2009 Georgia Corporation and Business Organization Case Law Developments

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This paper is not intended as legal advice for any specific person or circumstance, but rather a general treatment of the topics discussed. The views and opinions expressed in this paper are those of the author only and not Bryan Cave Powell Goldstein.

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2009 Georgia Corporation and Business Organization Case Law Developments

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I. INTRODUCTION AND OVERVIEW.

INTRODUCTION.

This paper surveys the decisions addressing corporate and business organization law issues handed down by the Georgia state and federal courts during 2009.[1] Although few of the cases decide matters of first impression, several discuss important points of law on which there is little Georgia authority. The survey includes many other decisions because they confirm the continued validity of established principles governing Georgia business organizations and reflect the way in which the courts view and apply those principles.

The survey is organized, first, by entity type – corporations, partnerships, limited liability companies and other forms of business ventures. The rest of the survey is grouped by subject matter with cases divided into (a) decisions primarily concerning transactional issues that should apply to all forms of business organizations and (b) decisions dealing with litigation issues characteristic of business organization disputes.

The brief overview of the decisions below is followed by a more extensive discussion of each of the decisions, organized and listed in the same order as the overview.

OVERVIEW.

A. DUTIES AND LIABILITIES OF CORPORATE DIRECTORS, OFFICERS AND EMPLOYEES.

One of the potentially most important decisions of the year, Brock Built, LLC v. Blake, 300 Ga. App. 816, 686 S.E.2d 425 (2009) confirms that officers and directors of Georgia corporations cannot be held liable for ordinary negligence in the performance of their corporate duties under O.C.G.A. § 14-2-830 and appears to be the Georgia appellate courts' first recognition of a business judgment rule presumption. The Georgia Court of Appeals applies

[1] This is the fifth annual survey of Georgia corporate and business organization case law developments. For copies of any of the prior years' surveys, contact the author at tom.richey@bryancave.com or at the address or telephone numbers listed at the end of the survey.

these principles to a limited liability company without explanation and without mention of the corresponding provisions of the Georgia Limited Liability Company Act. In an order following trial, the Court in In re: Maxxis Group, Inc.: Hays v. Curry, Adv. Case No. 06-06554-MGD, (N.D. Ga., Bankr. September 29, 2009) (unpublished), rejected a bankruptcy trustee's claims against directors of a corporate debtor under § 14-2-830, upholding the directors' rights to rely on management statements regarding corporate performance and finding insufficient evidence of their knowledge of the corporation's insolvency.

Two decisions dealt with claims for misappropriation of corporate opportunities – Professional Energy Management, Inc. v. Necaise, 300 Ga. App. 223, 684 S.E.2d 374 (2009), in which the Court held that employees with authority to bind corporations have fiduciary duties, but not as to corporate opportunities, and Brewer v. Insight Technology, Inc., 301 Ga. App. 694, 689 S.E.2d 330, (2009), holding that a "beachhead" by the corporation is not required for misappropriation of opportunities during a corporate officer's tenure and finding that punitive damages were not capped because of the officer's specific intent to harm the corporation.

Wachovia Insurance Services, Inc. v. Fallon, 299 Ga. App. 440, 682 S.E.2d 657 (2009) confirms that a former officer of a Georgia corporation does not owe fiduciary duties not to compete after his departure and after a close review of the evidence holds that the former officer had not violated any of his duties to the corporation before or after he left. The Court in Eayrs v. Absolute Roofing, Inc., 300 Ga. App. 825, 686 S.E.2d 432, (2009) ruled that a defendant, who was clearly acting as an agent of a disclosed principal, could not be held personally liable on a contract merely because the contract did not disclose the corporate status of the business. HRH Architects, Inc. v. Lansing, 2009 WL 1421217 (N.D. Ga. Apr. 2, 2009) discusses and applies the tests to determine when corporate officers can be held directly or vicariously personally liable for copyright infringement.

B. CORPORATE STOCK OWNERSHIP AND RIGHTS.

In 2009 there were several decisions addressing contractual issues involving purchases or option rights to receive stock or other equity-based investments. Two decisions involved applications of Georgia's blue sky law. Fernandez v. WebSingularity, Inc., 299 Ga. App. 11, 681 S.E.2d 717 (2009) dealt with a subscription agreement for an amount of shares inconsistent with oral representations. The Court held that there were issues of fact regarding whether the corporation had accepted the subscription before the purchaser rescinded it, but found his Georgia Securities Act of 1973 claims were barred because he was held to know of the alleged misrepresentations when he executed the subscription agreement. In Golden Atlanta Site Development, Inc. v. Nahai, 299 Ga. App. 646, 683 S.E.2d 166 (2009), the Court used the blue sky law test for an "investment contract" to determine whether a transaction was a loan or investment for purposes of a usury law claim.

The Court in BDI Laguna Holdings, Inc. v. Marsh, 301 Ga. App. 656, 689 S.E.2d 39, (2009) addressed an employee's claims against a corporation and one of its officers to enforce oral promises to award certain percentages of the corporation's stock for his service. The Court found the pre-employment promises too uncertain to be enforced and also barred by a merger

clause in the employment agreement and the subsequent promises were not supported by additional consideration over and above the services required under the employment agreement.

Capital Health Mgt. Group, Inc. v. Hartley, 301 Ga. App. 812, 689 S.E.2d 107 (2009) represents the first decision in the Georgia state appellate courts dealing with a stock appreciation rights agreement. The Court applied the standards for discretionary corporate decisions, finding that the corporation failed to act in good faith and exercise honest judgment in its refusal to award the plaintiff any stock appreciation rights. Clark v. Chapman, 301 Ga. App. 117, 687 S.E.2d 146 (2009) affirmed an injunction against a transfer of corporate assets by an officer after a judgment creditor's levy on his stock, rejecting in sweeping language the defendant's arguments based on the distinction between ownership of corporate stock and the corporation's ownership of its assets. In Kelley Manufacturing Company v. Martin, 296 Ga. App. 236, 674 S.E.2d 92 (2009), the Georgia Court of Appeals held as a matter of first impression that ESOP participants are entitled to exercise the rights of shareholders to inspect corporate books and records.

C. NONPROFIT CORPORATIONS.

The Victory Drive Deliverance Temple, Inc. v. Jackson, 298 Ga. App. 563, 680 S.E.2d 588 (2009) affirmed the dismissal of a suit by a church to remove its pastor because it was filed by an improperly constituted board of directors purporting to act for the church.

D. PARTNERSHIP LAW DEVELOPMENTS.

J.T. Turner Construction Co. v. Summerour, 301 Ga. App. 323, 687 S.E.2d 612 (2009) held that general partners who were not included as defendants in a suit against the partnership, while they were entitled to their day in court, did not have the right to contest the partnership's liability to the plaintiff on a default judgment and were thus held personally liable for the judgment. The Court in Asgharneya v. Hadavi, 298 Ga. App. 693, 680 S.E.2d 866 (2009) affirmed a judgment against a partner for wrongfully terminating an oral partnership and misappropriation of the partnership's business, including the award of lost profits to the partner frozen out of the business. Morris v. Nexus Real Estate Mortgage and Investment Company, 296 Ga. App. 477, 675 S.E.2d 511 (2009) addresses the procedures under O.C.G.A. § 14-8-28 for "charging orders" that enable judgment creditors to reach a judgment debtor's interest in a partnership under O.C.G.A. § 14-8-28. The Court held among other things that the judgment creditor was not barred by a four-year statute of limitations from reaching a partnership interest assigned by executors of the deceased judgment debtor's estate.

E. LIMITED LIABILITY COMPANY DEVELOPMENTS.

In Murphy v. McMaster, 285 Ga. 622, 680 S.E.2d 848 (2009), the plaintiff was a member of LLCs that were serving as general partners for several real estate limited partnerships. He sued to enforce his rights under the LLC operating agreements to provide property management services to the partnerships. The Georgia Supreme Court held that an interlocutory injunction

was properly denied, since equity does not generally compel performance of personal service contracts and since the member could recover damages and had an adequate remedy at law.

Ledford v. Peeples, 568 F.3d 1258 (11th Cir. 2009) concerns an alleged breach of disclosure obligations when management members of an LLC purchased the membership interests of the financial members of the LLC pursuant to a buy-sell agreement where one could name a price and force the other parties to decide whether to buy or sell. The 11th Circuit Court of Appeals held that the plaintiffs could not prove reliance or causation because they were admittedly unable to run the business or to replace management and thus had no choice but to sell at the named price.

F. OTHER FORMS OF BUSINESS ORGANIZATION.

Techbios, Inc. v. Champagne, 301 Ga. App. 592, 688 S.E.2d 378 (2009) is the first Georgia appellate court case involving a "teaming agreement" – an arrangement through which parties can coordinate business activities without necessarily forming a joint venture or partnership. The Court reversed dismissal of the plaintiff's claims for breach of the teaming agreement for failing to disclose and share business opportunities, where the defendants allegedly misappropriated opportunities for themselves which resulted from the plaintiffs' efforts under the teaming agreement and in which the plaintiffs could have profitably participated.

G. TRANSACTIONAL CASES.

In A&B Blind & Drapery Company, Inc. v. B&B Glass And Storefronts, Inc., 298 Ga. App. 210, 679 S.E.2d 782 (2009), the Georgia Court of Appeals affirmed a trial court ruling that enforced the purchaser's contractual set-off rights for the sellers' breach of warranties under an asset purchase agreement, but denied any other remedy because the purchaser was sophisticated and failed to conduct sufficient due diligence before entering into the transaction. The Court of Appeals in Corey v. Clear Channel Outdoor, Inc., 299 Ga. App. 487, 683 S.E.2d 27 (2009) enforced a covenant not to compete in an asset purchase agreement where the seller attempted to circumvent the covenant using a straw owner. In McKesson Corporation v. Green, 299 Ga. App. 91, 683 S.E.2d 336 (2009), the Court rejected claims by selling shareholders in a stock-for-stock merger based on misrepresentations regarding their own company. The plaintiffs argued that they would have sold their stock rather than accept shares of the merged company, but the Court held that the misrepresentations overvalued their shares and did not cause their losses. The decision in Summit Automotive Group, LLC v. Clark, 298 Ga. App. 875, 681 S.E.2d 681 (2009) reaffirms the rule that the Georgia Bulk Sales Act does not permit an action in tort against the transferee.

H. LITIGATION ISSUES.

Director and Officer Liability Litigation. The United States District Court for the Northern District of Georgia in Lubin v. Skow, 2009 WL 4641761 (N.D. Ga. Nov. 30, 2009) dismissed claims for mismanagement by a Chapter 7 bankruptcy trustee for a Georgia bank holding company against directors of its failed banking subsidiary, holding that the claims belong exclusively to the Federal Deposit Insurance Corporation as receiver, not the bankruptcy

trustee. In Goldstein v. Wells, 295 Ga. App. 870, 673 S.E.2d 325 (2009), the Georgia Court of Appeals, applying Maryland law, affirmed dismissal of a derivative action after rejection of the shareholders' demand by an independent committee of directors.

Insurance and Indemnification. In Four Seasons Healthcare, Inc. v. Willis Insurance Services of Georgia, Inc., 299 Ga. App. 183, 682 S.E.2d 316 (2009), the Georgia Court of Appeals sitting *en banc* affirmed dismissal of professional liability claims against an insurance broker engaged to obtain director and officer liability coverage for a pending transaction where the insurers, invoking different exclusions, denied coverage under both the existing and new D&O policies – a majority shareholder exclusion under the existing policy and a prior acts exclusion under the new policy. Over a strong dissent, the Court held the insureds barred by their knowledge and negligence in failing to discover the exclusions. Jansky v. SunTrust Banks, Inc., 2009 WL 33055200 (N.D. Ga. Sept. 18, 2009) enforced a corporate officer's rights to mandatory indemnification for successful defense of a counterclaim by the corporation, holding that even in the absence of a retainer agreement or payment of fees, the officer's liability to her counsel in *quantum meruit* would support the award.

Arbitration. In Hansen & Hansen Enterprises, Inc. v. SCSJ Enterprises, Inc., 299 Ga. App. 469, 682 S.E.2d 652 (2009) an arbitration award was vacated in a sale of business dispute because the arbitrator failed to decide counterclaims on promissory notes given in the transaction. While the notes themselves did not contain arbitration clauses, they were an integral part of a transaction governed by agreements requiring arbitration.

Corporate Separateness and Piercing the Corporate Veil. In an unusual case, EnduraCare Therapy Management, Inc. v. Drake, 298 Ga. App. 809, 681 S.E.2d 168 (2009), the Georgia Court of Appeals reversed a default judgment against a corporate parent that held it liable for its subsidiary's tortious conduct. The Court held that under O.C.G.A. § 9-11-55, the failure to answer a complaint admits only well-pleaded facts, and the complaint failed to allege any facts that would justify disregarding the legal separateness of parent and subsidiary and imposing liability for the subsidiary's acts. In two decisions, Anthony v. Gator Cochran Construction, Inc., 299 Ga. App. 126, 682 S.E.2d 140 (2009) (*certiorari* granted) and Renee Unlimited, Inc. v. City of Atlanta, 301 Ga. App. 254, 687 S.E.2d 233 (2009), the Court of Appeals upheld jury verdicts piercing the corporate veil as supported by the evidence. In Otero v. Vito, 2009 WL 3063426 (M.D. Ga. Sept. 22, 2009), the United States District Court for the Middle District of Georgia held that Georgia does not recognize reverse piercing of the corporate veil and permitting a corporation to be held liable for its owner's debts.

Evidence Issues. In Ross v. State, 298 Ga. App. 525, 680 S.E.2d 435 (2009), the Georgia Court of Appeals addressed the admissibility under the business records exception to the hearsay rule of documents that a business obtains from third parties. In this case, copies of checks dishonored by third-party banks were held admissible as part of the depository bank's business records. The Court in Standard Building Company, Inc. v. Wallen Concept Glazing, Inc., 298 Ga. App. 443, 680 S.E.2d 527 (2009) held that an unauthenticated printout of search results from the website of a foreign state's secretary of state were inadmissible, in a proceeding to

domesticate a default judgment, to establish that the defendant was doing business in the foreign jurisdiction.

Service of Process. Pallman Maschinenfabrik GmbH & Co. v. Evergreen Composite Technology, LLC, 2009 WL 112683 (M.D. Ga. Jan. 16, 2009); Tunstall v. Deutsche Bank Trust Company America, 2009 WL 274153 (M.D. Ga. Feb. 4, 2009) addressed provisions of the Georgia Business Corporation Act and the Georgia Limited Liability Company Act regarding the appointment and maintenance of agents for service of process. The Georgia Court of Appeals in Anthony Hill Grading, Inc. v. SBS Investments, LLC, 297 Ga. App. 728, 678 S.E.2d 174 (2009) held that substituted service on the Georgia Secretary of State under O.C.G.A. § 14-11-209(f) was ineffective because the plaintiff failed to comply with the technical statutory requirements regarding the number of copies that must be served on the Secretary of State and ineffective under O.C.G.A. § 9-11-4(e)(1) for the plaintiff's failure to make use of known alternative means of service.

Venue. The decision in HD Supply, Inc. v. Garger, 299 Ga. App. 751, 683 S.E.2d 671 (2009), a case involving allegedly jointly liable tortfeasors, addresses the issue of when venue is determined under O.C.G.A. § 14-2-510(b)(3) as to a corporate defendant added by amendment to the litigation. The Court held that venue as to the added defendant "relates back," i.e., is determined as of the date of filing suit, and thus venue was proper even though the original co-defendant did not maintain an office or transact business in the county and the added defendant had closed its office by the time it was joined.

Representation of a Corporation in Court. Heath v. Beech, 300 Ga. App. 756, 686 S.E.2d 283 (2009), applies the long-established rule that corporations may only appear in a court of record through duly licensed counsel, holding that where a corporate stockholder filed an answer on behalf of himself and the corporation, the trial court acted properly in striking the answer as to the corporation and entering a default judgment against it.

II. DISCUSSION AND ANALYSIS OF DECISIONS.

A. DUTIES AND LIABILITIES OF CORPORATE DIRECTORS, OFFICERS AND EMPLOYEES.

Brock Built, LLC v. Blake, 300 Ga. App. 816, 686 S.E.2d 425 (2009) – Business judgment rule presumption and standard of conduct for officers and directors of Georgia corporations.

The Georgia Court of Appeals again in 2009 addressed the statutory standard of conduct for directors and officers of Georgia corporations, confirmed that directors and officers cannot be held liable for "mere negligence" and again used the business judgment rule as a measuring stick determining compliance with statutory duties. Relying on an unpublished 11th Circuit decision, the Court also held that the business judgment rule provides a presumption that a corporate officers' business decisions are informed, deliberate and made in good faith, and requiring evidence of fraud, bad faith, or an abuse of discretion to overcome that presumption.

The former president of a residential construction company, after his termination, filed suit to recover severance payments under his employment contract. The company counterclaimed for breach of fiduciary duty and appealed a summary judgment dismissing its claims. The Court of Appeals affirmed. Its statement of the legal principles to be applied should be reviewed in the Court's own formulation:

> Georgia law requires that corporate officers and directors discharge their duties in good faith and with the care of an ordinary prudent person in a like position. OCGA §§ 14-2-830(a); 14-2-842(a). In determining whether a corporate officer has fulfilled his or her statutory duty, Georgia courts apply the business judgment rule. See *Regenstein v. J. Regenstein Co.,* 213 Ga. 157, 162 (97 S.E.2d 693) (1957); *Flexible Products Co. v. Ervast,* 284 Ga. App. 178, 181(2)(b)(ii) (643 S.E.2d 560) (2007). See also *Matter of Munford, Inc.,* 98 F.3d 604, 611(B) (11th Cir. 1996); *Medserv Corp. v. Nemnom,* 1997 U.S. Dist. LEXIS 18246, *9-10 (II) (N.D. Ga. 1997). The business judgment rule affords an officer the presumption that he or she acted in good faith, and absolves the officer of personal liability unless it is established that he or she engaged in fraud, bad faith or an abuse of discretion:
>
>> The business judgment rule protects ... officers from liability when they make good faith business decisions in an informed and deliberate manner. The presumption is that they have acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Unless this presumption is rebutted, they cannot be held personally liable for managerial decisions. However, officers may be held liable where they engage in fraud, bad faith, or an abuse of discretion.
>
> (Citations and punctuation omitted.) *TSG Water Resources v. D'Alba & Donovan Certified Public Accountants,* 260 Fed. Appx. 191, 197(IV)(A) (11th Cir. 2007). See *International Ins. Co. v. Johns,* 874 F.2d 1447, 1461(III)(B)(2) (11th Cir. 1989); *Cottle v. Storer Communication,* 849 F.2d 570, 574(II) (11th Cir. 1988); *In the Matter of Tom's Foods Inc.,* 2005 Bankr. LEXIS 2062, *6 (M.D. Ga .2005). Allegations amounting to mere negligence, carelessness, or "lackadaisical performance" are insufficient as a matter of law. *Medserv Corp. v. Nemnom,* 1997 U.S. Dist. LEXIS at *9 (II). See also *Matter of Munford, Inc.,* 98 F.3d at 610-611(B); *Flexible Products Co.,* 284 Ga. App. at 181(2)(b)(ii).

The Court affirmed summary judgment for the former president for lack of evidence as to allegations that he had accelerated closing transactions and deferred expenses to maximize income to increase his incentive compensation, but added the following citation, apparently to demonstrate that the presumption had not been rebutted simply by the fact that the CEO would benefit by actions otherwise properly performed.

> See *Turner Broadcasting System v. CBS,* 627 F. Supp 901, 909-910 (N. D. Ga. 1985) (that corporate officers or directors may stand to gain personally from their actions does not obviate the application of the business judgment rule).

In addressing the remaining allegations against the CEO, the Court made clear that the business judgment rule presumption is not limited to good faith, but also presumes that business decisions are informed and deliberate:

> . . . Brock Built's allegations regarding the deficiencies in Blake's management and budgeting amounted at best to a showing of negligent or careless performance of Blake's duties, which is insufficient to show breach of fiduciary duty as a matter of law.
>
> . . . .
>
> In sum, the allegations in the complaint in conjunction with the record evidence are simply not sufficient to rebut the presumption that Blake made good faith business decisions in an informed and deliberate manner or to present a jury question as to whether he engaged in fraud, bad faith, or an abuse of discretion.

The Brock Built decision helps remove the confusion created in 2007 when the Court issued inconsistent decisions on whether directors and officers of Georgia corporations could be sued for ordinary negligence. Compare Flexible Products Co. v. Ervast, 284 Ga. App. 178, 181, 643 S.E.2d 560, 565 (2007) (holding ordinary negligence not actionable under O.C.G.A. § 14-2-842 in light of business judgment rule) with Rosenfeld v. Rosenfeld, 286 Ga. App. 61, 648 S.E.2d 399 (2007) (holding ordinary negligence to be actionable, but because the opinion was not unanimous, the decision was physical precedent only, not binding precedent under Rule 33(a) of the Rules of the Court of Appeals of Georgia.).[2]

However, Brock Built was not a corporation, but a limited liability company, and the Court does not explain how the Georgia Business Corporate Code sections O.C.G.A. §§ 14-2-830 and 14-2-842 could apply to an LLC. The Georgia Limited Liability Company Act contains its own provision setting forth the standard of conduct for Georgia LLC members and managers, O.C.G.A. § 14-11-305. In its basic statement of the operative duties, § 14-11-305 is essentially identical in wording to its GBCC counterparts. This decision represented an opportunity for the Court to address the applicability of the business judgment rule, the effect of the rule on statutory claims and the actionability of ordinary negligence in the LLC context, but the opinion is entirely silent on the form of entity before the Court or the proper statutory law to apply.

In another ruling in the case, the Court rejected the former president's claim that the company owed and breached a fiduciary duty to him to calculate its profits in good faith. The Court held that the company's duties were contractual only, that an employer generally does not owe duties to an at-will employee, that the company did not owe a duty independent of the contract to him, and that he did not sustain any injury other than the benefits of the contract.

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[2] Notably, the Brock Built decision was written by Judge Debra Bernes who had concurred in the Rosenfeld opinion.

<u>In re: MAXXIS Group, Inc.: Hays v. Curry</u>, Adv. Case No. 06-06554-MGD, N.D. Ga., Bankr. September 29, 2009) (unpublished).

The trustee in bankruptcy for Maxxis Group, Inc., a Georgia publicly-held corporation, brought an adversary proceeding against former directors, officers and controlling shareholders asserting claims for breach of fiduciary duty, deepening insolvency, and equitable subordination. After settling with several defendants, the case proceeded to trial against four remaining directors on the breach of fiduciary duty claims. The defendants did not appear at trial. The trustee called a forensic accountant and a turn-around specialist, who testified that the company's records were in disarray and incomplete. In written findings of fact and conclusions of law, the Court found that the defendants had "no liability under O.C.G.A § 14-2-830 because the evidence did not establish any breach of the Defendants' duties of good faith and due care." The Court found as a matter of fact that Maxxis was insolvent by March 31, 2001. The Court held that the directors assumed duties to creditors upon the company's insolvency. It rejected testimony that the four directors knew or should have known of the company's insolvency in March 2001, however, because there was no evidence that the financial condition of the company was brought to their attention. On the contrary, the board of directors' minutes reflected efforts to grow sales after March 2001 and the retiring chief executive officer made positive statements regarding the company's performance in April 2002. Under § 14-2-830(b) and -(c), the directors were entitled to rely on those statements because they had no knowledge or reason to believe that the CEO was not reliable or competent. Examining five alleged incidents of breach of fiduciary duty, the Court found that the trustee's criticisms were based on the lack of success of a corporate decision which could only be assessed in hindsight and that the trustee had failed to show that the four directors had authorized or approved several of the transactions involved. The Court found no liability for a challenged stock repurchase program because the directors are only liable under O.C.G.A. § 14-2-640 for wrongful distributions if they violate their duties under § 14-2-830, which the trustee could not prove without showing the directors' knowledge of the company's insolvency prior to October 2002, and because the trustee could not show that there were any repurchases after that point. The Court addressed criticisms that the directors failed to adopt and execute a turnaround plan, stating "[t]he Court refuses to find breach of a corporate director's duty based solely on the absence of a turnaround plan. Such a standard is not supported by Georgia statute or common law. Instead, courts defer to the strategies and judgment of corporate management." Commenting on the trustee's failure to prove his case, the opinion states: "The Court is sensitive to Trustee's efforts to piece together the chain of events when Debtors' books and records were in disarray. However the state of Debtors' records cannot lower the standard of proof required to create personal liability for corporate directors. Trustee failed to establish any breach of Defendants' duties under O.C.G.A. § 14-2-80."

<u>Professional Energy Management, Inc. v. Necaise</u>, 300 Ga. App. 223, 684 S.E.2d 374 (2009) – Employees with authority to bind corporation have fiduciary duties, but not as to corporate opportunities.

This appeal involved claims against a former employee for breach of fiduciary duty, interference with contractual relations, conversion and misappropriation of corporate opportunities which the trial court had dismissed as preempted by the Georgia Trade Secrets Act. See O.C.G.A. §10-1-767(a). While still employed, the former employee, among other things, had allegedly formed a competing company, met with existing and prospective clients and persuaded some of them to terminate their contracts with the employer. The Court of Appeals found that that the claims were not preempted because they were not "based solely on the misappropriation of proprietary information." The Court rejected the employee's "right for any reason" argument as to the dismissal of the breach of fiduciary duty claim because the complaint failed to allege that he had authority to bind the corporation. The Court stated the general rule that employees do not breach fiduciary duties by making plans and arrangements to compete upon termination of employment, but are not allowed to solicit customers or do "other similar acts in direct competition with the employer's business" while still employed. 300 Ga. App. at 225. The Court held that allegations that the employee had served as an account executive with the responsibility of securing new clients for the company sufficed for purposes of a breach of fiduciary claim. 300 Ga. App. at 226.[3] However, the Court affirmed dismissal of the claims for misappropriation of corporate opportunities, noting that O.C.G.A. § 14-2-831(a)(1)(C) permits suits against officers and directors for such claims, but that the employee was not alleged to have been an officer or director. Although not clearly stated in the opinion, a non-officer, non-director employee who owes fiduciary duties to the corporation does not have a fiduciary duty at common law not to appropriate a corporate opportunity.

Brewer v. Insight Technology, Inc., 301 Ga. App. 694, 689 S.E.2d 330, (2009) – Beachhead not required for misappropriation of corporate opportunity during corporate officer's tenure; punitive damages not capped because of specific intent to harm corporation.

This case was an appeal after trial in ongoing litigation between Insight Technology, Inc. ("ITI") and its former president, Darren Brewer, for breach of fiduciary duty and misappropriation of corporate opportunity. In a previous decision, the trial court had granted summary judgment to three third-party defendants on ITI's claims for aiding and abetting breach of fiduciary duty, appropriation of corporate opportunities, punitive damages and attorney fees. The Georgia Court of Appeals reversed in part, holding that, whether denominated "aiding and abetting a breach of fiduciary duty," "procuring a breach of fiduciary duty," or "tortious interference with a fiduciary relationship," Georgia law authorizes a plaintiff to recover for such a claim against third parties.[4] These third parties eventually settled with ITI, but specifically excluded Brewer from the settlement agreement and mutual release.

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[3] The Court affirmed dismissal of the breach of fiduciary claims against the employee's newly formed company because it owed no fiduciary duty to the employer, distinguishing, Insight Technology v. FreightCheck, 280 Ga. App. 19, 633 S.E.2d 373 (2006) where the competing entity was alleged to have aided and abetted the employee's breach of fiduciary duty.

[4] See generally Insight Technology, Inc. v. FreightCheck, LLC, supra.

The jury found Brewer liable for breach of fiduciary duty and misappropriation of corporate opportunity, and the trial court entered a judgment for $395,000 in compensatory damages, $650,000 in punitive damages and $355,000 in attorney fees. On appeal, Brewer argued, among other things, that the trial court incorrectly charged the jury on the definition of "corporate opportunity." Citing Southeast Consultants v. McCrary Engineering Corp., 246 Ga. 503 (1980), the trial court had defined "corporate opportunity" as "a business opportunity which a corporation is financially able to undertake, is in the same line of business as the corporation's business, is of practical advantage to the corporation, and is one that the corporation has an interest or reasonable expectancy in." Brewer argued that the court should have applied the principle recognized in McCrary, requiring a corporation's interest or expectancy to be "a beachhead in the sense of a legal or equitable interest or expectancy growing out of a preexisting right or relationship." The Court of Appeals disagreed, holding that the "beachhead" requirement only applies in cases of misappropriation of corporate opportunity by *former* officers, not current ones.

Brewer also argued that the trial court erred in refusing to limit the punitive damages award to the $250,000 statutory cap set forth in O.C.G.A. § 51-2-5.1(f) and (g). However, relying on the language of the statute that allows for the cap to be lifted where the trier of fact finds that the defendant acted with specific intent to cause harm, the Court of Appeals held that the evidence supported the jury's finding of specific intent to harm the corporation and upheld the punitive damages award. Finally, Brewer argued that the trial court erred in refusing to set off the monetary settlement between ITI and the third parties against the jury award against him for the attorney fees and punitive damages. The Court held that because Brewer had been specifically excluded from the settlement agreement and release, and because punitive damages serve to punish the defendant and not to compensate the victim, there was no error in the trial court's decision refusing to set off the settlement amount.

Wachovia Insurance Services, Inc. v. Fallon, 299 Ga. App. 440, 682 S.E.2d 657 (2009) – Former officer of Georgia corporation does not owe fiduciary duties not to compete after departure.

Wachovia Insurance Services, Inc. ("Wachovia") acquired Hamilton, Dorsey & Alston Company ("HDA"), an insurance brokerage firm in 2001, obtaining non-competition agreements from the sellers. One of HDA's former owners took a position as an officer of Wachovia, but left in 2007 to form his own employee benefits firm, which began business the day after his employment at Wachovia terminated. When he began to solicit former customers and hired several Wachovia employees, Wachovia sued, asserting claims under a non-solicitation and confidentiality agreement that he signed three years after the HDA acquisition, claims for violation of the Georgia Trade Secrets Act, claims for breach of fiduciary duty and tortious interference with contractual relations. The Court affirmed summary judgment against Wachovia. It found the non-solicitation agreement overly broad and unenforceable, rejecting Wachovia's argument that it should be "blue-penciled" because it related to the HDA acquisition. The claims for violations of the Georgia Trade Secrets Act failed in part because most of the information on Wachovia's employee benefits and customers was available on the public website "freeERISA.com." The Court found no basis for any breach of the former officer of fiduciary duties because the "undisputed evidence" showed that he did not engage in any of

the alleged misconduct until after his departure. The Court conducted an extensive review of the record, involving Blackberries, customer cards and electronic copies of brochures, and affirmed summary judgment on the other claims for lack of any supporting evidence.

Eayrs v. Absolute Roofing, Inc., 300 Ga. App. 825, 686 S.E.2d 432, (2009) – Corporate employee held not liable for corporate obligations where clearly acting as agent of a disclosed principal, despite lack of reference to corporate status in contract.

In this case, Allan F. Eayrs, a property owner, sued Absolute Roofing, Inc., a roofing contractor and Don T. Harris, its employee, for breach of contract to repair a roof. The Court of Appeals affirmed the trial court's award of the summary judgment to the employee, because the employee was the agent of a disclosed principal and thus could not be held personally liable. The plaintiff hired Absolute Roofing to work on his roof. Harris drafted and signed Absolute Roofing's contract, and plaintiff wrote the check to Absolute Roofing. Eayrs contends that the trial court erred in dismissing Harris from the case because the contract did not show Absolute Roofing to be a corporation, because Eayrs was unaware that Absolute Roofing was a corporation and because he believed he was dealing with Harris as an individual. The Court of Appeals did not find any error in the trial court's ruling because under "OCGA 10-6-23, if the principal is disclosed and the agent professes to act for him, the form in which the agent acts is immaterial and the act will be held to be the act of the principal." The Court found no evidence showing that Harris held himself out to be doing business as an individual. Instead, all the evidence showed that Absolute Roofing was disclosed as the principal in this transaction, and it was irrelevant whether Absolute Roofing's corporate status was referred to in the contract.

HRH Architects, Inc. v. Lansing, 2009 WL 1421217 (N.D. Ga. Apr. 2, 2009) – Liability of corporate officers for copyright infringement.

An architectural firm employed to provide building designs for an office park development sued the real estate developer for unauthorized use of its copyrighted architectural plans on other projects. In denying motions for summary judgment, the Court provided a useful summary of the standards recognized in the 11th Circuit for corporate officers' direct and vicarious personal liability for copyright infringement. For direct liability constituting participation in the infringement, the Court cited Babbit Electronics, Inc. v. Dynascan Corp., 38 F.3d 1161, 1184 (11th Cir. 1994):

> "[A] corporate officer who directs, controls, ratifies, participates in, or is the moving force behind the infringing activity, is personally liable for such infringement without regard to piercing the corporate veil."

For vicarious liability, the Court cited Southern Bell Telephone & Telegraph Co. v. Associated Telephone Directory Publishers, 756 F.2d 801, 811 (11th Cir. 1985):

> "[a]n individual, including a corporate officer, who has the ability to supervise infringing activity and has a financial interest in that activity, or who personally participates in that activity is personally liable for the infringement . . . . . Liability falls on [such individuals] even if they were ignorant of the infringement."

B. CORPORATE STOCK OWNERSHIP AND RIGHTS.

Fernandez v. WebSingularity, Inc., 299 Ga. App. 11, 681 S.E.2d 717 (2009) – Issues of fact found as to acceptance of subscription agreement inconsistent with oral representations, but Georgia Securities Act claims held to be barred.

A shareholder filed suit against a corporation and its officers, asserting claims for money had and received, breach of agreement to rescind, conversion, and violation of the Georgia Securities Act. The shareholder alleged that one of the officers solicited him to invest money in the corporation, while it was still in formation, in exchange for one-third of the issued and outstanding stock. After the corporation was formed, the shareholder received documents and a request for payment, and he wired the discussed amount into the corporation's account. Later, he learned that the subscription agreement provided that his purchase was for a much lower percentage of the stock, not one-third. The defendants denied liability, relying on the subscription agreement he had signed. The subscription agreement provided that the shareholder would receive an ownership percentage of only approximately 8.16 percent. The shareholder argued that the subscription agreement was merely an offer, which he revoked prior to acceptance by the defendants. This issue turned on the date on which the defendants accepted his subscription, and the court found that this was a genuine issue of material fact that required evidentiary proof, and the defendants were not entitled to summary judgment.

The disclosure in the subscription agreement, however, sufficed to bar the shareholder's claims under the Georgia Securities Act. Those claims were governed by the Georgia Securities Act of 1973, not the Georgia Uniform Securities Act of 2008, which became effective July 1, 2009. The shareholder claimed that he relied on misrepresentations by one of the officers that he would be purchasing one-third of the common stock, which violated O.C.G.A. § 10-5-12(a)(2). The shareholder relied on Meason v. Gilbert, 236 Ga. 862, 226 S.E.2d 49 (1976) for his argument that the Georgia Securities Act claim survived his execution of the subscription agreement showing that he was not purchasing a one-third interest. In Meason, the plaintiff complained that he had been induced to purchase securities because of fraudulent misrepresentations. Despite the presence of an integration clause in the stock purchase agreement in Meason, the Supreme Court of Georgia ruled in favor of the plaintiff, reasoning that "[t]o allow a purchaser to waive by contract at the time of purchase all violations of the Securities Act would eviscerate the very protections afforded by the statute and such a purported waiver would be void and of no effect." Id. at 863. The Court of Appeals distinguished Meason because it was decided under an earlier version of the Georgia Securities Act. The 1973 Georgia Securities Act provision relied upon by the shareholder, O.C.G.A. § 10-5-12(a)(2), stated that a person who violates it is not liable if the purchaser knew of the untrue statement. Because the shareholder had received and executed the subscription agreement, which provided that he was only purchasing approximately 8.16 percent of the company, the Court held that he knew that the statements made by the officer were untrue. Thus, he was not entitled to recover for the alleged violation of O.C.G.A. § 10-5-12(a)(2). The result should be the same under the Georgia Uniform Securities Act of 2008, since O.C.G.A. § 10-5-58(b) similarly requires that the plaintiff lack knowledge of the untruth of alleged misrepresentations.

Golden Atlanta Site Development, Inc. v. Nahai, 299 Ga. App. 646, 683 S.E. 2d 166 (2009) – Blue sky law definition used to decide whether a transaction was a loan or investment for usury purposes.

As a matter of first impression, the Court of Appeals looked to the blue sky law definition of "investment contract" to determine whether a transaction was a loan or an investment for purposes of a usury defense. The investor had entered into an agreement with a corporation to purchase a share of interest in commercial property to be developed by the corporation. She agreed to invest $100,000, and the corporation promised a return on her investment in the amount of $165,000, or if the payment were not made within 12 months, the corporation promised to transfer the property to the investor. Under these facts, the Court held that the agreement could constitute an investment, and was not a loan. Because the existence of a loan was an essential element of the corporation's usury claims, the Court held that the usury laws did not apply to the transaction.

BDI Laguna Holdings, Inc. v. Marsh, 301 Ga. App. 656, 689 S.E.2d 39, (2009) – Employment agreement with merger clause bars prior promises of stock incentives and subsequent promises lack consideration.

When Charles Marsh was recruited to join BDI Distributors, Inc. to help grow the company and make it attractive to potential buyers, BDI's majority shareholder allegedly promised Marsh a "stock commission" of between 8% and 15% of BDI's stock in the event of the sale of the CEO's interest in the company. In 1999, Marsh entered into a five-year employment agreement that made no mention of the stock commission agreement. The agreement stated that incentive compensation might be paid in the "sole and absolute discretion" of the CEO, and contained a merger clause superseding all prior discussions and agreements. Three years later an investor group proposed an investment and merger. The investors wanted management employees to own stock, so the existing BDI stockholders entered into an agreement to contribute shares with which to make the distribution. That agreement contained a provision denying third party beneficiary rights. Marsh was not a party to the agreement, but the CEO sent him a letter notifying him that the shareholders had agreed to make Marsh a 2% owner. After a restructuring and change in management, Marsh was offered, instead, only an opportunity to purchase stock options. Marsh left the company at the end of the five-year term of his employment contract and sued to recover the stock incentives promised him. The trial court granted a directed verdict against Marsh as to his stock commission claim. The jury found for Marsh on his 2% incentive stock claim and he was awarded $1,577,660 for the value of the stock he did not receive. The Court of Appeals ruled against Marsh on both claims, affirming the directed verdict and reversing the jury verdict.

As to the stock commission claim for from 8% to 15% of the company, the Court found that it was barred by the merger clause in his employment agreement. It also found the CEO's promise not sufficiently definite to be enforceable, because Marsh admitted that neither he nor the CEO could have predicted what the sale price would be or what percentage of stock he would receive. The discussions and letter promising to award him 2% of the company's stock was held unenforceable because it lacked consideration, because it was not contained or referred to in his

employment agreement, he did not agree to provide additional services and no return promise was required. The Court noted that the employment agreement already obligated Marsh to devote his entire working time, attention, skill and energies exclusively to the Business of the Company."

> Therefore, Marsh's continued service to BDI Distributors and its affiliate BDII, was part of his original employment contract, and it could not serve as an additional obligation he performed in exchange for the promise of stock.

On rehearing, the Court added that the investors' desires that management employees become stockholders was not a condition to their investment and the merger, the merger agreement did not identify him as a recipient of stock or provide what he was to receive and the stockholders agreement (which did) expressly renounced third-party beneficiary rights. Thus the promise to award him 2% in stock, as opposed to the later stock option offer, was a matter of the CEO's discretion and did not represent consideration for the merger.

<u>Capital Health Mgt. Group, Inc. v. Hartley</u>, 301 Ga. App. 812, 689 S.E.2d 107 (2009) – Standards for discretionary corporate decision as to award of stock appreciation rights.

The plaintiff in this case, sued her former employer for breach of a stock appreciation rights ("SAR") agreement when she took her position as chief operating officer of the company. The agreement provided that the plaintiff was entitled to be paid the value of 60,000 shares of the company's stock upon the sale of the company, if she was still employed by Capital Health at the time of the sale, or if she had been terminated as a result of death, retirement, or disability. The SAR agreement further provided that the compensation committee of the board of directors was authorized to interpret and make "determinations" under the agreement in its "sole discretion." The company discharged the plaintiff after she contracted fibromyalgia and became unable to perform her duties. Four years after her termination the company was sold, but the plaintiff did not receive payment under the SAR agreement. The company contended, instead, that her employment had been terminated as a result of an internal corporate reorganization. The company appealing from an adverse jury verdict awarding the plaintiff the payment due under the agreement, interest and attorney's fees. Because the SAR agreement did not give the company absolute and uncontrolled discretion, the standard for abuse of a corporate discretionary decision-making authority was whether the decision was made "in good faith and involved the exercise of honest judgment." The Court of Appeals rejected the company's argument that the issue of abuse of discretion was a legal question. It decided that ERISA decisions and decisions under the common law of trusts were inapplicable because ERISA did not apply and the case did not involve administration of a trust. It held that the SAR agreement was "nothing more than a contract for deferred compensation" suitable for jury resolution. The Court also found a basis for contending that the company had acted in bad faith and its decision involved an "improper pecuniary motive," referring to participation in the decision by one of the principal shareholders of the company, who personally benefited from the denial of the plaintiff's benefits under the SAR agreement.

Clark v. Chapman, 301 Ga. App. 117, 687 S.E.2d 146 (2009) – Injunction against transfer of assets by corporate officer after levy on stock.

A judgment creditor of the sole owner of a corporation sought to enforce his judgment by obtaining an order to levy on the owner's stock and an injunction against any transfer of the stock by the owner. After the owner surrendered the stock, but before the sheriff's sale, the owner, acting as an officer of the corporation, transferred some cash and some land in South Carolina to himself. After purchasing the stock at the sheriff's sale, the creditor sought and obtained an order requiring the judgment debtor to render an accounting for corporate expenditures, return any personal property belonging to the corporation and reconvey the real property. In rejecting the judgment debtor's arguments that the trial court lacked jurisdiction over the property of the corporation, the Court of Appeals noted that trial courts have inherent authority to enforce their orders and grant complete relief. The judgment debtor argued that he had fully complied with the order to surrender the stock and not to transfer any interest in it and that the order did not prohibit a transfer of corporate assets. In rejecting that argument, rather than resort to possibly applicable provisions of the Georgia Business Corporation Code or common law relating to corporate officers' duties, misappropriation of corporate assets and self-dealing, the Court used very broad language effectively equating the owner's stock and the corporation's property:

> Stock certificates have no value in themselves; the paper certificates alone cannot satisfy a judgment. Rather, their value lies in the ownership interest represented by the certificates. "Stock is the capital of corporations, which is usually divided into shares of definite value; and the owner of stock is the owner of an interest in the property of the corporation." (Citations omitted.) *Ga. Power Co. v. Watts,* 184 Ga. 135, 190 S.E. 654 (1937). We conclude, therefore, that in ordering Clark to deliver all CLD stock to the sheriff, the trial court, in effect, transferred ownership of all corporate property into the court.
>
> . . . Accordingly, once Clark delivered the corporate stock to the sheriff, he no longer held ownership or control of the corporate assets, and although he was a corporate officer, he had no authority to transfer corporate assets without leave of the trial court.

By contrast, in other decisions the courts in 2009 have strongly emphasized the distinction between corporations and their owners. Compare EnduraCare Therapy Management, Inc. v. Drake, 298 Ga. App. 809, 681 S.E.2d 168 (2009) (separateness of parent and subsidiary); Otero v. Vito, 2009 WL 3063426 (M.D. Ga. Sept. 22, 2009) (No reverse piercing of the corporate veil). While those decisions dealt with liabilities, rather than assets, and the separateness of corporations and owners, rather than shares in a corporation and the corporation's property, the underlying principles applied in these cases appear inconsistent with the decision in Clark v. Chapman.

<u>Kelley Manufacturing Company v. Martin</u>, 296 Ga. App. 236, 674 S.E.2d 92 (2009) – ESOP participants held entitled to shareholders' rights to inspect corporate books and records.

In a matter of first impression in Georgia, the Court of Appeals, following precedent from other states, has decided that employee stock ownership plan participants are shareholders within the meaning of the definitional section of the Georgia Business Corporation Code, O.C.G.A. § 14-2-140(27) and the Code's provisions concerning shareholder rights to inspect corporate books and records. In the case before it, the Kelley Manufacturing Company ESOP owned 100% of the stock of the Company and was the registered owner of the stock, and the ESOP participants' accounts reflected shares vested. The participants in question were a former chief executive officer and a former president of the Company and had both been trustees of the ESOP. The former CEO had the largest single account in the ESOP. They had both been terminated and removed from these positions as a result of a dispute with the retired part owner of the Company. The Court ruled that the participants should be regarded as shareholders for purposes of inspection rights. The Court did not limit or even tie its holding, however, to the specific facts before it, but focused instead on the participants' position as beneficial or equitable owner of the shares. In other rulings, the Court held that the participants' state statutory inspection claims were not preempted by ERISA because they were not seeking to enforce rights or benefits under ERISA and it held the participants' stated purposes to be proper:

> "Maxwell and Martin sought inspection to enforce KMC's bylaws by ensuring proper corporate governance and determining if corporate waste, mismanagement, and other breaches of fiduciary duty were occurring; to inspect corporate records to protect their substantial ownership interest as well as the interest of other shareholders; and to inspect records related to their removal as trustees, directors, officers, and employees of KMC. The trial court found these to be proper purposes, and we agree."

296 Ga. App. at 241.

C. <u>NONPROFIT CORPORATIONS</u>.

<u>The Victory Drive Deliverance Temple, Inc. v. Jackson</u>, 298 Ga. App. 563, 680 S.E.2d 588 (2009) – Nonprofit corporation law: Dismissal held proper where suit to remove pastor was filed by improperly constituted board of directors.

The original board of directors of a church incorporated as a Georgia nonprofit corporation consisted of five members. After the death of one of the original members, two of the remaining members sought to reconstitute the board, appointing three other members, and purported to terminate the pastor's employment. When the pastor refused to leave, the five board members filed suit on behalf of the church to remove him. The church was named as plaintiff and was alleged to be suing "by and through its Board of Directors." The pastor moved to dismiss, contending that the three new members were not board members and could not act on behalf of the church and the actions of board were unauthorized for lack of a quorum. The five plaintiffs signed a consent action in lieu of a meeting to ratify the election of the three new members. In the meantime, the church held a meeting of its membership at which an entirely

new board was elected. Affirming dismissal of the case, the Court of Appeals held that the three newly elected directors "cannot sign as directors to ratify an action making themselves directors." The church's articles of incorporation required presence of a majority of the board to constitute a quorum for the purposes of conducting business at a board meeting, and the Court held that "two of four directors do not constitute a majority." Thus the consent action was insufficient to raise an issue of fact as to the standing of the plaintiffs to sue on behalf of the church. The Court's opinion does not discuss any of the provisions of the Georgia Nonprofit Corporation Code, nor does it refer to the suit as a derivative action. O.C.G.A. § 14-3-741 permits "any director" to sue derivatively on behalf of a Georgia nonprofit corporation so long as the director was serving on the board at the time of the act or omission complained of "or is a director . . . at the time the proceeding is commenced" and so long as the director "fairly and adequately represents the interests of the corporation in enforcing the right of the corporation." If the two existing director/plaintiffs had sought to sue using the statutory derivative action procedures, they would not have needed a quorum or action by the board. A director seeking to sue derivatively would be subject to the demand requirement of O.C.G.A. § 14-3-742, but an exception is made if "irreparable injury to the corporation would result by waiting for the expiration of the 90 day period."

D. PARTNERSHIP LAW DEVELOPMENTS.

J.T. Turner Construction Co. v. Summerour, 301 Ga. App. 323, 687 S.E.2d 612 (2009) – General partners held personally bound by default judgment against partnership.

The plaintiff obtained a default judgment against SWI Partners ("SWI"), a general partnership, and one of its partners. The plaintiff then filed a second lawsuit against two other SWI partners, alleging that they were jointly and severally liable for the judgment against SWI. The trial court denied the plaintiff's motion for summary judgment, holding that the plaintiff was required to present a prima facie case and prove the elements of the claims alleged in its complaint against defendants in the original suit.

On interlocutory appeal, the Court of Appeals noted that individual assets of partners in a general partnership are not bound unless the partners themselves are personally served with process and "have their day in court," but they are still subject to suit on the partnership's debt, even if they were not parties to the original suit. The question presented was thus what proof is required in a subsequent suit to bind a partner's individual assets when the partner was not served in the previous suit brought against the partnership.

Relying on Lamar-Rankin Drug Co. v. Copeland, 7 Ga. App. 567, 67 S.E. 703 (1910), the Court held that three elements must be proven before a partner served in a subsequent lawsuit can be held individually liable for a prior judgment rendered on a general partnership debt. First, the plaintiff must prove that the individual sued was a general partner of the partnership; second, that the indebtedness of the partnership was established; and third, that the indebtedness sued upon was the identical indebtedness upon which the former suit against the partnership was based. Because the plaintiff conclusively proved all three elements here, the Court held that he was entitled to judgment as a matter of law. The Georgia Court of Appeals reversed, finding that

the two SWI partners had "had their day in court," because there was no dispute that they were jointly and severally liable for all obligations of SWI and those obligations had been established on the merits – by default – in the prior proceeding, and they did not contest the validity of the judgment as to the partnership. Under those circumstances, they were not entitled to defend themselves by re-litigating the partnership's liability.

The upshot of the case is that a general partner who has not been served in litigation against the partnership, but believes that the partnership has viable defenses to liability, is not safe to stand on the sidelines in hopes of raising those defenses later after a judgment is rendered against the partnership and the judgment creditor sues the partner to collect on the judgment.

Asgharneya v. Hadavi, 298 Ga. App. 693, 680 S.E.2d 866 (2009) – Wrongful termination of oral partnership.

This appeal followed a bench trial of claims by one partner against the other for wrongfully terminating their partnership, freezing him out and misappropriating the partnership's business. The trial court found in favor of the claimant, awarding lost profits and attorney's fees. The Georgia Court of Appeals affirmed, ruling that the issues raised on appeal were largely factual ones and that the evidence supported the trial court's findings. Javad Hadavi and Asghar Asgharney entered into an oral partnership agreement to conduct a check-cashing business on the premises of a convenience store. After disagreements developed in their efforts to operate the business jointly, they modified their agreement to operate it separately on an alternating-month basis, each entitled to the profits from the months he conducted the business. As part of the modification, they closed a joint bank account. The convenience store owner agreed to the arrangement. After a few months of alternating operations, Asgharney, with the assistance of the convenience store owner, took advantage of Hadavi's absence from the country to board up the check-cashing booth and began to conduct business from space next to the register, soliciting the check-cashing customers that Hadavi was attempting to serve. The convenience store owner refused Hadavi's rent check, presented him a letter from Asgharney's attorney declaring the partnership had been terminated and evicted Hadavi. The Court of Appeals affirmed trial court's factual finding that the modification of the original oral partnership agreement did not constitute a novation that terminated the partnership. The Court rejected the argument that the partnership agreement was unenforceable because it lacked an agreed-upon date for termination of the partnership. A partnership of indefinite duration formed by oral agreement is terminable at will by either partner, but not unenforceable. The Court cited and quoted Artford v. Blalock, 199 Ga. App. 434, 437-38, 405 S.E.2d 698 (1991):

> Any partnership agreement includes, as a matter of law, an agreement for each partner to act in "the utmost good faith" toward the other partner. See OCGA § 23-2-58. The power of a partner to dissolve the partnership at will, like any other power held by a fiduciary, must be exercised in good faith. A partner may not "freeze out" a co-partner and appropriate the business to his own use. A partner may not dissolve a partnership to gain the benefits of the business for himself, unless he fully compensates his co-partner for his share of the prospective business opportunity.

In affirming the trial court's damages award, the Court cited without discussion O.C.G.A. § 14-8-38(b)(1)(B), which provides that "[e]ach partner who has not caused dissolution wrongfully shall have . . . [t]he right, as against each partner who has caused the dissolution wrongfully, to damages for such wrongful dissolution." The Court also affirmed the award of attorney's fees, finding that there was sufficient evidence of bad faith on Asgharney's part.

Morris v. Nexus Real Estate Mortgage and Investment Company, 296 Ga. App. 477, 675 S.E.2d 511 (2009) – Charging orders against partnership interests under O.C.G.A. § 14-8-28.

In this case, the Georgia Court of Appeals addresses the procedure under O.C.G.A. § 14-8-28 through which a judgment creditor by obtaining a "charging" order can recover from the partnership interest of a judgment debtor. The plaintiff had obtained her judgment in 1994 and filed her action under § 14-8-28 in 2000. The partnership interest had been transferred from the deceased judgment debtor's estate to two officers of a corporation that the judgment creditor had sued unsuccessfully to set aside a transfer. The trial court dismissed the case on summary judgment as barred by the four-year statute of limitations for fraudulent transfers and by *res judicata* as to the two officers. The Court of Appeals reversed, holding that the statute of limitations was not applicable to a claim under § 14-8-28, and that the officers were not in privity with the corporation for purposes of *res judicata* and also that they were sued under § 14-8-28 as assignees of the partnership interest, not as officers of the corporation and that the purpose of the suit was to charge the assigned interest and not to set aside the assignment.

E. LIMITED LIABILITY COMPANY DEVELOPMENTS.

Murphy v. McMaster, 285 Ga. 622, 680 S.E.2d 848 (2009) – Interlocutory injunction against violation of LLC member's management rights under operating agreements properly denied since member could recover damages and had an adequate remedy at law.

The plaintiff and defendant were the sole members of four limited liability companies, each of which served as a general partner of a limited partnership owning an apartment complex. The operating agreements allegedly gave the plaintiff the exclusive right to manage the properties, which he asserted that the defendant was violating. The Supreme Court affirmed the denial of an interlocutory injunction on the grounds that the contracts were for the provision of personal services, for which the defendant could be held liable in damages, and under O.C.G.A. § 9-5-7 courts will not enjoin violations of personal services contracts unless the services are of "peculiar merit or character and cannot be performed by others." In addition, the plaintiff had not sued for dissolution or appointment of a receiver and the only financial damage claimed was the loss of funds to the plaintiff's management company and potential loss of collateral for an alleged security interest. Under these circumstances the Court agreed with the trial court that the plaintiff had an adequate remedy at law and affirmed the denial of the injunction.

Ledford v. Peeples, 568 F.3d 1258 (11th Cir. 2009) – Disclosure obligations in purchasing LLC membership interests pursuant to a buy-sell agreement.

The 11th Circuit, in a 55-page opinion, affirmed the district court's summary judgment on securities fraud, common law fraud and aiding and abetting breach of fiduciary duty claims arising out of the purchase of a limited liability company membership interest pursuant to a mirror-image buy-sell agreement. The plaintiffs supplied the financing and invested in the LLC, Signature Hospitality Carpets, LLC, a carpet manufacturer, through an LLC of their own, DynaVision Group, LLC, which owned 50% of the membership interest in the company. The remaining 50% was owned by three members who ran the company's operations (the "Active Members"). The operating agreement's buy-out provisions permitted either DynaVision or the Active Members to set a buy-out price and give notice to the other side, who then had thirty days within which to decide whether to purchase or sell at that price. The parties owned the real property on which Signature's manufacturing plant was located through a separate company, which leased the property to Signature. The litigation concerned two transactions – the first was a refinancing of Signature's bank debt, in which the bank required the property to be transferred to Signature to serve as collateral. DynaVision's principals claimed that they had been deceived into executing the warranty deed transferring the property, that the Active Members had a duty to disclose the transfer and that they breached their fiduciary duties by failing to disclose it. The second transaction was the Active Members' presentation of notice under the buy-sell provision and the purchase of DynaVision's interest in Signature, without disclosing and falsely denying that they were backed by a lender who had previously expressed an interest in purchasing the entire company. The plaintiffs' claims against the Active Members were litigated and lost in Ledford v. Smith, 274 Ga. App. 714, 618 S.E.2d 627 (2005). In the course of that litigation the Plaintiffs freely admitted that, once they received notice under the buy-sell agreement, they had no choice but to sell, because they were not able to operate the business or find anyone who could do so. Thus, they were in no position to purchase the Active Members' interests. The federal suit was a separate case that the Plaintiffs brought against the Active Members' lender.

After an extended review and analysis of the factual record, the 11th Circuit Court of Appeals held that there was no underlying breach of fiduciary duty and no violation by the Active Members of their duties under O.C.G.A. § 14-11-305, with respect to either the refinancing and property transfer or the lender's undisclosed backing of the Active Members' purchase of the plaintiffs' membership interest. As to the buy-out, the Court of Appeals held that "[s]uch a disclosure is not required by Georgia common law, the Limited Liability [Company] Act, the Operating Agreement or Rule 10b-5." 568 F.3d at 1311. It noted that DynaVision had the right to equal representation on Signature's Board, and the Board had to approve all of Signature's actions. It also found in the right of first refusal provisions of the Operating Agreement a right to negotiate with their lender in secret. Id. at 1312. The Court also agreed with the Georgia Court of Appeals and the district court that there was no causative relationship between the statement regarding the buy-out that the Active Members were "doing it on our own" and DynaVision's decision to sell, since DynaVision had concluded that it would be unable to operate the company if it purchased the Active Members' interest. 568 F.3d at 1311.

F. OTHER FORMS OF BUSINESS ORGANIZATION.

Techbios, Inc. v. Champagne, 301 Ga. App. 592, 688 S.E.2d 378 (2009) – Reversal of dismissal of claim for breach of teaming agreement to share business opportunities.

In what is apparently a case of first impression, the Court of Appeals addressed claims based on the alleged breach of a "teaming agreement" between a technology industry staffing consultant and a client to identify business opportunities for their mutual benefit. The complaint alleged that after the plaintiff, Techbios, Inc. placed the defendants with an Atlanta hotel company, the defendants failed to disclose and share technology business opportunities with the hotel company that could have been profitable for Techbios. The trial court dismissed Techbios' claims for fraud, breach of contract, breach of the covenant of good faith and fair dealing and breach of a private duty under O.C.G.A. § 51-1-8, which provides:

> Private duties may arise from statute or from relations created by contract, express or implied. The violation of a private duty, accompanied by damage, shall give a right of action.

The Court of Appeals reversed, holding that the complaint stated a claim upon which relief could be granted as to each theory of recovery.

The opinion does not discuss the terms of the teaming agreement or the nature and structure of the relationship created, apparently because the agreement was not attached to the complaint. There is no mention of joint venture, partnership or fiduciary principles. Teaming agreements can be used to enable companies to pursue business opportunities together while avoiding the creation of a new entity or sharing ownership, control, profits and losses and liabilities. See, e.g., Combined Energies v. CCI, Inc., 628 F. Supp. 2d 226 (D. Me. 2009) (disclaiming agency, partnership, common ownership and control). The Court did state that Techbios might be able to introduce evidence that its relationship was a "special or confidential relationship" sufficient to give rise to a "private duty" under O.C.G.A. § 51-1-8, but it did not elaborate on what evidence would be needed for that purpose or what provisions the teaming agreement at issue would need to contain.

G. TRANSACTIONAL CASES

A&B Blind & Drapery Company, Inc. v. B&B Glass and Storefronts, Inc., 298 Ga. App. 210, 679 S.E.2d 782 (2009) – Purchaser's remedies for breach of asset purchase agreement affected by failure to conduct due diligence.

In a suit by the seller of corporate assets to collect on a promissory note given by the purchaser, the purchasers counterclaimed for breach of warranties under the asset purchase agreement claiming that the seller had overstated receivables and understated payables. The purchasers claimed that they had agreed to a price based on a multiple of annual net income and the misrepresented financials exponentially reduced the value of the business. The asset purchase agreement provided for a right of set-off for any liabilities of the seller, but also stated that in the event of a breach "the other party shall have the right to invoke any remedy allowed at law or in equity; reference to any particular remedy shall not preclude the exercise of any other remedies, all of which being cumulative." After a bench trial, the trial court allowed certain set-offs, reducing principal due on the promissory note on a dollar-for-dollar basis, but denied the purchaser any other relief and granted judgment for the balance of the note. The trial court found, and the Court of Appeals agreed, that the purchasers were not entitled to any additional

damages for diminution in value of the business because the purchasers failed to exercise due diligence to discover the discrepancies. The Court noted that the purchasers were sophisticated and experienced in purchasing businesses and had failed to review the seller's records adequately despite knowing that the seller did not maintain a general ledger or use a computer system. The Court did not explain how the purchasers' failure to exercise due diligence related to its rights under the contract, except to note that the trial court had found the specific contractual set-off provision provided the purchasers an adequate remedy at law.

<u>Corey v. Clear Channel Outdoor, Inc.</u>, 299 Ga. App. 487, 683 S.E.2d 27 (2009) – Covenant not to compete in asset purchase agreement enforced.

In selling its billboard assets to Clear Channel Outdoor, Inc. from Corey Media, Inc., its owner William Corey agreed to a non-competition clause prohibiting him from competing with Clear Channel in the billboard business in Atlanta for two years and not to interfere with Clear Channel's properties for five years. The provision obligated Corey to take reasonable steps to prevent Corey Media's affiliates, officers and directors from competing, as well. The agreement allocated $2,000,000 as consideration for the covenant not to compete. Shortly before the sale was completed, Corey's in-house counsel set up a new company, ostensibly to be owned by another individual. Clear Channel provided evidence that Corey funded the new company and ran it from his office using his employees. The new company purchased nine billboards in the Atlanta area within the two year non-compete period.

In defense to Clear Channel's claims, Corey claimed that Clear Channel was suing him because of a bid protest Corey lodged when not awarded an Atlanta airport advertising concession and to make an example of him to others with whom Clear Channel did business. He counterclaimed, contending that Clear Channel's motives violated an implied obligation of good faith and fair dealing it owed him as part of the non-compete agreement. The trial court dismissed the counterclaim on the ground that Clear Channel's only obligation with regard to the non-compete was the payment of money. The Court of Appeals reviewed prior precedent involving implied covenants of good faith and fair dealing. While not expressly approving the trial court's reasoning, the Court of Appeals held that the contract did not create an implied duty not to sue Corey. It noted that Corey did not claim that he did not violate the non-compete clause, that the evidence was insufficient or that the contract was unenforceable. His only claim could be for abusive litigation, which was premature. The Court held that Clear Channel's motivation for filing suit was irrelevant to any issue in the case and also affirmed the exclusion of all evidence regarding the bid protest.

<u>McKesson Corporation, et al. v. Green, et al.</u>, 299 Ga. App. 91, 683 S.E.2d 336 (2009) – Selling shareholders in stock-for-stock merger held unable to recover for misrepresentations that overvalued their own stock.

In this case several former shareholders of HBO & Company ("HBOC") sued McKesson Corporation, HBOC and two officers for common law fraud to recover losses they incurred when the stock of McKesson they received in the merger declined in value following discovery of

improper pre-acquisition revenue recognition at HBOC.[5] They contended that the joint prospectus issued in connection with the merger was materially misleading and they relied on it in voting for the merger and participating in the stock-for-stock exchange rather than selling their shares for cash. Following a decision dismissing federal securities laws claims by HBOC shareholders, In re McKesson HBOC, Inc. Securities Litigation, 126 F. Supp. 2d 1248 (N.D. Cal, 2000), the Court of Appeals held that the alleged misrepresentations were not material to an HBOC shareholder because their stock was artificially inflated in value and, if they truth had been known, they would have voted for the merger rather than sell their shares in a depressed market. For the same reason, the Court held, the alleged misrepresentations did not cause the plaintiffs' losses. In the process, the Court applied the standard of materiality adopted in TSC Industries v. Northway, Inc., 426 U.S. 438, 96 S. Ct. 2126, 48 L. Ed. 2d 757 (1976) for violation of proxy rules under the Securities Exchange Act of 1934, defining materiality in terms of a substantial likelihood that a reasonable shareholder would consider the information important in deciding how to vote.

Summit Automotive Group, LLC v. Clark, 298 Ga. App. 875, 681 S.E.2d 681 (2009) – No action in tort permitted under Georgia Bulk Sales Act against transferee.

In this action, automobile purchasers sued a dealership for failure to honor its agreement to pay off the loans on their trade-ins and to obtain the gap insurance, extended warranty and life insurance policies they had purchased. After suit was filed the dealer entered into an asset purchase agreement with a newly-formed entity, Summit Automotive Group, LLC to sell the dealership. Summit became aware of the litigation, a related cease and desist order issued by the Governor's Office of Consumer Affairs, and a stipulated Assurance of Voluntary Compliance entered into to comply with the order that required payment of the plaintiffs' liens and restitution. The plaintiffs added Summit to the case and attempted to assert claims under the Georgia Bulk Transfer Act, O.C.G.A. § 11-6-101 *et seq.* The Court affirmed the trial court's summary judgment on those claims, relying on prior authority and holding that the Bulk Transfer Act does not permit direct actions in tort against the transferee, but provides a remedy to creditors *in rem* against the transferred goods.

H. LITIGATION ISSUES.

1. Director and Officer Liability Litigation.

Lubin v. Skow, 2009 WL 4641761 (N.D. Ga. Nov. 30, 2009) – Claims for mismanagement of failed bank belong to its receiver, not bankruptcy trustee for bank holding company.

The Chapter 7 Bankruptcy Trustee for Integrity Bancshares, Inc. filed suit against the former officers and directors of its subsidiary Integrity Bank, which had been closed by the Georgia

[5] In prior litigation, McKesson had sued these former HBOC shareholders for unjust enrichment. See McKesson Corporation v. Green, 279 Ga. 95, 620 S.E.2d 54 (2005).

Department of Banking and Finance and placed into receivership.[6] The Federal Deposit Insurance Corporation intervened, asserting exclusive ownership of the claims under 12 U.S.C. § 1821(d)(2)(A)(i). The Court described the Trustee's claims:

> The Debtor raised the capital necessary to operate the Bank through stock offerings and bond issuances. The gravamen of Plaintiff's claims against Defendants is that they harmed the Debtor holding company and imperiled the capital provided to the Bank by negligently managing the Bank's operations and thus breaching their fiduciary duty to the Debtor. The Trustee contends that the Bank's lending practices were deeply flawed. The Trustee alleges that the bank: made loans for speculative land development projects with no projected income stream; made several loans outside of the Bank's primary geographic market; closed many loans in material variance to the Bank's underwriting and loan requirements; and lent a troublesome and perhaps illegal amount of money to related borrowers.

2009 WL 4641761 at *2 (footnote omitted). The Court held that whether a claim is direct or derivative is a matter of state law. It found that "all of the harm alleged by the Trustee occurred as a result of lending decisions made at the Bank level . . . The Complaint contains no similar allegations of any specific instance of negligence or malfeasance by Defendants for decisions made at the Debtor level." Id. at *4. The Court observed that the Trustee admitted in the complaint that repayment of the holding company's bond financing was dependent on the proper management and profitable operation of the bank. It held the claims to be derivative and once the FDIC was appointed receiver, the holding company no longer had the ability to bring derivative claims against officers and directors of the bank. The holding company's subsequent bankruptcy filing did not create any standing in the Trustee that the holding company did not already possess. The Court dismissed the Trustee's complaint. In light of this decision, the Court also dismissed as moot a declaratory judgment action that the trustee had brought against the holding company and the bank's director and officer liability insurance carrier. Lubin v. Cincinnati Ins. Co., 2009 WL 4641765 (N.D. Ga. Nov 30, 2009).

Goldstein v. Wells, 295 Ga. App. 870, 673 S.E.2d 325 (2009) – Derivative action properly dismissed on rejection of demand by independent committee.

This was an appeal arising from the dismissal of a shareholder derivative action arising from a REIT's decision to internalize certain management and advisory functions of its real estate business. The case was decided under Maryland law. The board of directors' decision had been approved by over 90 percent of the trust's shareholders, but the plaintiffs argued that the derivative action should not have been dismissed because three of the five committee members who had reviewed and rejected the plaintiffs' pre-suit demand had also served on the four-

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[6] The trustee's suit had been commenced as an adversary proceeding in the holding company's bankruptcy case. In an earlier decision, the district court had withdrawn the bankruptcy reference as to the adversary proceeding. Lubin v. Skow, 2009 WL 2175857 (July 21, 2009, N.D. Ga.).

member committee approving the internalization and because the same law firm had advised the demand committee and the Trust concerning the internalization. The Court found that the board members on the demand committee were not employees of the trust and did not receive any benefits as a result of the internalization. Thus, there was no conflict of interest with regard to the transaction. It also found that the law firm in question never represented any party having an interest in or obtaining a direct benefit from the internalization, so the fact that it advised the directors sitting on both the internalization committee and the demand committee did not taint the directors' decisions to deny the demand. The Court affirmed the dismissal.

2. Insurance and Indemnification.

Four Seasons Healthcare, Inc. v. Willis Insurance Services of Georgia, Inc., 299 Ga. App. 183, 682 S.E.2d 316 (2009) – Suit against insurance broker for failure to obtain director and officer liability coverage for pending transaction barred by insureds' knowledge and negligence in failing to discover major shareholder and prior acts exclusions.

In this case, management of a parent company formed a new corporation to purchase the pledged stock of its subsidiary in a foreclosure sale. Its insurance broker was asked to obtain coverage for the transaction, through a combination of a director and officer liability insurance policy for the new corporation and a "tail" or extension of the parent company's existing D&O policy. Against the broker's advice, the new corporation's policy was purchased with a "prior acts" exclusion, barring coverage for any actions and events occurring prior to policy inception. The parent company's existing policy contained a 5% major shareholder exclusion that barred coverage for claims by shareholders holding more than 5% of its shares. The tail policy included that exclusion, as well. The insureds failed to read the policies. After the foreclosure sale, suit was filed by a group of shareholders of the parent company that owned more than 5% of the shares. Coverage was denied under both policies. The insureds did not contest the denial of coverage.

In a 4-3 *en banc* decision by the Georgia Court of Appeals, the Court affirmed summary judgment for the broker. It cited a "general rule" that an insured cannot recover for a broker's negligent failure to obtain coverage requested if the insured fails to read the policy and determine what risks are covered. The Court recognized an exception to the general rule where the broker owes a fiduciary duty, holds itself out as expert and the insured must rely on the broker's expertise to procure adequate coverage. It found that even that exception is inapplicable when it would be readily apparent from an examination of the policy that the requested coverage was not provided. The Court held that the two exclusions were readily apparent and thus the exception did not apply. The Court also found that the insureds had failed to demonstrate that coverage could have been obtained without the two exclusions and thus could not prove the broker's alleged negligence proximately caused the loss.

The dissent argued that insureds could hardly be expected to understand the interplay of the two policies and obviously did not, given the fact that they were attempting to obtain policies

structured to provide seamless coverage with no coverage gaps and ended up with no coverage at all under either policy.[7]

Jansky v. SunTrust Banks, Inc., 2009 WL 33055200 (N.D. Ga. Sept. 18, 2009) – Mandatory indemnification of corporate officer in *quantum meruit* for successful defense of counterclaim.

The plaintiff, discharged as chief credit officer of a bank, filed suit in Superior Court against her former employer for defamation. The bank counterclaimed for costs incurred in investigating a committee she chaired and a related earnings restatement. The plaintiff's counsel represented her under a written contingent fee agreement as to the defamation claims and agreed to defend the counterclaim, as well, but without an agreement specifying the terms of that representation other than that the firm would seek indemnification on her behalf, if successful in the defense or the counterclaim, and a general understanding that the plaintiff would be obligated to pay if indemnification could not be obtained. There was no discussion of hourly rates or other details of the engagement. The trial court granted cross-motions for summary judgment and dismissed the case. Plaintiff sought indemnification in federal court, arguing that she was entitled to mandatory indemnification under the bank's bylaws and Georgia law because she was successful in defending the counterclaim. The Court quoted the provisions of the Georgia Business Corporation Code for mandatory indemnification under O.C.G.A. §§ 14-2-852 and 14-2-857(c) for officers successful in defending claims brought against them and for court enforcement of that obligation under § 14-2-854.[8] It found the bank's bylaws and Georgia law "clear that indemnification is required only when an appropriate party has incurred expenses and fees." Id. at *3. The bank contended that the plaintiff did not "incur" an obligation to pay her counsel for defense of the counterclaim. The Court agreed that the plaintiff did not have a contractual obligation to pay, but held that the firm would be entitled to recover in *quantum meruit* and that "Because Plaintiff is liable in quantum meruit, she has 'incurred' the legal expenses for defending the Counterclaim." Id.

3. Arbitration.

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[7] In McGregor v. Columbia National Insurance Company, 298 Ga. App. 491, 680 S.E.2d 559 (2009), the Georgia Court of Appeals held that a commercial general liability policy provided no coverage for an investment manager's and investment funds' liability to investors for fraud, negligent misrepresentation, false advertising, securities violations and misappropriation of investor funds because none of the claims alleged sought to recover for bodily injury, property damage, personal injury or advertising injury, the risks generally covered under CGL policies. The Court rejected the investors' efforts to bring their allegations within coverage for advertising injury, finding that their claims were based on false representations in the defendants' advertising, not misappropriation of advertising ideas or copyright infringement, the types of claims covered in the CGL policy.

[8] The Court also quoted but did not discuss the provision in § 14-2-854(b) permitting an award of the expenses incurred in successfully enforcing indemnification rights.

<u>Hansen & Hansen Enterprises, Inc. v. SCSJ Enterprises, Inc.</u>, 299 Ga. App. 469, 682 S.E.2d 652 (2009) – Arbitration award vacated in sale of business dispute because arbitrator failed to decide counterclaims on promissory notes that did not contain arbitration clauses.

This appeal resulted from a trial court's vacating of an arbitration award arising from a dispute between the sellers and purchasers of two UPS stores. The sales contracts required disputes to be arbitrated. The sellers gave promissory notes as part of the purchase price, which did not include arbitration clauses. When the stores allegedly did not perform in keeping with projections the purchasers filed an arbitration claim for fraud, breach of contract and rescission. The sellers counterclaimed on promissory notes given as part of the purchase price. The arbitrator ruled in favor of the sellers on the purchasers' claims, but dismissed the counterclaim on the ground that he lacked jurisdiction over the counterclaims on the promissory notes. The trial court had vacated the award under O.C.G.A. § 9-9-13(b) on statutory grounds of manifestly disregarding the law of rescission, overstepping his authority in awarding attorney's fees and imperfectly executing his authority for failing to consider the counterclaims on the notes. The Court of Appeals reversed the trial court on the first two grounds, finding that the arbitrator knew Georgia law on rescission and applied it and that the contract clearly authorized the award of attorney's fees. It held, however, that the arbitration clause in the sales contracts applied to the promissory notes, because they recited that they were given "in conjunction with the Memorandum of Sale" and were "subject to the terms and conditions of such Memorandum of Sale" and the language of the sales contracts and notes "establish that the execution of the notes was a transaction contemplated by the sales contracts; and vice versa." 299 Ga. App. at 473-74. The Court remanded with instructions to order a rehearing before the arbitrator on the sellers' counterclaims.

4. <u>Corporate Separateness and Piercing the Corporate Veil</u>.

<u>EnduraCare Therapy Management, Inc. v. Drake</u>, 298 Ga. App. 809, 681 S.E.2d 168 (2009) – Separateness of parent and subsidiary: Parent corporation's failure to answer complaint held insufficient to impose liability for subsidiary's obligations.

Plaintiffs sued a nursing home and fourteen other individuals and entities whom plaintiffs alleged "owned or controlled ownership interests" in the nursing home and were therefore responsible for any torts committed by the nursing home or its agents or employees. Two of these entities, EnduraCare Therapy Management, Inc. ("EnduraCare") and Brentwood Nursing, LLC and Brentwood Healthcare, LLC (collectively "Brentwood") failed to respond to the complaint, and the court entered default judgments against them, including a default judgment against EnduraCare for $2,000,000 in compensatory damages and $5,000,000 in punitive damages. Both Brentwood and EnduraCare appealed the default judgments against them.

In analyzing the issues, the Georgia Court of Appeals interpreted O.C.G.A. § 9-11-55(a), which states that the effect of a default is "as if every item and paragraph of the complaint or other original pleading were supported by proper evidence." The Court held this to mean that while a default operates as an admission of the well-pled factual allegations in a complaint, it does not admit the legal conclusions contained therein, and a defendant is not precluded from showing that under the facts as deemed admitted, no claim existed which would allow the

plaintiff to recover. The Court found that on its face, the complaint based EnduraCare's liability solely on its status as a corporation with an ownership interest in its nursing home subsidiary. It went on to strongly re-affirm that owners or shareholders of a corporation are not personally liable for corporate acts until such time as the corporate veil has been successfully pierced, and that the corporate entity may be disregarded only in exceptional circumstances. The Court also noted that "[a] parent/subsidiary relationship does not in and of itself establish the subsidiary as either the alter ego of the parent or as the parent's actual or apparent agent." (citing Matson v. Noble Investment Group, 288 Ga. App. 650, 659, 655 S.E.2d 275 (2007)). Because the plaintiffs alleged no exceptional circumstances that addressed the legal distinction between the corporation and its owners, the Court held that the presumption remained that EnduraCare maintained a separate identity from the nursing home and thus, despite its default, there was no factual basis for an independent claim against it as an owner of the nursing home. For these reasons, the Court also held that the plaintiffs could not recover punitive damages from EnduraCare, and it reversed the default judgment against Brentwood.[9]

Anthony v. Gator Cochran Construction, Inc., 299 Ga. App. 126, 682 S.E.2d 140 (2009) (*certiorari* granted); Renee Unlimited, Inc. v. City of Atlanta, 301 Ga. App. 254, 687 S.E.2d 233 (2009) – Jury verdicts piercing of corporate veil upheld on the evidence.

In Anthony v. Gator Cochran Construction, Inc., 299 Ga. App. 126, 682 S.E.2d 140 (2009), Gator Cochran Construction, Inc. ("Cochran") sued individual defendant, Ray G. Anthony and five related entities for breach of contract alleging defendants' nonpayment for construction services it provided to defendants. Following a jury trial and the denial of the defendants' motion for a directed verdict, plaintiff was awarded damages to be paid jointly or severally by the defendants. Defendants moved for judgment notwithstanding the verdict, or in the alternative, a new trial, both of which were denied. The Anthony entities appealed the trial court's denial of the j.n.o.v. motion contending that the evidence did not support the jury's disregard for its corporate form and entering judgment against all of them jointly and severally. The Court of Appeals disagreed with the Anthony entities' contention because the evidence showed "commingling [of funds] on an interchangeable or joint basis." It also showed that Anthony personally, and the Anthony entities separately, entwined their finances and their dealings with Cochran. In some instances Cochran invoices were sent to one Anthony entity and paid for by another Anthony entity. The Court of Appeals concluded that such commingling "or confusing the otherwise separate properties" supports piercing of the corporate veil. Having found "some evidence to support the verdict," the Court affirmed the trial court's denial of the j.n.o.v. motion. The Georgia Supreme Court granted a petition for a writ of certiorari and the case is under review there at the time of this writing.

In Renee Unlimited, Inc. v. City of Atlanta, 301 Ga. App. 254, 687 S.E.2d 233 (2009), the City of Atlanta sued to recover loans made under a federal housing program to rehabilitate an apartment project. The City asserted alter ego claims against the borrower's owner/chief

[9] Compare J.T. Turner Construction Co. v. Summerour, 301 Ga. App. 323, 687 S.E.2d 612 (2009), discussed above, in which general partners were held liable for a default judgment against the partnership.

executive officer and an affiliated corporation. The jury found for the City and the Court of Appeals affirmed, based on evidence that the borrower had transferred the property to the affiliate before obtaining the loan and because the owner/CEO disregarded the borrower's corporate separateness in obtaining and using the loan funds.

Otero v. Vito, 2009 WL 3063426 (M.D. Ga. Sept. 22, 2009) – Reverse piercing of the corporate veil not allowed.

This decision recognizes that Georgia law does not authorize reverse piercing of the corporate veil, i.e., to permit a creditor to recover from a corporate entity for the debts of one of its principals, even where the entity is found to be an alter ego of the principal formed for the purpose of putting assets out of the reach of creditors while maintaining control over them and using them for the principal's personal benefit. The judgment debtor admitted in an affidavit that he had used an elaborate system of "layered" corporations, LLCs and trusts, as well as the names of family members to transfer his assets "through or into nominee entities, over which entities, I retained control." The Court discussed the Georgia Supreme Court's decision in Acree v. McMahan, 276 Ga. 880, 585 S.E.2d 873 (2003) refusing to recognize the equitable remedy of reverse veil piercing and finding, instead, that such legal remedies as attaching the debtor's interest in the alter ego entities and setting aside transfers to the entities as fraudulent and voidable were adequate. The Court had already issued an injunction, appointed a special master, found the judgment debtor in contempt and appointed a receiver for the entities that the judgment debtor had created to shelter his assets. The fact that the entities were alter egos under the judgment debtor's control enabled the Court to find that they had knowledge of his intention to delay or defraud creditors when they received the transferred assets. The Court ruled that the entities "had no legitimate business and no income other than through fraudulent transfers" from the judgment debtor. Although declining to disregard the entities' separate status, the Court ordered that the property and funds held by the receiver on behalf of the entities "shall be considered" assets of the judgment debtor's bankruptcy estate.

5. Evidence Issues.

Ross v. State, 298 Ga. App. 525, 680 S.E.2d 435 (2009) – Copies of checks dishonored by third party banks held admissible as depository bank's business records.

In this case, the Court of Appeals found that checks deposited by defendant and returned for insufficient funds were admissible under business records exception to hearsay rule, even though the checks where not authenticated by the payor banks. Defendant opened two checking accounts at United Community Bank. She deposited into the UBC accounts six checks that were drawn on accounts from three different banks ("payor banks"). After depositing the checks at UBC, she removed all or most of the funds credited to her accounts. The six checks were returned by the payor banks for insufficient funds. At her trial for theft by deception, certified copies of the checks were offered into evidence through the testimony of the UCB's manager and assistant Vice President, who was familiar with the defendant's accounts and the bank's deposit procedures and records retention policy. The State did not call any representatives from the payor banks to authenticate the checks and the defendant contended, for that reason, that the checks should have been excluded for lack of foundation. The Court of Appeals disagreed,

interpreting O.C.G.A. § 24-3-14, the business records exception to the hearsay rule, and relying on Santana v. State, 283 Ga. App. 696, 642 S.E.2d 390 (2007) for the rule that "it is well established that a factual document may be admitted under the business records exception when an officer or employee of a business that received, relied upon, and retained the documents in the regular course of its business testifies to that effect, despite the lack of testimony from a witness associated with the business that originally created the document." The Court went further to discuss other cases that have dealt with admissibility of third party documents under the business records exception to the hearsay rule, including Walter R. Thomas Assocs. v. Media Dynamite, 284 Ga. App. 413, 643 S.E.2d 883 (2007) (admitting invoices for advertising time as business records of an advertising broker that received them in the regular course of business) and Lewis v. United California Bank, 240 Ga. 823, 242 S.E.2d 581 (1987) (the test is not who made the original document, it is rather whether the document became a part of the business records of the custodian of the record.)

Standard Building Company, Inc. v. Wallen Concept Glazing, Inc., 298 Ga. App. 443, 680 S.E.2d 527 (2009) – Unauthenticated printout of search results from foreign state's secretary of state website held inadmissible.

In this case, an Ohio property owner brought an action in Georgia to domesticate a default judgment it obtained in Ohio against a Georgia contractor. The contractor defended on the basis of a lack of personal jurisdiction in Ohio. In response, the judgment creditor filed an unauthenticated computer printout of search results from the Ohio Secretary of State's website to show that the contractor was a foreign corporation registered to do business in Ohio. The trial court relied on the printout in ruling in favor of the judgment creditor and domesticating the Ohio judgment. The Court of Appeals reversed, stating "We have held that uncertified copies of computer printouts from a Secretary of State's website are not admissible as evidence unless authenticated," citing Matson v. Noble Investment Group, 288 Ga. App. 650, 656, 655 S.E.2d 275 (2007) and O.C.G.A. § 24-7-20.

6. Service of Process.

Pallman Maschinenfabrik GmbH & Co. v. Evergreen Composite Technology, LLC, 2009 WL 112683 (M.D. Ga. Jan. 16, 2009); Tunstall v. Deutsche Bank Trust Company America, 2009 WL 274153 (M.D. Ga. Feb. 4, 2009) – Corporate and LLC agents for service of process.

In Pallman Maschinenfabrik, the plaintiff served a Georgia limited liability company by serving someone other than its registered agent who under O.C.G.A. § 14-11-1108(a) is its agent for service of process. The Court rejected the assertion that a Georgia LLC can only be served in a federal court civil action by serving its registered agent, holding that under F. R. Civ. Pro. 4(h)(1)(B), process could also be served on any officer, managing or general agent or any other agent authorized by appointment or law to receive service. Although not mentioned by the Court, O.C.G.A. § 14-11-1108(a) states that it "does not prescribe the only means, or necessarily the required means, of serving a limited liability company." In the Tunstall case, the Court found service on a registered agent of a Georgia corporation to be similarly non-exclusive and

held that the failure of a corporation to maintain a registered agent did not excuse the plaintiff's failure to serve the corporation timely in some other manner.

<u>Anthony Hill Grading, Inc. v. SBS Investments, LLC</u>, 297 Ga. App. 728, 678 S.E.2d 174 (2009) – Substituted service on the Secretary of State held ineffective under O.C.G.A. § 14-11-209(f) for failure to comply with statutory requirements and under § 9-11-4(e)(1) for failure to make use of known alternative means of service.

In this case, a subcontractor sought a special lien on property against owner of property, a limited liability company, after a third party failed to pay the subcontractor. Service was effected by serving the Secretary of State after personal service by the Sheriff at the LLC's registered office was not successful. The LLC failed to answer, and the trial court entered a default judgment in favor of the subcontractor. The Court of Appeals affirmed. The subcontractor served the Secretary of State by overnight mail but did not comply with the exact requirements of O.C.G.A. § 14-11-209(f), because it supplied the Secretary of State with only one, not two copies of process, as the statute requires, and it failed to include a certification that it had sent the summons and complaint to the defendant at its last registered address by certified or registered mail or statutory overnight delivery the required information, as the statute also requires. Instead, it had sent process by Federal Express to the defendant's registered office simultaneously with substituted service on the Secretary of State. The Court also noted that service on an LLC through provisions of the Georgia Limited Liability Company Act is not exclusive, O.C.G.A. § 14-11-209(h), and considered whether substituted service on the Secretary of State was available under O.C.G.A. § 9-11-4(e)(1). However, the LLC introduced evidence that the plaintiff was aware of its actual business address and knew its CEO, but made no effort to serve the LLC through either of those means. Substituted service on a "corporate" defendant is allowed under § 9-11-4(e)(1) only after the plaintiff has unsuccessfully attempted to serve the defendant using information of which it has actual knowledge.

7. <u>Venue</u>.

<u>HD Supply, Inc. v. Garger</u>, 299 Ga. App. 751, 683 S.E.2d 671 (2009) – Relation back of venue under O.C.G.A. § 14-2-510(b)(3) to filing of suit for later added corporate defendant.

The Georgia Court of Appeals affirmed denial of a motion to transfer the venue of a lawsuit filed in Fulton County against alleged joint tortfeasors, because venue was predicated on O.C.G.A. § 14-2-510(b)(3), permitting a suit based in tort to be brought against a corporation in the county where the cause of action allegedly originated if the corporation has an office and transacts business there. The only defendant who satisfied those requirements had been added on motion six months after suit was filed. That defendant had an office and transacted business in Fulton County at the time suit was filed, but not at the time it was added to the case. The Court of Appeals held that venue with regard to a party added under O.C.G.A. § 9-11-15(c) of the Georgia Civil Practice Act "related back" and thus must be determined as of the date when the suit was originally filed, not the date when it was added to the suit. Because venue was proper as to the added defendant, it was also proper as to other joint tortfeasors. This decision thus enables a plaintiff to cure a venue defect by adding a corporate defendant as to which venue would be proper at the time suit was filed. The should also be true – a venue defect cannot be

cured by adding a defendant that did not open its office and begin to transact business in the county until after suit was filed.

8. Representation of a Corporation in Court.

Heath v. Beech, 300 Ga. App. 756, 686 S.E.2d 283 (2009) – Corporations may only appear in a court of record through duly licensed counsel.

In this case, the plaintiff sued a corporation and its sole stockholder, who filed a joint answer on behalf of himself and the corporation. The trial court struck the answer as to the corporation and entered default judgment against it. The Court of Appeals affirmed because the stockholder was not a licensed attorney and thus could not represent the corporation, stating that "in this state, only a licensed attorney is authorized to represent a corporation in a proceeding in a court of record," citing Eckles v. Atlanta Technology Group, 267 Ga. 801, 485 S.E.2d 22 (1997).

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