CLAIMS OF AIDING AND ABETTING A DIRECTOR’S BREACH OF FIDUCIARY DUTY—DOES EVERYBODY WHO DEALS WITH A DELAWARE DIRECTOR OWE FIDUCIARY DUTIES TO THAT DIRECTOR’S SHAREHOLDERS?

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I. Introduction

Increasingly, litigation initiated by stockholders of Delaware corporations alleging a breach of fiduciary duty by the directors of those corporations has included a claim against those persons or corporations who dealt with the directors for knowingly participating in the alleged breach of duty.¹ From a stockholder’s point of view,

¹ A comprehensive sampling, but not an exhaustive list, of recent cases heard by the Delaware Court of Chancery and the Delaware Supreme Court
the most significant context in which this type of claim can occur may be when the injured stockholder is faced with directors who are without sufficient assets or insurance to meet a judgment against them. However, these claims have not been limited to those situations; they provide additional defendants increasing the likelihood of a complete recovery for stockholders and increasing the stockholders’ bargaining power at settlement negotiations. From the point of view of third parties who deal with directors, this claim, if construed broadly, can raise significant concerns; personal liability to the stockholders may result if a court finds that they knowingly participated in a breach of duty by the directors with whom they dealt.

Although there is no question that this legal theory is sound, Delaware courts have often looked at these claims with a skeptical eye, and rightly so, because a broad construction of this type of

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3. For instance, the pleading requirements applied by Delaware courts to
claim might impair a director's ability to deal with third parties. This note will examine this theory of law in an attempt to clarify the duty owed to the shareholders of a Delaware corporation by those dealing with the directors of that corporation. Additionally, some time will be spent determining who can be a defendant in this type of claim. Furthermore, after an examination of one of the most litigated issues with respect to this type of claim, its pleading requirements, conclusions will be drawn as to the status of these claims under Delaware law and their effect on directors and those who deal with directors.

II. Background

Under the most basic and fundamental principle of Delaware's General Corporation Law, the directors of a corporation are charged with the duty of managing the business and affairs of that corporation. Although directors are technically not trustees, Delaware courts have consistently held them to the status of a fiduciary in their relationship with their corporation and its stockholders. This status "demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty [and] requires an undivided and unselfish loyalty to the corporation [and] demands that there shall be no conflict between duty and self-interest." If these claims could be deemed stringent considering that the facts underlying these claims are often secret and difficult to obtain because they are in the possession of the breaching board and the third parties who have allegedly aided and abetted that board. See infra text accompanying notes 66-90.

4. See infra text accompanying notes 19-65.
5. See infra text accompanying notes 91-106.
6. See infra text accompanying notes 66-90.
7. Del. Code Ann. tit. 8, § 141(a) (1974) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors ....").
8. See J. Pomeroy, Equity Jurisprudence § 1090 (5th ed. 1941) ("[D]irectors and managing officers ... occupy a double position of partial trust; they are quasi or sub modo trustees for the corporation with respect to the corporate property, and they are quasi or sub modo trustees for the stockholders with respect to their shares of the stock."). (footnote omitted). The directors "are not, however, true trustees with the corporation or the stockholders as their true cestuis que trustent, since they hold neither the legal title to the corporate property nor that to the stock." Id. § 1089, at 264.
9. Mills Acquisition Co., 559 A.2d at 1280; Guth v. Loft, 5 A.2d 504, 510 (Del. 1939); Bodell v. General Gas & Elec. Corp., 132 A. 442, 446 (Del. 1926); Lofland v. Cahall, 118 A. 1, 3 (Del. 1922).
directors breach any of their fiduciary duties, they may be personally liable to the stockholders.\textsuperscript{11} In addition to being fiduciaries, directors are at the same time also considered agents.\textsuperscript{12} The directors power to act on behalf of the corporation is derived from their role as agents; a director’s role as an agent fixes the rights and obligations of the corporation in dealings with third persons.\textsuperscript{13} The distinction between the roles of agent and trustee is important; the equitable remedies available to the stockholders and the corporation rest upon the directors role as a trustee.\textsuperscript{14} One commentator has explained the double relationship simply: “[A]s to third persons, directors are agents of the corporation, but as to the corporation itself, equity holds them liable as trustees.”\textsuperscript{15}

Because directors are held to be fiduciaries, one of the duties placed upon people dealing with fiduciaries has been applied to those who deal with directors. Specifically, anyone who knowingly participates in a director’s breach of fiduciary duty will be personally liable to that director-fiduciary’s beneficiaries—the stockholders.\textsuperscript{16} In other words, the duty is placed on those who deal with directors not to knowingly participate in a breach of fiduciary duty. In Delaware a body of law has developed around this issue; it is known as the law of “aiding and abetting, civil conspiracy or knowing participation in a breach of fiduciary duty.”\textsuperscript{17} This theory of law implicates both fiduciary principles and agency principles; the latter are implicated because determining who can conspire with directors requires an analysis of the directors ability to act on behalf of the corporation as a legal entity.\textsuperscript{18}

\begin{itemize}
\item \textsuperscript{11} See, e.g., Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).
\item \textsuperscript{12} 3 W. Fletcher, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 838 (revised perm. ed. 1986).
\item \textsuperscript{13} Pomeroy, supranote 8, § 1089, at 264-65. See also Fletcher, supra note 12, § 841, at 209.
\item \textsuperscript{14} Pomeroy, supra note 8, § 1089, at 264-65.
\item \textsuperscript{15} Fletcher, supra note 12, § 841, at 209.
\item \textsuperscript{16} See, e.g., Penn Mart Realty Co., 298 A.2d at 351. See also G. Bogart, TRUSTS & TRUSTEES § 901 (revised 2nd ed. 1982); 4 A. Scott & W. Fratcher, SCOTT ON TRUSTS § 326.5 (4th ed. 1989).
\item \textsuperscript{17} Greenfield v. Tele-Communications, Inc., No. 9814, slip op. at 5, reprinted in 15 Del. J. Corp. L. at 187. It should be noted that referring to this body of law as “civil conspiracy” is overly broad because types of civil conspiracies, other than conspiracy to breach a fiduciary duty, exist. See, e.g., Zirn v. VLI Corp., No. 9488, slip op. at 23 (Del. Ch. July 17, 1989) (Hartnett, V.C.), reprinted in 15 Del. J. Corp. L. 789 (1990) (discussing test for civil conspiracy to defraud).
\item \textsuperscript{18} See infra text accompanying notes 91-106.
\end{itemize}
III. The Law of Conspiracy to Breach Directors’ Fiduciary Duties

A. The Standards

In Delaware, the test applied by courts to determine if an actionable claim for knowing participation in a breach of fiduciary duty exists was originally set forth in Penn Mart Realty Co. v. Becker and clarified slightly in Gilbert v. El Paso Co. Three elements (four if damages are included) must be asserted to support a claim for knowing participation in a director’s breach of duty: “(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary’s duty and (3) knowing participation in that breach by [a] party not in direct fiduciary relationship. A fourth element, the allegation of damages resulting from the action of the conspiracy parties, also is required.”

The Gilbert court also noted that “while the essence of a criminal conspiracy is the agreement, the essence of a civil conspiracy is damages.”

B. Analysis of the Standards

The first two elements of the test (and the fourth, damages) raise few issues. They merely state the obvious; namely, that there can be no knowing participation in a breach of duty absent a breach of duty. However, these requirements are very important because the breach of duty forms the basis of this claim.

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21. Id. at 1057. Compare id. with Penn Mart, 298 A.2d at 351. The requirement that the participation be by a party who is not in the direct fiduciary relationship was not stated in Penn Mart. This distinction is very significant in certain situations. See infra notes 91-92 and accompanying text. However, the omitted part of the test was not at issue in Penn Mart. Additionally, the “fourth element,” damages, was not stated in Penn Mart but it was necessarily present.
22. Gilbert, 490 A.2d at 1057 (citing Weinberger v. UOP, Inc., 426 A.2d 1333, 1348 (Del. Ch. 1981), rev’d on other grounds, 457 A.2d 701 (Del. 1983)). In Weinberger, the court of chancery stated the test somewhat differently: “[I]n order to establish a civil conspiracy it is necessary to show the combination of two or more persons for an unlawful purpose, or a combination for the accomplishment of a lawful purpose by unlawful means.” Weinberger v. UOP, Inc., 426 A.2d at 1348.
23. This is illustrated by the Delaware Supreme Court’s holding in Ivanhoe Partners v. Newmont Mining Corp., 555 A.2d 1334 (Del. 1987). Ivanhoe held that Consolidated Gold Fields PLC (Gold Fields) could not have participated in any
The most frequently litigated, most critical and often the most confusing element of the test, is the third. Stated simply, this element consists of two parts, knowledge and participation. A good place to begin an analysis of the third element is with the first case to address it, Penn Mart.

1. Penn Mart

In Penn Mart, the Delaware Court of Chancery denied a motion to dismiss filed by the defendants, which alleged that the plaintiff had failed to state a claim of knowing participation in a breach of duty upon which relief could be granted. Penn Mart Realty Company (Penn Mart) was a shareholder of Glen Alden Corporation (Glen Alden) and initiated a stockholder derivative action. During January and February of 1968, Glen Alden had acquired 92,700 shares of Schenley Industries, Inc. (Schenley) through a broker, Carter, Berlind & Weill, Inc. (Carter). In early February a meeting was attended by Investors Diversified Services, Inc. (IDS), one of the defendants, Carter and Glen Alden at which inside information regarding Glen Alden’s plans for the future was allegedly disclosed to both IDS and Carter. On March 14, Glen Alden sold, its 92,700 shares of Schenley through Carter, for $63 per share to Investors Variable Payment Fund, Inc. (Investors), a company for which IDS was the principal underwriter and investment manager. Seven days later, on March 20, Glen Alden purchased 945,126 shares of Schenley at $80 per share and soon thereafter made a tender offer for all the remaining shares of Schenley at approximately $80 per share.

breach of duty owed by Newmont Mining Corporation (Newmont) to its shareholders, where Gold Fields entered into an agreement with Newmont leading to its purchase of 26% of Newmont stock, because Newmont had breached no duty. Id. at 1344. See also, e.g., Yanow v. Scientific Leasing, Inc. Nos. 9536 & 9561 (Del. Ch. Feb. 5, 1988) (revised Feb. 8, 1988), reprinted in 13 Del. J. Corp. L. 1273 (1988) (Jacobs, V.C.) (no breach of duty).

25. Id. A stockholder derivative suit is "the equivalent of a suit to compel the corporation to sue, and [a] suit by the corporation, asserted by the stockholders on its behalf, against those liable to [the corporation]." Cantor v. Sachs, 162 A. 73, 76 (Del. Ch. 1932). Any recovery made is for the benefit of the corporation. Id. See also Del. Ch. Ct. R. 23.1 (setting forth requirements for a derivative action).
27. Id.
28. Id.
29. Id. at 350-51 (the tender offer involved cash and debentures).
Penn Mart claimed that the Glen Alden Directors were grossly negligent and wasted corporate assets by selling the 92,700 shares for $63 per share on March 14 because they knew at the time the $63 price was far below the true worth of the stock.\textsuperscript{30} Penn Mart further alleged that this information was disclosed to IDS (and therefore Investors also) during their meeting. Penn Mart alleged that IDS, with knowledge of the true value of the stock and awareness that they were dealing with a fiduciary, nevertheless, aided the Glen Alden Directors in wasting corporate assets.\textsuperscript{31}

Initially, the court flatly rejected IDS’s argument that Penn Mart was required to have alleged that “the IDS-Glen Alden negotiations were not conducted at arm’s-length [or] that IDS exerted an influence over the directors sufficient to infect their action with vitiating conflict of interest.”\textsuperscript{32} This argument was rejected because the breach of duty being alleged was not fraud and self dealing but was rather gross negligence and waste of corporate assets.\textsuperscript{33}

Additionally, the court rejected IDS’s remaining argument that holding them ultimately liable would leave them with an irreconcilable conflict between their duty to their own shareholders (to obtain the best price for stock purchased) and their duty not to participate in another’s breach of duty.\textsuperscript{34} The court did not explain its reasoning for rejecting this argument but it appears that the court was simply recognizing that when one is dealing with someone one knows to be a fiduciary, one cannot close his or her eyes to the fact that the party with whom he is negotiating is making a grossly negligent deal—regardless of his desire to extract maximum profit.\textsuperscript{35}

\textsuperscript{30} \textit{Id.} at 351.

\textsuperscript{31} \textit{Id.}

\textsuperscript{32} \textit{Id.} (court was apparently quoting one of the defendant’s briefs).

\textsuperscript{33} \textit{Id.} The court may have missed the point of the argument that an allegation that no arm’s-length transaction occurred was required. This allegation would have gone towards the knowledge prong of the test. In other words, if the transaction was in fact at arm’s-length (neither had superior bargaining position) the most Penn Mart could have alleged, absent a conclusory allegation of actual knowledge, was that IDS should have known that the Glen Alden Directors were wasting corporate assets. Whereas if there had been an allegation that the negotiations had not been at arm’s-length (i.e., collusion occurred) there would have been more than a mere conclusory allegation of “knowing participation.” \textit{See infra} text accompanying notes 65-90 (discussing pleading requirements).

\textsuperscript{34} \textit{Penn Mart}, 298 A.2d at 352.

\textsuperscript{35} Given the court’s rejection of IDS’s first argument that Penn Mart had to have alleged a lack of an arm’s-length transaction, see \textit{supra} note 33 and accompanying text, there seems to be a fairly heavy burden on those dealing with
This case is frequently cited because it sets forth the requirements for a claim for knowing participation in a breach of duty. However, the case raises more questions than it answers because of a lack of analysis and discernible reasoning.

2. Gilbert

Many of the questions raised and left unanswered by apparent gaps in reasoning in Penn Mart were addressed in Gilbert.  

Gilbert involved a class action by the shareholders of a target corporation, El Paso Corporation (El Paso). In December of 1982, Burlington Northern, Inc. (Burlington) made a tender offer for fifty-one percent of the shares of El Paso at $24 per share. Several conditions or "outs" were incorporated into the offer to be utilized at Burlington’s option. Not surprisingly many of these conditions did in fact occur.

fiduciaries at arm's-length; it appears that an arm's-length deal can be so good that you know that the fiduciary with whom you are dealing is being grossly negligent.

However, one commentator noted that:

[a] trustee or other fiduciary is placed in a situation where there may be a great temptation to pursue his own interest and lose sight of the interest of those for whom he acts. The rules as to the liability of fiduciaries may well be made strict. But a very different question arises as to the liability of third persons dealing with fiduciaries. If third persons knowingly participate with a fiduciary in a breach of his obligations it is proper to hold them liable. It is quite a different matter, however, to compel them to supervise the conduct of the fiduciary and to hold them liable for failure to do so. A rule imposing such liability upon them makes it dangerous to deal with a fiduciary and seriously interferes with the proper performance by the fiduciary of his duties. It is right to require that one who knowingly purchases trust property from a trustee or other fiduciary whose conduct is prima facie wrongful should make a reasonable inquiry, and to hold that he cannot escape liability unless such inquiry would satisfy a reasonable man that the trustee was not committing a breach of trust. If the trustee's conduct is not such as to excite suspicion, still it is held that the purchaser should make inquiry as to his authority to sell. But the rule that purchasers of trust property are bound to see to the application of the purchase money imposed too heavy a burden on purchasers and resulted in such an intolerable obstruction to the administration of trusts that the rule has been generally abolished.

Scott & Fratcher, supra note 16, § 326.6.

36. 490 A.2d 1050 (Del. Ch. 1984).

37. Id. at 1052-53.

38. Id. at 1053. There were basically five conditions allowing Burlington to withdraw its offer: (1) litigation over tender offer, (2) change in business or assets, (3) issuance of additional stock, (4) bylaw or charter amendment, (5) definitive combination agreement between Burlington and El Paso.

39. Id.
El Paso's Board initially opposed the offer claiming that the $24 price was inadequate and took steps to defend against the hostile takeover. 40 However, El Paso's shareholders evidently liked the offer which represented a twenty-five percent premium over market price because it was oversubscribed. 41

In the face of this controversy the hostile battle suddenly turned friendly; Burlington and El Paso announced that an agreement had been reached. Under the agreement the original offer was revoked, a new tender offer was commenced at the same price but for fewer shares (El Paso itself and some of its directors would provide Burlington with the nearly five million additional shares needed to obtain control) 42 and some of El Paso's Directors were granted golden parachutes. 43 Thus the agreement had the effect of reducing the amount of the participation from the first to the second offer and therefore denied shareholders the ability to realize the premium for all shares tendered under the first offer. 44

The court stated that these facts gave rise to several conspiracy scenarios. Under each, Burlington's superior bargaining position, which arose after sufficient shareholders had tendered to enable Burlington to gain control, was crucial. 45 To this argument Burlington replied that its duty to its shareholders obligated it to get the best price possible. 46

The court noted initially that the El Paso Directors had a duty not to pursue their own interests at the expense of the alienability of the shareholders' shares. 47 However, Burlington apparently claimed that, regardless of whether the El Paso Directors breached a duty, there could be no conspiracy because they were merely engaged in an arm's-length transaction. 48 The court said that it could not con-
clude that this was so as a matter of law. Burlington relied on an unreported chancery court case for the proposition that "pursuit of the best available price in negotiations with opposing management can be undertaken without regard to the target management’s fiduciary obligations to its shareholders." The court stated however that if participation in a breach of duty occurred, no arm’s-length deal could have taken place. The court summarized its analysis of aiding and abetting:

Thus, although an offeror may attempt to obtain the lowest possible price for stock through arm’s-length negotiations with the target’s board, it may not knowingly participate in the target board’s breach of fiduciary duty by extracting terms which require the opposite party to prefer its interests at the expense of its shareholders.

This statement becomes critically important in light of a statement made earlier by the court: "By agreeing to purchase [the shares] from El Paso’s directors, Burlington is chargeable with knowledge that El Paso’s directors were preferring their interests to certain of its shareholders who had already tendered." It appears that the court was saying that because Burlington committed "the act" or "participated" they were therefore chargeable with knowledge. Additionally, this language supports the implicit recognition by the court in Penn Mart that when one party is dealing with someone he or she knows to be a fiduciary, one cannot close his or her eyes to the fact that a breach of duty is occurring.

Penn Mart and Gilbert indicate that the components of "knowing participation"—knowledge and participation—are closely linked. In

49. Id.
51. Gilbert, 490 A.2d at 1058.
52. Id. The court noted that this was consistent with Penn Mart in that the duty on the part of the acquirer’s board to get the best price for its shareholders does not entitle it to knowingly participate in the target’s board’s breach of duty. Id. However, this statement seems inconsistent with the conclusion in Penn Mart that no allegation is required in the complaint that the deal was not at arm’s-length. See Penn Mart, 298 A.2d at 351. See also supra note 33 and accompanying text. One explanation to reconcile the apparent inconsistency is that once all the elements of an aiding and abetting claim are established no allegation that the deal was not at arm’s-length is needed because there is no way it could have been at arm’s-length.
53. Gilbert, 490 A.2d at 1058.
54. Id. at 1057.
55. See supra note 35 and accompanying text.
fact they were not clearly broken down in either case. It also appears that "knowing participation" is construed broadly. An alleged participant cannot claim a lack of knowledge if he need only open his eyes to be aware of a breach of duty. Furthermore, it seems that the "knowing participation" requirement will be satisfied, for all intents and purposes, if knowledge is shown because, unless the alleged participant withdrew completely from the transaction giving rise to the breach, he also "participated."

Significantly, "participation" in a transaction that objectively benefits the directors at the shareholders' expense may give rise to an inference that knowledge of the breach also existed.

However, the status of Delaware law on this issue is still evolving according to one recent unreported opinion from Chancellor Allen in which he indicated that the requirements of knowledge and participation are closely linked:

It is unclear at what point one who is not alleged to be a frank wrongdoer may have an obligation not to selfishly pursue one's own interests (or the interests of one's shareholders) because one suspects or knows that another with whom one is negotiating (a fiduciary) is or may be negotiating a transaction that constitutes a breach of loyalty to that other's cestui que trust. Trust law principles suggest that "knowledge" of a breach of trust may give rise to a duty not to cooperate in any respect (even as an arm's-length negotiator) if to do so assists completion of the breach.

3. Macmillan

Mills Acquisition Co. v. Macmillan, Inc. was a case in which the Delaware Supreme Court found aiding and abetting to have occurred.

56. Another slightly different formulation of this rule is that:

[m]ere knowledge by a third person that a breach of trust is in process, coupled with a failure to notify the beneficiary or to interfere with the action of the trustee, does not amount to a participation in a breach. Such conduct is inaction which may be reprehensible under the highest standards of ethics, but no legal duty has been violated. On the other hand, if the party by any act whatsoever assists the trustee in wrongfully transferring the benefits of the trust property to the trustee, another person, or the alleged participant, or aids in destroying or injuring that property, there has been conduct upon which liability can be predicated, if the requisite state of mind existed in the defendant.

Bogart, supra note 16, § 901, at 260 (emphasis added).


58. 559 A.2d 1261 (Del. 1989).
This case illustrates a classic example of knowing participation in a breach of duty and illustrates the true ramifications of knowingly participating in a director’s breach of duty. *Macmillan* involved a complex takeover battle for Macmillan, Inc. The Major players seeking to make an acquisition were Maxwell Communications Corporation (MCC)\(^{59}\) and Kohlberg Kravis Roberts & Company (KKR).\(^{60}\)

At issue in the supreme court was the propriety of the corporate auction that was conducted.\(^{61}\) The court held that KKR had received an improper “tip” of MCC’s bid from Macmillan’s chairman and chief executive officer, Edward P. Evans.\(^{62}\) Further the court held that Bruce Wasserstein of the investment firm of Wasserstein, Perella who had been hired to advise Macmillan’s management, and who was the primary orchestrator of the auction process, had denied MCC access to information regarding the bidding process that he had divulged to KKR.\(^{63}\)

Throughout the board meeting at which the final bids were considered by the Macmillan Board, Evans, Reilly, and Wasserstein failed to inform the board of the tips and the favoritism.\(^{64}\) The court held that

> [d]ecisions made on such a basis are voidable at the behest of innocent parties to whom a fiduciary duty was owed and breached, and whose interests were thereby materially and adversely affected. This rule is based on the unyielding principal that corporate fiduciaries shall abjure every temptation for personal profit at the expense of those they serve.\(^{65}\)

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59. The plaintiffs/appellants were “Mills Acquisition Co., a Delaware corporation, and its affiliates Tendclass Limited and Maxwell Communications Corp., PLC, both United Kingdom Corporations substantially controlled by Robert Maxwell.” *Id.* at 1264.

60. KKR is an investment firm specializing in leveraged buyouts. *Id.*

61. Basically, a corporate auction involves two or more competing bidders for a target corporation. An auction occurs when a corporation’s board of directors recognizes that a breakup of the company is inevitable or that the company is for sale. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986). The proper objective for a fiduciary in an auction situation is “to obtain the highest price reasonably available for the company, provided it [is] offered by a reputable and responsible bidder.” *Macmillan,* 559 A.2d at 1282 (citing *Revlon,* 506 A.2d at 182, 184) (footnote omitted).

62. *Macmillan,* 559 A.2d at 1282. William F. Reilly, president and chief operating officer of Macmillan, was also aware of the tip.

63. *Id.* at 1281.

64. *Id.* at 1283.

65. *Id.* at 1284 (footnote and citation omitted).
In a footnote the court made it clear that Wasserstein, although not a corporate official, was equally culpable under the theory of knowing participation in a breach of fiduciary duty. Under the undisputed circumstances there was no way Wasserstein could claim that he did not knowingly participate in the breach of duty; he was actively involved in it.

C. Pleading Requirements

The pleading requirements for a claim of knowing participation in a breach of fiduciary duty are frequently litigated in motions to dismiss or motions for summary judgment. As discussed above, the issue is almost always the sufficiency of the pleadings or allegations with respect to knowing participation.

Notwithstanding the liberal notice pleading requirements in the rules of civil procedure, the pleading requirements for knowing participation could be considered stringent. Specifically, it is very clear that a complaint must contain specific factual allegations that either state directly or imply that those dealing with the directors knew or should have known that the directors were breaching their fiduciary duties to their stockholders. The questions thus becomes, how specific must the factual allegations be?

66. Id. at 1284 n.33.
68. Rand, No. 8632, slip op. at 10-11 (aiding and abetting claim dismissed because nothing was alleged that would necessarily alert alleged participant to the directors' alleged breach); Brook, No. 10,276, slip op. at 3, reprinted in 15 Del. J. Corp. L. at 152-53 (aiding and abetting claim dismissed because complaint was devoid of facts from which court could infer knowing participation in the breach); Greenfield v. Tele-Communications, Inc., No. 9814, slip op. at 6, reprinted in 15 Del. J. Corp. L. at 187 (no facts alleged to show that merger negotiations were other than arm's-length); Siegman, No. 9477, slip op. at 10-11, reprinted in 15 Del. J. Corp. L. at 229 (no facts plead from which knowing participation could be inferred); In re Sea-Land, No. 8453, slip op. at 9 (alleged facts did not permit inference of knowing participation in breach); LA Partners, No. 9033, slip op at 16, reprinted in 13 Del. J. Corp. L. at 1197 (conclusory allegation of knowing participation insufficient; facts must be plead from which knowing participation can be reasonably inferred); Greenfield v. National Medical Care, Inc., Nos. 7720 & 7765, slip op. at 10-11, reprinted in 12 Del. J. Corp. L. at 743-44 (no facts from which to draw inference of knowing participation); Repairman's Serv. Corp., No. 7811, slip op. at 22-23, reprinted in 10 Del. J. Corp. L. at 916 (no indication of conspiracy in the record). But see Deutsch, No. 8808, slip op. at 6 (aiding and abetting claim not dismissed notwithstanding lack of an allegation of direct participation in negotiations leading up to merger by alleged "participating" corporation).
It has been held that the following allegation was insufficient to support an aiding and abetting claim: "'Defendants JC Partners, Jacobs, Chafoulias, and Barry have aided and abetted and are aiding and abetting the director defendants in their [entrenchment] scheme.'"69 Conclusory allegations of aiding and abetting or allegations characterizing merger negotiations as a "plan or scheme" are not sufficient. These fairly stringent pleading requirements may be criticized as unduly burdensome given that a civil conspiracy is usually secret, concealed and hidden. However, the Chancellor has recognized this argument and set out the standard:

It is the case that conspiracies are secret agreements and the law cannot expect a plaintiff, in order to state a non-dismissable claim, to plead evidentiary matter which, if true, would establish the conspiracy. But where 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 his duty to his *cestui que* trust, shareholders or other beneficiaries of his duty.70

The court went on to say that

[i]t may be that some circumstances will arise in which the terms of the negotiated transaction themselves are so suspect as to permit, if proven, an inference of knowledge of an intended breach of trust.71 In such a case, allegations of such egregious terms coupled with a conclusory allegation of "knowing participation" might be enough to withstand a Rule 12 (b)(6) motion.72

A further piece of the "pleading puzzle" is provided by *LA Partners v. Allegis Corp.*73 Allegis Corporation (Allegis)74 entered an

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71. Presumably this was or would have been the case in both *Penn Mart* and *Gilbert.*
74. At the time of the transactions at issue, Allegis owned United Airlines
agreement with the Boeing Company (Boeing) pursuant to which Allegis agreed to buy thirty-six airplanes from Boeing for $2.1 billion and in return Boeing purchased $700 million worth of convertible notes (the Note Agreement) from Allegis.73 This action was brought by a group of Allegis shareholders who were pursuing a written consent solicitation76 in an effort to replace the directors.

Allegis was "in-play"77 when their investment bankers recommend that they seek a white knight.78 Allegis approached Boeing and in an effort to encourage them to act as a white knight, offered to purchase thirty-six planes from them.79 Boeing allegedly agreed to the deal because they were very interested in the thirty-six-plane order.80 The plaintiffs alleged that the Note Agreement was an entrenchment device and that in executing the Note Agreement the Allegis Directors breached a fiduciary duty owed to their shareholders by failing to make an informed business judgment regarding the

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(UAL), Western Hotel Company, Hertz Corporation, and Hilton International Company. Id., slip op at 2, reprinted in 13 Del. J. Corp. L. at 1188. That Allegis' had a "total travel" strategy is evident. Id. Takeover rumors began when Allegis' investors became disenchanted with this strategy and wanted Allegis to return its focus to its core business, UAL. Id.

75. Id., slip op at 1, reprinted in 13 Del. J. Corp. L. at 1190.

76. A written consent solicitation is a process pursuant to which any action that can be taken at a stockholders meeting can be effectuated by consent in writing of a majority of the shareholders. Del. Code Ann. tit. 8, § 228 (Supp. 1988).

77. "In-play" is a term used to describe a corporation that is the subject of intense takeover speculation.

78. LA Partners, No. 9033, slip op. at 1, reprinted in 13 Del. J. Corp. L. at 1189. The plan devised was summarized in the Complaint:

"[T]he Company's management determined to seek to obtain a substantial investment in the Company from a 'selected' large corporation 'with connections to the travel industry' which would be a 'friendly investor.' From the outset, the proposal contemplated that the 'investment' would be in the form of a convertible security that would have provisions designed to discourage a 'hostile takeover' by giving the 'investor' veto power over 'any mergers or substantial acquisitions or dispositions of Company properties.' It was recognized that to obtain maximum protection from this 'investment', the transaction would have to be completed quickly so that it was 'in place before a tender is made.' To that end it was determined that the percentage of the Company's stock into which the investment could be converted must not exceed 181/2% 'in order to avoid stockholder approval of the sale.'"

Id., slip op. at 3-4, reprinted in 13 Del. J. Corp. L. at 1189 (quoting Complaint at ¶ 42).


Note Agreement.\textsuperscript{81} Boeing was named as a defendant for allegedly knowingly participating in this breach of duty but moved to dismiss for failure to state a claim upon which relief could be granted.\textsuperscript{82}

The dispute focused on by the vice-chancellor was whether there were sufficient factual allegations in the complaint from which knowing participation could reasonably be inferred.\textsuperscript{83} The plaintiffs argued that such an inference could be easily drawn from the allegations that: (1) when the Note Agreement was proposed to Boeing they knew that Allegis was facing a takeover threat; (2) Allegis, as a matter of public record, had no need for the proceeds of the Note Agreement; (3) Boeing knew that the Note Agreement was a "rush-job" and that it would need to be amended; (4) the conversion price was lower than Allegis' stock price; (5) the Note Agreement did not allow prepayment; and (6) Allegis abandoned a plan to consider competitive proposals for an aircraft acquisition and changed their outlook as to the size of the acquisition.\textsuperscript{84} Boeing argued in response that these allegations indicated, at best, that the Allegis Directors were interested in obtaining the takeover protection that would be provided by the Note Agreement.\textsuperscript{85} Thus, Boeing argued that the issue was whether they knew that the Note Agreement was an entrenchment device, an inference which they did not believe followed from the allegations.\textsuperscript{86} The court agreed and concluded that the necessary link, the knowledge of the breach, was not inferable from the allegations.\textsuperscript{87} According to the court, this was not a transaction like that involved in \textit{Gilbert} in which

\textsuperscript{81} \textit{Id.}, slip op at 5-6, reprinted in 13 Del. J. Corp. L. at 1190. Evidence of the lack of an informed business judgment was said to be the fact that the conversion price under the Note Agreement was allegedly less than the trading price of Allegis' common stock before the notes were issued, \textit{id.}, and was equivalent to an earlier bid made for UAL by the Pilot's Union which had been rejected as grossly inadequate. \textit{Id.}, slip op. at 6, reprinted in 13 Del. J. Corp. L. at 1190. The Note Agreement was alleged to be an entrenchment device because Allegis had no use for the $700 million supplied to them under the Note Agreement and the notes could not be prepaid. \textit{Id.}, reprinted in 13 Del. J. Corp. L. at 1191.

\textsuperscript{82} \textit{Id.}, slip op. at 16, reprinted in 13 Del. J. Corp. L. at 1196.

\textsuperscript{83} \textit{Id.}, slip op. at 16, reprinted in 13 Del. J. Corp. L. at 1196-97.

\textsuperscript{84} \textit{Id.}, slip op. at 16-17, reprinted in 13 Del. J. Corp. L. at 1196.

\textsuperscript{85} \textit{Id.}, slip op. at 17, reprinted in 13 Del. J. Corp. L. at 1197. This fact would not have been determinative of whether a breach of fiduciary duty occurred. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

\textsuperscript{86} \textit{La Partners}, No. 9033, slip op. at 17, reprinted in 13 Del. J. Corp. L. at 1197.

\textsuperscript{87} \textit{Id.}, slip op. at 18, reprinted in 13 Del. J. Corp. L. at 1197.
the necessary link was established because the transaction, by its terms, benefited the fiduciary at the expense of the stockholders. Here, the terms of the Note Agreement and the circumstances under which it was negotiated would not necessarily alert Boeing, a third party, to any wrongful conduct on the part of the Allegis directors. There is nothing in the complaint to suggest that Boeing was privy to the Allegis directors’ deliberations.88

It appears clear, therefore, that the transaction itself can be very important in determining whether the allegations support an inference of knowing participation. It might be argued, based on LA Partners, that knowing participation requires, at the very least, negotiations or terms of a transaction that would alert a third party to wrongful conduct on the part of the breaching board. This seems consistent with the chancellor’s conclusion in Greenfield that the terms of the transaction, if sufficiently egregious, might support an inference of knowing participation.89 It appears that in this case however, the vice-chancellor did not believe that the terms of the transaction were sufficiently egregious to make Boeing aware of a breach (assuming, of course, that there was a breach). This was so even though it is at least arguable that Boeing had a superior bargaining position because they knew that Allegis was in a hurry to make the deal to facilitate takeover defense goals. On the other hand, there is no suggestion that this potential superior bargaining position was sufficiently superior to render the negotiations less than arm's-length.

D. The Defendants

A critical question is: who can conspire with the directors? A number of possible answers are apparent, each of which will be addressed: other directors, officers or other employees, the corporation itself, subsidiaries, and completely independent entities.

It would seem logical that the answer to this basic question should be found in the requirements for the claim. However, when courts lay out the three requirements they seem to be inconsistent

88. Id. But see contra BoGaRT, supra note 16, § 901, at 260 (“In order that the third party be liable as a participant, it is not necessary to show that he benefited as a result of the transaction.”).
89. See supra note 72 and accompanying text.
in their formulation of the third requirement. However, the inconsistency seems to be the product of different writing styles and differences in the facts of the cases rather than a genuine dispute over the third requirement itself. In any event, it seems fairly clear that the third requirement indicates that the defendant must be someone (or some entity) who is not a fiduciary or who is not in the direct fiduciary relationship. This appears consistent with the basic theory of conspiracy law that it takes at least two parties to have a conspiracy.

1. The Corporation, Its Directors, Officers, and Employees

Corporations cannot and do not act except through their officers, directors, and other representatives. Therefore, in order for a cor-

90. For example, in Penn Mart the third requirement was said to be simply: "knowing participation in [the] breach by the defendants." Penn Mart, 298 A.2d at 351 (emphasis added). In Weinberger v. Rio Grande Indus., the third requirement was said to be: "a knowing participation in [the] breach by the defendants who are not fiduciaries." Weinberger v. Rio Grande Indus., 519 A.2d at 131 (citing Gilbert, 490 A.2d at 1057) (emphasis added). While in Gilbert the third requirement was stated somewhat differently again: "knowing participation in [the] breach by the party not in direct fiduciary relationship." Gilbert, 490 A.2d at 1057 (emphasis added). Finally, at least one other slightly different version of the third requirement can be found: "knowing participation in [the] breach by the non-fiduciary defendants." Greenfield v. Tele-Communications, Inc., No. 9814, slip op. at 5, reprinted in 15 Del. J. Corp. L. at 187 (emphasis added).

91. No Delaware case has directly addressed the issue of who may be a defendant, therefore, it is not surprising that the part of the requirements for the claim that addresses that issue is not given much consideration.

92. See supra note 91.


94. A question may be raised as to whether it matters whether a corporation can conspire or aid and abet its own directors in breaching their fiduciary duties. While it is generally accepted that all those potentially liable are named as defendants, it would seem self-defeating for a shareholder to seek retribution for a breach of a director's duty from the corporation itself. This would be analogous to holding the corporation vicariously liable for a director's breach of fiduciary duty. However, utilization of the vicarious liability doctrine against a corporation to hold it liable for its directors' breaches of duty to the stockholders is inconsistent with the fundamental nature of a corporate directors fiduciary relationship and has been clearly rejected by at least one court: "Liability for breach of the directors' fiduciary obligation could not possibly run against the corporation itself, for this would create the absurdity of satisfying the shareholders' claims against the directors from the corporation, which is owned by the shareholders." Radol v. Thomas, 772 F.2d 244, 258 (6th Cir. 1985), cert. denied, 477 U.S. 903 (1986).

Further, in Radol, the Sixth Circuit indicated that they were unaware of any
poration itself to aid and abet its own directors in breaching a fiduciary duty, a person other than the director allegedly breaching his or her fiduciary duty must do the aiding and abetting. However, a corporation's directors and officers are all a part of a single legal entity and, therefore, they cannot conspire with each other because it takes at least two people or entities to carry out a conspiracy.95

This doctrine appears consistent with the language of the third requirement for a claim of aiding and abetting under Delaware law—the defendant must not be in the direct fiduciary relationship. Other officers and directors who can act on behalf of the corporation as an entity are directly involved in the fiduciary relationship, they owe the same fiduciary duties. Additionally, the corporation itself is the subject of that relationship. In sum, therefore, Delaware appears to apply a concept similar to the intracorporate conspiracy rule under which a corporation cannot conspire with its own directors and officers.

However, there is an exception to the intracorporate conspiracy rule. If an officer or director has a personal stake in the activities in which a corporation had been held vicariously liable to its shareholders for a breach of the directors' fiduciary duty; the court apparently believed reason that no case was found to support this theory because "such a result would be flatly inconsistent with the rationale of vicarious liability, since it would shift the cost of the directors' breach from the directors to the corporation and hence to the shareholders, the class harmed by the breach." *Id.* at 259.


96. Although there is a lack of Delaware law addressing this issue, this rule is well established in the federal courts and in other state courts. See John C. Holland Enter. v. J.P. Mascaro & Sons, Inc., 653 F. Supp. 1242, 1247 (E.D. Va. 1987) ("[A]s a matter of law a corporation cannot conspire with its own officers, directors and shareholders, because they are deemed a single legal entity."). This rule of law, which is applied in the federal courts, has been deemed the "intracorporate conspiracy doctrine." *Id.* at 1248. See also Dussouy v. Gulf Coast Inv. Corp., 660 F.2d 594, 603 (5th Cir. 1981); Nurse Midwife Assoc's. v. Hibbet, 549 F. Supp. 1185, 1189 (M.D. Tenn. 1982); Jewel Foliage Co. v. Uniform Overseas Fla., Inc., 497 F. Supp. 513, 518 (M.D. Fla. 1980).

giving rise to the breach separate and distinct from that of the corporation, the corporation can be held to have conspired with or aided and abetted the directors in their breach.97

This exception may have the greatest significance in parent subsidiary mergers in which directors are on both sides of the transaction (i.e., one or more directors are directors of both the parent and the subsidiary). For example, in Deutsch v. Cogan,98 Knoll International, Inc. (Knoll) was merged into Hansac, Inc. (Hansac) and the Knoll shareholders were cashed out.99 They sued. One of the individual defendants was Marshall S. Cogan (Cogan), co-chairmen of Knoll’s Board and holder of voting control over Hansac and Hansac’s only director.100 Cogan was clearly on both sides of the transaction. One of the corporate defendants, Hansac, was alleged to have knowingly participated in Cogan’s alleged breach of duty to the Knoll shareholders.101 The Knoll shareholders wanted to get to the assets of Hansac through the dual director’s breach of duty. The court of chancery said that in light of the plaintiff’s allegation that Hansac participated in the transaction with the knowledge and under the direction of Cogan, a claim was stated against Hansac for knowingly participating in its own director’s breach of duty.102 Thus, in Deutsch, a claim was stated against a corporation for knowingly participating in its own director’s breach, but that breach was with respect to that director’s duty to another corporation to which he owed fiduciary duties because he was also a director of that other corporation.103

Although the court did not expressly address this issue, it is clear that Cogan had a personal stake in the activities giving rise to the breach separate and distinct from that of Hansac’s and, therefore,

100. Id., slip op. at 2, reprinted in 15 Del. J. Corp. L. at 171.
103. Dual directorships are permitted under Delaware law. Weinberger v. UOP, Inc., 457 A.2d at 710-11 (“[I]ndividuals who act in a dual capacity as directors of two corporations, one of whom is parent and the other subsidiary, owe the same duty of good management to both corporations . . . this duty is to be exercised in light of what is best for both companies.”).
no problem existed with the third requirement. In the capacity in which Cogan was acting (as a director of Knoll), his other corporation, Hansac, was not in the direct fiduciary relationship between himself (in his capacity as a Knoll Director) and the Knoll shareholders. Thus, at least one Delaware court has rendered a decision consistent with the exception to the intracorporate conspiracy rule in an aiding and abetting case.

2. Subsidiaries and Independent Entities

It is clear that completely independent entities can be defendants in aiding and abetting claims. Problems occur, however, when subsidiaries are named as defendants. Technically they may be considered independent corporate entities however in reality they are often just vehicles through which mergers are carried out. The plaintiffs in *Rabkin v. Philip A. Hunt Chemical Corp.*,104 former minority shareholders of the Philip A. Hunt Chemical Corporation (Hunt), raised this very issue. The Olin Corporation (Olin), Hunt's majority stockholder, was named as a defendant. The plaintiffs claimed that "since Olin allegedly breached its fiduciary duty in connection with the merger and Olin Acquisition was the corporate vehicle through which the merger was consummated, the subsidiary was a knowing participant liable for its parent's breach."105 The court flatly rejected this argument because "no allegation [was ever made] that Olin Acquisition even existed at the time the merger proposal was presented to Hunt."106

IV. Conclusions and a Look Ahead

When Delaware courts examine claims for aiding and abetting an alleged breach of duty by a Delaware director, they have not spent time examining the ramifications of this claim. If this type of claim is construed broadly, it could be dangerous to deal with a Delaware director. Those who do would have to use extreme care in an attempt to discover whether the director with whom they are negotiating is breaching any duty he owes to his corporation. The breadth of construction given to this claim by the Delaware courts

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105. Id. at 968.
106. Id.
turns on the definition of "knowing participation." While no case has analyzed this phrase in any great degree of depth, the decisions that have addressed the issue indicate that "knowing participation" might occur if someone dealing with a director should or could have been aware of the breach and if the participant did anything to further the breach, even deal with the director at arm’s-length. In other words, the duty may be put on those who deal with Delaware directors to pull out of deals in which an objectively visible breach of duty is occurring. This may be a difficult thing to do considering that a participant’s goal at the initiation of a transaction is to obtain the best deal for himself or his corporation; breaches may not be easy to discover in this situation although after the fact a reviewing court might not find it difficult to conclude that the only way the participant could not have known about the breach would have been if he had his eyes closed. On the other hand, the court of chancery has been fairly stringent with the pleading requirements for this claim. Specific facts must be plead from which knowing participation can be inferred. In the vast majority of cases that have passed this hurdle, the Delaware directors were alleged to have been engaged in activity that was illegal per se or in which objective evidence existed indicating that the transaction benefited the fiduciary at the stockholders' expense.

Critical judicial refinements of this claim will occur in the future. Those refinements may play a role in the ability of directors of Delaware corporations to deal effectively with third parties.

Ronald A. Brown, Jr.
Delaware Law Digest

INTRODUCTION

The DELAWARE LAW DIGEST* will be a continuing feature of The Delaware Journal of Corporate Law. The DIGEST contains a comprehensive outline of those areas of Delaware law that fall within the scope of the Journal’s subject matter.

Citations, unless otherwise indicated, are to the Delaware Code (1974 Revision) by Title and Section or Chapter (c.) number. Parallel citations to the Atlantic Reporter begin with 12 Del. and 6 Del. Ch. After 220 A.2d only the Atlantic Reporter is cited. Reference to court rules without designation of court indicates similar or identical Superior Court and Court of Chancery Rules.

For convenience, and to assist the attorney’s research, a table of abbreviations follows:

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