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2008 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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INTRODUCTION

This paper surveys case law developments dealing with corporate and business organization law issues, that were handed down by the Georgia state and federal courts during 2008. Only a few of the decisions concern important matters of first impression. Some illustrate and confirm settled points of law. Others are instructive for the types of claims and defenses that are asserted in business organization transactions, internal disputes and governance and how the courts are addressing them.

In general, the survey is organized first by entity type – corporations, limited liability companies, partnerships and joint ventures. The survey then covers areas in which the decisions concern transactional issues that apply to all forms of business organizations, decide litigation issues characteristic of business organization litigation or involve professional liability claims in the business context, and in this part of the survey, the cases are catalogued by subject matter.

The remainder of this first section is a brief overview of the decisions. The sections that follow contain more extensive discussion of each of the decisions, listed for ease of navigation in the same order as the overview.

OVERVIEW

A. Corporations.

Two decisions in 2008 dealt with shareholder agreements. Neither decision, however, addressed the Georgia Business Corporation Code provisions concerning shareholders agreements, O.C.G.A. § 14-2-732. The Georgia Court of Appeals in Levy v. Reiner, 290 Ga. App. 471, 659 S.E.2d 848 (2008) held it axiomatic that a corporation must be a party to a shareholders contract in order to be bound by it, a statement that would not be true for a shareholders agreement meeting the requirements of § 14-2-732. In other rulings, Levy held that the plaintiff could not pursue direct claims for breach of fiduciary duty based on the close corporation exception to derivative actions under Thomas v. Dickson, 250 Ga. 772, 301 S.E.2d 49 (1983) because not all shareholders were parties or adequately represented. The plaintiff could not sue derivatively, either, because his breach of fiduciary duty claims related to the value of his stock, he had dissented from a sale of the corporation's assets and was pursuing an appraisal remedy, and that remedy was exclusive. The Court of Appeals in Simpson v. Pendergast, 290 Ga. App. 293, 659 S.E.2d 716 (2008) addressed a mirror image buy-sell agreement under which one shareholder specifies the terms and the others must elect whether to buy or sell. The Court held a shareholder liable who refused to respond to such an offer because he considered that certain of the specified terms violated the agreement, but the Court reversed summary judgment for specific performance because the proposed terms would affect the corporation and might not be fair.

Planning Technologies, Inc. v. Korman, 290 Ga. App. 715, 660 S.E.2d 39 (2008) dealt with judicial review of corporate decisions entrusted to the discretion of the board of directors in the context of a determination of stock option vesting. The Court held that where the language does not clearly grant the board unbridled discretion, its decision is subject to review for whether it was made in good faith and in the exercise of honest judgment.

In Hilb, Rogal & Hamilton Co. of Atlanta, Inc. v. Holley, 295 Ga. App. 54, 670 S.E.2d 874 (2008), in a restrictive covenant context, the Court of Appeals held that a corporate employee who has authority to bind the corporation owes fiduciary duties to the corporation and can thus be held liable for diverting business from it while still employed.

The Georgia Court of Appeals decided three nonprofit corporation cases in 2008: (1) Madonna v. Satilla Health Services, Inc., 290 Ga. App. 148, 658 S.E.2d 858 (2008), in which a hospital's bylaws concerning physicians' practice privileges took precedence over a conflicting contract granting exclusive practice rights to a single physician group; (2) The Phoenix of Peachtree Condominium Association Inc. v. Phoenix on Peachtree LLC, 294 Ga. App. 447, 669 S.E.2d 229 (2008), in which the Court held a condominium association that filed suit in violation of a provision of its declaration barring suits on behalf of members, lacked standing to sue despite a later curative amendment to its bylaws and declaration; and (3) Parkridge Condominium Association, Inc. v. Callais, 290 Ga. App. 875, 660 S.E.2d 736 (2008), in which the Court ruled that the trial court's findings of a member's proper purpose and the association's absence of good faith must be upheld unless clearly erroneous, but reversed on the amount of attorney's fees awarded, holding that O.C.G.A. § 14-3-1604(c) requires a corporation to pay only the fees "incurred to obtain the order" for inspection and copying of records.

B. Limited Liability Companies.

The Georgia Court of Appeals handed down five decisions in 2008 concerning the rights and duties of limited liability companies, their managers and members to each other. In Old National Villages, LLC, v. Lenox Pines, LLC, 290 Ga. App. 517, 659 S.E.2d 891 (2008), the Georgia Court of Appeals, in a situation rife with conflicts of interest, held that an LLC general manager, authorized by the operating agreement to make all decisions on the LLC's behalf, can consent to a judgment against the LLC without notice to or approval from the sole member of the LLC. By contrast, in Internal Medicine Alliance, LLC v. Budell, 290 Ga. App. 231, 659 S.E.2d 668 (2008), the Court of Appeals found that an LLC's managing member owed duties of "utmost good faith and loyalty" to the other member and violated her duty of care and acted in bad faith when she failed to collect his receivables. That standard of conduct applies in the absence of a modification permitted under O.C.G.A. § 14-11-305(4)(A). ULQ, LLC v. Meder, 293 Ga. App. 176, 666 S.E.2d 713 (2008), applied the requirement of good faith in the exercise of discretionary authority to an LLC's decision to remove an officer and require the repurchase of his membership interest. The Court also held that the LLC could not be held liable for its manager's breach of fiduciary duty and that non-managing members do not owe a fiduciary duty to either the LLC or to other members. In Fielbon Development Co. v. Colony Bank of Houston County, 290 Ga. App. 847, 660 S.E.2d 801 (2008), the Court of Appeals interpreted the language of O.C.G.A. § 14-11-301(c), that a limited liability company is not liable for acts of a member that are "not apparently for the carrying on in the usual way the business or affairs" and held that the LLC was liable for the notes signed by one of its managers, notwithstanding his misappropriation of some of the loan proceeds. Gardner v. Marcum, 292 Ga. App. 369, 665 S.E.2d 336 (2008) dealt with a dispute over an investment in a recording project that was paid to an LLC, where the parties disagreed on whether an investment was a loan or an equity investment and where no rate of interest had been agreed on. The Court of Appeals held that there was no meeting of the minds, that the LLC was required to return the funds, but that, under O.C.G.A. § 14-11-3303(a), the individual LLC members were not liable for the LLC's obligations, solely by reason of being members.

In Georgia Rehabilitation Center, Inc. v. Newnan Hospital, 283 Ga. 335, 658 S.E.2d 737 (2008), the Georgia Supreme Court refused to compel arbitration of an independent claim for judicial dissolution under O.C.G.A. § 14-11-603, where the operating agreement required arbitration of claims related to the operating agreement or its breach and provided limited rights to dissolve the company under conditions inapplicable to the circumstances at hand. The Court also affirmed the appointment of a receiver.

IH Riverdale, LLC v. McChesney Capital Partners, LLC, 292 Ga. App. 841, 666 S.E.2d 8 (2008) upheld the validity of an amendment to an operating agreement, adopted by majority vote, that abolished payment of a special fee to the plaintiff. The Court rejected the plaintiff's argument that the amendment was a major decision requiring unanimous consent.

C. Partnerships. No partnership decisions of note came to our attention during 2008.

D. Joint Ventures.

In American Association of Cab Companies, Inc. v. Parham, 291 Ga. App. 33, 661 S.E.2d 161 (2008), in a personal injury case involving an uninsured cab, the Georgia Court of Appeals, *en banc,* held there to be sufficient evidence of joint control over the cab to constitute a joint venture. A defense verdict on RICO claims was reversed for improper instructions on burden of proof. Defendants' arguments on proximate cause under RICO were rejected, the Court finding a causal nexus between the lack of insurance and the plaintiff's ability to collect on his personal injury claim.

E. Business Law Issues.

Georgia courts decided four cases involving asset sales, each illustrating a different issue likely to arise in that setting and each resolved on the basis of the provisions of the asset purchase agreement or related agreements and/or who was party to the agreements. Wilkie v. 36747, LLC, 294 Ga. App. 179, 669 S.E.2d 155 (2008) enforced provisions of an Asset Purchase Agreement specifying what obligations the purchaser had assumed; Ahmed v. CUA Autofinder, LLC, 387 B.R. 906 (Bkrtcy. M.D. Ga. 2008) dealt with entitlement to escrowed funds, where the purchaser's principal made a payment required from the company, but failed to document the contribution and where the company went into bankruptcy and the trustee claimed the funds; Kilroy v. Alpharetta Fitness, Inc., 2008 WL 5049966 (Ga. App. Dec. 1, 2008) found fraud claims viable where there was evidence of breaches of representation and warranties in the asset purchase agreement; Accurate Printers, Inc. v. Stark, 2008 WL 5049960 (Ga. App., Nov. 26, 2008) enforced an anti-assignment clause where an individual had purchased the assets and his corporation attempted to enforce the asset purchase agreement's non-competition provision.

Deljoo v. Suntrust Mortgage, Inc., 2008 WL 5174307 (Ga. App. Dec. 11, 2008) applied a rarely cited provision outside the Georgia Business Corporation Code, O.C.G.A. § 14-5-7, regarding the validity of corporate conveyances of real estate.

In Dudley v. Wachovia Bank, 290 Ga. App. 220, 659 S.E.2d 658 (2008), the Court of Appeals addressed disputed stock transfers with signature guarantees under Article 8 of the Uniform Commercial Code, deciding, in a matter of first impression in Georgia, that a signature guarantor is not liable to a stock owner under O.C.G.A. § 11-8-306, but enforcing the issuers' strict liability under § 11-8-404.

F. Litigation Issues.

White v. Shamrock Building Systems, Inc., 294 Ga. App. 340, 669 S.E.2d 168 (2008) rejected a contractor's claims of aiding and abetting breaches of fiduciary duty, conspiracy and tortious interference with business relations as to a diverted business opportunity, based in part on allegations that the alleged third party aider and abettor "should have known" or failed to "investigate" the relationship between the contractor and his former employee before dealing with him.

In Peery v. CSB Behavioral Health Systems, 2008 WL 4425364 (S.D. Ga. Sept. 30, 2008), the Court held that the applicable statute of limitations for breach of fiduciary duty claims is determined by the nature of the conduct underlying alleged fiduciary breach.

In Fulp v. Holt, 284 Ga. 751, 670 S.E.2d 785 (2008) and Treu v. Humanism Investment, Inc., 284 Ga. 657, 670 S.E.2d 409 (2008) the Georgia Supreme Court upheld the trial court's discretion in deciding whether to appoint a receiver, affirming in Fulp the appointment of a receiver for a dissolved law firm and in Treu, the denial of a receivership where a court-appointed auditor had adequately sorted out the shareholders' interests in an investment corporation. Sampson v. Haywire Ventures, Inc., 293 Ga. App. 779, 668 S.E.2d 286 (2008) addressed the requirements for an accounting, holding that the plaintiff must be likely to obtain some recovery to warrant some recovery.

In Hampton Island Founders, LLC v. Liberty Capital, LLC, 283 Ga. 289, 658 S.E.2d 619 (2008), the Georgia Supreme Court reversed a temporary injunction prohibiting any effort to contest the voting rights of investors attempting to seize control of an LLC, oust its management and dismiss a lawsuit against a joint venture partner. The purpose of a temporary injunction should be to preserve the status quo, not to change it. The Court also held that the trial court erred in permitting the investors to intervene in the litigation, since their purpose in doing so was not to participate, but rather to dismiss the litigation.

The Georgia Court of Appeals in Stephens v. McGarrity, 290 Ga. App. 755, 660 S.E.2d 770 (2008), reversed the trial court's approval of a derivative action settlement under O.C.G.A. § 14-2-745 providing that most of the settlement funds would be paid out to the individual derivative plaintiff with the balance to be paid to senior management as bonuses. The Court found that despite the arms' length character of the negotiations, given the danger of collusion, the settlement was not entitled to a presumption of fairness and a review of its terms showed that the settlement was not in the corporation's best interest.

Three decisions addressed alter ego liability or piercing the corporate veil. In Pazur v. Belcher, 290 Ga. App. 703, 659 S.E.2d 804 (2008), the Georgia Court of Appeals held that sole ownership of a corporation, using a corporation for one's own ends, loans to or from the corporation or the forgiveness of such loans do not, without more, support piercing the corporate veil; it requires a disregard of the corporate entity, making it a mere instrumentality for transaction of personal affairs, and such a unity of interest and ownership that separateness of entity and owners ceases to exist. In an unpublished Eleventh Circuit Court of Appeals decision, BP Products North America, Inc. v. Southeast Energy Group, Inc., 282 Fed. Appx. 776 (11th Cir. 2008), the Court reversed a summary judgment piercing the corporate veil, because despite a disregard of the corporate form, there was an issue of fact whether the corporation had been used to defeat justice, perpetrate a fraud or evade liability. Bruce v. PharmaCentra, LLC, 2008 WL 1902090 (N.D. Ga. April 25, 2008) held that a plaintiff's alter-ego

allegations as to an affiliate of her employer estopped her from claiming that she was not required to arbitrate her claims against both entities.

In Barnette v. Coastal Hematology & Oncology, P.C., 294 Ga. App. 733, 670 S.E.2d 217 (2008), the Court of Appeals ruled on malicious prosecution claims arising from the prosecution of personnel accused of misappropriating company funds, holding that a presumption of probable cause based on police officers' affidavits averring independent judgment in recommending prosecution does not apply where the complainant knowingly makes false statements to the arresting officer, as the plaintiffs had alleged.

In two decisions, In re Sutton, 2008 WL 4527761 (Bankr. M.D. Ga. Oct. 2, 2008), a corporate officer and in In re Wheelus, 2008 WL 372470 (Bankr. M.D. Ga. Feb. 11, 2008) two former managers of an LLC were found not to be "fiduciaries" within the meaning of 11 U.S.C. § 523(a)(4) and thus the claims against them for breach of fiduciary duty could not be determined to be non-dischargeable.

Three of 2008's decisions concerned service of process on corporations. Vibratech, Inc. v. Frost, 291 Ga. App. 133, 661 S.E.2d 185 (2008) held that, unlike the resignation of a corporate officer or director, the resignation of an agent for service of process is not effective until filed with the Secretary of State. In Brock Built City Neighborhoods, LLC v. Century Fire Protection, LLC, 2008 WL 4740396 (Ga. App. Oct. 30, 2008), the Court held that service by publication on an LLC is not authorized until after the plaintiff has attempted service directly on the company. Holmes & Company of Orlando v. Carlisle, 289 Ga. App. 619, 658 S.E.2d 185 (2008) upheld service on a bank branch manager who was supervisor of a corporation's registered agent, even though the corporation did not conduct any business at the bank and neither the bank nor the branch manager was authorized to accept service on the corporation's behalf.

QOS Network Ltd. v. Warburg Pincus & Co., 294 Ga. App. 528, 669 S.E.2d 536 (2008) involves a lengthy analysis and application of the principles of *res judicata* and collateral estoppel as to a corporation based on the results of litigation against its controlling shareholders and officers.

G. Professional Liability.

The Georgia Court of Appeals decided two merger and acquisition accountant liability cases in 2008. In Atlanto Holdings, LLC v. BDO Seidman, LLP, 290 Ga. App. 665, 660 S.E.2d 463 (2008), a 15-year old dispute, it reversed an award of damages because the trial court erred in admitting evidence of a resale of the business many years after the disputed acquisition and a reclassification of acquisition debt as equity. In a nursing home company acquisition case, PricewaterhouseCoopers, LLP v. Bassett, 293 Ga. App. 274, 666 S.E.2d 721 (2008), the Court upheld a negligent misrepresentation jury verdict, ruling on issues of reasonable reliance and due diligence by the trustee of children's trusts into which stock obtained in the acquisition was transferred.

Saye v. Deloitte & Touche, LLP, 295 Ga. App. 128, 670 S.E.2d 818 (2008) is a defamation case illustrating the risk an auditor takes in reporting to an audit client adverse information concerning one of the client's employees and refusing to give its opinion on the financial statements if the employee remained in an accounting or financial reporting role. The Court of Appeals held that, given the auditor's independence, its reporting the information to its client constituted a publication and auditor's privilege to report such information is a qualified one, hence allegations of malice sufficed to survive a motion to dismiss.

In Smith v. Morris, Manning & Martin, LLP, 293 Ga. App. 153, 666 S.E.2d 683 (2008), the Court of Appeals held that written waivers that a law firm obtained from two clients, although valid with regard to the matters identified, were ineffective to protect it from claims when its representation of one client in dealings with the other exceeded the scope of the waivers.

In re Friedman's Inc., 385 B.R. 381 (S.D. Ga. 2008), *vacated in part on reconsideration by* In re Friedman's Inc., 394 B.R. 623 (S.D. Ga. 2008) is a lengthy decision on motions to dismiss a bankruptcy trustee's action against officers, directors, investment bankers and outside counsel who represented the company and a committee of independent directors. Among other rulings, the Court held that piercing the corporate veil requires insolvency under Georgia law, that Georgia law recognizes claims for aiding and abetting fraud, and that claims for legal malpractice can be based on the alleged failure of counsel to disclose adverse information to independent directors regarding interested party transactions.

II. DISCUSSION OF CASE LAW DEVELOPMENTS

A. Corporations.

Shareholders' Agreements, Direct vs. Derivative Actions and Exclusivity of Dissenters' Rights.

In Levy v. Reiner, 290 Ga. App. 471, 659 S.E.2d 848 (2008), the Georgia Court of Appeals held that a corporation, as a separate entity, must be named a party to a contract in order to bind it to obligations that the shareholders agree to impose on it. The Court also rejected the plaintiff's efforts to pursue a direct claim for breach of fiduciary duty based on the defendants' allegedly excessive salaries, holding that the plaintiff had not satisfied the requirements under Thomas v. Dickson, 250 Ga. 772, 301 S.E.2d 49 (1983) for the close corporation exception to derivative actions. The plaintiff was unable to pursue a derivative action, as well, because his breach of fiduciary duty claims related to the value of his stock, he had dissented from a sale of the corporation's assets, he was pursuing an appraisal remedy, and that remedy was exclusive.

Michael Levy, a minority shareholder of Peek-A-Boo, Inc. ("PAB"), sued Michael Reiner and Howard Alpern individually and in their capacity as PAB directors and officers, claiming breach of contract and breach of fiduciary duty. Levy and Alpern had entered into a stock purchase agreement that provided that PAB would offer consulting opportunities to Levy equal to those provided to Alpern. Levy alleged that Alpern breached this contract when PAB did not provide Levy with PAB opportunities equivalent to what Alpern himself received. The Court of Appeals rejected that claim, stating that it was "axiomatic" that the corporation, as a separate entity from its stockholders, must be a party to the contract in order for the contract to be valid and binding as to it. Because PAB was not a party to the contract between Levy and Alpern that provision of the agreement was not enforceable. While the Court treated the principles as self-evident, the only authority it cited was Plaza Properties, Ltd. v. Prime Business Investments, 240 Ga. App. 639, 642(2)(d), 524 S.E.2d 306 (1999), which involved a contract with a third party, not a shareholders' agreement. The Court did not mention O.C.G.A. § 14-2-732, which provides:

> "(a) An agreement among the shareholders of a corporation that complies with this Code section is effective among the shareholders and the corporation even though it is inconsistent with one or more other provisions of this Code in that it:
>
> . . . .

> (5) Establishes the terms and conditions of any agreement for the transfer or use of property or the provision of services between the corporation and any shareholder, director, officer, or employee of the corporation or among any of them
> . . .
> (8) Otherwise governs the exercise of the corporate powers or the management of the business and affairs of the corporation or the relationship among the shareholders, the directors, and the corporation, or among any of them, and is not contrary to public policy."

(Emphasis added) By its terms, Section 14-2-732 appears to render a shareholders' agreement binding on the corporation even if it is not a party. For a shareholders' agreement to qualify under § 14-2-732, among other things, it either must be contained in the corporation's articles or bylaws and be approved by all shareholders or must be in writing, signed by all shareholders, and must be "made known" to the corporation. O.C.G.A. § 14-2-732(b)(1). It appears that only Levy and Alpern were parties to the shareholders' agreement, in which case § 14-2-732 would not apply.

Levy also alleged that Reiner and Alpern breached their fiduciary duty as officers of PAB based on their excessive salaries. Invoking the Georgia exception to the requirement that claims based on breaches of duty to the corporation must be brought derivatively, Levy contended that he could bring a direct action against them instead of a derivative suit, because PAB was a closely-held corporation. Not all shareholders were parties. Levy argued that there was no danger of a multiplicity of proceedings, asserting that the non-party shareholders would not litigate because they benefitted from Reiner's and Alpern's actions. The Court of Appeals found that the record did not support Levy's argument.

Finally, the Court of Appeals held that Levy could not maintain a derivative action against Reiner and Alpern, either, since Levy tendered his shares to the corporation and dissented from the sale of PAB's assets. The Court found that his claims related to the value of his stock and held that the appraisal proceeding that he was separately pursuing provided his exclusive remedy.

Shareholder Buy-Sell Agreement – Specific Performance Requires Contract to Be Fair, Just and Not Against Good Conscience, Including Interests of Corporation.

Simpson v. Pendergast, 290 Ga. App. 293, 659 S.E.2d 716 (2008) illustrates the dilemma facing a shareholder who receives an offer containing unacceptable terms under a shareholders' agreement that requires the offerees to elect whether to buy or sell at the stated price and on the stated terms. The shareholder agreement in question required the offering shareholder to specify the price and set forth the terms and conditions on which he was prepared to purchase or sell shares. The offerees were then required to make their election within 60 days and, if they failed to respond, they were deemed to have elected to sell at the stated price and on the stated terms and conditions.

Joseph Pendergast, one of four shareholders in Historic Motorsports Holdings, Ltd. ("HMH") made an offer to the other three shareholders to buy or sell, naming a specific price, but adding three conditions: (a) that the corporation was required to make a pro rata distribution of 40% of its taxable income for the preceding and current year, (b) that the selling shareholder would be relieved of non-competition obligations, and (c) that the offer was based on a review of the June 30, 2004 financial statements and that there shall have been no adverse change in the company's financial condition, results of operations or assets through closing. Steve Simpson, one of the three offerees, took the

position that Pendergast's offer was invalid because of the added terms and conditions and failed to respond. Pendergast brought an action against Simpson for specific performance. In analyzing the terms of the shareholder agreement, the Court of Appeals found the language of the agreement unambiguous, held that it clearly contemplated that the offeror would specify terms and conditions, and found nothing in the agreement to support Simpson's position that inclusion of Pendergast's terms relieved him of his obligation to respond. It affirmed the grant of summary judgment to Pendergast as to the enforceability of the contract provisions. The Court rejected Simpson's argument that Pendergast failed to tender performance. The Court also rejected Simpson's unclean hands defense, holding that Pendergast's alleged breach of fiduciary duty by competing with HMH did not relate to the transaction at issue.

However, the Court stated that before ordering the remedy of specific performance, the trial court must determine that the contract is "fair, just and not against good conscience." The Court noted that the offer imposed terms on HMH, a non-party to the action and that HMH had filed an amicus brief objecting to specific performance on the ground that it would affect HMH's substantive rights as to the required payment and enforcement of the non-competition agreement against Pendergast. Under these "unusual circumstances," the Court found that there were genuine issues of material fact as to the claim for specific performance. In contrast to Levy v. Reiner, the shareholder agreement itself did not impose obligations on the corporation. Instead, a shareholder exercising rights under the agreement was attempting to use the coercive buy-sell provisions of the agreement to free himself of the obligation and deny the corporation the benefit of other portions of the agreement, namely, the non-competition provisions. By affirming summary judgment on liability, but denying that Simpson was entitled to specific performance as a matter of law, the Court implied that it was possible for him to demonstrate at trial that the agreement was fair, but offered no guidance on what evidence would suffice to establish fairness.

Stock Option Plans – Change in Control Provisions and the Standard of Review for Discretionary Decisions.

The plaintiff in Planning Technologies, Inc. v. Korman, 290 Ga. App. 715, 660 S.E.2d 39 (2008) was the former president of Planning Technologies, Inc. ("PTI"), who was a party to PTI's stock option plan. The plan provided for vesting over three years unless a change in control transaction occurred. The plan provided that determinations and decisions made by the Board or designated Committee "shall be final, conclusive and binding," and it further provided that

> "Any dispute or disagreement which may arise under, or as a result of, or in any way relate to, the interpretation, construction or application of this Agreement shall be determined by the Committee. Any determination made hereunder shall be final, binding and conclusive . . . for all purposes."

PTS entered into a transaction in which it issued stock in exchange for cash and the assets of another corporation. The Board determined that the transaction did not constitute a change in control under the stock option plan.

Korman attempted to exercise his options, was terminated for cause and sued, claiming that the transaction represented a change in control transaction under the stock option plan. The trial court agreed and granted summary judgment in Korman's favor. PTI argued on appeal that the stock option plan granted the Board absolute and uncontrolled discretion which was beyond review by the Court.

The Court of Appeals held that where there is a grant of discretionary decision-making authority, the issue to be determined is whether the decision must be made in good faith and in the exercise of honest judgment. The Court held that the language of the agreement gave the Board discretion, but not absolute and uncontrolled discretion. It then held:

> "Accordingly, the trial court was required to defer to the determination of PTI's Board of Directors that the ENS transaction was not a change in control and did not accelerate the vesting of Korman's stock options, so long as the Board's determination was made in good faith and involved the exercise of honest judgment."

Because the trial court had engaged in a *de novo* review, the Court of Appeals reversed. It elaborated on the correct standard of review, stating that a lack of good faith could be found in decisions made for arbitrary or capricious reasons, improper pecuniary motive, dishonesty or illegality, made with a total absence of any supporting factual evidence, or construing the plan agreement contrary to its obvious and exclusive meaning.

Breach of Fiduciary Duty.

Hilb, Rogal & Hamilton Co. of Atlanta, Inc. v. Holley, 295 Ga. App. 54, 670 S.E.2d 874 (2008)

The Georgia Court of Appeals affirmed a jury verdict against a former officer and employee of an insurance brokerage firm for breach of fiduciary duty in wrongfully diverting business to a new employer before leaving the plaintiff's employment. The Court found that Hugh Holley, the defendant, owed a fiduciary duty of loyalty as an officer (vice president). He also owed fiduciary duties as an employee because he had authority to "bind" the firm to certain obligations. The Court affirmed the jury's award of "nominal" damages in the amount of Holley's last two months' salary. The Court affirmed a directed verdict against the broker on its unjust enrichment claim in which it sought to recover the separate consideration paid for Holley's covenant not to compete. Since the non-compete had been held overbroad and unenforceable in a prior appeal,[1] the doctrine of illegality required the Court to leave the parties as it found them and barred recovery.

Nonprofit Corporations – Articles and Bylaws.

In Madonna v. Satilla Health Services, Inc., 290 Ga. App. 148, 658 S.E.2d 858 (2008), the Georgia Court of Appeals held that a hospital that has adopted bylaws to regulate clinical privileges for medical staff must abide by its own bylaws, even though they conflict with the hospital's obligations under an exclusive staffing contract.

The Satilla Regional Medical Center ("the hospital") had an exclusive Agreement with Baptist Specialty Physicians, Inc. ("BSP") to provide the hospital with Cardiologists. The Plaintiffs, Dr. Sonya Lefever and Dr. James Grigsby were affiliated with another practice group, Southern Heart Group ("SHG"). They applied for initial privileges with the hospital and were rejected because they were not members of BSP. Lefever and Grigsby sued the hospital for discrimination. Dr. John Madonna, a member of yet another practice group, South Georgia Cardiologists Associates ("SGCA"), was also denied initial privileges with the hospital and joined the suit. The distinguishing factor for Madonna was that he once held hospital privileges under BSP's exclusive agreement, but thereafter left BSP, joined SGCA and was seeking privileges as an SGCA member.

[1] Hilb, Rogal & Hamilton Co. of Atlanta, Inc. v. Holley, 284 Ga. App. 591, 644 S.E.2d 862 (2007).

The Georgia Court of Appeals looked to the provisions of the hospital's bylaws that governed granting and denying staff privileges. The bylaws provided that "initial appointments and reappointments to the Medical Staff shall be made by the Board. . . . The Board shall act on appointments and reappointments only after there has been a recommendation from the Credentials Subcommittee and MEC. . . . Initial requests for membership. Following procedures stated in the Credentials Policy Manual, and with a recommendation of the appropriate Department Chair, the Medical Staff organization will evaluate and make recommendations to the Board." Id. at 150-51. Citing Satilla Health Services v. Bell, 280 Ga. App. 123, 633 S.E.2d 575 (2006), the Court noted that neither public nor private hospitals can arbitrarily and unreasonably deny physicians staff privileges laid out in the hospital bylaws.

Furthermore, the Court of Appeals held that Madonna should be permitted to reapply for privileges because his prior agreement through BSP did not waive his rights under the bylaws to reapply. The court determined that all three physicians had the right to apply for clinical privileges under the staff bylaws and should be allowed to do so. The hospital's conflicting "exclusive" agreement with BSP did not affect the hospital's need to comply with its bylaws, which would remain in force until duly amended.

In The Phoenix of Peachtree Condominium Association Inc. v. Phoenix on Peachtree LLC, 294 Ga. App. 447, 669 S.E.2d 229 (2008), the Georgia Court of Appeals affirmed the dismissal of an action by a condominium association for construction defects in the common areas because the association's declaration of condominium prohibited suits on unit holders' behalf. The association members passed a curative amendment to its bylaws and condominium declaration removing the prohibition, but the Court refused to give it effect, holding that standing must be determined at inception of the case.[2] However, the Court reversed the trial court's denial of the association's motion to substitute individual unit holders as real parties in interest.

Nonprofit Corporations – Books and Records Inspection Rights: Attorney's Fees.

In Parkridge Condominium Association, Inc. v. Callais, 290 Ga. App. 875, 660 S.E.2d 736 (2008), the Georgia Court of Appeals held that a Georgia nonprofit corporation that is compelled to permit a member to inspect and copy corporate records must pay only the member's reasonable attorney's fees that were directly incurred in obtaining the court order.

Gail Callais, a resident of Park Ridge Condominium ("Park Ridge") and former director of the condominium association, requested to inspect and copy Park Ridge's bank statements, board meeting minutes, and other documents in order to understand the budget for 2006 before the annual board meeting. Park Ridge refused to allow Ms. Callais to see the records, so she sued under O.C.G.A. § 14-3-1602 and sought attorney's fees under § 14-3-1604(c). The trial court found that Ms. Callais had a proper purpose for her request and ordered Park Ridge to permit the inspection.

Section 14-3-1604(c) requires that a corporation ordered to permit inspection is liable for attorney's fees and expenses unless it proves that it refused inspection "in good faith because it had a reasonable basis for doubt about the rights of the member to inspect the records demanded." In ruling on her petition for attorney's fees, the trial court rejected the association's contention that the

[2] By contrast, the Court of Appeals held last year in Williams v. Martin Lakes Condominium Association, Inc., 284 Ga. App. 569, 644 S.E.2d 424 (2007), that under O.C.G.A. § 14-3-1422 reinstatement of an administratively dissolved nonprofit corporation can take place at any time and empower the corporation to pursue litigation filed during the period of its dissolution.

inspection was made for purposes of harassment, found that the association's refusal to allow the inspection was not made in good faith and granted Ms. Callais over $26,000 in attorney's fees.

The Court of Appeals held that the trial court's findings of the member's proper purpose and the association's absence of good faith must be upheld unless clearly erroneous and affirmed on those points. The Court reversed and remanded on the amount of attorney's fees awarded, however. Section14-3-1604(c) requires a corporation to pay only the fees "incurred to obtain the order" for inspection and copying of records. Callais sought payment of and was awarded fees and expenses she incurred, some of which were not directly related to her efforts to obtain the court order. The Court of Appeals directed the trial court to review and award only the expenses allowed under § 14-3-1604(c).

B. Limited Liability Companies.

Manager Powers and Conflicts of Interest.

In Old National Villages, LLC, v. Lenox Pines, LLC, 290 Ga. App. 517, 659 S.E.2d 891 (2008), the Georgia Court of Appeals held that a general manager of an LLC, who is authorized by an Operating Agreement to make all decisions on behalf of the company, can enter into a consent judgment against the company without giving notice to the sole member of the LLC and or obtaining the member's approval.

The litigation involved a $1.198 million loan that Lenox Pines, LLC ("Lenox Pines") made to Old National Villages, LLC ("Old National"). Lenox Pines was organized to make investments on behalf of a trust. David Smith, one of the trustees, was Lenox Pines' managing member. He was also general manager of the borrower, Old National. Old National's sole member was Valerie Smith, David Smith's estranged wife. Old National's operating agreement granted Mr. Smith "full, exclusive, and complete discretion, power, and authority, subject in all cases to the other provisions of this agreement and the requirements of applicable law, to manage, control, administer, and operate the business and affairs of the company . . . ."

The Smiths disagreed regarding the repayment terms of the loan, whether it had been repaid and funds that Mrs. Smith was withdrawing from Old National. Mr. Smith caused Lenox Pines to file suit against Old National on the loan. Three days later, acting as Old National's general manager, he filed a confession of judgment to Lenox Pines and shortly thereafter garnished Old National's bank account. Mrs. Smith was not given notice of either the filing of suit or the confession of judgment.

Old National, through Valerie Smith, moved to set aside the consent judgment. Her motion was denied by the trial court. Old National appealed, arguing that the consent judgment was void because Mrs. Smith, as sole member, did not receive notice of Lenox Pines' lawsuit and had not given approval for the consent judgment.

The Georgia Court of Appeals disagreed with Old National. The Court ruled that since the Smiths signed an Operating Agreement under which Mr. Smith was allowed to make all decisions concerning the business, he was authorized to enter into a consent judgment on behalf of Old National. The Court relied on well-established principle that legally separates a member of an LLC from the LLC itself. Thus, the sole member of the LLC did not need to be informed of any lawsuits against the LLC or approve of any consent judgment against the LLC, as long as the general manager is duly served and is authorized to act on behalf of the corporation.

In its opinion, the Court painstakingly lays out the actions and relationships of the parties, including David Smith's dual roles as managing member of Lenox Pines, the plaintiff/lender and as general manager of Old National, the defendant/borrower and his actions in bringing suit and confessing judgment to it. Curiously, however, the Court does not discuss or even mention the resulting conflict of interest, any arguments that Old National advanced regarding the conflict, and whether the Operating Agreement or the Georgia Limited Liability Company Code contained provisions addressing such a conflict. The clear implication is that the absolute power and discretion granted the general manager rendered any such conflict irrelevant, but there is certainly no ruling to that effect in the opinion.[3]

Fiduciary Duties of Managing Members, Valuation of Membership Interests and Claims of Conversion.

Internal Medicine Alliance, LLC v. Budell, 290 Ga. App. 231, 659 S.E.2d 668 (2008) involved an LLC ("IMA") established by two physicians, William Budell and Izabella Verbitsky, in 2005 in order to practice internal medicine together. They never entered into a written operating agreement, but orally agreed that each would hold a 50 percent ownership interest, share equally in profits and losses and jointly manage IMA. They made $70,000 capital contributions, purchased office equipment and entered into a 7-year lease for office space. Disputes arose immediately after opening. Budell, the plaintiff, left at the end of 2005, leaving Verbitsky as the remaining managing member. Budell also left $40,000 in receivables that IMA was to collect, but were instead neglected, while Verbitsky saw to it that her own receivables were processed and collected. Verbitsky also withdrew her $70,000 capital contribution. The plaintiff sued for the value of his membership interest, asserted a claim for breach of fiduciary duty based on Verbitsky's failure to collect his accounts receivable and a claim for conversion of his capital contribution.[4] Appealing the trial court's rulings after a bench trial, IMA, Verbitsky and her husband who was involved in the dispute, raised three issues. They argued, first, that the court improperly excluded IMA's lease obligations in calculating the value of Budell's interest. The Court of Appeals rejected that argument, finding that Verbitsky had agreed to a formula of valuation that did not include the lease.

Second, they appealed the finding that Verbitsky had breached her fiduciary duty by failing to collect the receivables for Budell's patients. The Court of Appeals affirmed, stating that "Managing members of an LLC owe fiduciary duties to the LLC and its member investors," citing O.C.G.A. § 14-11-305(1). The Court added that a managing member must act with utmost good faith and loyalty in managing the LLC, citing Quinn v. Cardiovascular Physicians, 254 Ga. 216, 326 S.E.2d 460 (1985), a case involving a closely-held corporation. The Court of Appeals noted that the members could have entered into an agreement under O.C.G.A. § 14-11-305(4)(A) modifying that standard, but did not do so. It then upheld the trial court's ruling that Verbitsky's neglect of Budell's receivables constituted a failure to exercise ordinary care and held that under the circumstances the trial court was authorized to find bad faith.

The Court of Appeals reversed on the third issue, the conversion claim, finding the plaintiff's right to the return of his capital contribution was an intangible property interest that had not been merged into a document susceptible to conversion, nor had it involved funds entrusted to Verbitsky for a particular purpose. It was nothing more than a failure to pay a debt.

[3] Contrast the Court of Appeals' decision in Planning Technologies, Inc. v. Korman, supra, which held the grant of discretionary powers to be subject to review for good faith and the exercise of honest judgment.

[4] The Court of Appeals noted that Budell brought the litigation as a direct claim, but that the appellants had not challenged his standing.

No Vicarious LLC Liability for Managing Members' Breach of Fiduciary Duty; No Fiduciary Duty for Non-managing Members; Discretionary Rights of Expulsion.

In ULQ, LLC v. Meder, 293 Ga. App. 176, 666 S.E.2d 713 (2008), the plaintiff was terminated as an officer of ULQ, LLC and his membership in ULQ was also terminated, triggering an obligation to sell his interest to ULQ for the value of his capital account, which because of losses was zero. Plaintiff sued ULQ for breach of contract, breach of fiduciary duty, and conversion. ULQ counterclaimed for breach of contract, breach of fiduciary duty and tortious interference with contractual and business relations arising out of plaintiff's actions following his termination as an officer but before the sale of his ownership interest. The trial court denied ULQ's motion for summary judgment on the plaintiff's claims and granted the plaintiff's motion for summary judgment on ULQ's counterclaims. ULQ appealed.

The Court of Appeals upheld the denial of ULQ's motion for summary judgment on the breach of contract claim, finding that ULQ was bound to exercise good faith in making the determination that the plaintiff's removal was in the company's best interests. The Court held that, under Georgia law, all contracts contain an implied covenant of good faith and fair dealing, and "where the manner of performance is left more or less to the discretion of one of the parties to the contract, he is bound to the exercise of good faith." The only relevant exception to this rule is an agreement that by its express terms grants the party absolute or uncontrolled discretion in making a decision. The Court found that the exception did not apply.[5]

The Appeals Court held that the trial court erred in denying ULQ's motion for summary judgment on the breach of fiduciary duty claims and held that a limited liability company owes no fiduciary duty to its members, either directly or vicariously for actions taken by its manager. This is because, "it would make no sense to hold ULQ responsible for its manager's breach of a fiduciary duty to ULQ and its members, as it would shift the cost of that breach to the company (and indirectly to its members), thereby shifting the cost to the very parties harmed by the breach." The Court looked to other states that have held that a corporation owes no fiduciary duty to its shareholders in making its determination. The Court held that the plaintiff's conversion claim also failed because it could not be based on a breach of contract alone, and no fiduciary duty was owed. The Court also found that the claims for tortious interference with business and contractual relations failed because the plaintiff was not a stranger to the contract.

The Court also held that the trial court erred in granting the plaintiff summary judgment on ULQ's counterclaim of breach of contract. There was substantial evidence that after the plaintiff's termination as an officer, but before the purchase or redemption of his interest, he persuaded a client not to do business with ULQ for two months, which cost it $40,000 in profits. The operating agreement obligated the plaintiff to refrain from such interference activities so long as he was a ULQ member or owner.

Finally, ULQ asserted that as a member of the company, the plaintiff owed it a fiduciary duty not to interfere with customer relationships. The Court held that the plain language of O.C.G.A. § 14-11-305 states that non-managing members in manager-managed LLCs do not owe duties to the LLC or other members, and therefore held that "non-managing members owe no fiduciary duties to the LLC or the other members" unless the operating agreement or articles of organization provide otherwise.[6]

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[5] Compare Planning Technologies, Inc. v. Korman and Old National Villages, LLC, v. Lenox Pines, LLC, supra.

[6] But cf. Perry Golf Course Development, LLC v. Housing Authority of Atlanta, 294 Ga. App. 387, --- S.E.2d --- (2008) holding without discussion or citation to the Georgia Limited Liability Company Code

LLC Member/Manager Authority and Liability.

Fielbon Development Co. v. Colony Bank of Houston County, 290 Ga. App. 847, 660 S.E.2d 801 (2008) addresses the issue whether a limited liability company can be liable under O.C.G.A. § 14-11-301(c) for the allegedly fraudulent borrowings by one of its managers. Colony Bank sued to recover on a promissory note signed by Fielbon Development Company, LLC and guaranteed by one of the LLC's managers, R.J. Fields. Fields and Calder Bond had formed Fielbon to develop real estate projects. Each was a fifty percent owner. Bond had the authority to manage the daily affairs while Fields was to handle the financial aspects. Bond could sign documents on behalf of Fielbon, could represent it at closings, and had authority to sign checks on the company checking account. The two also had an agreement that Bond could draw a certain amount per year from Fielbon accounts for his personal living expenses. Fielbon obtained a series of construction loans from Colony Bank, which both Fields and Bond personally guaranteed. After several months, Bond signed another promissory note on behalf of Fielbon, the note at issue, which was for a construction loan secured by a deed on a lot, Lot 4B, in one of the subdivisions being developed by Fielbon. Fields' and Bond's guarantees covered this promissory note as well.

Loan proceeds were used to purchase Lot 4B and Fielbon could make additional draws as construction on the lot progressed. The bank would inspect the property when a draw was requested to ensure that construction was progressing in proportion to the money advanced. Most draws on the loan were deposited directly into Fielbon's account. After a few months, the bank discovered that construction was not progressing. Bond told the bank that its documents were in error and that the loan was actually secured by Lot 4C. The bank changed the loan sheet and authorized subsequent draws based on its inspections of Lot 4C. In fact, the construction on Lot 4C was funded by a loan from another bank. In Colony Bank's suit on the note and guarantee, Fields and Fielbon filed lender liability counterclaims for negligence, attorney's fees and punitive damages.[7]

The Court held that the bank made out its prima facie case by producing the note and showing that it was executed by Bond, who had authority to sign such documents on Fielbon's behalf. Fielbon argued it should not be liable on the note because, under O.C.G.A. § 14-11-301(c), a limited liability company is not liable for acts of a member that are "not apparently for the carrying on in the usual way the business or affairs," the draws were not used for the development of Lot 4B and Bond allegedly embezzled some of the loan proceeds and failed to use the loan for the intended purpose. Closely examining Bond's and Fielbon's prior conduct and the circumstances of the loan, the Court found that there was nothing in Bond's actions that was so dissimilar from the acts the corporation had authorized him to perform as to make them "not apparently for the carrying on in the usual way the business or affairs" of the corporation.

Gardner v. Marcum, 292 Ga. App. 369, 665 S.E.2d 336 (2008), deals with the liability of an LLC and its members for return of funds that a third party invested in an aborted transaction. In Gardner, C. Rob Marcum sued Dan Gardner, Jay Steele, and DG Productions, LLC ("DGP"), claiming that he was entitled to the return of $50,000 he had loaned to the defendants. The trial court granted summary judgment in favor of Marcum and the defendants appealed. Dan Gardner was a musician, and his personal manager, Dennis Kurtz, had approached Marcum regarding investing up to $150,000 in an album by Gardner. Marcum wrote a check to DGP (an LLC owned solely by Gardner) in the amount of $50,000 to be used for "producing, releasing, and promoting" Gardner's album. Marcum argued that

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that members of an LLC formed to redevelop a housing project owed fiduciary duties to each other. Apparently, the operating agreement did not provide for managing members.

[7] The claims against Bond were discharged in bankruptcy.

these were initial funds to be used by Gardner for production, release, and promotion of the album, conditioned on the satisfactory completion of negotiations between Marcum and Gardner. If an acceptable agreement was finalized guaranteeing Marcum a proper return on his investment, he expected to invest an additional $100,000. He argued the money was therefore an "advance." Gardner argued the money was an "investment" and was the first of three investment installments with the understanding that a formal written agreement would be negotiated.

A formal agreement was never negotiated, and Marcum demanded that Gardner return the $50,000, which Gardner refused to do. Gardner claimed the project was ultimately unsuccessful because of Marcum's failure to complete his investment. The Court found that there was no assent to the essential terms of a contract because the parties never agreed on Marcum's rate of return on his investment, nor on whether the money was an unsecured loan or an equity investment, which were material terms.[8] At the most, the parties had entered into an unenforceable agreement to agree. The Court found no evidence, however, that Marcum had agreed to forfeit his money if the negotiations failed and held DGP liable for its return.

The defendants argued that the trial court erred in finding Gardner and Steele[9] individually liable. The Court of Appeals agreed and reversed. The Court found that Marcum paid the money to the LLC, and the LLC was liable for the return of the money to Marcum. Citing O.C.G.A. § 14-11-3303(a), the court held that Gardner and Steele were not liable for DGP's obligations solely by reason of being members. Because piercing the corporate veil would be an issue for the jury, the court concluded that it was error for the trial court to grant summary judgment against Gardner and Steele.

In addressing the defendants' argument that an issue of fact remained as to whether the money was a loan or an investment, the Court found that the argument had no merit. It found that because there was no meeting of the minds to form a contract, the result would be the same.

LLC Operating Agreement Provisions: Arbitration, Dissolution and Amendments.

In Georgia Rehabilitation Center, Inc. v. Newnan Hospital, 283 Ga. 335, 658 S.E.2d 737 (2008), the Georgia Supreme Court held that where an LLC Operating Agreement between members requires arbitration only of claims arising out of or in connection with the Operating Agreement or its breach and provides limited rights to dissolve the company, a member cannot be required to arbitrate an independent claim for judicial dissolution. The Court also upheld the trial court's appointment of a receiver to oversee the company during the litigation.

Georgia Rehabilitation Center, Inc. ("GRC") and Newnan Hospital ("Newnan") co-owned Cowetta Rehab Services ("CRS"). CRS became financially unstable, so Newnan requested that the trial court dissolve CRS under O.C.G.A. § 14-11-603. GRC moved to compel arbitration under CRS's Operating Agreement. The trial court denied the motion and appointed a receiver. GRC appealed, arguing that the Operating Agreement required arbitration on the issue of CRS's dissolution.

CRS's Operating Agreement provided that "any dispute, controversy or claim arising out of or in connection with, or relating to, this Operating Agreement or any breach or alleged breach hereof shall,

[8] In a prior appeal, Marcum v. Gardner, 283 Ga. App. 453, 641 S.E.2d 678 (2007), the Court held that the memorandum on the check, "1/3 investment on Don Gardner," was not determinative of the issue of whether the transaction was a loan or an investment, given Gardner's testimony that the transaction was a loan.

[9] The evidence conflicted about whether or not Steele was a member of DGP.

upon the request of any party involved, be submitted to, and settled by, arbitration." Id. at 335.[10] To determine whether CRS's judicial dissolution was a claim arising out of the Operating Agreement, the Georgia Supreme Court looked to the terms of the Operating Agreement concerning dissolution. The Agreement provided that "dissolution…occurs 'only upon [1] Dissolution Notice from a Member pursuant to [certain terms of the Operating Agreement]…[2] the unanimous written agreement of all Members…or [3] the bankruptcy or dissolution….of a Member.'" Id. The Court found it undisputed that none of those conditions applied. Since Newnan instead chose to invoke O.C.G.A. § 14-11-603 as the basis for CRS's dissolution, that the dissolution did not arise out of the Operating Agreement, and thus arbitration was required. Furthermore, since Newnan and GRC could not agree on how to move forward in any area regarding CRS, the Court held that the trial court was within its discretion to appoint a receiver to oversee CRS during the litigation.

Two justices dissented from the Court's ruling that Newnan's request for dissolution did not arise from a claim relating to the Operating Agreement. The dissent looked to the text of the statute that Newnan invoked as a grounds for dissolution, O.C.G.A. § 14-11-603(a), and also to Newnan's complaint. This statute provides that an LLC can be dissolved only "where it is not reasonably practicable to carry on the business *in conformity with* the articles of organization or *a written operating agreement*." Id. at 337. (emphasis in opinion). Newnan's complaint further clarified the choice to use that statute, specifically, "*on terms that are in accordance with . . . the provisions of the Operating Agreement between the parties*." Id. Thus, the dissent argued, Newnan's request for dissolution was a controversy that necessarily related to the Operating Agreement, and so arbitration should not have been denied.

In a subsequent decision, the Supreme Court affirmed the trial court's expansion of the receiver's powers, Georgia Rehabilitation Center, Inc. v. Newnan Hospital, 284 Ga. 68, 663 S.E.2d 204 (2008) (citing O.C.G.A. § 14-2-1431(c) which authorizes the appointment of receivers in connection with judicial dissolution of business corporations.)[11]

IH Riverdale, LLC v. McChesney Capital Partners, LLC, 292 Ga. App. 841, 666 S.E.2d 8 (2008) dealt with the validity of an amendment to an LLC operating agreement, made by the majority member, which eliminated a special quarterly distribution to a minority member of 5% of profits. That distribution was in addition to the distributions due to the minority member for his percentage ownership in the company and was allegedly in consideration for the minority member's guarantee of the company's debt. The LLC paid the lender $60,000 to eliminate the minority member's guarantee. The operating agreement authorized amendments made in writing and signed by members holding a majority interest in the company. The Court examined the operating agreement and found nothing to prohibit the amendment. It found nothing in the provisions regarding distributions to members that stated it was not subject to amendment. The minority member argued that a provision requiring unanimous consent to "major loan documents" and the entry into contracts obligating the company to expend more than $10,000 in company funds governed the majority member's actions. The minority member offered affidavit evidence regarding the elimination of his guarantee. The Court did not decide whether elimination of the guarantee violated the provision requiring unanimity for major decisions. It

[10] The Operating Agreement did not provide that the arbitrator should determine the issue of arbitrability, thus the scope of the arbitration clause was properly before the Court.

[11] Another decision regarding judicial dissolution of a Georgia LLC is Ervin v. Turner, 291 Ga. App. 719, 662 S.E.2d 721 (2008), a dispute among organizers of a bank who created an LLC through which to conduct fund-raising and organizational efforts. The trial court's order dissolving the LLC and its allocation of financial responsibility under a contribution agreement among the organizers was affirmed after rejecting a variety of arguments from the *pro se* appellants, none raising any legitimate questions for appeal.

stated, instead, that "the use of parol evidence to construe a contract is prohibited," but did not provide any analysis or explanation of how the parol evidence rule was implicated. Finding no express mention of the guaranty distribution in the major decisions provision of the operating agreement, it upheld the amendment as authorized under the operating agreement.

C. Partnership Law.

No significant 2008 decisions involving Georgia partnership law have come to our attention.

D. Joint Ventures.

Joint Venture, RICO Burden of Proof and Proximate Cause.

American Association of Cab Companies, Inc. v. Parham, 291 Ga. App. 33, 661 S.E.2d 161 (2008) involved a suit by an injured passenger in an under-insured taxicab against two cab companies who provided management services, including dispatching and insurance to cab drivers. The plaintiff sought to establish the cab companies' liability through alternate theories of agency, respondeat superior and joint venture. The cab companies objected to the jury charge and verdict form on the ground that there was no evidence supporting a joint venture. In a seven-judge decision with two dissenting judges, the Georgia Court of Appeals reviewed the evidence showing that there was the "mutual control" needed for a joint venture. The record reflected that the cab was co-owned by one of the cab companies and bore the insignia of the other. The driver obtained his license as one of the companies' listed drivers. The Court also noted that the driver himself exercised some control over his activities, although it is not clear why the mutuality of control needed to include the driver.

The Georgia Court of Appeals reversed a defense verdict on the plaintiff's Georgia RICO claim because the trial court had improperly instructed the jury that the plaintiff had to prove the defendants' RICO violations by clear and convincing evidence. The Court held that the Georgia Supreme Court's decision in Williams General Corporation v. Stone, 279 Ga. 428, 614 S.E.2d 758 (2005) establishing a preponderance of the evidence standard should be applied retroactively. The Court also rejected the defendant cab companies' argument that the plaintiff could not prove that the alleged RICO violations proximately caused his damages. The Georgia Commissioner of Insurance had issued a cease-and-desist order against one of the cab companies because it did not have the financial ability to provide coverage as a self-insurer or satisfy a judgment. Citing other decisions dealing with the applicability of RICO to fraudulently uninsured cab operations, the Court held that a jury could find that the cab companies misrepresented their financial condition and that this misrepresentation proximately compromised the plaintiff's ability to collect his judgment.

E. Business Law Issues.

Asset Purchase Agreements – Assumed Liabilities, Rights to Escrowed Funds, Breaches of Representations and Warranties, and Anti-assignment Provisions.

Assumed Liabilities. In Wilkie v. 36747, LLC, 294 GA. App. 179, 669 S.E.2d 155 (2008), a salesman seeking to recover unpaid commissions alleged to be owed by two software corporations that had sold their assets sued both the sellers and the purchaser. The Court held that the purchaser of the assets did not assume sellers' obligation to the salesman, even though purchaser was aware of the salesman's contract at the time of the purchase because the asset purchase agreement did not include the salesperson's contract among the liabilities being assumed, disclaimed responsibility for any liabilities not specifically assumed, and contained a merger clause. The transaction began with a "one-page

agreement, literally on a napkin" providing for the sale of all assets of two corporations for $4,800,000 with a non-refundable "deposit" of $500,000. A dispute arose between purchaser and seller in documenting the transaction and, after litigation and mediation, formal documents were prepared and executed. Reviewing the Asset Purchase Agreement, the Court stated:

> "The contract described included and excluded assets and liabilities, and explicitly provided that the Buyer did not assume any obligation of the Seller not specifically listed in the Assumption of Liabilities section of the contract, including any liabilities to 'any present or former employee.' The Seller otherwise continued to be responsible for all liabilities 'whether known or unknown, fixed or contingent, liquidated or unliquidated and secured or unsecured, whether arising prior to, at or subsequent to the [sale] date ... and whether or not disclosed to the Buyer.'"

The asset sellers, seeking indemnification from the purchaser, contended that the salesman's contract, entitled "Franchise Agreement," was a "software contract" expressly transferred under the Asset Purchase Agreement. The Court rejected that argument, finding that the software assets were "clearly and unambiguously" identified in the Agreement. The Court also rejected the argument that the salesman's contract, providing for the payment of future commissions, was a "trade payable" that the purchaser had assumed. Finally, the Court relied on the Asset Purchase Agreement's merger clause in holding that the purchaser's awareness of the salesman's contract did not result in assumption of liability.

Escrowed Funds. In Ahmed v. CUA Autofinder, LLC, 387 B.R. 906 (Bkrtcy. M.D. Ga. 2008), the Court decided who was entitled to the return of funds paid into escrow by the sole owner-member of an LLC formed to purchase assets of an automobile dealership. The LLC was to pay $650,000 of the $1,700,000 purchase price in cash, with the balance to be paid through a promissory note that the owner-member guaranteed. In the asset purchase agreement, the LLC agreed, as part of the purchase price, to escrow an additional $50,000 to pay the sellers' tax liabilities resulting from the sale. The LLC itself did not have the money required for the cash portion of the purchase price or to fund the escrow, so the owner-member made those payments from his personal funds, but did so without any formal documentation of any right or entitlement to the funds placed in escrow. The escrow agreement provided that the LLC was entitled to the funds not paid to the sellers. The LLC filed for bankruptcy when it could not make the final $550,000 payment under the note. The Court determined that the LLC's rights to the escrowed funds were part of the bankruptcy estate and that the sellers had failed to meet the conditions of the escrow within the time allowed. The owner-member asserted that, because he had discharged the LLC's obligations under the asset purchase agreement, he was equitably subrogated to the LLC's rights to return of the escrowed funds. Relying on case law from other jurisdictions, the Court set for the required elements for equitable subrogation as follows:

> "Equitable subrogation requires that a party show that (1) it paid a debt in order to protect its own interest, (2) it was not acting as a volunteer in making the payment, (3) it was not primarily liable for the debt, (4) the entire debt was paid, and (5) subrogation would not cause an injustice to the rights of third parties."

It then addressed the issue of whether the owner-member had acted as a volunteer in funding the escrow, quoting from Franco v. Cox, 265 Ga. App. 514, 594 S.E.2d 717, 719 (2004):

> "Subrogation is never applied for the benefit of a mere volunteer who pays the debt of another without any assignment or agreement for subrogation, and who is under no

legal obligation to make the payment, and is not compelled to do so for the preservation of any rights or property of his own."

The owner-member contended that his guarantee required him to perform the LLC's escrow obligations, but the Court determined that the escrow was not among the guaranteed obligations. The guarantee, moreover, contained an express waiver of rights to subrogation, which the Court held effectively waived any rights that the owner-member had against the LLC. It ruled that he had acted as a mere volunteer in funding the escrow and had no rights to return of the funds.

Breaches of Representations and Warranties. The decision in Kilroy v. Alpharetta Fitness, Inc., 2008 WL 5049966 (Ga. App. Dec. 1, 2008) concerns claims based on the alleged breach of representations and warranties by the seller in connection with the sale of assets of a Gold's Gym franchise exercise facility. The corporate purchaser, its shareholder and his wife sued the corporate seller and its shareholders for breach of contract, negligent misrepresentation and fraud, as well as fraudulent conveyance claims based on the selling corporation's distribution of proceeds to its shareholders. The trial court awarded summary judgment on the fraud and fraudulent transfer claims which the Court of Appeals reversed holding that triable issues existed as to elements of fraud and fraudulent transfer.

After the sale closed, the exercise facility produced less than expected revenues and the purchaser discovered that the seller had been factoring customer contract receivables, including the outright sale of some customer contracts. The purchaser sued, alleging that this practice breached representations and warranties in the asset purchase agreement that "no assignment of rights in or relating to [the contracts] have been made by Seller or Shareholders." The buyer also alleged that the asset purchase agreement's representations and warranties were also breached because the financial statements did not fairly present the company's financial condition and were not prepared in accordance with generally accepted accounting principles. An expert hired by the purchaser to analyze the accuracy of the financial records of the business concluded that the sales of the contracts were improperly reflected as an "immediate recognition of revenue" instead of "deferred revenue," inflating the revenue for a given month. The expert also found that in the first half of 2004, the seller's financial statements reported as revenue the net amounts received after expenses. In the second half of 2004, however, financial statements reflected the gross amounts received as revenue without reduction for expenses. This change in accounting methods could give a "false impression of growing revenue." The Georgia Court of Appeals found that there was some evidence to support each element of fraud and reversed the trial court's grant of summary judgment.

The Court also reversed the grant of summary judgment with respect to the fraudulent transfer claim because shortly after closing, the seller distributed the proceeds of the asset sale to its four shareholders leaving the corporation with no assets.

A petition for a writ of *certiorari* in this case is currently pending in the Georgia Supreme Court.

Anti-assignment clause. Accurate Printers, Inc. v. Stark, 2008 WL 5049960 (Ga. App., Nov. 26, 2008) involved the application of an anti-assignment clause in an asset purchase agreement. API's president and sole owner purchased Oxford Printing, Inc. from the defendant. The Asset Purchase Agreement was executed between the purchaser in his individual capacity, the seller defendant and the company Oxford Printing. As part of the transaction, purchaser (also in his individual capacity), the

seller defendant and the company Oxford Printing also executed a Restrictive Covenant prohibiting Oxford and Seller from involvement in "a competing business within the Area." API was not named a party to the transaction and did not execute the agreements. API did not contend that it was a third party beneficiary of any of the agreements. The purchaser himself was not a party plaintiff.

Seller agreed to work for purchaser and API to help with the business transition. Shortly thereafter, however, he went to work for Baxter Printing Co. in printing sales, where he began to compete with API, solicited API's customers, and disclosed proprietary information.

The trial court granted a directed verdict in favor of seller as to API's claims for breach of the non-compete clause and awarded attorney fees to seller, because API was not a party to the agreements it was trying to enforce. The Court of Appeals agreed, quoting Levy v. Reiner, 290 Ga. App. 471, 659 S.E.2d 848 (2008): "It is axiomatic that each corporation is a separate entity, distinct and apart from its stockholders." It affirmed the directed verdict as to the claims for breach of non-compete clause, but it reversed the award of attorney fees.

API argued that it had acquired the purchaser's rights by assignment. The Asset Purchase Agreement, however, prohibited the assignment of contract rights unless two conditions were met – the purchase price was paid in full and the seller consented. Neither of those conditions were met. API also argued that the seller had waived the anti-assignment prohibition. The Court of Appeals held that the waiver had to be "clear and unmistakable" and that the plaintiff's evidence did not satisfy those requirements. The award of attorney fees was reversed, since API as a non-party to the agreements could not breach them and had no liability for attorney's fees under them.

Corporate Conveyances of Real Estate – O.C.G.A. § 14-5-7.

Deljoo v. Suntrust Mortgage, Inc., 2008 WL 5174307 (Ga. App. Dec. 11, 2008). After financing the purchase of a residence, Suntrust and the purchaser discovered a previously unknown security deed on the property held by Shakrookh ("Daniel") Deljoo. Suntrust sued Deljoo, seeking to cancel the security deed or otherwise quiet title to the property as to the deed.

The security deed referred to the same lots of the subdivision at issue, but mistakenly identified them as being in the wrong land lot of the county district. The trial court granted summary judgment, concluding that the incorrect land lot number took the deed outside the chain of title and that the purchaser and Suntrust were bona fide purchasers without notice. The Georgia Court of Appeals affirmed that decision, 289 Ga. App. 396, 657 S.E.2d 319, but the Supreme Court reversed, 284 Ga. 438, 668 S.E.2d 245 (2008), finding that the incorrect description did not remove the deed from the chain of title.

On remand, the Court of Appeals vacated its earlier opinion, adopted the opinion of the Supreme Court, and considered the remaining enumerations of error. One of the remaining enumerations of error was that the trial court had erred in denying Deljoo summary judgment on the issue of whether the deed was properly executed. The trial court had found that there were genuine issues of material fact because: (1) the deed was signed only by the president of the corporation that had granted the property to Deljoo without any indication of his office or authority to bind the corporation and (2) the corporate seal affixed below the president's signature was illegible on the documents provided to the trial court.

The Court of Appeals affirmed the denial of summary judgment on this issue, basing its decision on O.C.G.A. § 14-5-7, a rarely cited Georgia statute on the validity of corporate conveyances of real estate, which provides that:

> "Instruments executed by a corporation conveying an interest in real property, when signed by the president or vice-president and attested or countersigned by the secretary or an assistant secretary or the cashier or assistant cashier of the corporation, shall be conclusive evidence that the president or vice-president of the corporation executing the document does in fact occupy the official position indicated; that the signature of such officer subscribed thereto is genuine; and that the execution of the document on behalf of the corporation has been duly authorized."

O.C.G.A. § 14-5-7. The Court applied the statute, noting that even if a deed is not signed by two corporate officers, the presence of an attested corporate seal could indicate authority to execute the document on a corporation's behalf. However, because the corporate seal here was illegible and because the president signed only his name with no reference to his title, the Court found that a genuine issue of fact remained as to the validity of the deed and affirmed the trial court's denial of summary judgment to Deljoo on this issue.

Article 8: Stock Owners Have No Claims Against Signature Guarantors under UCC or Common Law.

In Dudley v. Wachovia Bank, 290 Ga. App. 220, 659 S.E.2d 658 (2008), in a matter of first impression in Georgia, the Georgia Court of Appeals held that a signature guarantor is not liable to a stock owner under Article 8 of the Uniform Commercial Code.

Harold A. Dudley, Sr., executed a will bequeathing his stock to his estate to be divided among his children as executors. Years later, Mr. Dudley suffered from dementia and a stroke. Thereafter, Mr. Dudley's second wife had him sign forms that transferred the stock to her, as opposed to his estate, upon his death. One of the three issuers in which Mr. Dudley held stock (AFLAC) provided a Medallion Guarantee of his signature. Two commercial banks (Wachovia Bank, N.A. and Regions Bank) provided Medallion Guarantees as to his signature on the other two stocks (Southern Company and Regions Financial Corporation).

After Mr. Dudley's death, his executors sued Mrs. Dudley, the bank and the three corporate defendants for loss resulting from the wrongful transfer of the stock. Relying on decisions from other jurisdictions, the Court of Appeals held, as a matter of first impression in Georgia, that the warranties made by a signature guarantor under O.C.G.A. § 11-8-306 flow to those who deal in the security in reliance on the guarantee, but not to a stock owner. Second, the Court rejected the executors' common law negligence claim, holding that claims against signature guarantors are limited to the breach of warranty remedies specified in the UCC. Thus, under neither statutory nor common law can a signature guarantor be liable to a stock owner who suffers a loss from the wrongful transfer of stock. Third, the Court did recognize the executors' claim against the three issuers, who have "absolute liability" under O.C.G.A. § 11-8-404 for a wrongful register of transfer. Finally, the Court affirmed summary judgment on the executors' equitable claims against the corporate defendants under O.C.G.A. § 13-3-24 to void the transfers, because the corporate defendants did not own or control the stock at issue.

F. Litigation Issues.

Aiding and Abetting Breaches of Fiduciary Duty.

The Georgia Court of Appeals decision in White v. Shamrock Building Systems, Inc., 294 Ga. App. 340, 669 S.E.2d 168 (2008)) reflects further consideration of the tort of aiding and abetting a breach of fiduciary duty recognized in the business organization context in Insight Technology v. FreightCheck, LLC, 280 Ga. App. 19, 633 S.E.2d 373 (2006). The plaintiff in White, Shamrock Building Systems, Inc., a construction company, sued to recover for the loss of a business opportunity allegedly diverted by a salesman, Mitchell Cooke, who formed a company of his own, Cooke Enterprises, Inc., to bid on a mini-storage project developed by White Property Acquisition/Management, LLC ("WPA"). Shamrock asserted claims for aiding and abetting a breach of fiduciary duty, conspiracy and tortious interference with business relations against WPA and its principal Dewey White. It adduced evidence that a consultant to WPA had recommended Shamrock as a contractor for the project and identified Cooke as its representative. Shamrock argued that, as a result of these facts, WPA "knew or should have known" that Cooke was associated with Shamrock and had a "duty to investigate" the relationship before doing business with Cooke. White testified uncontroverted, however, that when Cooke met with WPA, he represented himself to be free to undertake the project and when Cooke bid on the project, he did not disclose any relationship with Shamrock. In reversing a denial of summary judgment to WPA and White, the Court did not address Shamrock's claims that they could be held liable for aiding and abetting a breach of fiduciary duty if they "should have known" of Cooke's relationship with Shamrock or for failing to "investigate" the status of the relationship at the time he bid on the project. However, those contentions were implicitly rejected because the Court, after carefully reviewing the required elements for aiding and abetting a breach of fiduciary duty under Insight Technology and the evidence in the record, held that there was no evidence that WPA had "acted, through improper action or wrongful conduct to procure an alleged breach of Cooke's fiduciary duty" or that it "took any action 'purposely and with malice with the intent to injure'" his relationship with Shamrock. The Court found no difference in the requirements for conspiracy or tortious interference with business relations and reversed on those claims, as well. In affirming the denial of summary judgment to Cooke and Cooke Enterprises, the Court noted that because Cooke was not an officer or director, he could not be held liable for misappropriating a business opportunity, but that as an agent of Shamrock he owed fiduciary duties not to compete with Shamrock and not to profit personally from business leads obtained through his relationship to Shamrock. The Court rejected the federal "single legal actor" theory of conspiracy under which a corporation cannot conspire with its employees and rejected Cooke Enterprises' contention that it could not conspire with its sole shareholder, citing Williams Gen. Corp. v. Stone, 280 Ga. 631, 632 S.E.2d 376 (2006) which held that a corporation can conspire with its officers under the Georgia Racketeer Influenced and Corrupt Organizations Act. The Court found issues of fact as to whether Cooke breached his fiduciary duty and whether Cooke Enterprises aided and abetted him in doing so.

Statute of Limitations for Breaches of Fiduciary Duty.

Peery v. CSB Behavioral Health Systems, 2008 WL 4425364 (S.D. Ga. Sept. 30, 2008) involved claims and counterclaims arising out of CSB Behavioral Health Systems' rescission of a settlement with its the former Executive Director, F. Campbell Peery, whose employment had been terminated. The Court does not mention what kind of organization CSB was, but states that it was owned and operated by a state agency, the Community Service Board of East Central Georgia. Peery sued to recover the benefits he was to receive under the settlement. CSB counterclaimed against Peery for breach of his

"good faith and fiduciary duties" and Georgia RICO violations. In rejecting Peery's argument that Georgia law does not recognize a cause of action for breach of a duty of good faith, the Court stated that "Georgia does recognize a duty of good faith on behalf of directors and officers, at least in some circumstances," citing O.C.G.A § 14-2-830, along with decisional authority. The Court rejected Peery's statute of limitations defense under O.C.G.A. § 9-3-26, which it noted applies to miscellaneous breaches of contract, because none of CSB's breach of fiduciary duty claims was related to a contract. The Court explained that, "[i]n Georgia, the statute of limitations applicable to a breach of fiduciary duty is the statute of limitations which applies to the conduct that caused the breach," citing last year's decision in Hendry v. Wells, 286 Ga. App. 774, 650 S.E.2d 338 (2007) which applied the four year statute of limitations for injury to personal property in O.C.G.A. § 9-3-31 to the limited partners' breach of fiduciary duty claims against the partnership and its general partners. The Court did not decide which statute of limitations would apply to the fiduciary claims before it, but noted that they alleged "violations of a fraudulent nature." In addressing a fraud count, the Court held that the statute of limitations for fraud begins to run when the fraud is or should have been discovered. It is not clear why the Court in Peery did not apply or at least mention the express four-year statute of limitations in O.C.G.A § 14-2-831 for derivative actions and actions by corporations against their officers and directors. Notably, the Georgia Nonprofit Corporation Code does not contain a counterpart to § 14-2-831, and, in light of a discussion of sovereign immunity, CSB itself might have been a state agency or instrumentality for which the provisions of the Georgia Business Corporation Code would serve only by analogy.

Receiverships and Accountings.

In Fulp v. Holt, et al., 284 Ga. 751, 670 S.E.2d 785 (2008), the Supreme Court affirmed the lower court's order appointing a receiver in proceedings to dissolve a law firm composed of two partners, where there was evidence that one of the partners misappropriated firm funds, borrowed money on the firm's line of credit without the other partner's permission and without disclosing to the bank that the firm was to be dissolved, and took records from the firm, including most of the personal injury case files belonging to the firm.

Two lawyers formed a professional corporation in which to conduct a law practice and a limited liability company through which to invest in real estate. They had an oral agreement to split the PC's income and expenses evenly. Five years later the two partners decide to dissolve the PC and the LLC. Shortly thereafter, one of the "partners" sued the other partner alleging breach of contract, breach of fiduciary duty, conversion, fraud and stubborn litigiousness asking the court to impose a constructive trust and appointing a liquidating agent. The second partner counterclaimed seeking among other things an accounting and the dissolution of the entities and appointment of a receiver of the LLC. After a hearing, the trial court appointed a receiver for the P.C. and requested both partners to file a list of all active files of the law firm and execute affidavits stating the status of fees and expenses as to each file. Fees collected were to be deposited with the receiver who would do an accounting and twice a month the court would entertain requests to withdraw funds from the fee deposit. The Receiver's fees were to be borne equally by the parties. The Supreme Court stated that, under O.C.G.A. § 9-8-3, a receiver may be appointed when there is "manifest danger of loss, destruction, or material injury" and noted the evidence of misappropriation by the second partner. Citing Georgia Rehabilitation Cntr., Inc. v. Newnan Hosp., 283 Ga. 335, 658 S.E.2d 737 (2008), the Supreme Court found that "the grant or refusal of a receivership 'is a matter addressed to the sound legal discretion of the [trial] court,'" and having found no abuse of the trial court's discretion, it affirmed the appointment of receiver by the lower court.[12]

[12] Georgia Rehabilitation Center, Inc. v. Newnan Hospital, 283 Ga. 335, 658 S.E.2d 737 (2008) (affirming appointment of receiver), is discussed in Section II.B., above.

In Treu v. Humanism Investment, Inc., 284 Ga. 657, 670 S.E.2d 409 (2008), the Supreme Court of Georgia affirmed the decision of the lower court refusing to appoint a receiver for the corporation. Humanism Investment, Inc. was formed in 1997. Plaintiff Treu invested $100,000 in the corporation. The corporation's sole asset was a building purchased for $1.055 million. Stock certificates were not issued to shareholders until 2000. In 2002, Treu and two of the corporation's eight shareholders filed an Application for Meeting of Shareholders, Inspection of Records, Accounting, Injunctive Relief, and Appointment of a Receiver. In response, the president of Humanism called the first meeting of shareholders, and salaries and other expenses were approved retroactively by the majority of shareholders. In addressing the Plaintiffs' Motion for Appointment of Receiver, Application for Accounting and Motion for Sanctions for Defendant's Failure to Comply with Consent Scheduling Order, the trial court appointed an auditor to examine corporate records, provide an accounting of investments and payments, and determine the interests of shareholders. The auditor concluded that the fair market value of the building had increased to $6 million, and the plaintiff's share of the corporation was more than 4 times more than the initial investment. The amount of certain allegedly improper expenditures was added back to shareholders' equity, so that the plaintiff's share could be properly calculated. Thus, the court concluded that in the absence of any indication that the corporation was insolvent, or that the plaintiff would not be able to ultimately gain her appropriate share of the corporation's value, the rights of shareholders could be protected without appointment of the receiver. The Supreme Court found no abuse of discretion by the lower court and affirmed refusal to appoint a receiver.

Sampson v. Haywire Ventures, Inc., 293 Ga. App. 779, 668 S.E.2d 286 (2008) involved an appeal of summary judgments in favor of a corporation and its LLC subsidiary on their claims against a former director, employee and shareholder for conversion of company funds and on his counterclaims against the companies for, among other things, breach of fiduciary duty, conversion of stock and an accounting. The Court of Appeals affirmed, holding that his claims for breach of fiduciary duty involved alleged wrongdoing by certain officers of the companies who were not parties to the litigation. Those claims would have to be brought against those parties either derivatively by the corporation or directly if the defendant had a personal cause of action based on a "special injury." His claim for conversion of his stock had been held in a prior appeal to be subject to dismissal because it had been belatedly added by amendment without leave of court. As to the claim for accounting the Court stated:

> "The sufficiency of [a] petition to set forth [a party's] right to an accounting depends upon whether the facts alleged showed that on an accounting the petitioner will likely be entitled to recover judgment for some amount." . . . . Because Sampson is unable to show that he will likely be entitled to recover judgment for any amount pursuant to his underlying conversion or breach of contract counterclaims, no accounting is warranted here.

Id. at *2 (quoting Charles S. Martin Distrib. Co. v. Roberts, 219 Ga. 525, 532(3), 134 S.E.2d 587 (1964)).

Member and Investor Intervention in LLC's Legal Proceedings; Temporary Injunction Against Contesting Voting Rights in a Control Battle.

Hampton Island Founders, LLC v. Liberty Capital, LLC, 283 Ga. 289, 658 S.E.2d 619 (2008) began as a suit by Hampton Island Founders, LLC ("Founders") against a joint venture partner because the partner had failed to meet its contractual obligation to obtain financing required for development of a retreat on Hampton Island. The joint venture itself was formed as an LLC and Founders transferred the

property to it. When Liberty Capital failed to raise all the funds required, Founders attempted to enforce provisions of the operating agreement that would increase its ownership in the joint venture company and give it control.

Founders and its four member entities, also LLCs, were originally controlled by a single individual, Wade Shealy. By the time of the litigation, certain of the investors in Founders' member companies had become dissatisfied with Mr. Shealy's management. Two of the four member companies and some of their investors were permitted to intervene in the litigation for the stated purpose of wresting control over Founders from Mr. Shealy and obtained an injunction against Founders to prevent any interference with their efforts. The Supreme Court posed the question presented by Founders' appeal as:

> "[W]hether the trial court abused its discretion in granting a temporary injunction which prohibited plaintiff from engaging in "any act which would have the effect" of contesting the voting rights of investors in plaintiff's member entities, when those investors wanted to use their votes to gain control of plaintiff and dismiss this lawsuit."

The Court found that the injunction was improper because, by permitting the dissidents an uncontested opportunity to remove Mr. Shealy, the trial court altered rather than preserved the status quo, and because the trial court had also failed to balance the equities.[13]

The Court also found that the trial court had erred in permitting intervention because the member companies and investors were not intervening to participate in the litigation, but rather to terminate it. The Court did not see why intervention was needed to protect their interests, why their interests were not adequately represented by the defendants and why they could not pursue their claims in a separate proceeding.

Adequacy of Representation and Intervention in Collusive Derivative Action Settlement.

Stephens v. McGarrity, 290 Ga. App. 755, 660 S.E.2d 770 (2008) addresses the importance of O.C.G.A. § 14-2-745's requirement for court approval of derivative action settlements, the importance of the adequacy of representation of the corporation in a derivative action by a close corporation minority shareholder and the importance of the right of other non-party shareholders to intervene and object to a collusive settlement that benefits the plaintiff personally at the expense of the corporation and the other shareholders. According to the Court of Appeals' opinion, this case represents the first appellate interpretation of § 14-2-745. Both the derivative action plaintiff Douglas McGarrity and Richard Stephens, the shareholder seeking to intervene, were 9½% shareholders in Northlake Foods, Inc., a large Waffle House franchisee. The majority shareholder William Johnson was alleged to have, among other things, borrowed over $14 million from Northlake through two companies he owned. Both McGarrity and Stephens sued Johnson separately over the loans. McGarrity's complaint asserted both direct and derivative claims. McGarrity agreed to a settlement of his case that provided that the debt to Northlake would be cancelled in exchange for a $2,937,000 payment in cash and notes to Northlake, $2,540,000 of which would be paid over to McGarrity and the balance would be paid in accrued bonuses to Northlake's senior management. The settlement provided for releases to Johnson and his entities. According to the Court, McGarrity's pro rata share of the Johnson debt to Northlake was $1,700,000.

[13] By contrast, the Court affirmed the trial court's injunction prohibiting both joint venture partners from interfering with management of the joint venture company because that injunction did attempt to preserve the status quo pending the outcome of the litigation.

Stephens filed objections to the settlement and sought to intervene. The trial court denied Stephens' motion and approved the settlement. The Court of Appeals first determined that Stephens had a protectable interest in obtaining an appealable determination of whether McGarrity's representation of the corporation as derivative plaintiff was adequate under O.C.G.A. § 14-2-741(2) and ruled that the trial court had abused its discretion in denying his motion to intervene. The Court then addressed § 14-2-745's requirements for judicial approval of derivative action settlements and determined that the standard of review would likewise be abuse of discretion. The parties to the settlement argued that the court should balance the risks and rewards of further litigation against the costs and uncertainty of the outcome and contended that the arms-length negotiation should give rise to a presumption of fairness. The Court responded:

> "When there is a substantial danger of collusion between an allegedly malfeasant majority shareholder (Johnson) and a previously aggrieved derivative plaintiff (McGarrity), however, we cannot grant the settlement the benefits of such presumptions . . . . [W]e cannot draw conclusions about the merits of the settlement without examining its specific benefits to Northlake."

After finding that the settlement was not in the corporation's best interests, the Court concluded:

> "The settlement before us succeeds only in making Northlake a conduit for funds going to McGarrity in exchange for the abandonment of the derivative action he brought – just the kind of direct recovery frowned on by our Supreme Court."

(citing Pickett v. Paine, 230 Ga. 786, 199 S.E.2d 223 (1973)). The Court of Appeals held that the trial court abused its discretion in approving the settlement and reversed.

Piercing the Corporate Veil.

Three decisions in 2008 addressing the alter ego or piercing the corporate veil deserve attention.

First, in Pazur v. Belcher, 290 Ga. App. 703, 659 S.E.2d 804 (2008), a former employee obtained a default judgment against a corporation for wrongful conversion of his commissions and then filed a separate suit against the corporation's former sole owner and CEO, seeking to pierce the corporate veil and hold her liable for the judgment. Because the statute of limitations had expired on any claim against the owner-CEO, the plaintiff had to pierce the corporate veil in order to establish liability. The trial court denied summary judgment to both parties, but certified the order for interlocutory appeal.

The plaintiff argued that the sole shareholder was bound by the admissions of the corporation in the default judgment and that her resulting culpability should suffice to pierce the corporate veil. The Court rejected that argument, patiently explaining that the corporation and its owner-CEO were separate legal persons, that a default judgment by the corporation does not constitute an admission binding on the shareholders, directors or officers, and that, in any case, an officer's personal culpability for his or her tortious conduct is irrelevant to the issue of whether the corporate veil can be pierced. Citing and quoting extensively from Baillie Lumber Co. v. Thompson, 279 Ga. 288, 612 S.E.2d 296 (2005), the Court held that the plaintiff must show that "the shareholders disregarded the corporate entity and made it a mere instrumentality for the transaction of their own affairs; that there is such a unity of

interest and ownership that the separate personalities of the corporation and the owners no longer exist." 279 Ga. at 289-90.

Reviewing the evidence on the relationship between the former sole owner and CEO, the Court held that:

- Sole ownership of a corporation by one person or entity is not a factor, nor is the fact that the owner uses the corporation to promote his or her own ends, unless there is accompanying abuse of the corporate form.
- Loans to or from the corporation, without abuse of the corporate form, do not support piercing the corporate veil, and forgiveness of the loans does not change the analysis.
- Use of a company credit card or car do not justify piercing the corporate veil if there is no showing that they were not legitimate business expenses or compensation.
- Alleged improper conduct against third parties does not represent evidence of abuse of the corporate form if the practice benefits the corporation.

Because the plaintiff had no evidence that the former shareholder CEO had disregarded the separateness of the corporation, the Court of Appeals reversed the denial of her summary judgment motion.

Second, the Eleventh Circuit Court of Appeals in an unpublished opinion, BP Products North America, Inc. v. Southeast Energy Group, Inc., 282 Fed. Appx. 776 (11th Cir. 2008), reversed a summary judgment holding the sole shareholder of a corporation liable for a corporate debt. In two depositions, the shareholder, Michael Hollis, had given highly contradictory testimony about the corporation, its business, finances and records. He had also permitted records to be destroyed, which the trial court presumed "would show lack of adherence to the corporate form and would also show Hollis' use of Southeast's assets as his own." The Court of Appeals found that the district court had implicitly determined that Hollis' actions were in bad faith and that the district court was authorized to make that determination as a sanction for failing to preserve evidence. Assuming that the trial court had sufficient evidence that the shareholder had disregarded the corporate form, however, the Court found that there remained a factual issue as to whether Hollis maintained Southeast as a sham corporation to "defeat justice, to perpetrate fraud, or to evade contractual or tort responsibility," citing Baillie Lumber Co. v. Thompson, 279 Ga. 288, 299, 612 S.E.2d 296 (2005) (decision on certified question from 11th Circuit).

Third, arbitration can be compelled as to both signatory and non-signatory companies to the arbitration agreement if they are alter-egos or are alleged to be. A plaintiff's alter ego allegations as to two affiliated corporations were used in Bruce v. PharmaCentra, LLC, 2008 WL 1902090 (N.D. Ga. April 25, 2008) to estop the plaintiff from contending that she was not bound to arbitrate her sexual harassment claims against both corporations based on an arbitration agreement she signed with the corporation that employed her.

See also In re Friedman's Inc., 385 B.R. 381 (S.D. Ga. 2008), *vacated in part on reconsideration by* In re Friedman's Inc., 394 B.R. 623 (S.D. Ga. 2008) (holding that under Georgia law piercing the corporate veil requires insolvency), discussed below.

Prosecution of Employees – Malicious Prosecution and Corporate Malice.

Barnette v. Coastal Hematology & Oncology, P.C., 294 Ga. App. 733, 670 S.E.2d 217 (2008), illustrates the risks in referring former employees for prosecution. In that case, two former employees of a health care practice filed a suit for malicious prosecution against the practice and a doctor following the dismissal of criminal charges of computer theft and computer forgery that had been brought against them related to payments to them discovered after their employment had been terminated.

Deborah Barnette began her employment in 1998 as the office manager of Coastal Hematology & Oncology, P.C., and had reported directly to Dr. Brian Kim. Later that year, Barnette obtained Kim's approval to hire her daughter, Susan Hendrix, to work for Coastal as a part-time billing clerk. At some point, a conflict arose between Hendrix and a full-time employee, and Hendrix was terminated.

In 2002, Coastal hired Howard Werner as its COO and Barnette began reporting directly to him, not to Kim. Soon after Werner began, Barnette received a pay increase, which she claimed was approved by Werner. Barnette also claimed that Werner approved the temporary re-hiring of her daughter, Hendrix, to help compile a compliance manual. Because of the previous conflict, Hendrix worked from home and completed the project after a few months, according to Barnette. Kim denied any knowledge that Hendrix was ever hired to work on the project, and neither Barnette's administrative assistant, nor any other Coastal employees were aware of Hendrix's work on the project. Later that year, Barnette was terminated, and the new office manager discovered in the tax documents the increased payments to Barnette after her alleged "pay raise" and the payments to Hendrix during 2002. When brought to Kim and Werner's attention, both denied any knowledge of Barnette's pay increase or Hendrix's employment during 2002.

Coastal contacted the police, and after a criminal investigation, Barnette and Hendrix were indicted on several counts of computer theft and computer forgery. The charges were ultimately dismissed by orders of *nolle prosequi*, and Barnette and Hendrix then sued for malicious prosecution. Under Georgia law, to state a claim for malicious prosecution, the plaintiff must show that a criminal prosecution was instigated against him/her with malice and without probable cause under a valid warrant, accusation or summons, which has terminated in the plaintiff's favor and has caused damage.

The trial court granted summary judgment to Coastal and Kim, finding that Barnette and Hendrix failed to present any evidence that there was a lack of probable cause. A police detective signed an affidavit averring that he had exercised his own professional judgment in deciding to pursue the case and that he had not been influenced by Kim's desire to prosecute. Such affidavits have been found to insulate defendants from liability for malicious prosecution because they indicate probable cause and give rise to a presumption that probable cause was present.

Barnette and Hendrix appealed, arguing that the trial court had failed to consider several decisions that recognized an exception to the presumption of probable cause based on officers' affidavits averring independent judgment. The Court of Appeals distinguished several of the cases recognizing the exception, but relied on one that found an exception when the informer knowingly makes false statements to the arresting officer. The Court found that an issue of fact existed as to whether Werner knowingly made false statements to the police detective in an attempt to influence his judgment. The Court reversed Coastal's summary judgment because Werner was its agent at the time. However, the Court found that there was no evidence that Kim knowingly made any false statements, and it found as a matter of law that he had conducted a reasonable inquiry to verify the information

upon which he based his complaint to police. Therefore, the Court upheld summary judgment as to Kim individually.

Dischargeability of Claims against Business Organization Officers in Bankruptcy.

Two decisions in 2008 addressed the question of whether claims against officers and directors of Georgia corporations or LLCs can be held nondischargeable under 11 U.S.C. § 523(a)(4), so that the claimants can pursue their claims as to post-petition income and assets.

First, in In re Sutton, 2008 WL 4527761 (Bankr. M.D. Ga. Oct. 2, 2008), Omega Cotton Company filed an adversary proceeding against the debtor, Omega's former president, seeking a determination that two claims should be excepted from discharge under 11 U.S.C. § 523(a)(4). In the first count, Omega sought nondischargeability for a $308,430.25 judgment that it had been awarded against the debtor in 2006 for claims of negligence and breach of fiduciary duties. For the second count, Omega sought $4,523,400.00 based on additional claims of fraud against the debtor not encompassed in the previous judgment. Both parties agreed on the facts, which were that Omega, a corporation engaged in the business of buying and selling cotton, had been required by its creditor to maintain a hedged position in the commodities futures market to protect its cotton inventory. Instead, the debtor used the proceeds of the notes held by the creditor to actively speculate on the commodities futures market. Omega claimed that this activity caused it a loss of $4,523,400.00.

In regard to the claim for the nondischargeability of the $308,430.25 judgment, Omega argued that the debtor's right to defend against nondischargeability of the judgment was barred by *res judicata*. The Bankruptcy Court for the Middle District of Georgia disagreed, finding that there was no identity of the cause of action. Though the judgment was rendered based on breach of fiduciary duty, the Court found that "mere breach of fiduciary duty is not the same as the requirements for an 11 U.S.C. § 523(a)(4) nondischargeability finding." Thus, because a breach of fiduciary duty is not *per se* sufficient for a finding that the debt was exempt from discharge, the Court found that *res judicata* did not preclude it from determining the judgment's eligibility for discharge.

The court relied heavily on Quaif v. Johnson, 4 F.3d 950 (11th Cir. 1993), an opinion in which the Eleventh Circuit construed the definition of "fiduciary capacity" and "defalcation" narrowly in determining nondischargeability under 11 U.S.C. § 523(a)(4). In Quaif, the Eleventh Circuit held that the term "fiduciary" is to be construed narrowly to refer only to "technical trusts" which existed prior to the act that created the debt. The Sutton court noted that a state statute can create the necessary fiduciary status so long as the statute defines the res, states the fiduciary duty, and imposes a trust on funds prior to the act creating the debt. However, the statutes setting forth the duties of officers and directors do not rise to the level of creating statutory fiduciary duties for the purposes of excepting a debt from discharge under 11 U.S.C. § 523(a)(4). The Court held that "[a] general duty of good faith does not rise to the level of an express or technical trust of the kind required for nondischargeability." Further, the Court held that even if a fiduciary relationship did exist, there must also be a "defalcation." Based on Quaif, the Court defined defalcation as a "failure to produce funds entrusted to a fiduciary." The Court found that the debtor's actions did not rise to the level of defalcation and held that the $308,430.25 judgment could not be held nondischargeable.[14]

[14] Finally, the Court found that the claim for $4,523,400.00, which arose from the debtor's alleged breach of fiduciary duties was barred by *res judicata*. The Court found that Omega had a fair opportunity to litigate the issues of fraud and breach of fiduciary duty in the previous case, and that the creditor's losses had already been the subject of the prior litigation and had been reduced to judgment. The Court held that Omega was barred by

In In re Wheelus, 2008 WL 372470 (Bankr. M.D. Ga. Feb. 11, 2008), an adversary proceeding was brought against two former managers of a limited liability company. The plaintiffs claimed that the debt owed to them was nondischargeable due to fraud or defalcation, pursuant to 11 U.S.C. 523(a)(4). The plaintiffs alleged that the debtors had used company funds to pay for personal expenses, that the debtors sold company equipment on credit in violation of company policy, provided rent-free business space to a third party, failed to identify the payee for many transactions from petty cash, and raided the petty cash and company bank account after being removed as managers.

At trial, the plaintiffs abandoned their fraud claim, so the only issue for the Court to determine was whether the debtors engaged in defalcation. The Court found that to prevail, the plaintiffs were required to prove both the fiduciary capacity of the debtors and defalcation by the debtors while acting in their fiduciary capacity. The Court relied on Quaif's definition of "fiduciary" as being narrowly construed to refer only to "technical" trusts. Thus, "the traditional meaning of fiduciary under state law – loyalty, good faith and fair dealing – is too broad for the purposes of [11U.S.C. § 523(a)(4)]." The Court found that a "technical" trust requires that property be entrusted to the debtor, such as in an express trust or statutory trust situation. There must be an identifiable trust res and imposed specific duties with regard to the res. Because the plaintiffs offered no evidence of a contractual or statutory trust, and only relied on the statutory fiduciary duties owed by managers of limited liability companies, the Court held that the plaintiffs failed to prove fiduciary defalcation and refused to accept the debt from discharge.

The holdings of the above cases may be distinguished from the decision in In re Pharr-Luke, 259 B.R. 426 (Bankr. S.D. Ga. 2000), but the distinction would be based on a rather outmoded view of the duties of corporate officers and directors in the insolvency context and may not square with the Georgia Business Corporation Code or current Georgia common law. In Pharr-Luke, the debtor was the owner of a corporation that had pledged pharmacy inventory to a bank. The debtor also granted a junior security interest in the same inventory to Smith Drug Company. In 1996, the corporation filed a Chapter 7 bankruptcy proceeding in which the trustee determined there was no value to the inventory and abandoned it as an asset of the Chapter 7 estate. Prior to that bankruptcy, the debtor had formed a second company in a store adjacent to the pharmacy. When the pharmacy inventory was abandoned by the Chapter 7 trustee, the debtor physically moved the assets of the second corporation into the location formerly occupied by the first company and combined the inventories. The debtor then granted a junior lien to the combined inventory, but Smith Drugs never obtained any security interest in the second corporation's inventory. In the debtor's personal bankruptcy, one of the issues to be resolved was whether the debtor had deposited money into the first corporation's account after it had filed Chapter 7 and used the funds to pay herself or to pay the second corporation, which would make the debt nondischargeable under 11 U.S.C. 523(a)(4).

The Court relied on the Quaif decision, finding that the only distinction was that the debtor's fiduciary obligation was created by common law rather than statute, as it was in Quaif. The Court found that Georgia law provides that when a corporation becomes insolvent, managing officers of a corporation have a duty to conserve and manage the remaining assets "in trust" for creditors. Thus, the debtor committed defalcation when she transferred funds from the account of the insolvent first corporation in violation of her duty to manage the funds for the benefit of creditors. Georgia courts had described the duty as "conserving and managing the remaining assets in trust for creditors." Thus, the Court held that the "technical" trust situation was created so that the debt fit into the narrow definition

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res judicata from now attempting to prove fraud in an amount greater than the judgment rendered in the previous litigation.

in 523(a)(4). The Georgia courts have not recently addressed the question of the duty of officers and directors of insolvent corporations, whether they owe duties directly to creditors or whether, instead, creditors not shareholders become the stakeholders for whose benefit officers and directors perform those duties, and whether there are substantive differences in the officers' and directors' duties once corporations become insolvent (i.e., are the "duties" to creditors limited to prohibiting self-dealing and misappropriation of assets).

Service of Process on Corporations and Business Organizations.

Vibratech, Inc. v. Frost, 291 Ga. App. 133, 661 S.E.2d 185 (2008) In this case, the owner of the airplane and the estates of the pilot and passengers killed in a plane crash brought claims of wrongful death against the non-resident manufacturer of the plane's damper. Three of the plaintiffs were residents of Georgia, and the other three resided in surrounding states. The defendant, Vibratech, Inc., was a Delaware Corporation with its principal place of business in Alden, NY, but was no longer in operation and had no officers, directors or employees. Vibratech had filed for bankruptcy 18 months before the accident. It never maintained a certificate of authority to conduct business in the state of Georgia and did not conduct any business operations in Georgia. Vibratech had sold the damper installed in the crashed plane to a Delaware company with its principal place of business in Alabama. The damper was installed in Georgia. The plaintiff served the lawsuit on CT Corporation, Vibratech's registered agent in Delaware. CT had given notice to Vibratech that it was discontinuing its service as registered agent for non-payment of fees, but it nevertheless accepted service of the complaint. CT forwarded the service documents to Ridge Capital Corporation, the last contact Vibratech had provided. Only after this service, CT submitted its resignation as Vibratech's registered agent. Ridge Capital returned service documents to CT Corp. CT Corp. returned documents to the Clerk of the Court, copying plaintiff's counsel on the transmittal letter stating that its statutory service for Vibratech had discontinued. Although aware that Vibratech had filed for bankruptcy, plaintiffs did not serve the bankruptcy trustee. Vibratech failed to answer the complaint within 30 days. Soon thereafter, plaintiffs amended their complaint asserting that they had obtained relief from stay in Vibratech's bankruptcy and sought to re-serve Vibratech. CT Corp. rejected service and plaintiffs served the Delaware Secretary of State. Vibratech was listed as an additional insured on a policy held by TCM. TCM began providing a defense to Vibratech, and Vibratech moved to open default along with a motion to dismiss. Reviewing the trial court's ruling for abuse of discretion, the Court of Appeals upheld the denial of Vibratech's motion to open default, concluding that Vibratech transacted business in Georgia when it sold parts to the installer in Georgia, and service of process on registered agent was valid because the agent did not effectively resign. The Court distinguished Georgia authority holding that service on an officer who had resigned, but was still listed in the Secretary of State's database as an officer based on the corporation's annual report, was invalid. The Court observed that, while the resignation by corporate officers and directors may be effective upon giving notice to the corporation, under Delaware General Corporation Law §§ 135, 136, a registered agent's resignation is not effective until the appropriate filing is made with the Delaware Secretary of State. The Court further noted that the fact that Vibratech did not receive actual notice of the complaint did not render the service of process invalid because the failure to receive actual notice was due to Vibratech's own failure or that of the bankruptcy trustee to replace the registered agent or to otherwise ensure that service would be forwarded to the trustee or some other designated person. The Court did not address the effectiveness of the later service on the Delaware Secretary of State.

Brock Built City Neighborhoods, LLC v. Century Fire Protection, LLC, 2008 WL 4740396 (Ga. App., Oct. 30, 2008). In this case, the Court of Appeals held that the plaintiff could not serve its breach of

contract complaint on the defendant LLC by publication even if the LLC's registered agent evaded service because the plaintiff knew the LLC's business address, and it did not attempt to serve other persons listed in the statute governing service on corporations, such as another officer or agent of the defendant. Plaintiff had been unsuccessful in several attempts to serve the LLC's registered agent at his business and residence address, and the trial court had granted plaintiff's motion for service by publication under O.C.G.A. § 9-11-4(f) which permits service by publication where the persons on whom service is to be made conceal themselves. The trial court entered a default judgment in favor of plaintiff when the LLC failed to answer. The LLC appealed, contending that the trial court erred in authorizing service by publication because plaintiff never attempted service directly on the LLC, nor on the Secretary of State, as required by O.C.G.A. 9-11-4(e). The Court of Appeals agreed and reversed.

Holmes & Company of Orlando v. Carlisle, 289 Ga. App. 619, 658 S.E.2d 185 (2008). In this case, the Court of Appeals affirmed the trial court's ruling that service of process on a branch manager of a bank where a defendant corporation's registered agent worked constituted valid service on the corporation, even though neither the bank nor the branch manager was authorized by the corporation to receive service. This was a personal injury action brought by an injured motorist against the driver of a truck for negligence and against the out-of-state corporation that owned the truck. The defendants moved to dismiss the complaint for insufficient service. The plaintiff had affected service on the corporation's registered agent by leaving the complaint with the branch manager of the bank where the registered agent worked. The evidence showed that there was no business conducted at that address other than the bank's business, the registered agent as a bank employee was not authorized to act as an agent of anyone there but the bank itself and that as the registered agent's supervisor, the bank manager had authority to accept documents on the registered agent's behalf. The service on the branch manager of the bank was held to be sufficient even if she was not authorized to accept service on behalf of the corporation, because there was no evidence that the branch manager lacked authority to accept service on behalf of the registered agent.

Res Judicata and Collateral Estoppel between Corporations and their Shareholders.

QOS Network Ltd. v. Warburg Pincus & Co., 294 Ga. App. 528, 669 S.E.2d 536 (2008) addresses the application of *res judicata* and collateral estoppel to a corporation's claims for fraud, breach of fiduciary duty, promissory estoppel and tortious interference with contract brought in Georgia, where its shareholders had been unsuccessful – both for lack of standing and on the merits – in asserting the same claims in New York. The disputes involved QOS Network Ltd., an Irish telecommunications firm, and its shareholders, on one side, and a private equity investment company, Warburg Pincus & Co. and several of its board representatives, on the other. QOS's managing shareholders, who comprised its board and controlled its stock, sued Warburg in New York. At the management shareholders' instigation, non-management shareholders filed a similar suit, also in New York, that was consolidated with the first suit. Warburg in turn filed a third New York action to recover on loans it made to the management shareholders to purchase QOS stock. QOS refused Warburg's efforts and offers to be joined in the New York litigation. Warburg won both the New York actions. Georgia's *res judicata* doctrine requires identity of the parties and causes of action, decisions on the merits and a fair opportunity to litigate. In other recent decisions, see Levy v. Reiner, 290 Ga. App. 471, 659 S.E.2d 848 (2008), Pazur v. Belcher, 290 Ga. App. 703, 659 S.E.2d 804 (2008) and Accurate Printers, Inc. v. Stark, 2008 WL 5049960 (Ga. App., Nov. 26, 2008), the Georgia Court of Appeals has emphasized the separateness between business organizations and their equity owners and the fact that an adjudication against one would not bind the other. Here, however, the Court held there to be a sufficient identity between the parties for QOS to be bound by the decisions of the New York courts based on the facts

that the management shareholders made up its board of directors, controlled the corporation and controlled the litigation in both states.

The Court also held QOS's claims against a former QOS board member and chief operating officer to be barred by collateral estoppel. The defense of collateral estoppel does not require identity of the parties; it may be raised by one "in privity" with a party, which can be found where there is a connection and identity of interests that the party to the judgment can be said to have fully represented the interests of the privy. The Court noted that QOS had alleged that the COO was jointly liable with Warburg, and then stated: "If Warburg with its greater number of shares and influence is not liable to QOS for damages, [the COO] with his lesser influence would not be liable . . . ."

G. Professional Liability Claims in Corporate Transactions.

Accountants' Liability: Proof of Damages – Subsequent Sale of Business and Conversion of Debt to Equity.

Atlanto Holdings, LLC v. BDO Seidman, LLP, 290 Ga. App. 665, 660 S.E.2d 463 (2008) is the latest decision in one of the longest-running M&A professional liability cases in Georgia, the negligent misrepresentation case brought by the purchaser of Mindis Corporation, a scrap metals business, against the accounting firm that performed an audit of Mindis' inventory. This year's decision involves an appeal from a retrial on damages in which the plaintiff was awarded essentially nothing. It turns on evidentiary issues in the proof of damages, namely, the admissibility of evidence of the price paid in a later sale of the business and the forgiveness and conversion of debt incurred to finance the sale into equity. In 1993, the accounting firm had estimated inventory to be worth $86 million, when subsequent audits found it to be worth only $16 million. On retrial of damages, the jury awarded zero damages. On appeal, the plaintiff-purchaser argued that the trial court erred in permitting the firm to introduce evidence that a subsequent acquirer, to whom the plaintiff sold the business in 1998 for $7 million, later sold it in 2005 for $65.5 million. The plaintiff objected that the 2005 sale was too remote in time, that there had been $32 million invested in the meantime in equipment and capital improvements, and that scrap metal market conditions had improved. The Court of Appeals agreed, also finding that any probative value was outweighed by the possibility that the evidence would confuse, mislead or prejudice the jury.

The purchaser also argued that it was error to permit the accounting firm to show that $10 million in loans that a shareholder made to the purchaser for the purchase and operation of Mindis were later reclassified as investment and forgiven in exchange for the issuance of additional stock in the purchaser. The Court of Appeals agreed with the purchaser that this evidence was irrelevant to the issue of whether the purchaser incurred any direct damages. The Court considered the purchaser's argument that it was also irrelevant to the issue of consequential damages since the money was "needed and used to keep Mindis afloat," as well as the firm's argument that it was an unrelated investment. The Court ruled that to be a disputed issue of fact for the jury to decide.

Accountants' Liability: Negligent Misrepresentation and Proof of Reliance.

PricewaterhouseCoopers, LLP v. Bassett, 293 Ga. App. 274, 666 S.E.2d 721 (2008) is an appeal from a jury verdict against PricewaterhouseCoopers ("PwC"), as the successor to Coopers & Lybrand, LLP ("Coopers"), for negligent misrepresentation regarding the financial condition of a nursing home corporation in a stock-for-stock merger. The appeal concerns a narrow issue of reliance, but the suit

and its outcome illustrate the use of professional liability claims in the merger context and the difficulties plaintiffs face in pursuing them.

Two brothers, Stiles and Samuel Kellett, agreed to merge their company, Convalescent Services, Inc. ("CSI") with Mariner Health Group, Inc. ("Mariner"), a public company. The Kelletts reviewed Mariner's financial statements which had been certified by Coopers with "unqualified" opinions, meaning "that the independent auditor had determined that the financial statements were free of material misstatements and were prepared according to [GAAP]." Several years later, the Kelletts learned that Mariner had used misleading accounting practices for three years leading up to the merger and that in the year between the signing of the purchase agreement and the closing, Mariner was having serious cash flow problems that were not disclosed to CSI and the Kelletts.

The Kelletts and four trusts they formed for their children brought suit against PwC asserting claims of fraud, negligent misrepresentation, breach of fiduciary duty and violations of the Georgia RICO statute. The Kelletts themselves had served as trustees at the time of the merger. Their successor as trustee had no involvement in the transactions. The jury rendered defense verdicts on all claims but negligent misrepresentation and on that claim awarded $10 million to the trusts and only nominal damages to the Kelletts.

On appeal, PwC contended that the successor trustee of the children's trusts had failed to prove reasonable reliance, and that the statute of limitations had expired because the trustee failed to discover the misrepresentations and file suit timely. The Court held that the trusts could prove their reliance on the alleged misrepresentations through the Kelletts, because a trust acts only through its trustee and the Kelletts were serving in that capacity at the time the misrepresentations were made. However, the successor trustee had no reason to suspect the fraud until the Kelletts, who did not learn of the misconduct while they were trustees, later brought it to his attention. Thus, the statute of limitation was tolled until the successor trustee learned of the fraud, and any notice of the fraud that the Kelletts had in the meantime could not be imputed to the trusts, because the Kelletts were then no longer acting as trustees.

Accountants' Liability: Defamation Claims against Auditors Who Report Adverse Information to the Audit Client Regarding Employees.

Saye v. Deloitte & Touche, LLP, 295 Ga. App. 128, 670 S.E.2d 818 (2008) illustrates the exposure to litigation and potential liability that corporate accountants incur when they perform their professional obligations to an audit client to report adverse information regarding an employee of the client.

Catherine Saye was hired in December 2005 to be the corporate controller of Wayne Farms LLC, a subsidiary of ContiGroup Companies, Inc. In March of the following year, Deloitte was engaged as the auditor for ContiGroup, and a Deloitte partner contacted ContiGroup's CFO to recommend that Saye be terminated, based on confidential information obtained by Deloitte in the course of another client relationship. ContiGroup conducted an independent investigation and decided to retain Saye and seek a retraction.

In July of 2006, Deloitte sent a letter to the President and CEO of ContiGroup advising that Deloitte was not willing to rely on Saye's representations for the purpose of the audits of Wayne Farms and ContiGroup and that it could not conduct its audits in compliance with GAAP so long as Saye was in

a financial reporting or accounting role. Saye was terminated from her position and she sued Deloitte for defamation by slander and libel, and tortious interference with business and employment relations.

The trial court granted Deloitte's motion to dismiss, finding that the communications were privileged and had not been published.[15] The Court of Appeals reversed, finding that Saye had sufficiently alleged malice and publication. In its opinion, the Court analyzed the statutory privilege provided to communications between certified public accountants and their clients found in O.C.G.A. § 43-3-32(b). The Court distinguished between two types of privilege: absolute and conditional. Finding that the doctrine of absolute privilege extends only to statements made in official court documents and acts of legal process, the Court concluded that the statements made here were subject to a conditional privilege. Under Georgia law, statements that are conditionally privileged will nevertheless be considered defamatory if made with malice. Because Saye had alleged that Deloitte acted maliciously in making the statements, the Court found that a question remained as to whether the privilege had been overcome.

The Court of Appeals went on to determine whether the statements had been published, which is a separate and distinct legal question from whether the statements were privileged. Georgia recognizes an intracorporate exception to the definition of publication, whereby communications that are "intracorporate, or between members of unincorporated groups or associations, and heard by one who, because of his/her duty or authority has reason to receive information" are considered to be equivalent to "talking to one's self," and are therefore determined to be not published. Deloitte argued that due to the unique nature of the accountant-client relationship, the two companies should be considered an "association" within the intracorporate exception to the publication rule. The Court disagreed, finding that an accountant's duty to remain independent of its client precluded a ruling that Deloitte and ContiGroup should be treated as a single entity for the purposes of the intracorporate exception. Thus, the Court held that the communications were published and that Saye had met that element of a defamation claim, reversing the trial court's grant of Deloitte's motion to dismiss.

A petition for a writ of *certiorari* in this case is currently pending in the Georgia Supreme Court.

Legal Malpractice: Conflicts of Interest and Waivers.

Smith v. Morris, Manning & Martin, LLP, 293 Ga. App. 153, 666 S.E.2d 683 (2008) illustrates pitfalls in attempting to rely on waivers of conflicts of interest when clients of a law firm do business with each other and the firm attempts to represent one of the clients, in this case the lender, in a transaction with the other client, a borrower.

Smith was the sole owner of a company named "Premier," which planned to develop a luxury apartment complex in Buckhead. Premier entered into a Purchase and Sale Agreement with Daltex Realty Services, Inc. to purchase property for the project. To obtain financing, Smith negotiated a loan from Howe D. Whitman of Whitman, Whitman & Merkle, Inc.

[15] The elements of a claim of defamation under Georgia law are: "(1) a false and defamatory statement concerning the plaintiff; (2) an unprivileged communication to a third party; (3) fault by the defendant amounting at least to negligence; and (4) special harm or the 'actionability of the statement irrespective of special harm.' Publication of the statement is imperative and, without it, the defamation claim fails." Id. at *2 (citations omitted).

Both Smith and Whitman and their companies were clients of the same law firm. The firm prepared a written conflict letter for the parties to sign providing that the firm would represent only Whitman and not Smith, in connection with the loan transactions and other transactions relating to the project, but that the firm would continue to represent both parties in other matters. The letter also said that should litigation arise between the two, the firm could not represent either. Both Smith and Whitman signed in their individual capacities.

As the parties' interests diverged, there were additional discussions between the firm and Smith, the borrower, who alleged that the firm made promises of cooperation in regard to Smith's continuing efforts to develop the project. The firm prepared a second conflicts waiver letter, which both parties signed, again acknowledging that the firm did not represent Smith. Smith alleged, however, that he relied on the law firm's promises of cooperation and paid the firm for legal work on a separate deal with another party to develop the project, for which the firm accepted payment but allegedly failed to perform the work, as a result of which Smith allegedly lost his interest in the project.

Smith and Premier sued the firm and individual attorneys for intentional breach of contract, intentional breach of fiduciary duty, fraud, simple negligence, tortious interference with contracts, tortious interference with business relations, and violations of Georgia's RICO statute. The trial court granted summary judgment on claims of simple negligence, tortious interference with contract, tortious interference with business relations and RICO. The trial court denied summary judgment on claims for breach of contract, breach of fiduciary duty, fraud, punitive damages and litigation expenses. The trial court found that certain damages were too speculative and remote and granted summary judgment on those damages claims.[16] For counts of intentional breach of contract, intentional breach of fiduciary duty and fraud, the trial court found they were premised on Smith's and Premier's contractually based relationship with the firm and granted summary judgment to the individual lawyers as to all claims. Smith and Premier appealed the grant of summary judgment to the individual lawyers and the partial grant of summary judgment to the firm. The firm cross-appealed the denial of its motion for summary judgment as to certain counts.

First, the Court of Appeals upheld the validity of the conflicts waivers. It rejected an argument by Premier that it was not bound by the conflict letters because Smith only signed them in his individual capacity, not on the company's behalf. The Court found that they were signed in his official capacity on behalf of Premier and, in any event, the language of each conflict letter put Smith on notice of the potential conflicts and informed him that the firm was representing only Whitman. Therefore, Premier could not reasonably have relied upon the firm to represent its interest in connection with the matters addressed by the conflict letters. Smith and Premier also argued that the conflict letters did not apply to the individual lawyers. The Court rejected that argument, finding that the attorneys acted within the scope of their employment and performed their services on behalf of the firm.

The Court found, however, that there remained issues of fact as to the following:

1) Whether Smith and Premier were aware that the firm was not representing their interests in the loan prior to execution of the conflict letters.

[16] In an earlier decision, the Court of Appeals ruled that the negligence claims Smith sought to pursue against the firm were barred by his failure to file the statutorily-required professional liability affidavit. See Smith v. Morris, Manning & Martin, 254 Ga. App. 355, 562 S.E.2d 355 (2002). Thus, this appeal addressed claims other than negligence-based legal malpractice.

2) Whether the firm violated the terms of the letters by conferring with Whitman's and the venture's attorneys in litigation filed against Smith.
3) Whether one individual attorney fraudulently represented that the firm would cooperate with Smith in his efforts to pursue the project with another party but then disparaged Smith in a telephone call over a speaker phone with Smith listening. The Court reversed summary judgment as to the individual attorney on that fraud claim.

On the firm's appeal, the Court found issues of fact existed as to whether the firm, while representing Whitman, later accepted an engagement from Smith, received payment, but allegedly failed to perform the task, causing Smith to lose his interest in the project; whether the firm favored Whitman over Premier during the time it had an attorney-client relationship with Smith and Premier; whether the firm used information gleaned from its relationship with Smith and Premier to assist other clients; and whether the firm intentionally assisted in the representation of other clients in litigation against Smith and Premier.

Finally, the Court affirmed the dismissal of the plaintiffs' RICO claims, finding that they could not prove damages proximately caused by the alleged predicate acts and therefore lacked standing to sue on that claim.

Legal Malpractice: Director, Officer and Professional Liability Claims by Bankruptcy Trustees.

In re Friedman's Inc., 385 B.R. 381 (S.D. Ga. 2008), *vacated in part on reconsideration by* In re Friedman's Inc., 394 B.R. 623 (S.D. Ga. 2008) is an 82-page decision on motions to dismiss an action arising out of the bankruptcy of a large jewelry retailer.[17]

The trustee of a creditor trust established in Friedman's Inc.'s bankruptcy proceedings brought an adversary proceeding against several former officers and directors, an investment banking firm that had performed services for Friedman's, and a law firm that had acted as debtor's outside counsel ("the Law Firm").

Friedman's was a Delaware corporation, with its principal place of business in Savannah, Georgia. Phillip Cohen held all of Friedman's Class B voting stock, which gave him the right to elect 75% of Friedman's directors. Cohen was also the chairman, controlling shareholder and sole owner of Morgan Schiff, an investment banking firm that contracted with Friedman's to provide investment banking and financial advisory services. Cohen also controlled Crescent Jewelers, Inc., another jewelry retailer to which Friedman's provided significant financial assistance from 1996 until 2004, when Crescent filed for bankruptcy. Sterling Brinkley served as a director of both Friedman's and Crescent, and was a paid consultant to Morgan Schiff. Bradley Stinn served as a director and CEO of both Friedman's and Morgan Schiff. Victor Suglia was CFO of both Friedman's and Crescent

The claims involve relationships and transactions between Friedman's, Morgan Schiff and Crescent and include allegations of breach of implied covenant of good faith and fair dealing, fraud, breach of fiduciary duty, aiding and abetting fraud and breaches of fiduciary duties, gross mismanagement, corporate waste and legal malpractice.

[17] The bankruptcy reference was withdrawn, so the case is pending before the United States District Court for the Southern District of Georgia, not the Bankruptcy Court.

The trustee alleged that the Friedman's insiders, Morgan Schiff and the Law Firm had committed wrongdoing with regard to transactions between Friedman's and Crescent, in which Friedman's financed Crescent despite Crescent's precarious financial situation. In one transaction, Crescent needed to refinance an outstanding debt it owed to Bank of America. Ernst & Young, the auditor for both Friedman's and Crescent, spoke with two lending institutions, both of which expressed concerns that Crescent's refinancing would require an investment by Friedman's so large that it could be considered a fraudulent conveyance. Eventually, Bank of America and Crescent came to terms on default waivers and an amendment to their existing line of credit with new terms that were extremely restrictive. One of Friedman's outside attorneys (the "Lead Attorney") at the Law Firm sent e-mails to his partners and to Friedman's CEO and CFO explaining that the agreement needed to be analyzed by E&Y to determine whether Crescent could comply with it and remain solvent. If not, the Lead Attorney explained, E&Y might have to issue an opinion questioning Crescent's ability to continue operating as a going concern. This could then trigger a call by Bank of America on Friedman's guaranty of Crescent's line of credit, which in turn could result in Friedman's receiving its own "going concern" opinion from E&Y. In attempting to provide a valuation of Crescent, E&Y notified the Lead Attorney that it was having difficulty using a fair market value basis as required by GAAP. Instead, E&Y came up with a value of Crescent using a non-GAAP basis for valuation called "investment value." Friedman's recorded this value in its financial statements.

Friedman's had three independent directors who, the trustee alleged, were never informed of the severity of Crescent's financial condition, "including the valuation issues, potential going-concern opinions, fraudulent conveyance issues, and Bank of America's unwillingness to continue the credit line, or the significance of the new terms and amendments to Crescent's credit facility." During the following year, Bank of America gave Friedman's a confidential offering memorandum that would establish a senior secured credit line for Friedman's. However, such a transaction implicated conflicts of interest, given the overlapping directors and officers between Friedman's and Crescent. The Lead Attorney therefore suggested the creation of a Special Committee of Friedman's independent directors to consider and either approve or disapprove the transaction. Initially, the Lead Attorney said independent Delaware counsel would be hired to represent the Special Committee, but when the Committee began to meet, the Lead Attorney and the Law Firm served as its counsel. Eventually, the Special Committee approved an $85 million investment in Crescent. The Trustee claimed that the inside directors and officers, who owed duties of loyalty to Friedman's, orchestrated the transaction to keep Crescent afloat at Friedman's expense, that they failed to disclose material information to the Special Committee regarding Crescent's financial condition, and that the Firm committed malpractice by failing to disclose information to Friedman's independent directors, by structuring transactions benefitting Crescent to the detriment of Friedman's, and by failing to conduct independent investigations into the wrongdoing at Friedman's. In deciding the motions to dismiss, the Court made the following rulings of interest:

Piercing the corporate veil. The Trustee alleged claims based on a contract between Friedman's and Morgan Schiff providing for Friedman's to pay fees and expenses to Morgan Schiff, including expenses that Brinkley "incurred in connection with the financial advice and assistance provided" to Friedman's. The Trustee alleged that Morgan Schiff breached the contract by billing Friedman's for unreasonable and improper expenses, performing services under the agreement not on behalf of Friedman's but for other parties to Friedman's detriment and over-billing Friedman's for services related to the refinancing transaction. The Trustee attempted to pierce the corporate veil, arguing that Morgan Schiff was an alter ego of Cohen. Cohen responded that even if all the allegations were true, the Trustee failed to allege that Morgan Schiff was insolvent. The Court found that Georgia law requires that the plaintiff show insolvency on the part of a corporation as a prerequisite to piercing the corporate veil.

"Thus, if the plaintiff fails to allege that the corporation is insolvent, then the Court must assume that the plaintiff has an adequate remedy at law. That, in turn, renders unavailable the equitable remedy of piercing the corporate veil. Therefore, the Court finds that the plaintiff must allege that the corporation is insolvent or unable to respond to damages as a threshold requisite for considering other facts pertinent to piercing the corporate veil." Id. at 415 (citations omitted). The Court granted Cohen's motion to dismiss the breach of contract claim against him as an alter ego of Morgan Schiff.

Fraud claims against insiders. The Trustee brought fraud claims against the Friedman's insiders, alleging that they knowingly or recklessly made false statements concerning Crescent to Friedman's independent directors and its Special Committee and made false statements about Crescent during deliberations concerning the $85 million unsecured investment in Crescent. The Trustee also alleged that they made false statements to Friedman's and/or its independent directors to induce Friedman's to enter into a Services Agreement with Crescent; to authorize and pay false invoices submitted by Morgan Schiff and Brinkley; and to pay Brinkley and Stinn, the CEO, bonuses based on false financial statements of Friedman's. The Court found that there were no allegations of false statements regarding Crescent's financial statements. But, the fraud claim against Stinn was not dismissed, because the Court found that the complaint had sufficiently alleged that he had information that the independent board members would have wanted to know that he omitted to tell them, thereby damaging Friedman's. The Court also allowed the fraud claims relating to misstatements on Friedman's financial statements to proceed.

Aiding and abetting fraud. The Trustee had pleaded alternatively that Morgan Schiff and the Friedman's insiders had aided and abetted the fraud and breaches of fiduciary duties described above. The Trustee conceded that no Georgia state court had recognized explicitly a claim for aiding and abetting fraud, but pointed to the Georgia Court of Appeals' decision in Insight Technology, Inc. v. FreightCheck. LLC, 280 Ga. App. 19, 633 S.E.2d 373 (2006) which recognized a claim for aiding and abetting a breach of fiduciary duty. Here, the Southern District of Georgia held that the tort of aiding and abetting fraud is a cognizable claim in Georgia, but dismissed the claim as deficiently pleaded because the trustee had simply repeated 210 prior paragraphs of the complaint and added conclusory statements of law.

Breach of fiduciary duty. The trustee's breach of fiduciary duty claims were fraud claims repleaded as breaches of the duty of loyalty. The Court held that under the internal affairs doctrine and O.C.G.A. § 14-2-1505(c), Delaware law would govern the breach of fiduciary duty claims. Many of the breach of fiduciary duty claims were dismissed for inadequate pleading; others are allowed to proceed. Relying on Georgia law, the Court also allowed some of the claims for aiding and abetting breaches of fiduciary duty to proceed.

Legal malpractice claims. The Trustee also brought claims of malpractice against the Law Firm. First, the Trustee claimed that the firm failed to disclose material information in its possession to Friedman's independent directors concerning matters relating to the $85 million investment in Crescent. Also, it claimed that the Law Firm structured transactions and agreements that benefitted Crescent to Friedman's detriment. The Trustee alleged that the firm failed to inform the independent board members that Friedman's was paying unearned and excessive fees to Morgan Schiff and Brinkley and should have informed the board members of Morgan Schiff's, Cohen's Brinkley's and Suglia's wrongful conduct and breaches of fiduciary duty. Finally, the Trustee claimed that the firm was not independent enough to act as Friedman's counsel and that it failed to obtain appropriate consent to its conflicted representation. As a threshold matter, the Court held that regardless of whether malpractice claims are

assignable under Georgia law, they could be assigned under bankruptcy law to a court-appointed trustee for debtor's estate.

The Law Firm argued that it could not be liable for the claims alleged because as legal counsel it was not obligated to give business advice. The Court held that the allegations involved claims that certain material facts it knew regarding Crescent should have been disclosed, which is not business advice. In ruling that the Law Firm had an obligation to disclose, the Court relied on a single, 35-year old district court decision from another jurisdiction, Spector v. Mermelstein, 361 F. Supp. 30 (S.D.N.Y. 1972), aff'd., 485 F.2d 474 (2d Cir. 1973). The Court determined that the real question had to do with the scope of the duties that Friedman's employed the Law Firm to perform. The evidence showed that the lead attorney was involved in counseling Friedman's concerning the implications for it arising from Crescent's financial problems. He was also highly involved in all matters related to Crescent, and served as a liaison between banks/accountants and Friedman's CEO and CFO. The scope of representation was further expanded when the firm recommended the appointment of a Special Committee and acted as its counsel. The Court found that the Trustee had sufficiently alleged material facts which the Law Firm did not disclose and an erroneous legal conclusion that the firm did not correct; a duty on the part of the firm to disclose such facts and correct the error; and damages proximately caused to the plaintiff by the malpractice because the Special Committee would not have approved the transaction. The Court also found that the Trustee had sufficiently asserted a malpractice claim against the firm for failure to obtain Friedman's informed consent to continue its representation of Friedman's and its representation of the Audit Committee in an internal investigation stemming from a government investigation. The Court found that while the Law Firm had originally obtained valid consent to represent both Friedman's and the Audit Committee, it had a duty to obtain informed consent to continue once the conflicts became more severe.

The Court denied the Law Firm's *in pari delicto* defense, finding, among other things that the defense was inappropriate in light of the firm's representation of committees of independent directors to whom it was alleged to have breached duties of disclosure.

Finally, the Court held that the breach of fiduciary duty claims brought against the Law Firm were mere duplications of the legal malpractice claims. Under Georgia law, when such claims are duplicative, the breach of fiduciary duty claim should be dismissed.

To discuss any aspect of this bulletin, please contact **Thomas S. Richey** at **404.572.6663** or **tom.richey@bryancave.com**.