

April 27, 2016

**Maryland Legislature Amends the Maryland General Corporation Law and the Maryland REIT Law to Clarify Director and Trustee Duties**

The General Assembly of Maryland has enacted Senate Bill 148 and the identical House Bill 354 (together, the “2016 Legislation”), which make changes to the Maryland General Corporation Law (the “MGCL”) and the Maryland REIT Law (the “MRL”) to clarify the duties of directors of Maryland corporations and trustees of Maryland real estate investment trusts in light of the decision of the Court of Appeals of Maryland (our highest state court) in *Shenker v. Laureate Education, Inc.*, 411 Md. 317, 983 A.2d 408 (2009). Governor Hogan signed the 2016 Legislation into law yesterday.

*STATUTORY STANDARD OF CONDUCT*

Maryland has had a statutory standard of conduct for directors of Maryland corporations since 1976 when Section 2-405.1(a) of the MGCL was enacted, based almost verbatim on Section 8.30(a) of the Model Business Corporation Act as it was then in effect. Under Section 2-405.1(a), each director is required to act (1) in good faith, (2) in a manner he or she reasonably believes to be in the best interests of the corporation (not the stockholders or any group of stockholders) and (3) with the care that an ordinarily prudent person in a like position would use under similar circumstances.\*

Regarding the duties of trustees of a Maryland real estate investment trust formed under the MRL (a “Maryland REIT”), the MRL for several years has cross-referenced subsections (d) through (g) but not subsections (a) through (c) of MGCL Section 2-405.1, casting some doubt on whether the duties of trustees of a Maryland REIT were the same as those of directors of a Maryland corporation. However, it has long been our view that a Maryland court would look to the MGCL in interpreting the duties of trustees of a Maryland REIT.

*THE SHENKER DECISION*

In *Shenker*, a case involving a “cash-out merger,” the Court of Appeals held that, where a decision to sell the corporation has been made, directors of a Maryland corporation owed stockholders common law duties of “candor and good faith efforts to maximize shareholder value.” The *Shenker* court also held that a claim of a breach of these common law duties may be pursued in a direct stockholder suit, even though MGCL Section 2-405.1(g) prohibits a direct claim by a stockholder for a breach of director duties. Other language of the

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\* It is noteworthy that both Section 8.30(a) of the Model Business Corporation Act and the Official Comment to Section 8.30(a) in 1976 omitted any reference to “fiduciary,” as the “term could be confused with the unique attributes and obligations of a fiduciary imposed by the law of trusts, some of which are not appropriate for directors of a corporation.”

court in *Shenker* was also troubling, including the notion that directors have two types of duties: day-to-day managerial duties contained in the MGCL and some other set of undefined duties in the common law in the context of an extraordinary matter. There is nothing in the MGCL to suggest that the statutory standard of conduct applies only to routine matters. In fact, MGCL Section 2-405.1(d) specifically addresses director duties in the context of extraordinary actions such as a change of control of the corporation. However, with no basis in the MGCL, the *Shenker* court limited the application of Section 2-405.1(d) to hostile takeovers, excluding a negotiated acquisition of control such as in *Shenker*.

### THE 2016 LEGISLATION

While plaintiffs' attempts to broaden the application of *Shenker* in subsequent litigation have not been successful, and *Shenker* generally did not affect the advice we provide to directors or trustees regarding their duties in a change of control or otherwise, the 2016 Legislation provides additional clarity regarding director and trustee duties under Maryland law. The legislation confirms that a director must act in accordance with the statutory standard of conduct under Section 2-405.1(a) of the MGCL *in all circumstances*, both in day-to-day management activities and in extraordinary matters, such as a change of control. The legislation also confirms that the duties of directors are identical in both unsolicited and solicited transactions.

In addition, the 2016 Legislation distinguishes between the "acts" and "duties" of a director. Acts are what a director does as a director, including as a member of a committee of the board of directors, such as overseeing the management of the business and affairs of a corporation and making decisions. Duties are the standard for the performance by a director of those acts: (a) good faith, (b) action in a manner reasonably believed by the director to be in the best interests of the corporation and (c) the care of an ordinarily prudent person in a like position under similar circumstances. It is important to note that these duties apply to each director individually, director by director, and not collectively to the board of directors as a whole.

The 2016 Legislation further amends the MGCL by deleting Section 2-405.1(g), the statutory bar to direct stockholder claims for breach of the statutory standard of conduct. We believe that this statutory prohibition on direct claims contributed to the court's decision in *Shenker* to invoke common law director duties paired with a right to bring a direct action for breach of those duties. The result of this amendment should be that a stockholder's right to sue directly or derivatively for breach of the statutory standard of conduct will be determined under applicable case law, which distinguishes between injury to the corporation (derivative claim available) and injury to the stockholder (derivative claim not available), as was the case prior to the addition of Section 2-405.1(g) in 1999.

The 2016 Legislation also (a) retains the statutory presumption in Section 2-405.1 that any act of a director of a corporation is in accordance with the three-part statutory standard and (b) expands the disclaimer in Section 2-405.1 to provide that "an act of a director of a corporation relating to or affecting [i] an acquisition or a potential acquisition of control of the

corporation or [ii] any other transaction or potential transaction involving the corporation may not be subject to a higher duty or greater scrutiny than is applied to any other act of a director.”

Finally, the 2016 Legislation amends the MRL to expand the cross-reference to all subsections of MGCL Section 2-405.1 to clarify that a trustee of a Maryland REIT is generally subject to the same duties as a director of a Maryland corporation.

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Each of us participated in the drafting of the 2016 Legislation through the Committee on Corporation Law (of which each of us is a former Chair) of the Business Law Section of the Maryland State Bar Association, which proposed the legislation in the culmination of a multi-year effort to address *Shenker*. As always, please do not hesitate to call any of us or our colleagues if you have any questions or comments about any of the foregoing or any other matter of Maryland law.

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