

## Storetrax.com, Inc. v. Gurland: An Unnecessarily Broad Rule That Could Adversely Affect a Corporation's Shareholders

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### Recommended Citation

Julie M. Dietrick, *Storetrax.com, Inc. v. Gurland: An Unnecessarily Broad Rule That Could Adversely Affect a Corporation's Shareholders*, 4 J. Bus. & Tech. L. 201 (2009)

Available at: <http://digitalcommons.law.umaryland.edu/jbtl/vol4/iss1/10>

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## *Storetrax.com, Inc. v. Gurland*: An Unnecessarily Broad Rule That Could Adversely Affect A Corporation's Shareholders

IN *STORETRAX.COM, INC. v. GURLAND*,<sup>1</sup> THE MARYLAND COURT OF APPEALS adopted a rigid bright-line rule when it held that a director who sues the corporation of which he is a board member and attaches the corporation's assets without notice does not breach his fiduciary duty to that corporation.<sup>2</sup> The appellate court should have instead followed well-established fiduciary principles governing conflicts of interest which favor a fact-specific inquiry over a stringent standard.<sup>3</sup> By adopting such a bright-line rule, the Maryland Court of Appeals has unnecessarily expanded a corporate director's power and created a situation where a corporate officer could abuse his position on a board while suing the corporation, which could have undesirable policy implications and adversely affect the corporation's shareholders.<sup>4</sup>

### I. THE CASE

In 1997, Joshua A. Gurland founded Storetrax.com (hereinafter "Storetrax"), a corporation which operates an internet-based commercial real estate listing service.<sup>5</sup> In 1999, Gurland entered into an agreement with a group of investors whereby they acquired a majority interest in Storetrax's shares and Gurland remained a member of the board and became president and chief executive officer of the corporation.<sup>6</sup> The employment agreement provided for Gurland to serve successive, one-year terms that were renewed automatically unless either party notified the other in writing at least 90 days in advance of the agreement's expiration date.<sup>7</sup> The corpo-

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1. 915 A.2d 991 (Md. 2007).

2. *Id.* at 1010.

3. *See infra* Part II.

4. *See infra* Part IV.

5. *Storetrax*, 915 A.2d at 994.

6. *Id.* In January 2000, Gurland relinquished his CEO title, and one year later, he also surrendered the title of president. *Id.* at 994 n.1. Gurland then assumed the position of Senior Vice President of Technology and Strategy until his employment was terminated in November 2001. *Id.* On December 5, 2002, Gurland resigned from his position on the board of directors. *Id.*

7. *Storetrax.com, Inc. v. Gurland*, 895 A.2d 355, 359 (Md. Ct. Spec. App. 2006).

ration could also terminate the agreement at any time, with or without cause, upon ten days written notice.<sup>8</sup> Upon termination, the corporation was to pay Gurland twelve months salary as compensation.<sup>9</sup>

Gurland was fired on November 15, 2001.<sup>10</sup> The parties disagreed as to whether he was entitled to the severance payout in the contract.<sup>11</sup> Gurland wrote a letter on December 11, 2001 stating that he was entitled to his severance and while he hoped the situation would be amicably resolved, he had consulted an attorney and would proceed with a lawsuit if the issue was not resolved by December 21, 2001.<sup>12</sup> Storetrax responded with a letter on December 20, 2001, stating that (1) Gurland was not entitled to severance;<sup>13</sup> (2) “there [was] still an opportunity to part on amicable terms, provided that” he withdraws his demand for severance; and (3) that if Gurland pursued litigation, the Company would defend itself.<sup>14</sup> In January 2002, a member of Storetrax’s board attempted to end the dispute by offering a settlement, which Gurland said he would consider.<sup>15</sup> This was the last direct dialogue between the parties.<sup>16</sup>

On January 31, 2002, Gurland filed a complaint against Storetrax alleging breach of contract and seeking \$150,000 in severance pay.<sup>17</sup> The complaint was properly delivered to Storetrax’s resident agent in Maryland—the company’s principal place of business.<sup>18</sup> Although the complaint was forwarded to the corporation’s agent in Delaware, where the company is incorporated, Storetrax never received notice of the lawsuit and failed to timely respond to the complaint or Gurland’s motion for summary judgment.<sup>19</sup> During this same period of time, Gurland also visited the corporation’s Maryland headquarters several times as part of his employment with the company, but never informed anyone there of the complaint.<sup>20</sup> As a result of

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8. *Storetrax*, 915 A.2d at 995.

9. *Id.* The initial employment agreement set Gurland’s salary at \$125,000; however, in the summer of 2001, Gurland requested an increase in his salary to \$150,000. *Storetrax*, 895 A.2d at 361. The corporation granted this increase but claimed it only did so because the business was relocating and needed Gurland’s services. *Id.* After his salary was increased, Gurland requested that the agreement be amended to reflect the change and it was then that the company informed him they did not think the agreement was valid. *Id.* at 361–62. In November 2001, Storetrax requested that all employees agree to a reduction in salary, which Gurland agreed to, bringing his salary to \$135,000. *Id.* at 362.

10. *Storetrax*, 915 A.2d at 995.

11. *Id.*

12. *Id.* Gurland further claimed that Storetrax had not yet given him the reason for his termination. *Storetrax*, 895 A.2d at 362.

13. The Board took the position that Gurland was not entitled to severance because of his frequent changes in job title, his downward adjustments in salary and his weak job performance. *Storetrax*, 915 A.2d at 995.

14. *Id.*

15. *Id.* at 995–96.

16. *Id.* at 996.

17. *Id.*

18. *Id.*

19. *Id.*; *Storetrax.com, Inc. v. Gurland*, 895 A.2d 355, 364 (Md. Ct. Spec. App. 2006).

20. *Storetrax*, 895 A.2d at 364.

Storetrax's failure to respond, the Circuit Court granted Gurland's motion for summary judgment and entered a judgment against Storetrax in the amount of \$150,000.<sup>21</sup> In an effort to enforce the judgment, Gurland petitioned for a writ of garnishment attaching Storetrax's bank account, which was granted on March 19, 2002.<sup>22</sup>

The writ of attachment was the first time Storetrax received actual notice of the lawsuit, after which the board wrote a letter to Gurland asking him to voluntarily set aside the default judgment and withdraw the garnishment of the corporation's bank account.<sup>23</sup> When Gurland refused, Storetrax then moved to set aside the summary judgment motion and quash the writ of attachment.<sup>24</sup> The trial court denied both requests and Storetrax appealed.<sup>25</sup> Storetrax then filed suit against Gurland alleging that when he sued the corporation and attached its assets, he breached his fiduciary duties to the corporation because he was a member of Storetrax's board of directors.<sup>26</sup> The trial court found for Gurland, and Storetrax appealed this judgment to the Maryland Court of Special Appeals.<sup>27</sup> The appellate court consolidated the cases<sup>28</sup> and affirmed in relevant part, holding that Gurland had not breached his fiduciary duties.<sup>29</sup> The Maryland Court of Appeals granted certiorari to address whether a member of the board of directors of a corporation breaches his fiduciary duty when he sues the corporation in his capacity as an aggrieved former employee, obtains summary judgment by default, attaches the corporation's assets without notice, and refuses to lift the judgment and garnishment.<sup>30</sup>

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21. *Id.*

22. *Storetrax*, 915 A.2d at 996.

23. *Id.*

24. *Id.*

25. *Id.* at 996–97. The Court of Special Appeals, in an unreported opinion, *Storetrax.com, Inc. v. Gurland*, No. 0561, September Term 2002, reversed the judgment and remanded the case, holding that it was an abuse of the trial court's discretion to deny the corporation's motion. *Storetrax*, 915 A.2d at 997. The night before the new trial, Gurland moved for partial summary judgment on the grounds that Storetrax had not terminated him for cause and the motion was granted. *Id.* The case proceeded to trial on the breach of contract issue and a jury returned a verdict in favor of Gurland for \$150,000. *Id.* Storetrax appealed this judgment as well. *Id.*

26. *Id.* In particular, Storetrax argued that Gurland specifically knew Storetrax was insolvent when he filed the lawsuit, never advised the corporation of his lawsuit despite visiting the corporation after its filing, concealed existence of the lawsuit in order to obtain a default judgment, obtained summary judgment despite knowing the corporation opposed his breach of contract claims, attached Storetrax's bank account, and opposed attempts to have the judgment and the garnishment set aside. *Id.*

27. See *Storetrax.com, Inc. v. Gurland*, 895 A.2d 355 (Md. Ct. Spec. App. 2006).

28. *Id.* at 358.

29. *Id.* The Court of Special Appeals did find, however, that the trial court erroneously entered summary judgment in favor of Gurland. *Id.* at 365–71. The appellate court also discussed Storetrax's argument that the trial court erroneously applied principles of Maryland law, when it should have applied principles of Delaware law. *Id.* at 371. However, the court noted that, as Storetrax conceded, the substantive law regarding breach of fiduciary duty was the same in both Maryland and Delaware and thus any alleged error was harmless. *Id.* at 373. The court therefore continued to apply principles of Maryland law, when available. *Id.*

30. *Storetrax*, 915 A.2d at 998.

## II. LEGAL BACKGROUND

Maryland courts have outlined a set of broad, underlying fiduciary duty principles applicable to all corporate officers, regardless of their position or interest in a corporation. While *Storetrax.com, Inc. v. Gurland*<sup>31</sup> was a case of first impression in Maryland, there are still well-settled principles of the general fiduciary duties that govern corporate officers and directors, a director's ability to sue the corporation he works for, and a director's right to pursue his claim against that corporation as a creditor.<sup>32</sup>

*A. Maryland's Fiduciary Principles Emphasize That a Director Must Place The Corporation's Interests Ahead of His Own*

Maryland has long held that a director of a corporation bears an important fiduciary relation to the corporation—one of trust and confidence that requires him to act in the best interests of the corporation.<sup>33</sup> In *Cumberland Coal & Iron Co.*,<sup>34</sup> the Maryland Court of Appeals first explained that the affairs of corporations should be entrusted to the exclusive control of the directors and when they accept the position, there is an inherent obligation that they will use their best efforts to promote the interests of the shareholders and will not place their own interests ahead of those of the corporation.<sup>35</sup> The court further noted that if a director places himself in such a position, he cannot be acting both for himself and the corporation.<sup>36</sup> If he does so, the corporation is “deprived of the benefit of his judgment and supervision in regard to matters in which such judgment and supervision might be most essential” to the corporation's interests and the other directors are placed in an undesirable and potentially embarrassing situation.<sup>37</sup> The policy behind this rule is not only to ensure that corporate directors and officers operate in good faith, but also to remove any temptation to do wrong.<sup>38</sup> As a result, courts subject transactions between parties operating under fiduciary duties to exact and rigid scrutiny.<sup>39</sup> Six years later in *Booth v. Robinson*,<sup>40</sup> the court again noted the important role of the corporate director, and explained that because directors have such a wide

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31. 915 A.2d 991.

32. See *infra* Part II.A.—D. The Maryland Court of Appeals applied Maryland law where it was available under the theory that the law of both Maryland and Delaware was substantively the same regarding fiduciary duty principles. *Storetrax*, 895 A.2d at 373. This note does not address whether this determination was correct.

33. See *Cumberland Coal & Iron Co. v. Parish*, 42 Md. 598 (1875).

34. *Id.*

35. *Id.* at 605–06.

36. *Id.* at 606.

37. *Id.*

38. *Id.*

39. *Id.* Once a claim is brought before the court, the party who is being accused of breaching his fiduciary duty has the burden of proof in establishing that the transaction he entered into was fair and equitable. *Id.* at 605–06.

40. 55 Md. 419 (1881).

breadth of power,<sup>41</sup> they should be liable not only for fraud or negligence, but also for any acts that are contrary to the good faith duty required of them.<sup>42</sup>

Since these early cases, the Maryland courts have continuously applied these rules and expanded on what it means to be a director of a corporation. In *Parish v. Maryland & Virginia Milk Producers Ass'n*,<sup>43</sup> the Maryland Court of Appeals explained that because of his fiduciary duties, a director must reveal all facts material to the corporation's transactions and can be held liable when he conceals something.<sup>44</sup> In *Parish*, members of a milk producing farm cooperative brought suit against the cooperative and its directors alleging gross negligence and breach of fiduciary duty when the directors sold the cooperative's assets for less than cost and personally benefited from transactions involving the cooperative.<sup>45</sup> In reversing the trial court's dismissal of the action, the appellate court noted that directors do have wide discretion in corporate operations and, in general, the court will not interfere with the internal management of a business simply at the request of a stockholder or member.<sup>46</sup> However, the court explained that corporate directors can lose this shield "if they permit the funds of the corporation or the corporate property to be lost or wasted by their gross or culpable negligence,"<sup>47</sup> which the court found was sufficiently alleged in the complaint.<sup>48</sup>

In 2000, the Maryland Court of Appeals expanded these principles further when it decided *Werbowsky v. Collomb*,<sup>49</sup> and ruled that the director's obligation to perform his duties in good faith runs to the corporation as a whole.<sup>50</sup> In *Werbowsky*, minority stockholders brought suit against corporate directors alleging breach of fiduciary duty and gross negligence arising out of a transaction where the corporation purchased assets from the majority stockholder that exceeded their worth by \$150 million.<sup>51</sup> In deciding the case, the Court of Appeals reasoned that as a check on directors' broad managerial authority, they are required to perform their duties in good faith and in a manner they reasonably believe to be in the best interests of

41. *Id.* at 436–37. Specifically, the court noted that corporate directors can make all necessary contracts, sell or otherwise dispose of corporate property, and make any other judgments that are necessary for the best interests of the corporation. *Id.*

42. *Id.* at 437–38. "[D]irectors are not liable for the consequences of unwise or indiscreet management, if their conduct is entirely due to mere default or mistakes of judgment." *Id.* at 438. For additional discussion of when corporate directors cannot be held liable for their actions taken on behalf of the corporation, see *Coffman v. Maryland Publ'g Co.*, 173 A. 248, 253–54 (Md. 1934) (rejecting stockholder's claim against a newspaper corporation that the corporation was unprofitable and wasteful on the grounds that insolvency alone is not enough to prove that a corporation's directors breached their duty of good faith).

43. 242 A.2d 512 (Md. 1968).

44. *Id.* at 540.

45. *Id.* at 520–37.

46. *Id.* at 540.

47. *Id.*

48. *Id.* at 541.

49. 766 A.2d 123 (Md. 2000).

50. *Id.* at 133 (citing MD. CODE ANN., CORPS. & ASS'NS § 2-405.1 (1976, 1999 Repl. Vol.)).

51. *Id.* at 126–33.

the corporation.<sup>52</sup> The court noted that such a situation could not conceivably have been in the corporation's best interests and therefore it was void.<sup>53</sup> A few months later, the Court of Appeals reiterated this in *Leavy v. American Federal Savings Bank*<sup>54</sup>—a case where a bank brought action against its corporate officer alleging he breached his fiduciary duties in secretly taking a loan brokerage fee—and explained that the policy behind the fiduciary duties is to keep corporate directors interests aligned with the interests of the company and not working for their own personal gain.<sup>55</sup> By advocating such a high duty for directors, the court ensured that the directors would be likely to go to great lengths to avoid the appearance of placing their interests ahead of those of the corporation.

*B. Maryland Law Governing Conflicts of Interest Has Evolved From a Bright-Line Rule That Automatically Voids Interested Director Transactions to a Fact-Specific Inquiry*

The Maryland Court of Appeals has long held that where a person is a director of and interested in two corporations, that person cannot make or participate in the making of contracts between the two companies.<sup>56</sup> Maryland also had a long-standing common law that any contract entered into by a corporation where one of the directors had a substantial personal interest in the transaction is automatically void or voidable because it is a conflict of interest.<sup>57</sup>

This bright-line rule slowly began to evolve, however, and Maryland courts began to evaluate the facts of each transaction instead of automatically ruling it void. The court explained in *Indurated Concrete Corp. v. Abbott*<sup>58</sup> that where there is a conflict with an interested board member, the transaction should not be automatically void but instead should be subject to close scrutiny, with the burden on the director accused of breaching his fiduciary duty.<sup>59</sup> In *Abbott*, a stockholder sued directors of the corporation for payments he alleged were made without the authorization of the complete board or the stockholders.<sup>60</sup> The court, in finding against the directors, noted that the conflict of interest rule is designed to ensure that directors operate in good faith and again explained that “exact and rigid scrutiny” is necessary to achieve this goal.<sup>61</sup> The court clarified this need for a more

52. *Id.* at 133.

53. *Id.*

54. 764 A.2d 335 (Md. Ct. Spec. App. 2000).

55. *Id.* at 372 (citing *Levin v. Levin*, 405 A.2d 770 (Md. Ct. Spec. App. 1979)).

56. *Booth v. Robinson*, 55 Md. 419, 430 (1881).

57. See *Sullivan v. Easco Corp.*, 656 F. Supp. 531, 533 (D. Md. 1987) (discussing the common law governing conflict of interest transactions before 1979); see also *Shapiro v. Greenfield*, 764 A.2d 270, 276 (Md. Ct. Spec. App. 2000) (citing *Sullivan*, 656 F. Supp. at 533).

58. 74 A.2d 17 (Md. 1950).

59. *Id.* at 20 (citing *Francis v. Brigham-Hopkins Co.*, 70 A. 95, 104 (Md. 1908)).

60. *Id.* at 19.

61. *Id.* at 20 (citing *Hammond v. Lyon Realty Co.*, 163 A. 480, 489 (Md. 1933)).

circumstantial inquiry in *Chesapeake Construction Corp v. Rodman*,<sup>62</sup> where it acknowledged what the *Abbott* Court had noted—that transactions involving interested directors were historically automatically void—but said that the more appropriate law was that such transactions be closely scrutinized and nullified only if they are either unfair or entered into in bad faith.<sup>63</sup> This ensures that those transactions where there is some benefit despite the conflict of interest will not be lost to the corporation. The *Chesapeake* court also explained that merely because a transaction appeared fair did not mean it was not subject to the close scrutiny previously held to be necessary.<sup>64</sup>

In 1976, the Maryland legislature formally adopted this view when it passed section 2-419 of the Maryland Code, Corporations and Associations article, which rejected the bright-line common-law rule and adopted a fact-specific rule that focuses on the circumstances surrounding each particular transaction.<sup>65</sup> The Maryland Code provision indicates that an interest conflict is not automatically void because it is not, in and of itself, a crime or injurious to the corporation and its shareholders.<sup>66</sup> The provision recognizes that in many situations, the corporation and its shareholders may secure benefits from a transaction even though one of the directors involved in it was operating under a conflict of interest.<sup>67</sup> Therefore, when a director is operating under such a conflict, the transaction becomes subject to close scrutiny to determine whether it benefits the corporation and the shareholders or solely the director.<sup>68</sup> If the transaction benefits the director alone, then it will still be held void.

62. 261 A.2d 156 (Md. 1970).

63. *Id.* at 158 (citing *Cumberland Coal & Iron Co. v. Parish*, 42 Md. 598 (1875)). In *Chesapeake*, the court nullified a transaction where a corporation's officer sold most of the corporation's stock prior to his death without the consent of the board or stockholders. *Id.*

64. *Id.*; see also *Devereux v. Berger*, 284 A.2d 605 (Md. 1971).

65. See MD. CODE ANN., CORPS. & ASS'NS § 2-419(a)–(b) (West 2006). This provision is identical to the rules that have been adopted by courts in Delaware, one of the centers of corporate litigation and legislation. For an in-depth look at the Delaware law surrounding interested director transactions, see 1 DENNIS BLOCK ET AL., *THE BUSINESS JUDGMENT RULE* 267–71 (5th ed. 1998).

66. MD. CODE ANN., CORPS. & ASS'NS § 2-419(a)–(b).

67. *Id.* Some interested director transactions are “not inherently detrimental to a corporation.” BLOCK ET AL., *supra* note 65, at 266. The law regulates interest conflict transactions because “experience shows that people do often yield to the temptation to advance their self-interests and, if they do, other people may be injured. That contingent fear is sufficient reason to warrant caution and to apply special standards and procedures” to transactions where there is a conflict of interest. *Id.* Thus, the manner in which an interested director deals with the conflict will ultimately determine whether the conflict is a breach of fiduciary duty. *Id.* at 266–67.

68. MD. CODE ANN., CORPS. & ASS'NS § 2-419(a)–(b). The purpose and effect of the provision is that the interested director no longer bears the burden of proving the fairness and reasonableness of his conduct as long as his interest was disclosed to the board of directors and a majority of the disinterested directors nonetheless approved or remained silent. *Id.* § 2-419(a), (b)(1).



The Maryland Code provisions also create a safe harbor for certain transactions.<sup>69</sup> In *Shapiro v. Greenfield*,<sup>70</sup> the court explained that the safe harbor permits an interested director to escape liability for breach of fiduciary duty if he informs the shareholders or directors of his conflicting interests.<sup>71</sup> The transaction will then not be a breach of a corporate director's fiduciary duties because notice gives the corporation and its remaining directors the opportunity to protect the corporation's interests.<sup>72</sup> The court further noted that even if the director does not disclose the interest, the transaction can still be saved if it is found to be fair and reasonable to the corporation.<sup>73</sup> Whether the transaction is found to be "fair and reasonable" is evaluated on a case-by-case basis by the court.<sup>74</sup>

*C. Fiduciary Duty Principles Enable a Director to Sue the Corporation He Works For So Long As He Provides Notice to the Corporation of His Intentions*

Courts in other jurisdictions have found that a director of a corporation is not precluded from bringing suit merely because he is a director in the corporation. The Court of Chancery of Delaware added a safeguard to this rule in *Henshaw v. American Cement Corp.*,<sup>75</sup> where the court held that a director was permitted to bring suit against the corporation he worked for and did not give up his right to inspection of the corporation's books because of this.<sup>76</sup> The court noted that despite this right, the director could not give his attorneys the right to inspect the books, as an ordinary plaintiff could do, because of his role as a corporate director.<sup>77</sup>

In recent cases, courts in both Delaware and Maryland have upheld these notions.<sup>78</sup> Specifically, in 2007 in *Weaver v. ZeniMax Media, Inc.*,<sup>79</sup> the Court of Special Appeals of Maryland allowed a former chief technology officer to sue the corporation for his nonrenewal benefits as provided in his contract without breaching his fiduciary duties to that corporation.<sup>80</sup>

69. An interested director transaction falling within the statutory safe harbor can still be challenged, however, on other grounds, such as waste or lack of an informed decision. BLOCK ET AL., *supra* note 65, at 270.

70. 764 A.2d 270 (Md. Ct. Spec. App. 2000).

71. *Id.* at 277.

72. *Id.*

73. *Id.* (citing MD. CODE ANN., CORPS. & ASS'NS § 2-419(b)(2)).

74. *Id.* at 277.

75. 252 A.2d 125, 130 (Del. Ch. 1969).

76. *Id.*

77. *Id.* The court noted that this would give the director an "unfair advantage." *Id.*

78. See, e.g., *Levy v. Hayes Lemmerz Int'l, Inc.*, No. 1395-N, 2006 WL 985361, at \*3 (Del. Ch. Apr. 5, 2006); *Radiancy, Inc. v. Azar*, No. 1547-N, 2006 WL 224059, at \*3 (Del. Ch. Jan. 23, 2006).

79. 923 A.2d 1032 (Md. Ct. Spec. App. 2007).

80. *Id.* at 1047-56. The appellate court also ultimately held that the former director did not breach his fiduciary duties to the corporation because his conduct did not rise to the level of gross misconduct required to sustain such a claim. *Id.*

Several courts have also found that when suing a corporation, a director must provide ample notice to the board of directors about the possibility of such a lawsuit. In *Neukom v. North Butte Mining Co.*,<sup>81</sup> the United States Court of Appeals for the Ninth Circuit held that a director has the same rights as any creditor in his ability to sue a corporation, but in order to appropriately exercise this right, he must make full disclosure of all of the circumstances surrounding his claim and provide ample notice to the corporation of his intentions to act as a creditor.<sup>82</sup>

*D. Fiduciary Duty Principles Enable a Director to Attach Corporate Assets to a Judgment Against a Corporation As Long As The Director is Acting in Good Faith*

Other jurisdictions have adopted various rules about a director's ability to include a pre-judgment writ of attachment for the corporation's assets in his lawsuit against the corporation. In *Marr v. Marr*,<sup>83</sup> the New Jersey appellate court found that a director may bring an action against a corporation and enforce the judgment so long as he does so "not covertly, but openly, and with fair notice to his company."<sup>84</sup> In *Marr*, the corporation's director filed a lawsuit against the corporation and obtained judgment on the debt, causing the corporation's assets to be sold at a sheriff's sale.<sup>85</sup> This occurred without notice of the attachment to the shareholders or directors.<sup>86</sup> The court found that without such notice of his intentions, the director had breached his fiduciary duty because he had offered no proof that his actions were consistent with the best interests of the stockholders.<sup>87</sup>

Additionally, in *Union Ice Co. v. Hulton*,<sup>88</sup> the Pennsylvania District Court held that a director or officer may use the typical means that an outside creditor would have to enforce a judgment against the corporation, but he may not take unfair advantage of the situation because of his position.<sup>89</sup> In that case, the president of a corporation made loans to the corporation and when they went unpaid, he brought suit against the corporation, causing the corporation's assets to be sold at a sheriff's sale, and then the president repurchased the assets at a low price.<sup>90</sup> The court held that the president ordinarily had a right to attach the corporation's assets but he had taken advantage of the situation because of his knowledge and his position and so he lost that right.<sup>91</sup>

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81. 84 F.2d 101 (9th Cir. 1934).

82. *Id.* at 104.

83. 70 A. 375 (N.J. 1908).

84. *Id.* at 378.

85. *Id.* at 376-79.

86. *Id.*

87. *Id.* at 378-80.

88. 140 A. 514 (Pa. 1928).

89. *Id.* at 514-15.

90. *Id.* at 514.

91. *Id.* at 515. The court also noted that the president had not given proper notice of the impending attachment, which the court found was integral to a director's acting in good faith. *Id.*

## III. THE COURT'S REASONING

In *Storetrax.com, Inc. v. Gurland*,<sup>92</sup> the Maryland Court of Appeals affirmed the judgment of the Maryland Court of Special Appeals and held that when a corporation's director sues the corporation as an aggrieved former employee and attaches the corporation's assets to the judgment, he does not breach his fiduciary duties to that corporation.<sup>93</sup> Writing for the court, Justice Harrell began by explaining the general fiduciary principles that guide all directors who serve on corporate boards—these principles require that a director perform his duties in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would use under similar circumstances.<sup>94</sup> A director must act in the best interests of the corporation and must always place the corporation's interests ahead of his own, as he cannot act both for himself and the corporation.<sup>95</sup> However, the court noted that there are occasions when a corporate director may proceed with an individual plan of action even though his interests conflict with those of the corporation and, in some cases, the corporation can actually secure a benefit from a director operating under a conflict.<sup>96</sup> Storetrax argued that Gurland operated under such a conflict of interest and thus breached his fiduciary duty not necessarily by filing the lawsuit but by failing to inform Storetrax of the lawsuit when he knew they had no knowledge of it.<sup>97</sup> Storetrax further argued that when there was no response from the corporation, Gurland should have realized that the corporation did not have notice of the lawsuit and by pursuing summary judgment by default, he had placed his interests ahead of the corporation.<sup>98</sup> The court noted that while Gurland's lawsuit was an obvious conflict of interest,<sup>99</sup> Maryland law did not require the transaction to be automatically void, but instead should be subjected to close scrutiny.<sup>100</sup> The court

92. 915 A.2d 991 (Md. 2007).

93. *Id.* at 1010. The court noted that the internal affairs doctrine probably required that the court apply Delaware law, the law in the state where Storetrax was incorporated, to the case. *Id.* at 999–1000 (citing *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982); *NAACP v. Golding*, 679 A.2d 554, 559 (Md. 1996)). However, the court also affirmed the intermediate appellate court's decision that there is no discernable difference between the corporate and fiduciary laws of Maryland and Delaware, and thus held that it did not matter which law is applied. *Id.* at 1000. The court went on to apply the rules and principles of corporate law in Maryland. *Id.*

94. *Id.* at 1000–01.

95. *Id.* at 1001 (citing *Booth v. Robinson*, 55 Md. 419, 436–37 (1881); *Indurated Concrete Corp. v. Abbott*, 74 A.2d 17, 20 (Md. 1950)).

96. *Storetrax*, 915 A.2d at 1001 (“An interest conflict is not in itself a crime or a tort or necessarily injurious to others and in many situations, the corporation and the shareholders may secure major benefits from a transaction despite the presence of a director's conflicting interest.” (citing *Shapiro v. Greenfield*, 764 A.2d 270, 277 (Md. Ct. Spec. App. 2000))).

97. *Id.* at 1002.

98. *Id.*

99. Gurland was operating under a conflict of interest because his personal interests in obtaining his severance payout were adverse to those of the corporation because “threatened or actual litigation is adversarial in nature.” *Id.* at 1004. Gurland's seeking \$150,000 in payment was “clearly not in the corporation's best interests.” *Id.*

100. *Id.* (citing MD. CODE ANN., CORPS. & ASS'NS § 2-419(a)–(b)).

then explained that a director operating under such a conflict may find a safe harbor by disclosing the conflict of interest to the corporation and giving the board notice so that a majority of the remaining disinterested shareholders may approve the transaction or otherwise take action to protect the corporation.<sup>101</sup> In this case, providing such notice would “strike the proper balance” between Gurland’s legal right to seek his severance payout while also requiring him to fulfill his fiduciary obligations to the corporation.<sup>102</sup> Here, the court reasoned that Gurland had sufficiently notified the corporation of the imminence of a lawsuit such that he could seek the protections of the safe harbor because his December 11, 2001, letter specifically said if the matter was not resolved within ten days that he would inform his attorney to proceed with litigation.<sup>103</sup> The court further noted that Storetrax’s response to Gurland’s letter said that the corporation had engaged counsel and was prepared to defend itself—further indication that it had notice of potential litigation and was preparing for litigation itself.<sup>104</sup> The court also found that Gurland had not used any insider information to conceal the pending lawsuit or prevent Storetrax from receiving notice.<sup>105</sup> To the contrary, the court noted there was nothing in the record to support the assumption that Gurland knew the corporation did not have notice of the actual lawsuit filing.<sup>106</sup>

The court next addressed whether Gurland had breached his fiduciary duty by attaching the corporation’s assets to enforce the summary judgment by default and by failing to voluntarily relinquish the writ at the corporation’s request.<sup>107</sup> The court noted it was a case of first impression in Maryland, but that most jurisdictions permit corporate directors to become creditors of his or her corporation in the absence of bad faith or fraud.<sup>108</sup> The director then has the same rights as any other creditor would have to enforce a judgment against the corporation and his rights are as extensive as any other creditors’ would be.<sup>109</sup> For these reasons, the

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101. *Id.* at 1002–03 (citing MD. CODE ANN., CORPS. & ASS’NS § 2-405.1 (stating the Maryland rules governing interested director transactions and permitting a safe harbor for director disclosure); *Shapiro v. Greenfield*, 764 A.2d 270, 277 (Md. Ct. Spec. App. 2000)). The court explained that “[a]lthough the analogy is by no means perfect, applying to the present case a requirement that the director notify the corporation of his intention to file a lawsuit against the corporation allows the director to assert his or her legal rights against the corporation while giving the corporation, at the same time, the opportunity to act in defense of its own interests.” *Id.* at 1003–04.

102. *Id.* at 1004.

103. *Id.*

104. *Id.* at 1004–05.

105. *Id.* at 1005.

106. *Id.*

107. *Id.*

108. *Id.* (citing *Beaver Park Co. v. Hobson*, 283 P. 772, 775–76 (Colo. 1930)). The court further noted that it could not find any general rule forbidding a director from becoming a creditor of his or her corporation or preventing the director from enforcing claims made against the corporation. *Id.* at 1005.

109. *Id.* at 1004.

court found that Gurland had not breached his fiduciary duties simply by attaching the corporation's assets and failing to notify the corporation of his intentions.<sup>110</sup>

The court then addressed Storetrax's arguments that two cases supported the proposition that Gurland should have given the corporation actual notice before filing the lawsuit and attaching the corporation's assets.<sup>111</sup> The court first discussed *Marr v. Marr*,<sup>112</sup> in which the New Jersey appellate court found that a director may bring an action against the corporation and proceed to judgment so long as he does so openly and with fair notice to the company.<sup>113</sup> Next, the court looked at *Union Ice Co. v. Hulton*,<sup>114</sup> where the Supreme Court of Pennsylvania found that vague and indefinite notice indicating only that there was a possible future intention to attach a corporation's assets was not sufficient to constitute the notice required.<sup>115</sup> In analyzing both of these cases, the court found them distinguishable because of the factual circumstances regarding the quality and definiteness of Gurland's notice to Storetrax.<sup>116</sup> In *Marr*, the director only gave oral notice at a shareholder's meeting that he would file a lawsuit sometime in the future but no specific deadline was given, whereas in this case, the court explained, Gurland gave a specific deadline and indicated that litigation was imminent.<sup>117</sup> Similarly, in *Union Ice*, the court noted that the notice did not establish any time frame and only informed the corporation that the claims would "eventually" be reduced to a judgment.<sup>118</sup> Again, the court noted the detail of Gurland's letters which it found provided ample notice.<sup>119</sup> Because of these factual distinctions, the court rejected Storetrax's argument and found Gurland's notice sufficient and specific.<sup>120</sup>

Finally, the court explained that Gurland's refusal to lift the garnishment or voluntarily set aside the judgment was not a breach of his fiduciary duty.<sup>121</sup> The court found that Maryland law has recognized that the fiduciary relationship between the director and the corporation is not enough to impose a legal obligation on the director to accede to the corporation's demands when they are adverse to the director's personal financial interest.<sup>122</sup> The court reasoned that to permit the rule that a director violates his fiduciary duty to the corporation merely because he fails to relinquish a legal interest at the corporation's request would mean that a corpora-

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110. *Id.* at 1006.

111. *Id.*

112. 70 A. 375 (N.J. 1908). For a discussion of *Marr*, see *supra* notes 83–87 and accompanying text.

113. *Storetrax*, 915 A.2d at 1007 (citing *Marr*, 70 A. at 378).

114. 140 A. 514 (Pa. 1928). For a discussion of *Union Ice*, see *supra* notes 88–91 and accompanying text.

115. *Storetrax*, 915 A.2d at 1008 (citing *Union Ice*, 140 A. at 514–15).

116. *Id.*

117. *Id.* Additionally, Storetrax engaged counsel and responded to the letter—further indication that they were prepared for the lawsuit. *Id.*

118. *Id.*

119. *Id.*

120. *Id.* at 1008–09.

121. *Id.* at 1009–10.

122. *Id.* at 1010 (citing *Waterfall Sys., Inc. v. Craig*, 914 F. Supp. 1213 (D. Md. 1995)).

tion could prohibit any director from suing the corporation because he would be obligated to cease pursuing his legal rights at the corporation's request.<sup>123</sup>

#### IV. ANALYSIS

In *Storetrax.com, Inc. v. Gurland*,<sup>124</sup> the Maryland Court of Appeals held that a director who sues the corporation of which he is a board member and then attaches the corporation's assets without notice does not breach his fiduciary duties to the corporation.<sup>125</sup> In so holding, the appellate court failed to consider both the policy behind the fiduciary rules and the well-established precedent governing conflict of interest dealings between a director and the corporation he works for.<sup>126</sup> By failing to use a more fact-specific inquiry that enables the courts to look at the circumstances of each case, the appellate court fashioned a rigid rule that could result in undesirable public policy consequences by abandoning the specific purpose of the fiduciary rules—to ensure that directors are acting in the best interests of the corporation and its shareholders.<sup>127</sup> The court could have reached the same conclusion using the well-established fiduciary duty and conflict of interest principles, allowing a more flexible standard that would enable courts to appropriately consider the interests of corporations and their shareholders in the future.<sup>128</sup>

##### A. *The Maryland Court of Appeals Failed to Consider the Rationale Behind the Fiduciary Rules*

Instead of creating a bright-line rule, the *Storetrax* Court should have considered the possible policy implications of fashioning a rule that does not permit evaluation of the factual circumstances of each situation. An underlying premise for the imposition of fiduciary duties is a separation of legal control from beneficial ownership.<sup>129</sup> One of the earliest principles the Maryland courts recognized was that the design of the fiduciary duty rules is to ensure that the corporation is operated in the best interests of the business and not for the personal profit of one particular person.<sup>130</sup> If one of a corporation's directors is permitted to place himself in a position of personal gain or profit at the expense of the corporation, he obviously cannot be acting to advance both his interests and those of the corporation he is

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123. *Id.*

124. 915 A.2d 991.

125. *See generally id.* at 1005–10.

126. *See supra* Part II.A.–B.

127. *See infra* Part IV.A.

128. *See infra* Part IV.B.

129. *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998) (discussing the fiduciary duties that corporate directors of Delaware corporations owe to their shareholders).

130. *Cumberland Coal & Iron Co. v. Parish*, 42 Md. 598, 601 (1875); *see also Booth v. Robinson*, 55 Md. 419, 428 (1881) (explaining that the fiduciary duties applicable to directors are necessary because of the powers the directors have over the corporation's affairs).

supposed to serve.<sup>131</sup> The policy behind this rule is that if a director puts his own interests ahead of the corporation's, not only do the stockholders and the corporation's creditors lose out, but the remaining directors are forced into the embarrassing position of having to scrutinize and check the transactions of one of their fellow board members.<sup>132</sup> Moreover, as a corporate director, one of the key components of the job is to choose the corporate interest over personal interest when the job so requires.<sup>133</sup>

Thus, the fiduciary duty rules are designed to protect two parties: shareholders and the investing public who have placed their trust in the director as an agent of the corporation, as well as the remaining directors, who would be placed in an awkward and potentially disastrous position of having to closely scrutinize every transaction involving the compromised director. These rules ensure that the interests of the corporation are always placed above the interests of the director.<sup>134</sup> By eliminating this rationale from its consideration, the Maryland Court of Appeals failed to consider the interests of both these groups.

#### *B. The Maryland Court of Appeals Should Have Applied the Well-Established Fact-Specific Inquiry Used to Evaluate Conflict of Interest Transactions*

Stemming from the policy behind these fiduciary duties, Maryland courts have adopted a well-developed and established body of case law on the fact-specific inquiry that governs conflict of interest transactions—one of the key signs of a breach of fiduciary duty.<sup>135</sup> Allowing the courts to weigh in on the specific circumstances behind each transaction helps to create a balance between transactions which should be voided because of the conflict of interest they present and those in which the conflict might actually benefit shareholders.<sup>136</sup> It was the long-standing common law rule that such transactions were automatically void.<sup>137</sup> However, as the United States District Court for the District of Maryland noted in *Sullivan v. Easco Corp.*<sup>138</sup> and the Maryland Court of Appeals noted in *Chesapeake Construction Corp. v. Rodman*,<sup>139</sup> the law has since evolved and favored a more fact-specific

131. See, e.g., *Cumberland Coal*, 42 Md. at 605–06.

132. *Chesapeake Constr. Corp. v. Rodman*, 261 A.2d 156, 157–58 (Md. 1970).

133. See *Henshaw v. Am. Cement Corp.*, 252 A.2d 125, 130 (Del. Ch. 1969).

134. See generally *Cumberland Coal*, 42 Md. 598.

135. See *supra* Part II.B (explaining the history and development of conflict of interest principles in Maryland, including the abandonment of the bright-line rule and the shift to a more factual inquiry).

136. See *Shapiro v. Greenfield*, 764 A.2d 270, 277 (Md. Ct. Spec. App. 2000) (“[A]n interest conflict is not in itself a crime or a tort or necessarily injurious to others, in many situations, the corporation and the shareholders may secure major benefits from a transaction despite the presence of a director’s conflicting interest.”); see also *BLOCK ET AL.*, *supra* note 65, at 266–95.

137. See *Cumberland Coal & Iron Co. v. Sherman*, 20 Md. 117 (1863); *Hoffman Steam Coal Co. v. Cumberland Coal & Iron Co.*, 16 Md. 456 (1860).

138. 656 F. Supp. 531 (D. Md. 1987).

139. 261 A.2d 156 (Md. 1970).

inquiry that takes each transaction's details into account.<sup>140</sup> Under Maryland law today, a transaction involving an interested director such as the one involving Gurland will always be closely scrutinized and, if shown to be unfair or entered into in bad faith by the corporate director, nullified.<sup>141</sup> Additionally, the burden of proving that the contract is fair, adequate and equitable is upon the interested director.<sup>142</sup> This policy creates a system where a director is required to adhere to the utmost good faith in his relation with the corporation, but can be excused in certain circumstances where his transgression would not have an adverse impact on the corporation.<sup>143</sup> Under such a rule, the transaction here might still be void, but Gurland would have had the opportunity to defend and justify the transaction and explain its possible benefits to the corporation.

Here, the Maryland Court of Appeals has adopted a rule that eliminates this system and creates the possibility of directors abusing their positions of power to act only in their personal interests.<sup>144</sup> This rule has the possibility of creating unintended and far-reaching consequences for future disputes involving similar facts. In *Storetrax*, there is no evidence that Gurland entered into any such transaction that tainted his judgment to vote on corporate matters, nor is there any evidence that Gurland concealed information to benefit himself. However, one can imagine where such a situation could arise and create a rule that would not permit analysis of the facts of such a situation severely undermines the purpose of the fiduciary rules in ensuring that corporate directors act in the best interests of the corporation and its shareholders.<sup>145</sup> In such a case, the court should be permitted to evaluate the transaction in light of the particular facts, without being forced to rule that potentially egregious behavior is not a breach of fiduciary duty.<sup>146</sup>

Additionally, by not using a fact-specific inquiry, the Maryland Court of Appeals has adopted a rule that runs contrary to prior established notice requirements in the fiduciary duty context by permitting Gurland to attach the corporation's assets without notice.<sup>147</sup> There is little doubt that Gurland had the right to file suit against

140. *Sullivan*, 656 F. Supp. at 533–35.

141. *Id.*

142. *Id.*

143. See generally *Shapiro v. Greenfield*, 764 A.2d 270, 277–80 (Md. Ct. Spec. App. 2000).

144. See, e.g., *Francis v. Brigham-Hopkins Co.*, 70 A. 95, 101 (Md. 1908) (noting the importance of not weighing the transaction when a director is interested to ensure that the director's transgression was not furthering his own interests at the expense of the corporation).

145. See, e.g., *Union Ice Co. v. Hulton*, 140 A. 514 (Pa. 1928) (finding that a corporation's director who made loans in the corporation's name and, when the corporation defaulted, executed a sheriff's sale and repurchased the corporation's assets at less than market value had breached his fiduciary duty because he had placed his own interests in financial gain ahead of the corporation's by not providing notice to the directors or shareholders).

146. See *Shapiro*, 764 A.2d at 276 (discussing the rationale behind the evolution of the common-law rule from a bright-line rule to a fact-specific inquiry).

147. *Storetrax.com, Inc. v. Gurland*, 915 A.2d 991, 1006 (Md. 2007) (holding that "it was not a violation of Gurland's fiduciary obligations as a director of *Storetrax* for him to garnish the corporation's bank account, despite not informing the corporation in advance that he would be seeking garnishment").



the corporation claiming his severance package.<sup>148</sup> However, the fact that Gurland attached the corporation's assets while still sitting as a boardmember without providing any notice of the pending attachment is much more troubling. As adopted by the Maryland legislature and as articulated by the courts in Maryland and other jurisdictions, notice is an integral part of a conflict of interest transaction evaluation.<sup>149</sup> While Gurland provided adequate notice of an impending lawsuit, it is questionable whether such notice was sufficient to put the corporation on notice that he might attach corporate assets to such a suit and could drain corporate assets, like in *Marr v. Marr*<sup>150</sup> and *Union Ice Co. v. Hulton*.<sup>151</sup> Additionally, part of this evaluation notes that a director may certainly use any ordinary methods to attach a corporation's assets, but he must give notice and do so in a fair manner.<sup>152</sup> Without the requirement of notice, the entire purpose of the fiduciary duty rules is lost because directors are no longer required to disclose potential conflicts to the board of directors, thus making it easier for them to place their personal interests ahead of the interests of the corporation—they never have to justify it to anyone. By fashioning a rule that permits this, the Maryland Court of Appeals has created a situation where shareholders and creditors are not adequately protected.<sup>153</sup>

## V. CONCLUSION

In *Storetrax.com v. Gurland*,<sup>154</sup> the Maryland Court of Appeals found that a director of a corporation did not breach his fiduciary duty when he sued the corporation and attached its assets to a default judgment without notice.<sup>155</sup> In so holding, the appellate court departed from well-established precedent which permits a fact-specific inquiry whenever an interested director is involved.<sup>156</sup> By creating a bright-line rule instead of considering the policy rationale behind the fiduciary rules, the Maryland Court of Appeals has expanded the breadth of power that a corporate direc-

148. See *Hutchinson v. Phila. & G.S.S. Co.*, 216 F. 795, 798 (E.D. Pa. 1914) (“[T]here is no rule of law or equity which prohibits a creditor of a corporation from bringing suit because he is also a director.”); *Weaver v. ZeniMax Media, Inc.*, 923 A.2d 1032 (Md. 2007) (noting that while there is a duty of loyalty protecting shareholders against self-interested directors, the director still has a right to assert claims against the corporation without impinging upon the expectations of the shareholders in disinterested directors).

149. MD. CODE ANN., CORPS. & ASS'NS § 2-419(a), (b)(1) (West 2006) (statutory provision explaining that if there is a conflict of interest with one of the directors, he can only seek the safe harbor and not have the transaction voided by disclosing the interest to the board of directors and stockholders); see also 3 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 907 (perm. ed., rev. vol. 2002) (“A director or other corporate officer may, in a proper case, become a creditor of the corporation . . . [but to] make a valid claim as a creditor against his or her corporation, a director must make full disclosure of all circumstances surrounding the claim.” (emphasis added) (citing *Neukom v. North Butte Min. Co.*, 84 F.2d 101, 104 (9th Cir. 1936))).

150. 70 A. 375 (N.J. 1908).

151. 140 A. 514 (Pa. 1928).

152. *Neukom*, 84 F.2d at 103.

153. See, e.g., *Leavy v. Am. Fed. Sav. Bank*, 764 A.2d 366 (Md. 2000).

154. 915 A.2d 991 (Md. 2007).

155. See *supra* Part III.

156. See *supra* Part II.B.

tor has into an uneasy sphere.<sup>157</sup> By not evaluating the situation under the traditional conflict of interest principles, the rights of shareholders could be impinged by this rule and the ramifications could be far-reaching and enable directors to engage in personal dealings at the expense of Maryland corporations.<sup>158</sup>

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157. *See supra* Part IV.A.

158. *See supra* Part IV.B.