IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

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| WALTER B. HEWLETT, WALTER B. HEWLETT as Trustee of the WILLIAM R. HEWLETT REVOCABLE TRUST, EDWIN E. van BRONKHORST, as Co-Trustee of the WILLIAM R. HEWLETT REVOCABLE TRUST, | ) | C.A. No. 19513-NC |
| Plaintiffs, | ) | |
| v. | ) | |
| HEWLETT-PACKARD COMPANY, a Delaware corporation, | ) | |
| Defendant. | ) | |

OPINION

Date Submitted: April 7,2002
Date Decided: April 8,2002

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CHANDLER, Chancellor

This lawsuit challenges certain actions taken in connection with a hotly contested shareholder vote on a proposed merger. The merger would combine Hewlett-Packard Company ("HP") and Compaq Computer Corporation, the second and third largest computer makers in the United States. HP's management strongly supported the merger. Plaintiffs, Walter B. Hewlett, Edwin E. van Bronkhorst, and the William R. Hewlett Revocable Trust (collectively, "the Hewlett Parties"), opposed the merger and waged a vigorous proxy contest against it. On March 19, 2002, HP held its special meeting of stockholders to vote on the proposed combination. Following the meeting, HP announced that the proposed merger had been approved by a slim but sufficient, margin of votes. The independent inspector of elections has not informed either party of any preliminary results of the voting, and is not expected to certify final results until the latter part of April, 2002.

Nine days after HP's stockholder meeting, the Hewlett Parties filed this action, pursuant to 8 *Del.* C. § 225(b), seeking a declaration that the merger was not validly approved. They attack the merger vote on two fronts. First, they allege that a large number of votes were cast in favor of the merger by a stockholder whose approval was obtained through coercion, intimidation, or enticement by HP management. Second, they assert that HP management procured its proxies in

favor of the merger by knowingly making material misrepresentations about key financial numbers at the center of HP's proxy campaign.

On April 1, 2002, HP moved to dismiss the complaint. Because all parties to the controversy were concerned about a prompt resolution, I directed all briefing on the motion to be completed by April 6, and oral argument was held on April 7. This is the Court's decision on that motion.

## I. STANDARD OF REVIEW

The standard governing a Chancery Rule 12(b)(6) motion to dismiss is well-established. A party is entitled to dismissal of the complaint only where it is clear from its allegations that the plaintiff would not be entitled to relief under any set of facts that could be proven to support the claim. Moreover, the Court is required to accept all of plaintiff's factual allegations as true and give plaintiff the benefit of all inferences that may be drawn from the facts. Dismissal is appropriate under Rule 12(b)(6) only where it appears with a reasonable certainty that a plaintiff would not be entitled to the relief sought under any set of facts that could be proven to support the action.

## II. BACKGROUND FACTS[1]

HP and Compaq are each publicly traded Delaware corporations and global providers of computers and computer-related products and services. Hewlett and van Bronkhorst are co-trustees of The William R. Hewlett Revocable Trust (the "Trust"), which owns 72802,148 shares representing approximately 3.75% of HP's outstanding stock. The Hewlett Parties beneficially own 75,748,594 shares of HP representing approximately 3.90% of HP's outstanding stock.[2]

On September 4, 2001, HP and Compaq entered into an agreement by which the two companies would be combined. Under the terms of this proposed merger, Compaq stockholders would be issued 0.6325 of a share of HP common stock for each share of Compaq stock they owned, representing in the aggregate approximately 35.7% of the combined company. HP stockholders would continue to hold the same number of shares they owned before the merger but, because of the new HP shares issued to former Compaq shareholders, the equity ownership percentage of the existing HP stockholders would be considerably diluted. Consummation of the proposed merger required a majority vote of HP stockholders voting at a meeting where a majority of the outstanding HP shares

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[1] The facts recited are taken from the well-pleaded allegations contained in the complaint and any documents incorporated by reference therein.

[2] Hewlett has also been a director of HP for approximately 15 years and is the son of the late William R. Hewlett, one of HP's founders.

were present and properly approved the issuance of HP stock to Compaq stockholders.

Immediately following the announcement of the proposed merger, HP's stock price dropped 18.7% from $23.21 to $18.87 (representing an aggregate loss of approximately $8.5 billion in stockholder value). By early November 2001, the price of HP's shares had dropped 27.2%. This continued decline in share price contrasts with a 9.9% gain in share value realized by an index of comparable companies.

On November 6, 2001, in reaction to this decline in value that Hewlett believed confirmed his concerns over the proposed merger, Hewlett publicly announced that he, the Trust, the William and Flora Hewlett Foundation, and his two sisters would all vote against the proposed merger. That same day, David Woodley Packard, son of HP's other founder, announced that he would also vote against the transaction. Later the Packard Foundation also announced its shares would be voted against the proposed merger. The Hewlett Parties, the William and Flora Hewlett Foundation, Hewlett's two sisters, David Packard, and the Packard Foundation collectively represent approximately 18% of HP's voting shares. By a definitive proxy statement dated February 5, 2002, the Hewlett Parties solicited proxies in opposition to the proposed merger.

On March 19, 2002, HP held a stockholders meeting to vote on the proposed transaction. After the meeting, HP publicly claimed that the proposed merger was approved by a slim margin. The independent inspector responsible for certifying the vote, however, has not informed either party of any preliminary results of the voting.

## III. ANALYSIS

### *A. The Vote-Buying Claim*

#### 1. Contentions of the Parties

The Hewlett Parties' allegation with regard to proxies cast in favor of the proposed merger by Deutsche Bank[3] is essentially, although not captioned as such in the complaint, a vote-buying claim Deutsche Bank holds at least 25 million shares of HP. The plaintiffs allege that Deutsche Bank's last-minute switch from voting 17 million of its shares against the merger to voting those shares for the merger was the result of a combination of inducement and coercion, orchestrated by HP's management, which caused Deutsche Bank to vote in favor of the proposed merger for reasons other than those based upon the merits of the

[3] Plaintiffs' allegations concerning "Deutsche Bank" include Deutsche Bank AG as well as all subsidiaries and affiliates (including Deutsche Asset Management, Inc.).

transaction.[4] The Hewlett Parties' allegations in support of this claim focus on actions taken during the four days before and the morning of the special meeting.

On or before March 15, 2002, the proxy committee of Deutsche Asset Management, Inc. conducted an independent review from which it determined to vote its shares against the proposed merger. Consistent with that decision, Deutsche Bank submitted its proxies and voted against the proposed merger. On March 15, 2002, HP closed a new multi-billion dollar credit facility to which Deutsche Bank had been added as a co-arranger. As of March 18, 2002, the day before the shareholders meeting, Deutsche Bank was concerned that HP's reaction to the proxy committee's disapproval of, and vote against, the proposed merger would be to end the ongoing, and desired future, business dealings between HP and Deutsche Bank. Allegedly at the demand of HP management, a telephone conference was held between Deutsche Bank and HP management on the morning of the March 19 vote. After that conference call, Deutsche Bank switched as many as 17 million votes to favor the proposed merger. The plaintiffs contend that this switch was elicited as a result of the inducement provided by the current HP credit facility, to which Deutsche Bank had just been added, combined with the coercion of the telephone conference from which Deutsche Bank understood that its future

[4] Presumably if only 17 million of Deutsche Bank's 25 million shares were switched from voting against to voting for the merger, Deutsche Bank still voted 8 million (or approximately 1/3) of its shares against the merger.

business dealings with HP would be jeopardized if it did not switch its votes to favor the proposed merger. The Hewlett Parties suggest that evidence of the import of this switch to HP's management is shown from HP's CEO and board chairwoman, Carleton S. Fiorina ("Fiorina"), first delaying the scheduled opening of the March 19 special stockholder meeting to wait for word from Deutsche Bank, and then announcing the closing of the polls promptly after apparently receiving word on the podium that Deutsche Bank had switched its vote. This vote-buying arrangement allegedly had the purpose and effect of defrauding and disenfranchising HP stockholders.

HP had 1,941,391,000 shares outstanding and eligible to vote on the proposed merger as of the record date. HP's management reported that the proposed merger was approved by an extremely thin margin. If the parties are correct that the margin between the votes in favor of and those against the merger was less than 1% of the shares voted, the improper influence on Deutsche Bank's decision to switch 17 million votes to favor the proposed merger could have determined the outcome of the vote. Based on the facts alleged, the Hewlett Parties seek a declaration that the Deutsche Bank proxies which were switched in favor of the merger were improperly induced and/or coerced and are, therefore, void.

HP responds to these allegations by contending that a claim of vote-buying is disfavored in Delaware as a basis upon which to disenfranchise stockholders and overturn a vote. HP contends that it is the plaintiffs who are, in fact, seeking to disenfranchise shareholders through their prayer for a declaration from this Court that Deutsche Bank's proxies are invalid. Finally, HP argues that the Hewlett Parties have failed to plead adequately a vote-buying claim (assuming that such a claim is still cognizable) because there was not a binding voting agreement governing Deutsche Bank's stock and because a majority of HP stock was not obligated to vote in favor of the transaction.

2. Legal Standard for a Vote-Buying Claim

This Court has, on several earlier occasions, addressed so-called "vote-buying" allegations. In some instances the claims were successful and in others they were not. There does not, however, appear to be an obvious predisposition on the part of the Court one way or another toward vote-buying claims.[5]

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[5] In the seminal Delaware case on vote-buying, *Schreiber* v. *Carney*, the Court recounted the history of challenges to vote-buying agreements in Delaware jurisprudence. 447 A.2d 17, 23-26 (Del. Ch. 1982). The *Schreiber* Court noted that earlier cases "had summarily voided the challenged votes as being purchased and thus contrary to public policy and in fraud of the other stockholders." *Id.* at 23 (citing *Macht v. Merchants Mortgage & Credit Co.,* 194 A. 19 (Del. Ch. 1937); *Hall* v. *Isaacs*, 146 A.2d 602 (Del. Ch. 1958), *aff'd*, 163 A.2d 288 (Del. 1960); and *Chew* v. *Inverness Mgt. Corp.,* 352 A.2d 426 (1976)). The Court noted that all of the cited cases "emphatically stated that vote-buying was against public policy but failed to discuss the reason why, other than because of the obvious presence of fraud." *Id.* In attempting to discern the bases for the result in those cases, *the Schreiber Court* examined the cases cited by *Macht* (all from other jurisdictions) as support for voiding the challenged votes. Two principles were apparent from those cases. First, those cases held that vote-buying was illegal *per se* if that agreement was entered into for the purpose of either defrauding or disenfranchising other

The appropriate standard for evaluating vote-buying claims is articulated in ***Schreiber v. Carney.***[6] ***Schreiber*** indicates that vote-buying is illegal ***per se*** if "the object or purpose is to defraud or in some way disenfranchise the other stockholders."[7] ***Schreiber*** also notes, absent these deleterious purposes, that "because vote-buying is so easily susceptible of abuse it must be viewed as a voidable transaction subject to a test for intrinsic fairness."[8] At first blush this proposition seems diffkult to reconcile with the Genera-l Assembly's explicit validation of shareholder voting agreements in § 218(c).[9] Significantly, however,

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shareholders. Second, they indicated that vote-buying was illegal ***per se*** "as a matter of public policy, [because] each stockholder should be entitled to rely upon the independent judgment of his fellow stockholders." ***Id.*** at 24.

This second principle was based on the notion that there was a duty owed by all shareholders to each other. The rationale for that notion was that "while self interest motivates a stockholder's vote, theoretically, it is also advancing the interests of other stockholders. Thus, any agreement entered into for personal gain, whereby a stockholder separates his voting right from his property right was considered a fraud upon this community of interests." ***Id.*** The ***Schreiber*** Court noted that the notion that vote-buying was illegal ***per se*** as a matter of public policy was "'obsolete because it is both impractical and impossible of application to modem corporations . . . and [that] the courts have gradually abandoned it."' ***Id.*** at 25 (quoting 5 Fletcher ***Cyclopedia Corporation*** (Perm. Ed.) § 2066). Furthermore, the Legislature has codified, at 8 ***Del.*** C. 218(c), the permissibility of creating voting agreements. As noted below, however, the principle that vote-buying is illegal ***per se*** if entered into for deleterious purposes survives.

[6] 447 A.2d 19 (Del. Ch. 1982).

[7] ***Id.*** at 25-26.

[8] ***Id.*** at 26; ***see also In re ZXC Communications, Inc. Shareholders Litig.,*** 1999 WL 1009174 at *8 (Del. Ch.) ("Generally speaking, courts closely scrutinize vote-buying because a shareholder who divorces property interest from voting interest, fails to serve the 'community of interest' among all shareholders, since the 'bought' shareholder votes may not reflect rational, economic self-interest arguably common to all shareholders.").

[9] Section 218(c) provides:

> (c) An agreement between 2 or more stockholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as provided by the agreement, or as the parties may agree, or as determined in accordance with a procedure agreed upon by them.

it was the management of the defendant corporation that was buying votes in favor of a corporate reorganization in ***Schreiber.*** Shareholders are free to do whatever they want with their votes, including selling them to the highest bidder. Management, on the other hand, may not use corporate assets to buy votes in a hotly contested proxy contest about an extraordinary transaction that would significantly transform the corporation, unless it can be demonstrated, as it was in ***Schreiber,*** that management's vote-buying activity does not have a deleterious effect on the corporate franchise.[10]

I am not persuaded by HP's contention that, as a threshold matter, a plaintiff cannot state a cognizable claim unless he establishes that there was a binding obligation to vote a specific way, in the nature of a contract, on the part of the shareholder whose vote is challenged. Of course there must be ***some*** kind of agreement with regard to how the challenged shares are to be voted for the issue to arise in the first place. I am not convinced, however, by the argument that such agreement must rise to something akin to a contractual obligation to vote shares according to the wishes of another before a cognizable claim may be stated. It is more logical to tie cognizability of a vote-buying claim to actual voting in accordance with a purportedly illegal agreement. Protection of unsuspecting

[10] Significantly, the vote-buying at issue in *Schreiber* was ratified in an independent and fully informed vote of the disinterested shareholders. Such ratification carries substantial weight when the Court is determining whether a vote-buying arrangement has a deleterious effect on the shareholder franchise, even if the vote-buying transaction is subject to a test of intrinsic fairness.

shareholders who are at risk of being defrauded or disenfranchised should be the focus of the Court, not whether the allegedly bad actors were contractually obligated to each other. I conclude, therefore, that a contractually binding obligation between parties to an agreement to vote shares in a particular manner is not a prerequisite to a vote-buying claim. The threshold showing required of a plaintiff is that he plead facts from which it is reasonable to infer that in exchange for "consideration personal to the stockholder," a stockholder has agreed to vote, or has in fact voted, his shares as directed by another. [11]

I also disagree with HP's assertion that to establish the invalidity of a vote-buying agreement, a plaintiff must show that a majority of all outstanding shares was obligated to vote in favor of the transaction as a result of the vote-buying. Again, the focus of the Court's analysis should be on possible deleterious effects of a challenged vote-buying agreement on shareholders. Less than a majority of votes can be decisive in tipping the results of an election one way or another. If voiding the votes cast in accordance with a fraudulent vote-buying agreement with corporate management is sufficient to change the result of a vote, I am again of the

[11] ***Schreiber,* 447** A.2d at 23; see ***also Henley Group, Inc. v. Santa Fe S. Pac. Corp., 1988*** WL 23945 (Del. Ch.) (finding that no vote-buying agreement existed under the facts of that case because the purported **"agreement"** left the challenged shareholder free to wage a proxy contest ***against*** the alleged vote-buyer and noting that **"[a]n** essential element of a vote buying agreement is that '. . . the stockholder divorces his discretionary voting power and votes as directed by the offeror"' (quoting ***Schreiber,* 447** A.2d at 23)).

opinion that the defrauded or disenfranchised shareholders should not be prevented from bringing a vote-buying claim.

### 3. Analysis of the Vote-Buying Claim

I must now determine whether the well-pleaded facts of the complaint, if true, would establish that Deutsche Bank's vote of 17 million of its shares in favor of the proposed merger was procured by HP as the result of an agreement or understanding whose purpose was to limit the effectiveness of the votes of the other HP stockholders.

Initially, I believe the facts as alleged in the complaint support a reasonable inference that the switch of Deutsche Bank's vote of 17 million shares to favor the merger was the result of the enticement or coercion of Deutsche Bank by HP management. The Hewlett Parties allege that just four days before the stockholders meeting Deutsche Bank was named as a co-arranger of a multi-billion dollar credit facility. That same day (March 15), Deutsche Bank had submitted all of its proxies and voted 25 million shares against the merger. On Monday, March 18, it is alleged that Deutsche Bank expressed fear over losing future business as a result of HP's negative reaction to Deutsche Bank's vote against the HP management-sponsored merger. Finally, the complaint alleges that, on March 19, the date of the special stockholder meeting, HP delayed the meeting while HP management was involved in a purportedly coercive telephone conference and then

closed the polls immediately after Deutsche Bank switched 17 million of its votes as a result of the understanding arrived at during that call. As stated above, however, a vote-buying agreement is not illegal per *se*, even when company management is buying votes. The more difficult question is whether or not the facts alleged support a reasonable inference that the agreement had a materially adverse effect on the franchise of the other HP shareholders.

The Hewlett Parties' primary argument as to why the alleged vote-buying agreement between HP and Deutsche Bank is illegal is that HP management used corporate funds (in essence, funds in which all of HP shareholders have a common interest as owners of HP) to purchase votes in favor of a transaction favored by management that management was required to put to a shareholder vote.[12] Furthermore, HP management failed to use any devices, such as a ratifying vote of independent shareholders, which would protect the integrity of the vote on the proposed merger.

The allegations of the Hewlett Parties, if true, are particularly troubling. The extraordinary transaction at issue in this case is one of the limited types of transactions a corporate board cannot unilaterally cause its corporation to consummate. Because the transaction would have a fundamental impact on the

[12] HP's contention at oral argument that, even if there was an agreement, corporate funds were not used to purchase Deutsche Bank's vote because all that is alleged is that Deutsche Bank was promised "future business" is less than convincing. That future business with Deutsche Bank would necessarily have to be paid for with corporate funds.

ownership interests of a company's shareholders, the board must present the proposal to the shareholders for approval. If the allegations of the Hewlett Parties are true, the implication is that HP management was concerned that the proposed merger, which ***they*** supported, would not be supported by a majority of HP's shareholders. Despite the fact that it was for the shareholders to make the ultimate determination of whether to approve the proposed merger, HP management purportedly used the shareholders' own money (in the form of corporate funds) to buy votes in opposition to HP shareholders who did not favor the merger. These actions, if they in fact were taken impermissibly, tipped the balance in favor of HP management's view of how the vote should turn out and made it proportionally more difficult for shareholders opposing the merger to defeat the transaction. In my opinion, that is an improper use of corporate assets by a board to interfere with the shareholder franchise. Whether the shareholders disagreed with, did not believe, or even did not understand the information presented to them by HP management about the proposed merger, it was the right of the shareholders to cast their votes on the proposed merger without impermissible interference from HP management.

*Schreiber* is instructive in demonstrating how a vote-buying agreement in which a board expends corporate assets to purchase votes in support of a board-favored transaction may be validly consummated. There, a vote-buying agreement

was being contemplated in which corporate assets were to be loaned to a 35% shareholder on favorable terms as consideration for that shareholder's agreement to vote in favor of a management-endorsed merger. The company formed a special committee to consider the merger and also the advisability of entering into the vote-buying agreement. The special committee hired independent counsel and then determined that both the merger and the shareholder agreement would be in the best interests of the company and its shareholders. After arm's-length bargaining with the 35% shareholder, the parties arrived at agreeable terms for the loan and the special committee recommended the shareholder agreement to the full board. The board of directors unanimously approved the agreement as proposed and submitted the vote-buying proposal to the shareholders for a separate vote-in effect a vote on vote-buying in that particular setting. As a condition for passage of the vote-buying proposal, a majority of outstanding shares, as well as a majority of the shares neither participating in the agreement nor owned by directors and officers of the company, had to be voted in favor of the proposal. After distribution of a proxy statement that fully disclosed the terms of the agreement, the vote-buying proposal was easily approved by the shareholders.[13]

The ***Schreiber*** Court noted all of these protective measures and ultimately held that "the subsequent ratification of the [shareholder agreement] by a majority

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[13] *Schreiber, 447* A.2d at 20.

of the independent stockholders, after a full disclosure of all germane facts with complete candor precludes any further judicial inquiry."[14] I agree with the well-reasoned opinion by then-Vice Chancellor Hartnett in ***Schreiber.*** Absent measures protective of the shareholder franchise like those taken in ***Schreiber,*** this Court should closely scrutinize transactions in which a board uses corporate assets to procure a voting agreement. This is not to say that all of the protective measures taken in ***Schreiber*** must be present before the Court will validate vote-buying by management using company assets. Each case must be evaluated on its own merits to determine whether or not the legitimacy of the shareholder franchise has been undercut in an unacceptable way. It is certainly possible for management to enter into vote-buying arrangements with salutary purposes. Accepting the allegations of the complaint as true in this case, however, I conclude that the plaintiffs have stated a cognizable vote-buying claim

Because the Hewlett Parties successfully have alleged that HP bought votes from Deutsche Bank with corporate assets and because no steps were taken to ensure that the shareholder franchise was protected, HP's motion to dismiss the plaintiffs' vote-buying claim is denied. At trial, the plaintiffs will have the significant burden of presenting sufficient evidence for me to find that Deutsche Bank was coerced by HP management during their March 19, 2002 telephone

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[14] ***Id.***

conference into voting 17 million shares in favor of the proposed merger and that the switch of those votes was not made by Deutsche Bank for independent business reasons.

### *B. The Disclosure Claim*

#### 1. Contentions of the Parties

The Hewlett Parties' second claim is that in soliciting proxies in favor of the proposed merger, HP management knowingly made numerous materially false and misleading public statements with regard to the integration of HP and Compaq. Those statements purportedly convinced Institutional Shareholder Services ("ES") to recommend to its subscribers that they vote in favor of the proposed merger.[15] That recommendation caused at least one of HP's largest shareholders, Barclays Global Investors ("Barclays"), to vote for the proposed merger.[16] Because of the extremely narrow margin of victory claimed by HP management, the vote by Barclays of more than 60 million shares (representing 3.1% of HP's voting shares) in favor of the proposed merger was likely outcome determinative.

[15] ISS is a subscription service that "helps institutional investors research the financial implications of proxy proposals and cast votes that will protect and enhance shareholder returns." See http://www.issproxy.com/services/index.html. The ISS recommendation to vote for the proposed merger was subscribed to by institutional stockholders holding as much as 23% of HP shares. Compl. ¶ 7(b).

[16] Before ISS had issued its recommendation to vote for the proposed merger, Barclays had stated that it would unconditionally vote its shares in accordance with the ISS recommendation.

To support this claim, the Hewlett Parties allege that in the months leading up to the stockholder vote, HP management repeatedly said, at investor and analyst conferences, to the media, and elsewhere, that HP's efforts to integrate its business with that of Compaq were progressing at least as well as planned. HP management gave assurances that HP was going to achieve at least $2.5 billion in cost savings in the first two years after the merger while losing no more than 5% of revenue, and having to lay off only 15,000 employees.

The plaintiffs report two specific instances when these purportedly false and misleading statements were made. First, at the Goldman Sachs Technology Conference held on February 4, 2002, HP's CEO, Fiorina, claimed: "We have now entered the third and final phase of our integration planning. We are at the point where detailed business plans are being drawn up for the new company. We are over-achieving on both our cost-reduction and revenue targets." Second, at HP's February 27, 2002 Security Analyst Meeting, HP management similarly said that as it looked at the value capture goals of the integration in greater detail, it felt comfortable with them, and was highly confident that those goals would be met. As a result, HP stated that the proposed merger would be accretive to HP stockholders by the end of HP's fiscal year 2003. These statements were allegedly made to quell the concerns of HP stockholders over HP's ability to integrate Compaq successfully.

In contrast to the public statements made by HP management, plaintiffs allege that at the time those statements were made, management knew that the integration plan was not on track, that projected cost savings and revenue losses were not what investors expected, and that the reality of the integration meant that HP was going to have to have higher revenues, to cut other costs, or to lay off 24,000, not 15,000, HP employees.

The Hewlett Parties contend that this allegation, that HP management's misrepresentations to the public were made knowingly, is supported by internal information available to management at the time when the purportedly misleading statements were made, internal information that was contrary to HP's public statements. At meetings of the HP-Compaq integration team, it was allegedly disclosed that the integrated company might not meet projections until at least 2004 and that the numbers for 2002 and 2003 were significantly below both HP's published projections and the expectations of financial analysts. It was allegedly further revealed that actual earnings would be over 30 cents per share less than the earnings per share HP was publicly projecting, a difference of about one billion dollars in profits. Rather than engaging in free and open debate about matters that were subject to reasonable disagreement, the Hewlett Parties contend, HP management made public statements about integration that it knew were not true based on the reports made to management by HP's integration team.

HP responds that the plaintiffs fail to state a disclosure claim because HP shareholders were fully informed of the competing positions and reservations with regard to the proposed merger through the proxy contest, which the Hewlett Parties themselves characterize as "unique in recent corporate history" and the "most intensive proxy contest in recent years." HP contends that all aspects of the integration issue were thoroughly debated, analyzed, and scrutinized, not only by Hewlett, but also numerous sophisticated institutional investors. HP invites the Court to take judicial notice of press releases personally issued by Hewlett, as well as of the other extensive coverage of the integration issue. HP contends that these sources reveal that the very integration issues the Hewlett Parties claim were presented inaccurately to HP shareholders (projections concerning revenue and the risks of integration with Compaq) were in fact disclosed.

HP also attempts to cast the Hewlett Parties' disclosure claim as one alleging, through the benefit of 20/20 hindsight, that the statements by HP management with regard to integration were misleading because it is *now* apparent that the integration planning efforts have not gone as well as expected and that, as a result, projected earnings will be lower than expected, thus necessitating more layoffs than were earlier anticipated. In other words, HP contends that this claim amounts to nothing more than fraud by hindsight and, moreover, that the allegations are particularly spurious because they relate to properly disclaimed

forward-looking statements about projected future results. As evidence of the baselessness of the Hewlett Parties' disclosure claim, HP cites *Bickel v. Fiorina*,[17] in which the United States District Court for the Northern District of California "impliedly rejected plaintiffs' disclosure claim."[18]

Finally, HP contends that if the Hewlett Parties believed HP's disclosure information was materially misleading, the time to bring suit was before the shareholder meeting rather than only after the vote when it appeared that the proposed merger had passed. HP argues that the disclosure claim should be barred due to the Hewlett Parties' failure to bring the matter to this, or some other, court before the vote when any maladies created by possible misinformation could have been cured.

2. Legal Standard for a Disclosure Claim

In a proceeding under § 225(b), the Court is permitted to "hear and determine the result of any vote of stockholders . . . upon matters other than the election of directors."[19] Part of that power includes the power to determine the

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[17] No. 014983 CW, C 02-0717 CW (WDB), Brazil (Magistrate) slip op. (N.D. Cal. Mar. 1, 2002).

[18] Def.'s Opening Br. at 14. The District Court's decision did not comment on the merits of the case; it merely refused to grant a motion to expedite discovery in an injunction proceeding.

[19] Section 225(b) provides in full:

> (b) Upon application of any stockholder or any member of a corporation without capital stock, the Court of Chancery may hear and determine the result of any vote of stockholders or members, as the case may be, upon matters other than the election of directors, officers or members of the governing body. Service of the application upon the registered agent of the corporation shall be, deemed to be service upon the corporation, and no other party need be joined in order for the

validity of votes cast. To the extent that HP management procured proxies by disclosing material information that it knew to be false, therefore, the plaintiffs' disclosure claim is cognizable in a proceeding under § 225(b).[20] To be actionable in this context, false or misleading statements must be material to those receiving the statements, which means that there must be a "substantial likelihood that the disclosure of the [the additional information] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" to the shareholders.[21]

3. Analysis of the Disclosure Claim

According to the Hewlett Parties, the misleading information disclosed to the public regarding the progress of integration was material to the decision of ISS to recommend voting in favor of the merger to its subscribers. The materiality to ISS of integration-related information is purportedly evident from ISS's March 5, 2002 Proxy Analysis, which described integration as "the single process most important to the success or failure of a merger." ISS warned that "the combined company could fail to realize those benefits if it is unable to successfully integrate

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Court to adjudicate the result of the vote. The Court may make such order respecting notice of the application as it deems proper under the circumstances.

[20] *See, e.g.*, ***Zaucha v. Brody***, 1997 WL 305841 at *4 (Del. Ch.) (addressing, in a § 225 action, disclosure claims affecting the validity of consents), *aff'd*, 697 A.2d 749 (Del. 1997).

[21] ***Rosenblatt v. Getty Oil Co.***, 493 A.2d 929, 944 (Del. 1985) (quoting ***TSC Indus., Inc. v. Northway, Inc.***, 426 U.S. 438, 449 (1976)); see also ***Zaucha***, 1997 WL 305841 at *4 (applying this standard to disclosure claims in a $225 action).

HP and Compaq," but counseled that "[s]trong integration planning can minimize the risks associated with failure, and thereby shift the balance in favor of the deal."

The Hewlett Parties further contend that information about the effect of the proposed merger on HP's employees was also material. The fact that 9,000 additional employees might lose their jobs was allegedly material because the attitude of employees toward the proposed merger was an important factor analysts considered in assessing the risk that the integration would be unsuccessful.

HP responds to these allegations by arguing that even if there was misleading information contained in the statements of management, the total mix of information available to the HP shareholders included materials presented to the shareholders by the Hewlett Parties in their attempt to defeat the proposed merger. These materials purportedly contain the precise facts that the plaintiffs allege were withheld from or misrepresented to the shareholders. At oral argument, both parties conceded that it would be appropriate for the Court to take judicial notice of these public documents for purposes of determining what was disclosed, although not for purposes of determining their veracity. HP contends that settled Delaware law indicates that when alleged misrepresentations and omissions are aired by competing parties in a proxy contest, the shareholders are fully apprised of all material facts and, consequently, subsequent disclosure claims based on the alleged misrepresentations must fail.

I note initially that the authorities relied upon by HP, *Zaucha v. Brody*[22] and *In re Seminole Oil Gas Corp.*,[23] both reached their conclusions about the total mix of information after trials. It is generally difficult, though not necessarily impossible, to determine the total mix of information available to shareholders at the motion to dismiss stage before the factual record has been developed more fully. Even if I were inclined to do so, however, HP's argument ultimately misses the point of the plaintiffs' allegation. As the plaintiffs reiterated at oral argument, their claim is that there is even more information that was not disclosed— specifically what the integration team told HP management. The integration team's reports are internal documents that would not appear in any of the hundreds of SEC filings about this merger. If the integration team explicitly informed HP management that what HP was disclosing was factually incorrect, and that was not disclosed to HP shareholders, than the total mix of information available to shareholders was inadequate.

The plaintiffs' assertion is that at the time the statements were made, those making the statements knew that their predictions were inaccurate and could not come true. Despite the knowledge that the statements were false, the Hewlett Parties contend, HP management nevertheless presented an overly optimistic

[22] 1997 WL 305841 (Del. Ch. 1997).
[23] 150 A.2d 20 (Del. Ch. 1959).

picture of the integration process for the purpose of calming investor fears over the impact of integration upon the surviving company. The hoped-for result of those misleading comments was to induce ISS (which was particularly concerned about integration) and others to recommend and to vote in favor of the proposed merger. Accepting the facts alleged in the complaint as true, which I must at this stage of the litigation, it’ would be impossible for me to hold, as a matter of law, that the Hewlett Parties failed to state a cognizable disclosure claim in this § 225 action.”

For the same reason, the defendants’ fraud by hindsight argument is also inappropriate. The plaintiffs are not arguing that, in hindsight, the statements made by HP management were materially misleading when they were made because it is now apparent that the predictions made in those statements will not come true. Instead, they are claiming that the statements were false when they were made and that HP management knew that to be the case. If these allegations are true, then the plaintiffs have stated a claim for which relief can be granted under Delaware law.

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[24] I reiterate that the plaintiffs in this case have done more than just allege in conclusory form that they thought the defendant was lying. Such a bare-bones allegation would not be sufficient to invoke § 225 after a party lost a proxy contest. The plaintiffs here have specifically identified reports to management by the integration team that can be verified and that would, accepting the alleged facts as true, prove the bad faith of HP management. The credibility of these allegations, made primarily upon information and belief, is bolstered by the fact that one of the plaintiffs, Walter Hewlett, is a director of the defendant corporation and as such has access to confidential company documents. Finally, the alleged misstatements pertain to integration, an issue that was particularly important to ISS, an institution that was effectively able to dictate the vote of a block of shares that we now know was likely outcome determinative. It is in light of all of these factors that I conclude that the plaintiffs may proceed with this challenge under $225.

HP next contends that the specific disclosures mentioned by the plaintiffs were forward-looking statements that cannot result in liability if those predictions later prove to be inaccurate. This is generally true. Here, however, the allegation is that those forward-looking statements were known to be lies at the time they were made. Under Delaware law, a participant in a proxy contest may not lie and then obtain protection by describing that lie as a forward-looking statement. Indeed, as HP acknowledges, protection is not afforded forward-looking statements that were "'not made in good faith *(i.e.,* not genuinely believed to be true).'"[25] At this stage of the litigation I must accept as true well-pleaded allegations contained in the complaint. As described above, the allegations of the complaint can reasonably be read to imply that statements were made which HP management did not genuinely believe to be true.

Finally, HP makes what amounts to a laches argument. It contends that if, as is evident from Hewlett's public statements during the proxy contest, Hewlett believed that HP was making materially misleading statements, he should have asserted that claim before the vote when "any improprieties might have been cured without undue prejudice."[26] Although it may very well have been more efficient,

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[25] Def.'s Reply Br. at 9 (quoting ***Hubbard v. Hibbard Brown & Co., 633*** A.2d 345, 350 (Del. 1993)).
[26] ***Id.*** at 15.

in terms of both time and finances expended, to have litigated this issue earlier, there is no forfeiture of the right to seek redress for failure to have done so here. Indeed, the case cited by HP for the argument that this Court should consider the timing of this litigation, while noting that "it is obviously ***preferable*** that disclosure claims be litigated in advance of the relevant decision to be made," ultimately concludes that "that preference does not necessarily translate into the conclusion that a challenge brought. . . after the vote is necessarily barred by laches."[27] Although it is certainly possible for a plaintiff to wait too long to bring a claim, I do not believe that these plaintiffs have done so. Here, the disclosure claim has been brought in an expedited action under § 225 before the merger has been consummated and, indeed, before the result of the vote has been conclusively certified. It is also difficult for me to see how HP has been harmed by this delay because it was certainly on notice that Hewlett was questioning its public statements. Moreover, if the allegations that HP was lying are true, it was definitely on notice that there were potential disclosure problems. I, therefore, decline to bar this claim for failure to bring it before the vote.

Because the complaint raises a reasonable inference, accepting its allegations as true, that HP management knowingly misrepresented material facts

[27] ***R.M.S.*** *Inc.* ***v.*** *Alliance Capital Mgmt. Holdings LP., 790* A.2d 478, 499 n.34 (Del. Ch. 2001) (emphasis added).

about integration in an effort to persuade ISS and possibly others to approve of the merger, HP's motion to dismiss the disclosure claim must be denied. At trial, the plaintiffs have the burden of proving, through analysis of reports of the integration team, that this was actually the case.

## IV. CONCLUSION

Based on the foregoing reasons, I deny HP's motion to dismiss. The Hewlett Parties' complaint adequately pleads claims under 8 ***Del. C.*** **§ *225(b)*** sufficient to withstand a motion to dismiss. They are entitled to a judicial determination of the validity of certain votes cast at HP's March 19, 2002 special stockholder meeting concerning the proposed merger of HP and Compaq. Whether the Hewlett Parties can meet their burden of proving their claims must await the trial on the merits, presently scheduled to commence in this Court on April 23, 2002.

IT IS SO ORDERED.