IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

EDWARD T. MCGOWAN,)
)
Plaintiff,) C.A. No. 18672-NC
)
v.)
)
PETER A. FERRO, JR; ROBERT W.)
KEGLEY, SR;WILLIAM J.)
McENERY; CHARLES P.)
HAMMERSMITH, JR.; WILLIAM)
J. SABO; THOMAS J.)
LAMBRECHT; JOSEPH CANFORA)
and HORSESHOE GAMING)
HOLDING CORP., a Delaware)
corporation)
)
Defendants.)

MEMORANDUM OPINION

Date Submitted: September 5, 2001
Date Decided: January 11, 2002

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A. Gilchrist Sparks, III and S. Mark Hurd, Esquires of MORRIS NICHOLS ARSHT & TUNNELL, Wilmington, Delaware; and Martin Nussbaum, Robert M. Friedman and Benjamin E. Rosenberg, Esquires of SWIDLER BERLIN SHEREFF FRIEDMAN, LLP, New York, New York; Attorneys for Defendants

JACOBS; VICE CHANCELLOR

The plaintiff, Edward T. McGowan ("McGowan"), a director of Empress Entertainment, Inc. ("Empress"), brought this lawsuit against the other six members of Empress's Board of Directors (the "director-defendants"), and also against Empress's former President, Joseph Canfora ("Canfora") and Horseshoe Gaming Holding Corp. ("Horseshoe"). In this action, McGowan challenges the validity of a merger between certain subsidiaries of Empress and Horseshoe Gaming, L.L.C., Horseshoe's predecessor (the "merger"). McGowan claims that the director-defendants breached their fiduciary duties in connection with the merger, and, in Count III of the Complaint (the "aiding and abetting claim"), claims that Horseshoe knowingly participated in those fiduciary breaches.

Horseshoe has moved to dismiss Count III of the Complaint under Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted. For the reasons next discussed, Horseshoe's motion will be granted.

I. FACTS[1]

In September 1998, Empress and Horseshoe entered into a merger agreement that the Empress board of directors, including McGowan,

[1] For purposes of this Opinion, the facts as alleged by McGowan are assumed to be true. Del. Ch. Ct. R. 12(b)(6); ***Loudon v. Archer-Daniefs-Midland Co.,*** Del. Supr., ***700*** **A.2d** 135,140 (1997).

unanimously approved (the "merger agreement"). Under the merger agreement, Horseshoe would acquire two Empress subsidiaries that owned the Empress Joliet and Empress Hammond riverboat casinos, for a price of $609 million. The closing of the merger was conditioned upon obtaining appropriate state regulatory approvals. If those approvals were not obtained, the merger agreement would expire on June 30, 1999.

In January 1999, defendants Canfora and Peter Ferro, Jr., an Empress director, entered into employment contracts with Horseshoe. The employment agreements provided that Ferro would become the executive vice-president of Horseshoe and earn at least $400,000 per year; and that Canfora would become the president of Horseshoe and earn a base salary of $500,000. According to the Complaint, Canfora "also stood to gain $5,750,000 in additional compensation from Empress Entertainment as a bonus should the transaction with Horseshoe be consummated."[2] In addition, four of Empress's six directors "had an enforceable contract to provide consulting services or engage in business transactions with Horseshoe that would occur or continue to occur upon the consummation of

[2] Complaint ¶ 25.

the merger."[3] The precise nature of these "consulting services" or "business transactions," and their value, are not disclosed in the Complaint.

In March 1999, after it became clear that the merger would not receive approval before the termination date Horseshoe requested from the Empress board a three-month extension of the termination date of the merger agreement. The Empress board granted that request. Thereafter, Horseshoe needed and requested another extension, but the board denied that request for an extension on April 23, 1999.

Finally, in July 1999, Horseshoe made a third-and this time, successful-request for an extension of the termination date of the merger agreement. That extension (the "second extension") was negotiated for Empress by Ferro and Canfora, both of whom had employment offers from Horseshoe. The second extension was approved by Empress's board of directors. As consideration for the grant of the second extension, Horseshoe paid Empress a $20 million fee.

McGowan alleges that, during the interval between the original execution of the merger agreement and the granting of the second extension, the value of Empress's casinos increased by $230 million, that both the

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[3] Those contracts, together with the employment contracts, are referred to as the "collateral agreements." Complaint ¶ 36.

Empress board and Horseshoe knew of that increase in value, and that Empress, nonetheless, did not negotiate any increase in the purchase price to account for the increased value of the casinos.

II. THE LEGAL STANDARD AND THE CONTENTIONS

A. The Legal Standard

On a motion to dismiss under Court of Chancery Rule 12(b)(6), the Court must assume the truthfulness of the well-pled allegations of the complaint and draw all reasonable inferences therefrom.[4] A complaint will not be dismissed unless it can be determined with reasonable certainty that the plaintiff could-not prevail on any set of facts reasonably inferable from the complaint's allegations! This standard governs the analysis of the issues presented on this motion.

B. The Contentions

In his Complaint, McGowan claims that Horseshoe aided and abetted the director-defendants' breaches of fiduciary duty by negotiating for the second extension with two Empress fiduciaries who had a disabling conflict of interest by virtue of their employment contracts with Horseshoe. Because

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[4] *Loudon,* *700* A.2d at 140.

[5] *Solomon v. Pathe Communications Corp.,* Del. Supr., 672 A.2d 35, 39 (1996).

of that conflict of interest, McGowan claims, Horseshoe knowingly paid less for Empress than the company was actually worth. Horseshoe responds that even if those allegations are true, they do not state a legally cognizable claim against Horseshoe, because they do not establish that Horseshoe "knowingly participated" in the defendant-directors' breach.[6] I find, for the reasons next discussed, that Horseshoe's position is meritorious and that the aiding and abetting claim must be dismissed.

III. ANALYSIS

A. Elements of a Claim for Aiding and Abetting

To state a cognizable claim for aiding and abetting, the plaintiff must plead four elements: (i) the existence of a fiduciary relationship, (ii) a breach of that relationship, (iii) knowing participation in the breach by a defendant who is not a fiduciary, and (iv) damages proximately caused by the breach.[7]

The parties agree that McGowan has adequately pled two of the elements of an aiding and abetting claim: the existence of a fiduciary

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[6] *Crescent/Mach I Partners, L.P. v. Turner,* Del. Ch., C.A. No. 17455, mem. op. at 48, Steele, V.C. (Sept. 29, 2000).

[7] *Malpiede v. Townson,* Del. Supr., *780* A.2d *1075, 1097* (2001); *Crescent/Mach I Partners, L.P.,* C.A. *No. 17455,* mem. op. at *48; In re Lukens Inc. S'holders Litig.,* Del. Ch., 757 A.2d 720, 734 (1999) (citing *Gilbert v. El Paso Co., 490* A.2d 1050, 1057 (1984), *aff'd,* Del. Supr., 575 A.2d 1131 (1990)).

relationship and damages. For the purposes of this Opinion only, I assume, without deciding, the second element, i.e., that the director-defendants breached their fiduciary duty of loyalty. Even so, I conclude that McGowan has failed adequately to plead the third element of aiding and abetting-that Horseshoe knowingly participated in the assumed breach of the defendant-directors' fiduciary duties.

B. The Pleading Requirements for Knowing Participation and their Application to this Case

Although "knowing participation" does not have to be pled with particularity,* to survive a Rule 12(b)(6) motion the Complaint must either allege facts establishing either that Horseshoe and the director-defendants conspired to breach a fiduciary duty,[9] or must otherwise contain "some factual allegations from which knowing participation can be inferred."" Where (as here) the Complaint does not plainly allege that Horseshoe conspired with the directors to breach a fiduciary duty, a court can infer a non-fiduciary's knowing participation "only if a fiduciary breaches its duty

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'*Jackson Nat'l Life Ins. Co. v. Kennedy,* Del. Ch, 741 A.2d 377,391 (1999).

[9] ***Malpiede,*** *780* A.2d at 1097-98 ("[A] bidder may be liable to' a target's stockholders for aiding and abetting a fiduciary breach by the target's board where the bidder and the board conspire in or agree to the fiduciary breach.").

[10] *Jackson Nat 'l Life Ins. Co.,* 741 A.2d at 392 (quotations and citations omitted).

in an inherently wrongful manner, and the plaintiff alleges ***specific facts*** from which that court could reasonably infer knowledge of the breach.“”[11] Conclusory statements that are “devoid of factual details to support an allegation of knowing participation will fall short of the pleading requirement needed to survive a Rule 12(b)(6) motion to dismiss.”[12]

Three cases relied upon by the parties demonstrate the level of factual detail needed to plead “knowing participation” by a non-fiduciary. Those cases-*In re USACafes, L.P. Litigation,*[13] *Jackson National Life Insurance Co. v. Kennedy,*[14] and *Crescent/Mach I Partners, L.P. v. Turner*[15]— underscore the inadequacy of McGowan’s aiding and abetting claim against Horseshoe. In all three cases, the collateral or side agreements granted by the non-fiduciary acquiror to the fiduciary directors were so excessive, in that they represented such a significant percentage of the total transaction value, that the court could reasonably infer that the payments were made specifically to induce the fiduciaries to breach their duties. Indeed, the

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[11] ***Id.*** (quotations and citations omitted) (emphasis added).

[12] ***Id.*** (citing ***In re Santa Fe Pacific Corp. S’holder Litig.,*** Del. Supr., 669 A.2d 59, 72).

[13] Del. Ch., 600 A.2d 43 (1991).

[14] Del. Ch., 741 A.2d 377 (1999).

[15] Del. Ch., C.A. No. 17455, mem. op., Steele, V.C. (Sept. 29, 2000).

complaints in those cases alleged that the payments were "'incentives to ignore their fiduciary obligations. '"[16]

USACafes involved a non-fiduciary's acquisition of the assets of the target corporation for $72 million. The complaint alleged that the target corporation's directors and officers had received $15 to $17 million—representing nearly 24% of the transaction's value-in side payments. The complaint also specifically alleged that these "grossly excessive" payments were incentives for the defendants to disregard their fiduciary duties."

The court denied a motion to dismiss the aiding and abetting claim. Observing that the alleged side agreements amounted to more than "conventional collateral agreements,"" the Court held that "plaintiffs have included enough detail about their size and nature to support, at least at this preliminary stage, the assertion that they were inducements, knowingly *made,"* to cause the fiduciaries to breach their duty to the plaintiffs."

Similarly, in *Jackson National Life Insurance* Co., the complaint alleged- that the defendant-acquirer had provided "financial incentives"

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[16] *In re USACafes, L.P. Litig. 600* A.2d at 56 (quoting the complaint).

[17] *Id.*

[18] *Id.*

[19] *Id.* (emphasis added).

totaling more than 20% of the transaction's value "to induce and aid [the fiduciary] into ignoring his fiduciary obligations."[20]

In *Crescent/Mach I Partners,* the complaint alleged that the merger was structured to maximize the fiduciary's personal benefit at the expense of the stockholders. Under various side agreements with the non-fiduciary acquiror, the fiduciary would receive a "substantial equity interest" in the successor entity.[21] The complaint further alleged that the fiduciary had told the acquirors that he would "'not consent to any transfer of [the business] unless he and his affiliates received special treatment in the transaction.'"[22] Those allegations were found sufficient to establish an inference of "knowing participation" by the acquirors in the director's breach of fiduciary duty.

Unlike the complaints in *USACafes, Jackson,* and *Crescent/Mach I,* the Complaint in this case does not allege that the collateral agreements between Horseshoe and the director-defendants were so "grossly excessive"[23] as to be "inherently wrongful"[24] or that those agreements were

[20] *Jackson Nat '1 Life Ins. Co.,* 741 A.2d at 392 (quoting the complaint).

[21] *Crescent/Mach I Partners, L.P.,* C.A. No. 17455, mem. op. at 8.

[22] Id. at 51 n.88 (quoting the complaint).

[23] *In re USACafes, L.P. Litig., 600* A.2d at 56.

[24] *Jackson Nat-Y Life Ins. Co.,* 741 A.2d at 392.

unfair to Empress. Nor does the Complaint disclose the value of the collateral consulting and service agreements between Horseshoe and the director-defendants,[25] or the percentage of the total transaction value they represent. McGowan also advances no claim that the collateral agreements were intended, or used, to induce the director-defendants to breach their fiduciary duties. Indeed, the collateral agreements were negotiated after most of the negotiations over the merger agreement had concluded, and before any need to negotiate a second extension had materialized.

What the Complaint does allege is that Horseshoe knew (i) "that the Empress entities had increased substantially in value since the signing of the original merger agreement" and (ii) that "when [Horseshoe] 'negotiated' the terms of the Second Extension with Canfora and Ferro . . . [they] both had lucrative employment contracts with Horseshoe."[26] In other words, McGowan claims that Horseshoe acquired the casinos for a favorable price

[25] The Complaint alleges that Horseshoe and the director-defendants had (i) "an agreement to continue to provide oil and fuel for the Empress riverboats;" (ii) "an agreement to continue to provide insurance for the Empress casinos;" (iii) "a contract for consulting services;" and (iv) "an agreement to allow [a director-defendant's] construction company (without any charge or consideration) to dump excess fill and construction debris on the Empress properties." Complaint ¶ 36. The Complaint does not allege that the terms of the employment agreements with Ferro and Canfora were materially different than the terms of their then-existing employment or that the agreements were anything other than "conventional collateral agreements." *Cf. In re USACafes, L.P. Litig.*, 600 A.2d at 56.

[26] Complaint ¶¶ 104-05.

by bargaining effectively with representatives of the business who had job offers from Horseshoe-job offers that are not alleged as improper. Although the complaint alleges that Empress's directors voted to approve the second extension because they had those collateral agreements with Horseshoe, those agreements are not claimed in the Complaint to be "inherently wrongful" or grossly excessive.[27] Accordingly, even if the pled facts state a claim that the Empress directors breached their fiduciary duty in granting the second extension to Horseshoe, there is no factual basis to infer that Horseshoe "knowingly participated" in that breach.[28] Conclusory allegations that Horseshoe "knew of the fiduciary duty breach[] . . . alone

[27] Only in his brief does McGowan argue that the collateral agreements were "inherently wrongful," and "provide[] the basis for this Court to infer Horseshoe's 'knowing participation'" in the director-defendants' breach of fiduciary duty. McGowan Ans. Br. at 10 (citing *Jackson Nat'l Ins.* Co., 741 A.2d at 391). Such collateral agreements, contends McGowan, "inherently require knowing participation in the Director-Defendants' breach of their fiduciary duty of loyalty." Id. Arguments contained in a brief, however, cannot cure a defect caused the failure to allege critical facts in the complaint. *Harber v. Bell,* Del. Ch., 465 A.2d 353 (1983). Moreover, I know of no instance when a Delaware court has held that *any* collateral agreements among the directors of an acquired corporation and the acquiring corporation *automatically* lead to an inference of "knowing participation" by the acquiror in breach of a director's fiduciary duty. On the contrary, "conventional collateral agreements" may be part of a transaction without implicating fiduciary duties. *In re USACafes, L.P. Litig., 600* A.2d at 56. The Complaint alleges no facts which suggest that those collateral agreements were out of the ordinary.

[28] *Jackson Nat'l Life Ins., 741* A.2d at 392.

would not establish [its] complicity with the [defendants'] alleged breach[]."[29]

More specifically, the claim that Horseshoe knew that the value of the business had increased substantially after the merger agreement was executed and before the deal closed, and that Horseshoe did not fully compensate Empress for the full value of that increase, does not support an inference that Horseshoe knowingly participated in a breach of fiduciary duty by the director-defendants. Horseshoe was entitled to bargain to obtain the best price for itself, and breached no duty by doing so, even if the result was a price that was unfairly low from the standpoint of Empress stockholders.[30]

Because the Complaint does not allege that Horseshoe conspired with the director-defendants to breach their fiduciary duty, or that Horseshoe provided the director-defendants with self-evidently improper and excessive

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[29] *Oliver v. Boston Univ.,* Del. Ch., C.A. No. 16570, mem. op. at 27, Steele, V.C. (July 25, 2000) (citing *In re Lukens Inc. S'holders Litig.,* Del. Ch., C.A. No. 16102, mem. op. at 29, Lamb, V.C. (Dec. 1, 1999)); *see also Greenfield v. Tele-Communications, Inc.,* Del. Ch., C.A. No. 9814, ltr. op. at 7, Allen, C. (May 12, 1989) ("[W]here the charge is conspiracy or knowing participation with a breaching fiduciary, some facts must be alleged that would tend to establish, at a minimum, knowledge by the third party that the fiduciary was endeavoring to breach its duty. . . .").

[30] *Repairman's Serv. Corp. v. Nat'l Intergroup, Inc.,* Del. Ch., C.A. No. 7811, mem. op. at 22, Walsh; V.C. (March 13, 1985). After the request for an extension was denied by the Empress board, Horseshoe was required to pay an additional $20 million to obtain the second extension.

side-payments, it cannot be inferred that Horseshoe knowingly participated in a breach of fiduciary duty by the director-defendants.

IV. CONCLUSION

For the reasons set forth above, Horseshoe's motion to dismiss Count III of the Complaint for failure to state a cognizable legal claim against it is granted. **IT IS SO ORDERED.**