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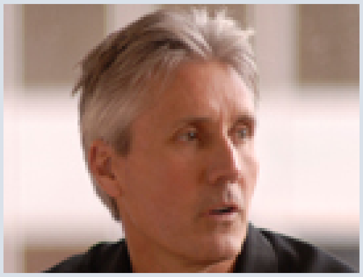
Client Alert

This alert discusses a recent decision by Maryland's highest court that should be of interest to the sponsors, directors and officers of REITs and other corporations.



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Recent Decision is Troubling News for Directors of REITs and Other Maryland Corporations

In an important recent decision, Maryland's highest court has ruled that directors and officers of a Maryland corporation owe common-law fiduciary duties directly to the corporation's shareholders in circumstances where a decision has been made to sell the corporation. Maryland is the state of choice for organizing real estate investment trusts, or REITs, because of provisions of Maryland's statutory corporation law designed to be more favorable to sponsors, directors and officers of REITs than comparable laws of other states such as Delaware. This recent decision, in *Shenker v. Laureate Education, Inc.* , No. 8 September Term, 2009 (Md. App. 2009), is likely to detract from Maryland's attractiveness to sponsors of REITs and other corporations.

The Shenker case involved a common type of transaction in which one or more members of management of a public company team with outside financial investors to acquire the company and take it “private.” In Shenker, the Chairman and Chief Executive Officer and another member of the Board of Directors of Laureate Education, Inc. joined with several private equity investors to acquire Laureate in an all-cash merger.

Mr. Shenker and other shareholders of Laureate sued the members of Laureate's Board of Directors directly in Maryland state court alleging that the directors breached their fiduciary duties to shareholders in agreeing to the merger price that the Laureate shareholders would receive in the merger. The defendant directors filed a motion to dismiss the lawsuit, which the trial court granted, with prejudice, on the basis that the plaintiffs failed to allege that the defendant directors owed the plaintiffs a recognizable duty.

According to the trial court, the plaintiffs were not entitled to a direct action against the directors for alleged breach of fiduciary duties. The trial judge based his decision on the codification of directors' duties contained in Maryland's statutory corporations law, holding that the plaintiffs should have proceeded by way of a derivative action — that is, by first making demand on Laureate to pursue the claims against the directors or, if demand would be futile or excused in the circumstances, by suing derivatively in the right of Laureate.

The trial court also held that defendant directors' statutory fiduciary duties ran only to Laureate, itself, and not directly to the plaintiffs or other shareholders of Laureate.

The plaintiffs appealed the trial court's decision to Maryland's intermediate Court of Special Appeals, which upheld the trial court's decision to dismiss the plaintiffs' action on the basis that directors of Maryland corporations owe no common law fiduciary duties directly to their shareholders. According to the court of appeals, in a cash-out merger transaction, any claims shareholders may have against directors for breach of fiduciary duties must be brought derivatively on behalf of the corporation as contemplated by Maryland's statutory corporations law.

On further appeal by plaintiffs to the Court of Appeals, Maryland's highest state court, the high court reversed the decision of the lower court and held that, where corporate directors exercise “non-managerial” duties outside the scope of the directors' duties contained in Maryland's statutory corporations law, such as negotiating the price that shareholders will receive for their shares in a cash-out merger transaction after the decision to sell the corporation already has been made, they remain liable under common law directly to shareholders for any breach of their fiduciary duties. According to the high Court, the Maryland statutory corporation law in question governs the duty of care owed by directors only when they undertake “managerial decisions” on behalf of the corporation.

Duties concerning the management of the corporation's affairs change after the decision is made to sell the corporation, and when directors undertake to negotiate a price that shareholders will receive in the context of a cash-out merger transaction, they assume a different role than solely “managing the business affairs of the corporation.” The Court of Appeals found, therefore, that at least in a cash-out merger transaction where the decision to sell the corporation already has been made, shareholders may pursue direct claims against directors for breach of their fiduciary duties of candor and maximization of shareholder value and need not resort to the more cumbersome derivative lawsuit.

Conclusion: The decision of the Maryland Court of Appeals is a break from the current law in California and Delaware regarding the circumstances in which shareholders may assert direct claims against directors and officers. It remains to be seen whether courts in other states may follow the decision.

About TroyGould

Founded in 1970, TroyGould is a Los Angeles law firm with a diverse client base and a practice covering a broad range of business transactions, litigation, and legal counseling, with emphasis in the areas of corporate finance, mergers & acquisitions, real estate, financial services, entertainment, sports, employment, tax, and competitive business practices.

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