



2010

# Recent Developments: Shenker v. Laureate Education, Inc.: Where Corporate Directors Exercise Non-Managerial Fiduciary Duties beyond Those Enumerated in Section 2-405.1(a) of the Corporations and Associations Article, They Remain Liable Directly to Shareholders for Any Breach of Those Fiduciary Duties

David Feliciano

Follow this and additional works at: <http://scholarworks.law.ubalt.edu/lf>



Part of the [Law Commons](#)

## Recommended Citation

Feliciano, David (2010) "Recent Developments: Shenker v. Laureate Education, Inc.: Where Corporate Directors Exercise Non-Managerial Fiduciary Duties beyond Those Enumerated in Section 2-405.1(a) of the Corporations and Associations Article, They Remain Liable Directly to Shareholders for Any Breach of Those Fiduciary Duties," *University of Baltimore Law Forum*: Vol. 40 : No. 2 , Article 11.

Available at: <http://scholarworks.law.ubalt.edu/lf/vol40/iss2/11>

This Article is brought to you for free and open access by ScholarWorks@University of Baltimore School of Law. It has been accepted for inclusion in University of Baltimore Law Forum by an authorized editor of ScholarWorks@University of Baltimore School of Law. For more information, please contact [snolan@ubalt.edu](mailto:snolan@ubalt.edu).

## RECENT DEVELOPMENT

---

***SHENKER v. LAUREATE EDUCATION, INC.: WHERE CORPORATE DIRECTORS EXERCISE NON-MANAGERIAL FIDUCIARY DUTIES BEYOND THOSE ENUMERATED IN SECTION 2-405.1(a) OF THE CORPORATIONS AND ASSOCIATIONS ARTICLE, THEY REMAIN LIABLE DIRECTLY TO SHAREHOLDERS FOR ANY BREACH OF THOSE FIDUCIARY DUTIES.***

**By: David Feliciano**

The Court of Appeals of Maryland held that, when corporate directors exercise duties that are non-managerial and outside the scope of section 2-405.1(a) of the Corporations and Associations Article of the Annotated Code of Maryland, they remain liable to shareholders for any breach of their fiduciary duties. *Shenker v. Laureate Educ., Inc.*, 411 Md. 317, 983 A.2d 408 (2009) (citing MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(a)). Therefore, when directors of Maryland corporations exercise the non-managerial duty of negotiating the value that shareholders will receive in a cash-out merger transaction, they owe to the shareholders the fiduciary common law duties of candor and maximization of shareholder value. *Id.* at 336, 983 A.2d at 419.

In June 2006, Chairman and CEO of Laureate Education, Inc. (“Laureate”), Douglas Becker (“Becker”), proposed the idea of a cash-out merger to Laureate’s Board of Directors (“the Board”). On September 8, 2006, Becker informed the Board that he, along with several investors, intended to make an offer to purchase Laureate. The Board immediately created a special committee of disinterested directors to assess proposed offers. After Becker withdrew his first offer, the special committee unanimously recommended that the Board accept Becker’s second offer. Becker’s second offer price provided an 11.1% premium over Laureate’s most recent stock trading price. On June 3, 2007, Laureate further announced that it had accepted a “short-form” merger where Becker and the other respondent investors could purchase up to one share above 90% of the total shares outstanding. Petitioner shareholders alleged that the Board: (1) failed to carry out a

suitable market check of Laureate's stock value; (2) issued a materially deceiving summary form of the tender offer; and (3) created an evaluation process that was riddled with conflict.

The shareholders filed a direct lawsuit, rather than a derivative complaint, in the Circuit Court for Baltimore City, alleging that the Board breached its fiduciary duties to the petitioners as shareholders, conspired to breach those duties, and aided and abetted that breach. The circuit court granted the Board's Motion to Dismiss, citing section 2-405.1(g) of the Corporations and Associations Article, which states that shareholders may not directly sue corporate directors for alleged violations of fiduciary duties. The Court of Special Appeals of Maryland affirmed, holding that corporations do not owe a common law fiduciary duty directly to shareholders, and any shareholder claims must be raised in a derivative suit on behalf of the corporation. Shenker petitioned the Court of Appeals of Maryland, which granted certiorari.

The Court of Appeals of Maryland began its analysis by addressing the legal sources of a corporate director's duties. *Shenker*, 411 Md. at 335-36, 983 A.2d at 418-19. The Board contended that section 2-405.1(a) is the only source of directorial duties. *Id.* at 339, 983 A.2d at 421. Specifically, section 2-405.1(a) states that directors must perform their managerial acts in good faith, reasonably in the best interest of the corporation, and with the care of an ordinarily prudent person under similar circumstances. *Id.* at 336, 983 A.2d at 419 (citing MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(a)). The court, however, found that, beyond the duties of section 2-405.1(a), are the additional common law duties of candor and maximization of shareholder value. *Id.* at 337-38, 983 A.2d at 419-20. These two common law duties arise when a corporate director is negotiating the monetary amount that shareholders will receive in a cash-out merger transaction. *Id.*

The Court of Appeals of Maryland acknowledged that section 2-405.1(a) governs a director's duty of care when making managerial decisions for the corporation itself. *Id.* at 338, 983 A.2d at 420. The court, however, identified that section 2-405.1(a) lacks guidance regarding a director's duty of care in non-managerial decisions. *Shenker*, 411 Md. at 338-39, 983 A.2d at 420. The court adopted its reasoning from *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, a landmark Delaware case. *Id.* at 338-39, 983 A.2d at 420-21 (citing *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986)). The court stated that, after making the threshold decision to sell the company, the director's role changes from that of

the manager of business affairs for the corporation to the negotiator of the highest possible price for the stockholders. *Id.* at 338-39, 983 A.2d at 420-21 (citing *Revlon*, 506 A.2d at 182). It is this new role that instills in the director the fiduciary duties of finding the best value reasonably possible for stockholders and making complete disclosures of every important fact concerning the merger. *Id.* (citing *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 48-49 (Del. 1994); *Bennett v. Propp*, 187 A.2d 405, 409 (Del. 1962)).

The court based the need for the common law fiduciary duties of candor and maximization of shareholder value on the following: (1) the confidence and trust placed in directors during negotiations; (2) a director's position to affect the finances of shareholders; and (3) the conflict of interest between directors and shareholders during a cash-out merger. *Id.* at 339, 983 A.2d at 421 (citing *Bennett*, 187 A.2d at 409).

The Court of Appeals of Maryland rejected the lower court's holding that section 2-405.1(a) supersedes all recognized common law duties that came before the adoption of the statute in 1976. *Id.* at 340-41, 983 A.2d at 421-22. The court also disagreed with the Board's argument that section 2-405.1(f), a 1999 amendment to the statute, demonstrated the Maryland Legislature's intent to reject *Revlon*'s reasoning. *Shenker*, 411 Md. at 340-41, 983 A.2d at 421-22. The court found that the amendment did not reject the duties characterized in *Revlon* because the basis for section 2-405.1(f) and the basis for the holding in *Revlon* rely on different circumstances. *Id.* at 340-41, 983 A.2d at 421-22. Section 2-405.1(f) sought to strengthen and protect a director's defense mechanisms against hostile takeover attempts, whereas the holding in *Revlon* involved circumstances where the sale of the corporation was inevitable, and the only shareholder interest remaining was to maximize the value of their shares. *Id.*

The Court of Appeals of Maryland also rejected the argument that the shareholders' action could only come in the form of a shareholder derivative suit. *Id.* at 346, 983 A.2d at 425. The court stated that, because the injury alleged by the shareholders was a breach of a duty that the Board owed directly to them, rather than to the corporation, the shareholders could bring a direct suit. *Id.* Additionally, the court affirmed the holding of the Court of Special Appeals of Maryland that the shareholder's civil conspiracy and aiding and abetting complaints should be dismissed. *Id.* at 352-54, 983 A.2d at 428-30.

With this holding, the Court of Appeals of Maryland has injected new life into the common law. The court doubled the avenues of legal relief available to corporate shareholders in the context of a cash-out

corporate merger transaction where the board of directors has already made the decision to sell the company. Attorneys for shareholders may now directly pursue common law claims against board members, in addition to statutory claims. Corporate shareholders are also not forced to seek relief through a shareholder derivative suit when they are directly harmed in a cash-out merger transaction. Practitioners should take note of the applicability of this opinion, as the court left open the possibility of expanding its holding outside of cash-out mergers, indicating that common law fiduciary duties of directors to shareholders can be triggered by other appropriate events.