed by McKesson HBOC, which formed the basis of the Plaintiffs' Complaint in this litigation. This will be an area that the parties will have to explore further in discovery as the litigation moves forward.

The final issue raised in Defendant's answering brief to Count I is the materiality of the breach. First, it appears to this Court that the parties agree that materiality is an issue of fact, not normally subject to a summary judgment proceeding. As such, it is unclear whether there remains a dispute as to this issue. Second, the Court does discuss materiality later in the opinion in the context of a security violation and finds the same reasoning and issues discussed there are applicable in a contractual context.[28] However, in fairness to the parties, this Court does not believe that the record has been sufficiently developed on this issue for this

[28] See this Opinion at 35-36.

Court to rule on its applicability. If at a later point in the litigation the parties want to pursue this issue, they are free to file an appropriate motion, and follow normal briefing patterns to insure that this Court fully appreciates the positions of each party. At the moment, materiality will remain a factual issue for the jury to decide.

In conclusion, as to the assertions made as to Count I, both the Defendant's motion to dismiss and the Plaintiffs' motion for partial summary judgment are hereby denied.

B. Count II

McKesson HBOC asserts that Count II, which alleges a breach of an implied duty of good faith and fair dealing, fails to state a claim because claims for breach of this implied duty that mirror breach of contract claims are not permitted. As such, McKesson HBOC moves to dismiss this Count.

Every contract in Delaware has an obligation of good faith and fair dealing, which is implied into the agreement by law.[29] As such, a party to a contract has made an implied covenant to act reasonably to fulfill the intent of the parties to the agreement.[30] This implied covenant was created to promote the spirit of the agreement and to protect against one side using underhanded tactics to deny the other

[29] *Chamison v. Healthtrust, Inc.*, 735 A.2d 912, 920 (Del. Ch. 1999).

[30] *Id*.

side the fruits of the parties' bargain.[31] In such a claim, the Court must extrapolate the spirit of the agreement through the express terms and determine the terms that the parties would have bargained for to govern the dispute had they foreseen the circumstances under which their dispute arose.[32] But the Court will not readily imply a contractual obligation where the contract expressly addresses the subject of the alleged wrong, yet does not provide for the obligation that is claimed to arise by implication.[33] The implied covenant cannot contravene the parties' express agreement and cannot be used to forge a new agreement beyond the scope of the written contract.[34] To state a claim for breach of an implied covenant of good faith and fair

[31] *Id*.

[32] *Id*. at 921.

[33] *Moore Business Forms, Inc. v. Cordant Holdings Corp*., No. 13911, 1995 WL 662685, at *8 (Del.Ch. Nov. 2, 1995)(quoting *Abex Inc. v. Koll Real Estate Group Inc.,* No. 13462, 1994 WL 728827, at *12 (Del. Ch. Dec. 22, 1994).

[34] *Chamison,* 735 A.2d at 921.

dealing, the Plaintiffs must identify a specific implied contractual obligation.[35]

Here the Plaintiffs argue that McKesson HBOC was obligated to accurately and timely disclose their financial position, practices, and results so that the value of McKesson HBOC's shares, and consequently, the full consideration to which the Plaintiffs were actually entitled, could be determined fairly and in good faith. The Plaintiffs argue that McKesson HBOC violated the implied covenant of good faith and fair dealing when it misrepresented, omitted and failed to disclose material facts concerning McKesson HBOC's financial condition and artificially inflated their stock price during the January 1999 valuation period. The Plaintiffs explain that since their consideration was dependent upon the integrity of the market price for McKesson common stock during the valuation period, the Defendant had an implied covenant not to distort the value of the stock by misleading or manipulating the market place.

The Court finds that the Complaint states a legally sufficient claim in Count II under the implied covenant of good faith and fair dealing theory. It appears that the Plaintiffs' implied covenant argument originates from Paragraphs 4.4 and 4.5 of the Merger Agreement, which sets forth the information that would be relied upon during the merger period to insure a fair and accurate valuation of the Defendant's stock as it

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[35] *Moore Business Forms* at *12. *See also Painewebber R&D Partners, L.P. v. Centocor Inc.,* No. 96C-04-194, 1998 WL 109818 (Del. Super. Feb. 13, 1998).

related to the purchase price of the Plaintiffs' business. Implied in the contractual terms is the understanding that the Defendant would refrain from distorting its financial condition so as to not adversely affect the value of its stock which was to be used as the linchpin to the Plaintiffs' bargain. This implied covenant insured that there would be no attempt by the Defendant to adversely influence the market to artificially inflate the price of their stock thereby diminishing the number of shares the Plaintiffs were entitled to receive under the agreement. The absence of such an implied obligation would violate the spirit of the Merger Agreement and would result in the Plaintiff not receiving the full benefit of its bargain. As such, the Court finds this assertion has been adequately plead in the Complaint, and there is a legal basis for this claim to proceed forward. As a result, the Defendant's motion to dismiss Count II is denied.

C. Counts III and IV

McKesson HBOC argues that the Plaintiffs' claims against it under Counts III and IV concerning violations of Sections 11 and 12, respectively, of the Securities Act must fail because the issuance of stock to the Plaintiffs was not made pursuant to a public offering. Conversely, the Plaintiffs argue that this was a public offering and that they are entitled to summary judgment. As such, the first question is whether Sections 11 and 12 of the Securities Act are applicable, and more specifically, whether this was a public or a private offering.

It is undisputed by the parties that Sections 11[36] and 12[37] of the Securities Act

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[36] Section 11 of the Securities Act, 15 U.S.C.§77k(a)(2), states in part:

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue--

* * * *

(2) every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted...

[37] Section 12 of the Securities Act, 15 U.S.C. §77l(a)(2), states in part:

(a) Any person who--
(2) offers or sells a security...by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a

only apply to public offerings.[38] An offering is considered private only if limited to investors who have no need for the protection provided by registration.[39] The reason for the registration statement is to protect investors by promoting full disclosure of information thought necessary to make informed investment decisions.[40] It is clear that when there has been no registration of the stock and there is a dispute as to the private nature of the offering, the focus of the inquiry is on the need of the offerees for the protections afforded by registration and whether they would have access to the kind of information which registration would disclose.[41] In determining whether an offering was appropriately private, courts must make a fact-intensive inquiry into the following factors: (1) the number of offerees; (2) the sophistication of the offerees, including their access to the type of information that would be contained in a

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> material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,
>
> shall be liable...to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon...

[38] *See Van de Walle v. Salomon Bros., Inc.*, No. 9894, 1997 LEXIS 140 , at *9(Del. Ch. Sept. 30, 1997)(*citing Gustafson v. Alloyd Co., Inc*., 513 U.S. 561, 582 (1995)).

[39] *Securities and Exchange Comm'n v. Ralston Purina Co*., 346 U.S. 119, 125 (1953).

[40] *Id*. at 124.

[41] *Id*. at 127.

registration statement, and (3) the manner of the offering.[42] However, while this logical inquiry is appealing to the Court, its applicability to publicly registered stock is not as clear. [43]

McKesson HBOC argues that the Court should consider the McKesson stock issue pursuant to the Merger Agreement to be a private offering because it involved a small number of sophisticated offerees, five individuals. It argues that the sophistication is indicated by the Accredited Investor Certificates that were signed by the Plaintiffs. The "Accredited Investor Certificate" stated:

> The undersigned represents and warrants that she has completely and accurately filled out the Accredited Investor Information questionnaire attached as Exhibit A. The undersigned further represents and warrants that she is an "accredited investor" within the meaning of Rule 501(a) as promulgated under the Securities Act of 1933, as amended.[44]

Conversely, the Plaintiffs argue that this was not an unregistered private offering of stock, but rather, a publicly registered shelf offering and that because their stock was

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[42] *United States v. Arutunoff*, 1 F.3d 1112, 1118 (10th Cir. 1993).

[43] *See Flake v. Hoskins*, 55 F.Supp.2d 1196, 1229, n.21 (D. Kan. 1999).

[44] The information in the questionnaire provided that each individual's net worth was in excess of $1,000,000, that each individual's income for each of the years 1997 and 1998 and anticipated 1999 was in excess of $200,000, and that each individual's joint income for the years 1997 and 1998 and anticipated 1999, was in excess of $300,000. Each of the Plaintiffs answered the questions in the affirmative, with the exception of Brian Dillon, who is not a Plaintiff.

issued pursuant to a Registration Statement, Sections 11 and 12(a)(2) clearly apply to this case.

McKesson publicly registered all of the shares it issued to the Plaintiffs in its June 24, 1998 Amendment No. 1 to Form S-4 Registration Statement, which contained a Prospectus. The Prospectus related to 5,000,000 shares of common stock of McKesson in a "shelf offering" pursuant to Rule 415 of the Securities Act, 17 C.F.R. §230.415.[45] The Prospectus stated:

> This Prospectus relates to 5,000,000 shares [] of common stock, par value $0.01 per share [], of McKesson Corporation [] which may be offered and issued from time to time in connection with one or more business combinations with the Company or its subsidiaries. The Shares may be issued from time to time in connection with (I) mergers, consolidations, recapitalizations or similar plans of acquisition;...
> The Company anticipates that the specific terms of each such business combination in which Shares will be issued will be the result of negotiations with the owners and controlling persons of the businesses, assets, securities or other interests involved in the business combination....

[45] 17 C.F.R. §230.415, entitled "Delayed or continuous offering and sale of securities," provides in part:

> (a) Securities may be registered for an offering to be made on a continuous or delayed basis in the future, Provided, That --
>
> (vii) Securities which are to be issued in connection with business combination transactions;

In a "shelf registration," the registrant can register a large number of securities and offer the securities to the public "on a continuous or delayed basis."[46] In a shelf registration, the registration statement is filed but the securities are put on the shelf until the manner and date of the offerings are determined.[47]

In the Merger Agreement, 7.2(e) provides that

> [t]he shares of McKesson Common Stock to be issued to the Shareholders in the Mergers shall be covered by a Registration Statement, which Registration Statement shall be effective under the Securities Act and applicable state blue sky Laws.

In addition, 6.2(b) states that

> Buyer shall use its best efforts to cause the shares of McKesson Common Stock issuable pursuant to the Mergers to be covered by Buyer's Registration Statement on Form S-4 (as amended) dated June 24, 1998 or another effective registration statement under the Securities Act and applicable blue sky laws . . . and to be approved for listing on the NYSE and the PE, subject to official notice of issuance, prior to the Closing.

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[46] *Finkel v. Stratton Corp*., 962 F.2d 169, 174 (2d. Cir. 1992); 17 C.F.R. §230.415.

[47] Thomas L. Hazen, *The Law of Securities Regulation* §3.8, at 79 (1985).

What makes this issue difficult is that the factors utilized to determine whether the private offering exemption to public registration is appropriate are uniquely applicable to the facts of this case. Here, there is a very small group of sophisticated investors who have access guaranteed by their Merger Agreement of significant financial information, and the stock offering is for the limited purpose of acquiring the Plaintiffs' businesses. If there was no registration of the stock, it appears the Defendant would be able to meet their burden of establishing a private transaction. However, neither party has been able to cite to the Court any authority where a stock offering was publicly registered, and then is subsequently determined by the Court to be a private offering. However, the lack of case law on this issue is not surprising because there is no logical reason once the registration has occurred, and the information publicly disclosed, to make such an argument unless one is attempting to avoid the liabilities imposed by Sections 11 and 12 once a transaction has become problematic. It was McKesson who made the decision to create a publicly registered shelf offering with the express purpose of acquiring other business ventures. Having made that decision, this Court will not allow them to legally reverse what at the time was a rational business decision simply because they now find themselves in a changed economic and legal position. The filing of the registration statement made this a public offering. As such, the Court finds that stock issued in the transaction between McKesson and McKesson HBOC and the Plaintiffs was a public offering and

the claims under Sections 11 and 12 of the Securities Act remain viable.[48] Further, because of this ruling, the Court finds the arguments made by the Plaintiffs in their motion to strike exhibit A of McKesson HBOC's opening brief have become moot and that motion is thus denied.

Although the Court finds that the Sections 11 and 12 claims are viable, McKesson HBOC further asserts that the misstatements in the pro forma financial information contained in the Joint Proxy Statement/Prospectus and the Form 8-K were not actionable because they were non-material, forward-looking statements. Specifically, McKesson HBOC argues that the Joint Proxy Statement/Prospectus and the Form 8-K are immunized under SEC Rule 175, 17 C.F.R.§230.175, the "safe harbor" rule. Rule 175 provides in part:

> (a) A statement within the coverage of paragraph (b) of this section which is made by or on behalf of an issuer or by an outside reviewer retained by the issuer shall be deemed not to be a fraudulent statement (as defined in paragraph (d) of this section), unless it is shown that such statement was made or reaffirmed without a reasonable basis or was

[48] The Court finds support for its position from both the present and past Chancellors of the Delaware Chancery Court in decisions considering the required elements of a Section 11 claim. Chancellor Allen in the case of *Bernstein v. Vestron, Inc.,* No. 1986 WL 3138, at *4 (Del. Ch. Mar. 11, 1986) found that a Section 11 claim required the Plaintiff to acquire a "registered security" and Chancellor Chandler addressing a similar issue in *Glaser v. Norris,* found that the Plaintiff must have purchased under Section 11 "a security issued pursuant to a registration statement."

> disclosed other than in good faith.
>
> * * *
>
> (c) For the purposes of this rule, the term "forward-looking statement" shall mean and shall be limited to :
> (1) A statement containing a projection of revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items;
> (2) A statement of management's plans and objectives for future operations;
> (3) A statement of future economic performance contained in management's discussion and analysis of financial condition and results of operations included pursuant to Item 303 of Regulation S-K (§229.303 of this chapter) or Item 5 of Form 20-F; or
> (4) Disclosed statements of the assumptions underlying or relating to any of the statements described in paragraphs (c)(1), (2) or (3) of this section.
> (d) For the purposes of this rule the term "fraudulent statement" shall mean a statement which is an untrue statement of a material fact, a statement false or misleading with respect to any material fact, an omission to state a material fact necessary to make a statement not misleading, or which constitutes the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business, or an artifice to defraud, as those terms are used in the Securities Act of 1933 or the rules or regulations promulgated thereunder.[49]

The purpose of the safe harbor protection is to encourage the disclosure of projections.[50] Rule 175 minimizes the disincentives on corporate disclosure created by the securities fraud laws so that investors may have information directly from the

[49] 17 C.F.R. §230.175.

[50] *Katz v. Household Int'l, Inc.*, 897 F. Supp. 1106 (D. Ill. 1995).

companies themselves about how they believe their economic performance will be.[51]

However, as ruled earlier in this opinion, the Court does not find that the documentation filed by McKesson with regard to the proposed merger with HBOC were forward-looking statements. They related to financial statements for a period of time prior to the date of the filing and were not projections or statements of future economic performance. While SEC Rule 175 has a specific definition for forward-looking statements, the documentation filed by McKesson also fails to meet the terms of that definition. As such, the safe harbor protection found in this Rule is not applicable to the facts of this case.

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[51] *Id*. at 1112.

Because the Court found that the Section 11 claim is viable against McKesson HBOC, the Court must now determine whether the Plaintiffs are entitled to summary judgment under Count III of the Complaint. The Plaintiffs argue that under Section 11(a) of the Securities Act, the issuer is liable when a Registration Statement contains a material misstatement or omission. Under Count III, the Plaintiffs assert, *inter alia*, that because McKesson HBOC admitted that reported financial results were materially false and omitted material facts necessary to make the statements not misleading, McKesson HBOC was strictly liable for its misstatements and omissions under Section 11 of the Securities Act. They further argue that McKesson's Registration Statement incorporated McKesson's false SEC filings, including Amendment No.1 to the Company's Form S-4 Registration Statement containing the Joint Proxy Statement/Prospectus for the HBOC transaction filed with the SEC November 27, 1998 and Form 8-K filed with the SEC January 14, 1999.

McKesson HBOC counters that summary judgment should be denied because the Plaintiffs cannot prove damages under Section 11(e) and that summary judgment is inappropriate at this juncture since, under Section 11(a), an alleged misstatement must be material, and materiality creates questions for the fact finder.

The elements of a Section 11 claim require the Plaintiffs to establish (1) that

they acquired a registered security and (2) that any part of the registration statement relating to such security contained an untrue statement of a material fact or material omission.[52] While scienter is not required, the false statement or omission must be shown to have been or would have been material to a decision to purchase the security or not. The Court has previously ruled that the securities obtained by the Plaintiff were publicly filed and registered and thus it is clear that the initial requirement of a Section 11 claim has been established. It also cannot be reasonably disputed that the registration statement issued by McKesson/McKesson HBOC contained omissions which subsequently had to be corrected by the Defendant. Thus the resolution of this motion centers on whether there are undisputed facts to establish that the McKesson/McKesson HBOC statements were material to the Plaintiffs' decision to proceed with the merger and obtain the stock. There is a natural tendency to believe that the obvious answer to this question is "yes" because of the dramatic drop in the value of the stock once the discrepancies were disclosed. However, this tendency is flawed because it is based on the benefit of hindsight and knowledge of what effect the disclosure had on the value of the stock. The critical inquiry is not whether one would do the transaction now, but whether at the time of the merger the omitted

[52] *Glaser v. Norris*, No. 9538, 1989 WL 79875, at*3, (Del.Ch. July 13, 1989); *Bernstein v. Vestron, Inc.,* 1986 WL 3138, at *4 (Del. Ch. Mar. 11, 1986).

information or false representations were material to the decision to acquire these securities and proceed with the merger. The Court believes the present record is insufficient to make such a finding. At a minimum, there remains a dispute between the parties as to the significance of this information to the merger decision that will need to be flushed out during discovery. While the Court acknowledges that under the appropriate circumstances the issue of materiality, as it relates to alleged misrepresentations or omissions from a registration statement, can become a question of law for the Court to decide, it is generally an issue of fact not suited for disposition by summary judgment.[53] As a result, the Plaintiffs' motion for partial summary judgment as to this Count is denied.

The Court believes that the final argument made by the Defendant relating to damages has been mooted by the above decision denying the Plaintiffs' motion for partial summary judgment. However, the Court views the issue of damages to be separate and distinct from whether a prima facie case of a Section 11 violation has occurred. Once one establishes such a violation, the issue of whether the plaintiffs have suffered damages and are entitled to an award under Subsection (e) of Section 11 is an issue for the jury to decide with appropriate instructions from the Court as to the law in this area. The Court finds it is not an area appropriately considered in a

[53] *Branson v. Exide Electronics Corporation*, 645 A.2d 568 (1994).

summary judgment motion.

III. Defendant Mark A. Pulido's Motion to Dismiss
Defendant Charles W. McCall's Motion to Dismiss
Defendant Richard H. Hawkins's Motion to Dismiss

A. Lack of Personal Jurisdiction

The Plaintiffs assert in Counts III, IV, and V, *inter alia*, that the individual Defendants Pulido, McCall, and Hawkins violated Sections 11, 12(a)(2), and 15 of the Securities Act. Defendants Pulido, McCall, and Hawkins individually have moved to dismiss these claims pursuant to Superior Court Civil Rule 12(b)(2) and 12(b)(6), in essence for lack of personal jurisdiction, and failure to state a claim upon which relief can be granted. Their motions vary based on their individual involvement and the Plaintiffs' personal jurisdiction theories, but Pulido, McCall, and Hawkins, all primarily assert that the Court lacks personal jurisdiction under 10 *Del. C.* §3114, 10 *Del. C.* §3104, 15 U.S.C.§77v, and under the "Consent to Jurisdiction" provision of the Merger Agreement. Before proceeding to the arguments, it is important to generally set forth the positions held by the individual Defendants as they relate to this litigation.

Pulido, a California resident, was Chief Executive Officer, and Director of McKesson and McKesson HBOC. Pulido signed the Registration Statement pursuant to which Plaintiffs' McKesson HBOC shares were issued. In addition, Pulido signed

Amendment No. 1 to the November 27, 1998 Form S-4 Registration Statement, which contained the Joint Proxy Statement/Prospectus, the October 17, 1998 merger agreement between McKesson and HBOC, and other SEC filings and related documents, which included documents pertaining to the McKesson HBOC merger.

McCall, a Florida resident, was Chief Executive Officer of HBOC prior to the McKesson HBOC merger, and on January 12, 1999, became Chairman of McKesson HBOC's Board of Directors. On June 21, 1999, McCall was dismissed from his position as Chairman of the Board, but continues to be a director of McKesson HBOC.[54] Hawkins, a California resident, was Executive Vice President and Chief Financial Officer of McKesson and McKesson HBOC.

On a motion to dismiss for lack of personal jurisdiction, pursuant to Rule 12(b)(2), the plaintiff is obligated to establish a prima facie case, that personal jurisdiction is sound.[55] This Court will first consider whether the Plaintiffs have established sufficient service under the provisions of Title 10 of the Delaware Code, and then will address the remaining jurisdictional claims.

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[54] McCall affidavit at 2.

[55] *In re USACafes*, 600 A.2d 43, 47 (Del.Ch. 1991).

1. 10 *Del. C.* §3114

Pulido, a California resident, and McCall, a Florida resident,[56] were both served pursuant to 10 *Del. C.* § 3114, and assert that this Court does not have personal jurisdiction over them, pursuant to this statute. Section 3114(a) provides in part:

> Every nonresident of this State who . . . accepts election or appointment as a director . . . of a corporation organized under the laws of this State . . . shall, by such acceptance or by such service, be deemed thereby to have consented to the appointment of the registered agent of such corporation . . . as an agent upon whom service of process may be made in all civil actions or proceedings brought in this State, by or on behalf of, or against such corporation, in which such director . . . is a necessary or proper party, or in any action or proceeding against such director . . . for violation of a duty in such capacity, whether or not the person continues to serve as such director. . . at the time suit is commenced.[57]

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[56] Hawkins was served under 10 *Del. C.* §3104.

[57] 10 *Del. C.* §3114(a).

The Plaintiffs contend that the individual Defendants availed themselves of the privilege of being directors of a Delaware Corporation, received the protection of Delaware law, and therefore, it is reasonable for them to expect to be held accountable in a Delaware court. This Court however, is bound by the holdings of prior precedent, and in *Pestolite Inc. v. Cordura Corporation*, this Court thoroughly examined and discussed the legislative intent of 10 *Del. C.* §3114. The *Pestolite* court noted that §3114 was the legislative response to *Schaffer v. Heitner*,[58] and was designed to protect Delaware's "substantial interest in defining, regulating, and enforcing the fiduciary obligations, which directors of Delaware corporations owe to such corporations and the shareholder who elected them."[59] That court also held that § 3114 only authorizes jurisdiction in actions which are "inextricably bound up in Delaware law and where Delaware has a strong interest in providing a forum for redress of injuries inflicted upon or by a Delaware domiciliary."[60] Thus, Delaware

[58] 433 U.S. 186 (1977).

[59] *Pestolite Inc., v. Cordura Corp.*, 449 A.2d 263, 265 (Del. Super. 1982).

[60] *Id.*

does not have a significant and substantial interest in overseeing each and every claim brought against a director of a Delaware corporation.[61]

[61] *See id.*(holding that “[i]n the absence of such substantial interest or legitimate State purpose, the mere status as director of a Delaware corporation, standing alone, is not a significant basis for the individual Defendants to reasonably anticipate being haled into this Court.”). *Pestolite* at 267.

It appears then, that 10 *Del. C.* § 3114 only applies to lawsuits brought against a nonresident director of a Delaware corporation for acts performed as a director, which involve fiduciary duty violations.[62] Section 3114 "does not confer personal jurisdiction over nonresident corporate directors simply on the basis of their status as directors of Delaware corporations."[63] Further, Delaware courts have consistently held that 10 *Del. C.* §3114 does not confer personal jurisdiction over nonresident directors for alleged violations of the Securities Act.[64] The *In Re USACafes* court held

> Because the Securities Act claims do not arise under Delaware law or otherwise substantially implicate action in or affecting this state, the relationship among those claims, Delaware, and the defendants is not strong enough to permit the exercise of jurisdiction here based solely on the directors' status as directors.[65]

Based upon the above, this Court finds that § 3114 does not confer this Court with personal jurisdiction over Pulido or McCall. Here, the Plaintiffs have alleged that Pulido and McCall violated Sections 11 and 12 of the Securities Act, but have not asserted directly or by inference, that Pulido and McCall breached their fiduciary

[62] *Mt. Hawley Ins. Co. v. Jenny Craig, Inc.*, 668 A.2d 763, 768 (Del. Super. 1995); *Steinberg v. Prudential-Bache Securities, Inc.*, Del. Ch., No. 8173, Jacobs, V.C. (Apr. 30, 1996)(Mem. Op.).

[63] *Van de Walle v. Rothschild Holdings, Inc.,* No. 9894, 1994 WL 469150, at *6 (Del. Ch. Sept. 30, 1997).

[64] *See In Re USACafes,* 600 A.2d 43, 47 (Del. Ch. 1991).

[65] *In re USACafes* 600 A.2d at 54.

duties as directors. Therefore, Pulido and McCall have solely been sued based on their status as directors in a Delaware corporation, and similar to the situation in *In re USACafes*, the relationship here between the alleged Securities Act violations, the State of Delaware, and Pulido and McCall, is not strong enough to confer personal jurisdiction over them.

2. 10 *Del. C.* §3104

Next, the Plaintiffs assert that jurisdiction over the Defendant Hawkins is proper pursuant to Delaware's long arm statute, 10 *Del.C.* §3104. Hawkins was the only individual Defendant served under 10 *Del. C.* §3104, specifically 10 *Del. C.* § 3104(c)(1), because of his business transactions, which allegedly occurred in Delaware. The Plaintiffs thus premise jurisdiction based on Hawkins' involvement in buying the Plaintiffs'companies.

10 *Del. C.* § 3104(c)(1) gives this Court personal jurisdiction over any nonresident who "transacts any business or performs any character of work or service in the State."[66] "In order for a court to exercise jurisdiction under subsection[] (c)(1) . . . some act must actually occur in Delaware."[67] [68]

As previously indicated, Hawkins, a California resident, was Executive Vice

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[66] 10 *Del. C.* §3104(c)(1).

[67] *Tristrata Technology, Inc. v Neoteric Cosmetics, Inc.* 961 F. Supp. 686, 690 (D.Del. 1997)(holding that absent actual conduct in Delaware, an employee's position as president, stockholder and researcher for a corporation is insufficient to establish jurisdiction.). The parties have not however, asserted this doctrine in their motions and briefs to this Court.

[68] *See id.*

President and Chief Financial Officer of McKesson and McKesson HBOC. The Complaint alleges that through his attorney-in-fact, Hawkins signed (1) the Registration Statement pursuant to which the Plaintiffs' McKesson HBOC shares were issued, (2) the October 17, 1998 merger agreement between McKesson and HBOC, (3) McKesson HBOC's Form 10-Q filed with the SEC on February 13, 1999, and (4) other SEC filings and related documents, including those pertaining to the McKesson and HBOC merger. Hawkins contends that he had no contacts with Delaware, and never conducted business in Delaware. While he was an officer of McKesson and McKesson HBOC when the company changed its name on January 12, 1999, he asserts that the Registration Statement's signing in California, which was filed with the SEC in Washington, does not equate to "transacting business" under 10 *Del. C.* §3104.

After a thorough review of the facts and pertinent law, this Court finds that the Plaintiffs did not present sufficient facts to establish that this Court has personal jurisdiction of Hawkins. The signing of the Registration Statement in California on behalf of a Delaware corporation does not meet the contacts necessary to establish personal jurisdiction under 10 *Del. C.* §3104(c)(1). Absent actual conduct in Delaware, Hawkins' positions at McKesson, or McKesson HBOC, are insufficient to

establish jurisdiction.[69] Because Hawkins did not have any contacts in Delaware, this Court will not establish personal jurisdiction on the mere fact that he was employed by a Delaware corporation.[70] In conclusion, the Court finds that the Plaintiffs have failed to establish sufficient facts to subject Hawkins to the personal jurisdiction of this Court pursuant to 10 *Del. C.* §3104(c)(1).[71]

3. Nationwide Service of Process

Next, the Plaintiffs alternatively argue that personal jurisdiction was established over Pulido, McCall, and Hawkins pursuant to the nationwide service of process provision of the Securities Act, 15 U.S.C. §77v(a), which provides:

> The district courts of the United States and United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, except as provided in section 77p of this title with respect to covered class actions, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or

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[69] *See Tristrata Tech.*961 F.Supp. at 690.

[70] It would also seem that the fiduciary shield doctrine would prevent personal jurisdiction over Hawkins. This doctrine is judicially created, and immunizes acts performed by an individual in the individual's capacity as a corporate employee from serving as the foundation for the exercise of personal jurisdiction over that individual. Since this issue was not raised by the parties, and is mooted by this Court's decision, it will not be addressed in detail.

[71] Because the Court concluded that the individual Defendants were not subject to jurisdiction under 10 *Del. C.* §3114 and 10 *Del. C.* §3104(c)(1), the Court will not undertake the due process inquiry of whether the individual Defendants had sufficient minimum contacts with Delaware to satisfy the "traditional notions of fair play and substantial justice." *See Tristrata Tech.*, 961 F. Supp. at 691 (*citing International Shoe Co. v. Washington*, 326 U.S. 310 (1945)).

> sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found... Except as provided in section 77p(c) of this title, no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.[72]

The Plaintiffs argue that the Securities Act grants concurrent jurisdiction to state and federal courts, and permits state courts to use nationwide service of process. The Plaintiffs also assert that the Securities Act provisions permit this Court to employ the national contacts test in determining personal jurisdiction.

[72] 15 U.S.C. §77v(a).

The Securities Act of 1933 confers subject matter jurisdiction over federal claims to state courts and allows them to hear what has traditionally been matters considered by the federal courts. The Plaintiffs raise the issue of whether two provisions of this statute, one which confers concurrent jurisdiction, and one that provides for nationwide service of process, should be read jointly or separately. If they are read as separate, independent provisions, then the statute confers nationwide service of process only upon federal courts, but would allow the subject matter jurisdiction of the federal claim to remain in state court if the prerequisites of that state's long-arm statutes have been met.[73]

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[73] *See* David Carlebach, Note, *Nationwide Service of Process in State Courts*, 13 Cardozo L. Rev. 223 (1991).

It appears that only two courts have reviewed this issue and have conflicting views on whether the explicit grant of concurrent jurisdiction in 15 U.S.C. §77v extends to the nationwide service provision as well. In *Lakewood Bank & Trust Company v. Superior Court*,[74] a California court stated in dicta that the nationwide service of process was available to the state court when enforcing the Securities Act.[75] Contrary to that holding, a New York court in *Negin v. Cico Oil & Gas Company,*[76] held that the Securities Act nationwide service provision did not apply to state courts.

Unfortunately neither of these decisions are particularly helpful in analyzing this issue since it was not addressed in detail in those opinions. However, the Court is fortunate that the parties have done an excellent job in addressing this issue in their briefs. Having carefully considered those arguments, the Court finds that nationwide service of process is not available to a plaintiff if they choose to pursue their securities act litigation in a state proceeding. First, the Court does recognize that there was no attempt in this litigation to pursue service under this statute when the Complaint was filed with the Court. It is only when questions concerning service and personal jurisdiction under Title 10 of the Delaware Code were raised by the Defendant that the

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[74] 129 Cal. App. 3d 463 (1982).

[75] *Id*. at 470.

[76] 259 N.Y.S.2d 434 (1965).

issue of nationwide service has been pursued. However, the Court does not find this circumstance to be fatal to the plaintiff if nationwide service is appropriate and the plaintiffs have complied with the applicable statutes.

Second, the Court finds that the language of the statute reflecting service is clearly written in a federal context. The words "district", not state, are used and clearly these references are to the federal judicial districts into which the federal court system is divided. If Congress had intended to preempt the requirements of service under state law, they could have easily done so in a clear and precise manner. They did not, and the Court must conclude that the drafters of the statute recognized the unique meaning of the word district and the limitations they were placing on the statute.

Third, the Securities Act statute under which nationwide service was enacted was done so in 1933 at a time the *Pennoyer v. Neff*[77] decision on territorial sovereignty was still law, and before the Supreme Court had decided *International Shoe Company v. Washington*.[78] The Court agrees with the Defendants that given the jurisprudence setting in 1933 it would have been unthinkable for Congress to have passed legislation

[77] 95 U.S. 714 (1877).

[78] 326 U.S. 310 (1945).

which would have radically interfered and trounced upon the independence of state rights without explicitly doing so.

Fourth, the Plaintiffs have been unable to cite any federal court decision nor state court decision other than *Lakewood Bank & Trust Company* that have ruled that the nationwide service provision of the Securities Act applies in a state court action. To the contrary, similar violations involving the Securities Act have been litigated in Delaware and the Chancery Court has resolved issues of personal jurisdiction by analyzing the requirements of Title 10 of the Delaware Code. If nationwide service was applicable to a state court proceeding, such an analysis would have been unnecessary by that Court.

Finally, the Court finds that separately considering these two provisions of the Securities Act does not cause the statute to become inconsistent or irreconcilably in conflict. It would have been appropriate for Congress to increase the number of forums available to individuals to redress conduct actionable under the Securities Act by allowing those actions to be filed in a local court where inconvenience and costs could be minimized. It does not, however, logically flow that with such action, Congress intended to impose upon those courts a service process foreign to it and inapplicable and unavailable to other litigants in that Court. If that was their intent, the Court believes it would have been incumbent upon them to explicitly indicate so in

the statute. Since such clear and unequivocal language requiring states to enforce nationwide service inconsistent with the service of process provisions of that state's statutory laws are not present in the statute, the Court declines to create one.

The Plaintiffs have chosen the state court forum to litigate this matter, and as such they will be required to comply with the State of Delaware service provisions regarding personal jurisdiction. As such, the Plaintiffs cannot rely upon the nationwide service provisions of the Securities Act to obtain jurisdiction over the individual Defendants.

4. *The Merger Agreements "Consent to Jurisdiction" Provision*

Lastly, the Plaintiffs assert that Pulido and McCall are bound by the Merger Agreement's terms to the same extent as McKesson, despite the fact Pulido and McCall were not parties to the Merger Agreement. The Plaintiffs rely upon the Merger Agreement's Paragraph 9.12, which provides:

> Consent to Jurisdiction. EACH OF THE PARTIES HERETO (I) CONSENTS TO SUBMIT TO THE PERSONAL JURISDICTION OF ANY FEDERAL COURT LOCATED IN THE STATE OF DELAWARE OR ANY DELAWARE STATE COURT IN THE EVENT ANY DISPUTE ARISES OUT OF THIS AGREEMENT OR ANY OF THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT, (II) AGREES THAT SUCH PARTY SHALL NOT ATTEMPT TO DENY OR DEFEAT SUCH PERSONAL JURISDICTION BY MOTION OR OTHER REQUEST FOR LEAVE FROM ANY SUCH COURT, AND (III) AGREES THAT SUCH PARTY SHALL NOT BRING ANY ACTION RELATING TO THIS AGREEMENT OR ANY OF THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT IN ANY COURT OTHER THAN A FEDERAL COURT LOCATED IN THE STATE OF

> DELAWARE OR A DELAWARE STATE COURT. THE FOREGOING SHALL NOT LIMIT THE ABILITY OF ANY PARTY TO ENFORCE ANY DECREE OF A FEDERAL COURT LOCATED IN THE STATE OF DELAWARE OR A DELAWARE STATE COURT IN ANY OTHER COURT OF COMPETENT JURISDICTION.

Pulido, McCall, and Hawkins assert that because they were not parties to the Merger Agreement, they are not bound by its terms. Indeed, none of the individual Defendants signed this Merger Agreement, as it was signed by McKesson's Vice President, William J. Dawson. In Delaware, as in other jurisdictions, it is well settled law that "a party may consent to the personal jurisdiction of a court."[79] Unlike subject matter jurisdiction, "personal jurisdiction is based on individual liberty interests protected by the due process clause," and it therefore "can be waived by a party's express or implied consent to jurisdiction."[80]

Here, the parties to the Merger Agreement consented to submit to the personal jurisdiction of any Delaware State Court in the event that a dispute arose from the Merger Agreement. The parties to the Merger Agreement consisted of KWS&P, Inc., KWS&P/SFA, Inc., Judy Kelly, Harriette Owens Waldron, Michael Putnick, Scott Symons, Brian Dillon, McKesson, MKW, Inc., and MSF, Inc. Notably, Pulido and McCall were not included in the above mentioned parties, and were not signatories of

[79] *Resource Ventures, Inc. v. Resources Management Int'l, Inc.*, 42 F.Supp.2d 423, 431 (D.Del. 1999)(citing *Insurance Corp. of Ireland v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 703 (1982); *Chrysler Capital Corp. V. Wodhling*, 663 F.Supp. 478, 481 (D.Del. 1987)).

[80] *Resource Ventures, Inc.* 42 F.Supp. at 431.

the Merger Agreement. Because Pulido, McCall, and Hawkins were not parties to the Merger Agreement, and were not signatories of the Merger Agreement, there is no basis to conclude that they have consented to personal jurisdiction by the Delaware court.

For the reasons set forth in this section of the opinion, the motions to dismiss filed by Pulido, McCall, and Hawkins are granted due to a lack of personal jurisdiction.[81]

CONCLUSION

For the reasons set forth in this opinion, the Plaintiffs' motion for partial summary judgment is denied; Defendant McKesson HBOC's motion to dismiss is denied, Plaintiffs' motion to strike exhibit A of Defendant McKesson HBOC's opening brief is denied, Defendants Mark A. Pulido, Charles W. McCall, and Richard H. Hawkins motions to dismiss are granted.

Judge William C. Carpenter, Jr.

[81] The individual Defendant's remaining assertions in their Motions to Dismiss will not be addressed, as a result of the Court's finding that it lacks personal jurisdiction over them.