The State Bar of Georgia

BUSINESS LAW SECTION

Newsletter

Elizabeth H. Noe, Chair	August 2011	Darcy R. White, Editor

Report from the Chair of Business Law Section

By: Elizabeth H. Noe
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2010—2011 was a busy year for the Business Law Section and its committees. The Section continues its tradition of service to the Georgia State Bar by considering legislative proposals and monitoring legislative developments in the numerous areas of business law practice. The Section's committees also conduct numerous practice area focused CLE programs during the year, with a two-day annual institute covering developments in business law in general.

As of April 2011, the Section has 1607 members.

The Section is governed by an Executive Committee composed of a Chair, Vice Chair, Secretary and the chairs of the various Section committees as follows:

Elizabeth Noe:	Chairman
Bruce Wanamaker:	Vice Chairman
Bill Rowland	Secretary Pro Tem
Bruce Wanamaker	Corporate Code Committee Chair
Bobbi Acord Noland	UCC Committee Chair
Bob Hussle	Securities Committee Chair
Darcy White	Publications Committee Chair
Beth Tanis	Business Litigation Committee Chair
Lee Lyman	Partnership/LLC Committee Chair
David Cayce	Opinions Committee Chair
Beth Tanis	Securities Litigation Chair

The Section sponsored the following seminars during the year:

1. Business Law Institute, Oct. 21-23, 2010, with 61 attendees. Following the policy set last year, the Section again awarded a limited number of scholarships (6) covering attendance fees for the Business Law Institute to business attorneys either out of work or in reduced circumstances.

2. LCCs, September 16, 2010, with 56 attendees;

3. Securities Litigation & Regulatory Practice, Oct. 29, 2010, with 58 attendees;

4. Secured Lending, Feb. 4, 2011, with 134 attendees;

5. Banking Law (on statewide satellite), Feb. 18 and 25, 2011, with 172 attendees;

6. Negotiated Corporate Acquisitions, March 2, 2011, with 107 attendees; and

7. Advanced Securities Law, March 25, 2011, with 96 attendees.

As part of the Section's ongoing effort to conduct in depth studies of various areas of law or practice that affect business lawyers, the Corporate Code Committee has continued its comprehensive Corporate Code Review Project launched in January 2009. George Shepherd, Emory Law School Professor, the reporter for this project, Corporate Code Committee Chair Bruce Wanamaker and numerous Corporate Code Committee members have spent significant time on this project, creating four broad subcommittees and six focused working groups. Each of these subcommittees and working groups has been charged with responsibility for reviewing a particular set or category of provisions of the Code and working with Professor Shepherd to identify, consider, and recommend any proposed changes. While this project is taking longer then initially planned, the Committee has made significant progress and has a revised timetable contemplating a July 1, 2013 effective date for any resulting legislation that the Section decides to initiate. Also, the UCC Committee is working on proposed amendments in Georgia to address Revised Article 9 of the Uniform Commercial Code.

Please consider involvement in the Section through participation in our seminars and through membership in one of the committees. Please contact a committee chair to find out how to get more involved.

Thank you.

SAVE THE DATE!

The Business Law Section of the State Bar will sponsor the 30th Annual Business Law Institute on Thursday and Friday, October 21-22, 2011. This year's Institute will be held in Atlanta. The seminar chair, Robert Hussle, is putting together an outstanding program of topics and speakers. The Institute will provide 11.5 hours of CLE, including one ethics hour, one professionalism hour and one trial practice hour. A brochure will be sent to Section members shortly. Don't delay in registering when you receive the brochure, as a full house is expected for this always timely program.

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CORPORATION AND BUSINESS ORGANIZATION
CASE LAW DEVELOPMENTS

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I. INTRODUCTION AND OVERVIEW

INTRODUCTION

This paper surveys case law developments involving corporate and business organization law issues that have been handed down by the Georgia state and federal courts during 2010. A few of the decisions decide matters of first impression or appear to have significant precedential value. Others illustrate and confirm settled points of law, are instructive for the types of legal issues that arise in a corporate law practice, or are typical of claims and defenses that are asserted in business organization disputes.

The survey is divided into two parts – first, this Introduction and Overview, which catalogs the 2010 Georgia business organization decisions covered in the survey with a brief description of its principal rulings and, second, a Discussion of Case Law Developments, which discusses the decisions in more detail, with some analysis where warranted.

In both parts, the decisions are organized in sections, first, by entity type – decisions that focus on corporations, limited liability companies and partnerships – and, second, by business transactions and litigation issues that are generally common to all forms of business organization. A final section covers selected decisions handed down in 2010 by the Georgia Business Court.

OVERVIEW

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

Holmes v. Grubman, 286 Ga. 636, 691 S.E.2d 196 (2010), was probably the year's most far-reaching decision. In that case, the Georgia Supreme Court, responding to a certified question from the U.S. Court of Appeals for the Second Circuit, held that Georgia common law recognizes "holding claims," claims for fraud and negligent misrepresentation by shareholders who forbear selling stock in public companies in reliance on misrepresentations. The Court also established the parameters and requirements for public company holding claims, namely that the misrepresentation must be "directed at" the plaintiff through a "direct communication," and the plaintiff must plead and prove "specific reliance" consisting of actions indicating that the plaintiff actually and justifiably relied on the misrepresentation. In response to other certified questions, the Court also addressed the issue of proximate cause in the public company holding claim context and the limited fiduciary duties that a stockbroker owes its customer.

Several decisions in 2010 addressed various aspects of standing with regard to claims against corporate officers and directors. In *Barnett v. Fullard*, 306 Ga. App. 148, 701 S.E.2d 608 (2010), the Georgia Court of Appeals reaffirmed that claims for misappropriation of corporate assets are derivative, not direct claims. The Court also ruled in that case that claims to enforce shareholder inspection rights must be asserted against the corporation, not against directors and officers. In *In re Integrity Bancshares, Inc.: Lubin v. Skow*, 382 Fed. App'x. 866 (11th Cir. 2010), the U.S. Court of Appeals for the Eleventh Circuit, also addressing the distinction between direct and derivative claims, ruled that the Federal Deposit Insurance Corporation as receiver is the exclusive owner of claims against officers of a failed bank. The trustee in bankruptcy of the bank's holding company can assert claims against the holding company's officers only for distinct holding company level conduct. In *Heard v. Perkins*, 441 B.R. 701 (N.D. Ala. 2010), the U.S. District Court for the Northern District of Alabama held that deepening insolvency claims are not cognizable under current Georgia law, because duties to creditors in Georgia are limited to a prohibition against self-preferential conduct. The court also held that under current federal pleading standards, the business judgment rule may be considered on a motion to dismiss breach of fiduciary duty claims.

Decisions on Personal Liability of Corporate Officers for Corporate Conduct. The courts in 2010 addressed officer liability issues under Georgia common law and federal and state statutes in a variety of contexts. In *Barrs v. Acree,* 302 Ga. App. 521, 691 S.E.2d 575 (2010), the founder and registered agent of a company was held not liable for an employee's conduct through agency by implication or ratification. In *Alexander v. Hulsey Environmental Services, Inc.*; *LHR Farms, Inc. v. Alexander*, 306 Ga. App. 459, 702 S.E.2d 435 (2010), the Georgia Court of Appeals confirmed that corporate officers may be held personally liable for the corporation's conduct constituting a nuisance when they direct or participate in that activity. The 11th Circuit reaffirmed in *Goolsby v. Gain Technologies, Inc.*, 362 Fed. App'x. 123 (11th Cir. 2010) that officers cannot be held personally liable for a corporate tort without directing or participating in the act. As to statutory liabilities, in *Joe Hand Promotions, Inc. v. Blanchard*, 2010 WL 1838067 (S.D. Ga. May 3, 2010), the court found personal liability for pirating of sports broadcasts under the Communications Act of 1934 based on a bar owner's right and ability of supervision and financial interest; *Ojeda-Sanchez v. Bland Farms, LLC*, 2010 WL 3282984 (S.D. Ga. Aug. 18, 2010) holds that personal liability for violations of the Fair Labor Standards Act requires operational control; and in *In re Haysman: Haysman v. State of Georgia*, 432 B.R. 336 (N.D. Ga. June 28, 2010), the chief executive officer and 50% shareholder of a corporate taxpayer was held not liable for unpaid state sales and withholding taxes when his actual role, authority and duties were inconsistent with his corporate titles.

B. CORPORATE STOCK OWNERSHIP AND RIGHTS.

Rakusin v. Radiology Associates of Atlanta, P.C., 305 Ga. App. 175, 699 S.E.2d 384 (2010), considered the statutory requirements for the valuation and redemption of stock of a deceased shareholder of a Georgia professional corporation under O.C.G.A. § 14-7-5(c), which utilizes dissenting shareholder procedures from the Georgia Business Corporation Code. Strictly construing the statutes, the Georgia Court of Appeals held that under GBCC § 14-2-1325(c), the deceased shareholder's estate was not deemed to have accepted the corporation's required offer of payment when the executrix failed to respond within 30 days, because the offer was not contemporaneously accompanied by required financial information and was thus invalid. In an unpublished decision, *Graphic Packaging Holding Co. v. Humphrey*, 2010 WL 4608775 (11th Cir. Nov. 16, 2010), the 11th Circuit held that a corporation failed to show that it committed a mistake when it valued the restricted stock units of its retired president as of the date of his retirement, rather than the date of payment, because there was no past practice of valuing restricted stock units of key employees who were subject to a six-month holding period under § 409A of the Internal Revenue Code. The Georgia Court of Appeals in *Ansley v. Ansley*, 307 Ga. App. 388, 705 S.E.2d 289 (2010) held that O.C.G.A. § 14-2-732(b)(3), which now imposes a 20-year limit on duration of shareholder agreements in non-publicly held corporations, does not apply retroactively to a pre-existing shareholder agreement with no expiration date. The Court also ruled that the four-year limitations period for breach of oral contract to devise stock to surviving shareholders began to run when the shareholder died intestate and that an oral agreement among the shareholders resulted in a waiver of the right to enforce buyout provisions under a prior written agreement. In *Vidalia Outdoor Products, Inc. v. Higgins*, 305 Ga. App. 836, 701 S.E.2d 217 (2010), the Georgia Court of Appeals ruled that whether a stock purchase agreement was materially breached and could be unilaterally rescinded by the purchaser for the company's failure to issue a stock certificate was an issue of fact, given the silence of the agreement on that point. In *In re Value Family Properties-West Atlanta, LLC: Value Family Properties-West Atlanta, LLC v. Harrison*, 2010 WL 2025592 (Bankr. N.D. Ga. March 30, 2010), the Court rejected an effort by a former shareholder to characterize his claim for default under a buy-out agreement as an unsecured debt of the bankrupt issuer, even when the shareholder limited his claim to unpaid past due interest under the agreement. The Court held that his claim retained its character as an equity claim and was thus subject to subordination under 11 U.S.C. § 510(b).

C. NONPROFIT CORPORATIONS.

In *Bailey v. Stonecrest Condominium Association, Inc.*, 304 Ga. App. 484, 616 S.E.2d 462 (2010), the Georgia Court of Appeals held that a decision by a condominium association board of directors to prohibit members from leasing their units, that was allegedly motivated by racial discrimination, could constitute a breach of fiduciary duty under established standards for judicial review of corporate decisions, namely whether the exercise of corporate decision-making authority was procedurally fair and reasonable and whether the substantive decision was made in good faith and was reasonable, not arbitrary and capricious.

D. LIMITED LIABILITY COMPANY DEVELOPMENTS.

In *Giacomantonio v. Romagnoli*, 306 Ga. App. 26, 701 S.E.2d 510 (2010), the Georgia Court of Appeals held that a merger clause in an LLC operating agreement barred all tort claims based upon pre-contract misrepresentations, whether characterized as fraud or breach of fiduciary duty. The Court in *Kim v. First One Group, LLC*, 305 Ga. App. 861, 700 S.E.2d 729 (2010), held that an LLC manager's oral resignation was effective where the LLC operating agreement did not establish a procedure for resignations. LLC members' request for judicial dissolution of an LLC in *Simmons Family Properties, LLLP v. Shelton*, 307 Ga. App. 361, 705 S.E.2d 258 (2010), was held not to be subject to an arbitration clause in the operating agreement. The Court found the failure to conduct meetings to be evidence of deadlock sufficient to support a finding under O.C.G.A. § 14-11-603 that the LLC was unable to carry on business in conformity with the operating agreement.

E. PARTNERSHIP LAW DEVELOPMENTS.

In *Valone v. Valone*, 2010 WL 4437076 (N.D. Ga. Nov. 1, 2010), the U.S. District Court for the Northern District of Georgia held that a limited partnership could not be judicially dissolved because it was able to fulfill the purpose for which it was organized. The Court rejected a claim of deadlock where a majority of partners acting as a bloc effectively controlled the partnership. *Winchester v. Newlin*, 436 B.R. 236 (M.D. Ga. 2010), illustrates the difficulties involved when a partner, in an ongoing professional practice that is embroiled in disputes between the partners, files for bankruptcy. The court upheld an assignment by the bankruptcy trustee of a turnover claim against the debtor under 11 U.S.C. § 542(a) for partnership payments allegedly based on pre-petition operations when the assignment was part of the trustee's sale of the debtor's partnership interest to his former partner.

F. TRANSACTIONAL CASES.

In *Trawick Construction Company, Inc. v. Georgia Department of Revenue*, 286 Ga. 597, 690 S.E.2d 601 (2010), the Georgia Supreme Court held that given the interplay of Georgia and federal tax laws provisions, a Subchapter S corporation would not be liable for tax when selling shareholders are able to avoid tax liability by electing to treat their sale of stock as a deemed sale of all corporate assets. This decision was promptly overruled by the Georgia Legislature. In a case involving the sale of the Atlanta Hawks and Atlanta Thrashers professional sports franchises, *Turner Broadcasting System, Inc. v. McDavid*, 303 Ga. App. 593, 693 S.E.2d 873 (2010), the Georgia Court of Appeals held that an expired letter of intent that conditioned an asset purchase transaction on execution of formal documentation did not preclude a subsequent binding oral contract for the sale of the teams. The Court also rejected arguments that the agreement was barred by the statute of frauds.

Two 2010 transactional decisions involve statutes rarely considered by the courts. In *Deutsche Bank National Trust Company v. JP Morgan Chase Bank, N.A.*, 307 Ga. App. 307, 704 S.E.2d 823 (2010), the Georgia Court of Appeals interpreted O.C.G.A. § 14-5-7, a statute concerning corporate authority required in transactions involving property interests. It held that, unlike the requirements for a deed, under O.C.G.A. § 14-5-7(b) a release of a lien can be executed by any corporate officer. *Walker v. Amerireach.com*, 306 Ga. App. 658, 703 S.E.2d 100 (2010), dealt with claims under Georgia's Sale of Business Opportunities Act, which was enacted to prevent and prohibit fraudulent and deceptive practices in the marketing and sale of business opportunities and which is enforceable in part through Georgia's Fair Business Practices Act; among other things the Court held that the Fair Business Practices Act itself creates separate and distinct causes of action, independent of other possible theories of recovery.

G. LITIGATION ISSUES.

1. Jurisdictional Issues, Administrative Dissolution and Access to the Courts by Foreign Business Organizations. In *GC Quality Lubricants, Inc. v. Doherty, Duggan & Rouse Insurors*, 304 Ga. App. 767, 697 S.E.2d 871 (2010), the Georgia Court of Appeals reconciled two provisions of the GBCC, O.C.G.A. § 14-2-1422(d),

which provides for retrospective reinstatement of a corporation administratively dissolved by the Secretary of State upon its registration and payment of fees, and § 14-2-1410, which bars a corporation's assertion of all claims that have not been brought within two years of dissolution. The Court held that § 14-2-1422(d) cannot revive claims barred under § 14-2-1410. *Hall v. Sencore, Inc*., 302 Ga. App. 367, 691 S.E.2d 266 (2010), held that a single Georgia transaction by a foreign corporation does not trigger the registration requirement under O.C.G.A. § 14-2-1501. By contrast, *Westmoreland v. Jordan Partners, LLLP*, 306 Ga. App. 575, 703 S.E.2d 39 (2010), held that, under O.C.G.A. § 14-8-54(a), a foreign limited liability partnership that is transacting business in Georgia could not maintain an action without obtaining a certificate of authority to do business in the state. In *Cashatt v. Merrimac Assoc., Inc.*, 2010 WL 3906856 (N.D. Ga. Sept. 30, 2010), the Georgia Court of Appeals examined the contacts that a foreign corporation made in its efforts to explore business opportunities within the state, including its representation by the plaintiff who was suing it for compensation, and held that it was transacting business for purposes of Georgia's long arm statute.

2. <u>Director and Officer Liability Insurance Decisions</u>. In *Cox Communications Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa.*, 708 F. Supp. 2d 1322 (N.D. Ga. 2010), *on motion for reconsideration*, 2010 WL 5092282 (N.D. Ga. Dec. 8, 2010), the Court ruled in favor of the insureds, holding that each lawsuit was a separate "claim" for purposes of determining whether it was "first made" within the policy period, that the prior notice exclusion was not triggered by another company's giving notice under its policy, and that an exclusion in the outside directors coverage provisions for claims "by" the outside entity did not apply to a creditors' committee that obtained the outside entity's claims by assignment. In *Southwest Georgia Financial Corp. v. Colonial American Casualty and Surety Co.*, 397 Fed. App'x. 563 (11th Cir. 2010), D&O coverage for a lead lender's settlement payments to participating banks was held barred by a loan carve-out from the definition of "loss." *MedAssets, Inc. v. Federal Insurance Company*, 705 F. Supp. 2d 1368 (N.D. Ga. 2010), held that an intellectual property exclusion in a D&O policy does not bar coverage for claims for misappropriation of confidential information; an insured may obtain judgment against an insurer in excess of policy limits as consequential damages for the insurer's breach of the contractual duty to defend without establishing bad faith.

3. <u>Derivative Action Procedure</u>. In *Pounds v. Brown*, 303 Ga. App. 674, 695 S.E.2d 66 (2010), the Georgia Court of Appeals held that a court-approved derivative action settlement prevents a corporation's board from taking action inconsistent with the terms of the settlement agreement.

4. <u>Nondischargeability of Breach of Fiduciary Duty Claims</u>. The U.S. Bankruptcy Court for the Middle District of Georgia in *In the Matter of Conner: Davis v. Conner*, 2010 WL 1709168 (Bankr. M.D. Ga. April 23, 2010), determined that intentional breaches of fiduciary duty by a partner were nondischargeable in the partner's bankruptcy proceeding under 11 U.S.C. § 523(a)(6), but not under § 523(a)(4) because that provision requires a technical trust fiduciary relationship not satisfied by the fiduciary relationship among partners. Similarly, in *In re Robustelli: Lou Robustelli Marketing Services, Inc. v. Robustelli*, 430 B.R. 709 (N.D. Ga. 2010), a debtor's misappropriation of corporate assets was held nondischargeable under 11 U.S.C. § 523(a)(6).

5. <u>FDIC Receivership Decisions</u>. The Court in *Silverton Mortgage Specialists, Inc. v. Silverton Financial Services, Inc.*, 2010 WL 2490955 (N.D. Ga. June 15, 2010), permitted a bridge bank, formed by the FDIC to acquire a failed bank's assets and liabilities, to open a default in a trademark infringement action; the Court also permitted the FDIC as receiver to be substituted for the failed bank. *McClelland v. First Georgia Community Bank*, 2010 WL 3199349 (M.D. Ga. Aug. 12, 2010), addresses at length judicial review of the FDIC's receivership administrative claim procedures in the context of the FDIC's denial of a former bank director's claims for compensation for loss of his bank-owned life insurance policy.

6. <u>*Alter Ego*, Piercing the Corporate Veil and Other Forms of Secondary Liability</u>. In *Guarantee Insurance Co. v. Merchants Employer Benefits*, 2010 WL 3937325 (M.D. Ga. Sept. 30, 2010), the U.S. District Court for the Middle District of Georgia found evidence sufficient to find that a company's owner used the company as an *alter ego* without regard for its separate corporate entity. The Court of Appeals reached the opposite result in *Ramcke v. Georgia Power Co.*, 306 Ga. App. 736, 703 S.E.2d 13 (2010), finding that a parent corporation could not be held liable for negligence of subsidiaries because there was insufficient evidence to pierce the corporate veil or show that the parent acted as subsidiaries' *alter ego*.

7. Professional Liability Claims in Business Organization and Transactional Context. In *Alston & Bird LLP v. Mellon Ventures II, L.P., et al.*, 307 Ga. App. 640, ___ S.E.2d ___, 2010 WL 5116611 (Dec. 16, 2010), a venture capital investor's claims for legal malpractice in drafting a tag-along clause was held subject to a comparative negligence defense where the investor and its attorney reviewed the clause prior to closing. In *Kitchen v. Hart*, 307 Ga. App. 145, 704 S.E.2d 452 (2010), the Georgia Court of Appeals ruled that an attorney's alleged negligence in drafting a collateralization agreement with respect to his clients' obligations on three promissory notes was not a proximate cause of their joint and several liability on the entire debt; the clients also failed to adduce expert or fact evidence sufficient to raise an issue of fact on their claim for lost profits.

H. 2010 DECISIONS FROM THE GEORGIA BUSINESS COURT.

Selected decisions handed down by the Georgia Business Court during 2010 are reported at http://digitalarchive.gsu.edu/col_businesscourt/. The following decisions concern issues within the scope of topics covered by our review of the decisions by the Georgia appellate courts and the federal courts discussed above:

Payless Car Rental Systems, Inc. v. PRG Group, LLC, Civil Action No. 2007-CV-129218, Superior Court of Fulton County (Jan. 7, 2010, Bonner, J.) – Summary judgment granted dismissing veil piercing and fraudulent transfer claims against sole managing member of LLC for lack of evidence.

ING USA Annuity and Life Insurance Company v. J.P. Morgan Securities Inc, Civil Action No. 2007-CV-135490, Superior Court of Fulton County (Aug. 11, 2010, Bonner, J.) – A disclaimer in a private placement memorandum and the investor's extensive due diligence were held not to preclude reliance on alleged misrepresentations. In a separate order, the Court found issues of fact on elements of plaintiffs' fraud claims, ruling that rescission was unavailable against an investment banker under the former Georgia Securities Act of 1973 and that the plaintiff would thus have to prove causation of damages.

Cannon v. H&R Block Inc.; Cain v. H&R Block Inc., Civil Action Nos. 2007-CV-137010 and 2009-CV-162592, Superior Court of Fulton County (Feb. 24, 2010, Bonner, J.) – Minority shareholder claims for breach of fiduciary duty and fraud were held not to be barred by exclusive, binding valuation provisions of shareholders agreement; claims by option holders allegedly fraudulently dissuaded from exercising options were allowed to proceed over arguments that the options were too contingent and the claims for damages too remote and speculative to support a claim.

SCS Fund, LP v. Odom, Civil Action No. 2008-CV-152062, Superior Court of Fulton County (April 23, 2010, Long, J.), *aff'd.*, Appeal No. A-10A-2161 (Ga. App. Mar. 4, 2011) – Claims for fraud, negligent misrepresentation and securities fraud in exchange of assets for stock and holding claims failed for lack of actionable misrepresentations, material omissions or a duty to disclose.

Hawk v. Odom, Civil Action No. 2009-CV-162588, Superior Court of Fulton County (April 23, 2010, Long, J.), *aff'd.*, Appeal No. A-10A-2213 (Ga. App. Feb. 24, 2011) – Claims for fraud, negligent misrepresentation and securities fraud in sale of stock failed where plaintiffs could not prove reliance on misrepresentations and defendant owed no duty to disclose because it was an arms-length business transaction.

An v. Hanna, Civil Action No. 2009-CV-178060, Superior Court of Fulton County (Aug. 16, 2010, Long, J.) – Limited discovery permitted in derivative action where defendants filed a motion to dismiss under O.C.G.A. § 14-2-744(a) based on decision of special litigation committee not to pursue claim.

Ragland v. Sevex North America, Inc., Civil Action No. 2008-CV-153555, Superior Court of Fulton County (Jan. 25, 2010, Long, J.) – Dispute resolution process in stock purchase agreement held not to bar suit.

II. DISCUSSION OF CASE LAW DEVELOPMENTS

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

***Holmes v. Grubman*, 286 Ga. 636, 691 S.E.2d 196 (2010) – Georgia common law recognizes "holding claims" claims for fraud and negligent misrepresentation by shareholders who forbear selling stock in public corporations in reliance on misrepresentations.**

The Georgia Supreme Court in this decision addressed three certified questions from the United States Court of Appeals for the Second Circuit. The questions were posed in an action by Georgia investors who sued Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney & Co., Inc. and its financial analyst Jack Grubman for $200 million in losses incurred because they were dissuaded by their broker based on Grubman's research reports from selling their WorldCom, Inc. stock when Grubman and Smith Barney knew that WorldCom was grossly overvalued, but wanted to keep its investment banking business. The first question was: "Does Georgia common law recognize fraud claims based on forbearance in the sale of publicly traded securities?" The Supreme Court answered in the affirmative stating that it was "well settled" that Georgia law recognizes fraud claims where the plaintiff is induced to refrain from acting, citing *Argentum Intl. v. Woods*, 280 Ga. App. 440, 445(2)(b), 634 S.E.2d 195 (2006), and *Mack v. Smith*, 178 Ga. App. 652, 653(4), 344 S.E.2d 474 (1986), both of which involved plaintiffs who were allegedly defrauded into retaining investments. To address arguments regarding potential abuses, the Court imposed two limitations adopted by other jurisdictions in recognizing holding claims: (1) requiring a "direct communication," i.e., that the misrepresentation be "directed at" the plaintiff, and (2) requiring "specific reliance," i.e., that the plaintiff allege "actions" indicating that the plaintiff actually and justifiably relied on the misrepresentation. The plaintiffs had allegedly sought to place sell orders for their WorldCom stock and were persuaded not to sell, so there was a clear example of the specific reliance required. The Court emphasized that indirect reliance under the "fraud-on-the-market" theory would not suffice. Although outside the scope of the Second Circuit's certified question, the Supreme Court went on to authorize holding claims based on negligent misrepresentation and stated that those claims would likewise be subject to the direct communication and specific reliance requirements. With regard to the second certified question from the Second Circuit concerning proximate cause, relying on *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005), the Court ruled that a holding claim plaintiff, as part of proving proximate cause, must prove "loss causation" by showing "that the truth concealed by the defendant entered the marketplace, thereby precipitating a drop in the price of the security." The Second Circuit posed as its third question: "Under Georgia law, does a brokerage firm owe a fiduciary duty to the holder of a non-discretionary account?" In response, the Supreme Court held that a stockbroker has "limited fiduciary duties" to customers with non-discretionary accounts, which are not limited to the execution of transactions. Apparently speaking to the factual allegations of the specific case before the Second Circuit, the Supreme Court held that "[t]he broker will generally have a heightened duty, even to the holder of a non-discretionary account, when recommending an investment which the holder has previously rejected or as to which the broker has a conflict of interest."

This decision will have wide-ranging implications. The limitations that the Georgia Supreme Court placed on holding claims reduces, but does not prevent their use in the class action context. Notably, the United States Supreme Court has held that the Securities Litigation Uniform Standards Act of 1998, which applies to class actions involving exchange-traded securities and registered investment company shares, preempts state law holding claim class actions relating to those securities. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 126 S. Ct. 1503, 164 L. Ed. 2d 179 (2006). Also, the requirement of direct communication and elimination of fraud-on-the-market theories of reliance prevents their use in the typical secondary market fraud-on-the-market stock-drop class action. However, communications to shareholders and pension plan participants will likely satisfy the direct communication requirement, and it is within the discretion of the trial court to certify a class on common issues of liability and reserve proof of reliance to subsequent proceedings.

Although the Second Circuit's certified questions were focused on publicly-traded securities, the Supreme Court's broad blessing of holding claims, particularly given the Court's citation of prior Georgia Court of Appeals decisions, invites applications outside the public securities markets. As illustrated by *Barnett v. Fullard*, 306 Ga. App. 148, 701 S.E.2d 608 (2010), discussed below, claims based on actions and omissions by corporate officers and directors that lead to the decline in the value of the shareholders' stock generally must be brought derivatively. Those same allegations, coupled with misrepresentations that induce shareholders not to sell their stock, can now be asserted as holding claims. Shareholders of failed banks and insolvent bank holding companies are already invoking the decision in suits against bank and holding company officers and directors.

Shareholders of close corporations and even those investing in privately placed securities may have difficulty meeting the specific reliance and proximate cause requirements, however, because they must show what action they could and would have taken if not induced to hold their securities, their opportunities to sell are limited if they exist at all, and there is no market by which to measure “loss causation.”

Finally, the exculpatory provisions of O.C.G.A. § 14-2-202(b)(4) may offer directors of Georgia corporations protection against holding claims based on alleged negligent misrepresentations, since the claim would fit literally into the statutory language, which does not restrict the scope of exculpation to breaches of fiduciary duty. However, since holding claims are based on common law fraud and negligent misrepresentation, not the Georgia Business Corporation Code or common law principles of corporate governance, the business judgment rule may not serve as a defense and supply a presumption of proper conduct. The statutory reliance defense that permits directors and officers to rely on information from trustworthy subordinates and professionals also may not strictly apply. Even so, officers and directors who have satisfied the requirements of the business judgment rule by acting in good faith and duly informing themselves may have all the evidence they need to show that they were not negligent.

***Barnett v. Fullard*, 306 Ga. App. 148, 701 S.E.2d 608 (2010) – Claims for misappropriation of assets are derivative claims; claims to enforce shareholder inspection rights must be asserted against the corporation, not against directors and officers.**

This decision addresses the frequently raised distinction between direct and derivative claims, with the Court holding that a claim for misappropriation of corporate assets is a derivative claim while a claim involving failure to account for corporate income attributed to a single director is a direct claim. In addition, a claim concerning refusal of a demand to inspect a corporation’s books and records must be brought against the corporation, and not against individual officers and directors who refuse the shareholder access.

A shareholder in a Georgia corporation brought suit against certain other shareholders, alleging that the shareholder defendants: (1) had violated O.C.G.A. § 14-2-1602 by refusing his demand to inspect corporate records; (2) had misappropriated corporate assets for their personal use and for a rival business solely controlled by one of the defendants and had inappropriately altered the corporate books and records to disguise the misappropriations; and (3) had failed to account for corporate income attributed to him in corporate tax filings or to distribute the income to him. The plaintiff originally included the corporation as a defendant, but then voluntarily dismissed it from the case. The shareholder defendants moved to dismiss Barnett’s complaint for failure to state a claim upon which relief could be granted on the ground that none of his claims could be pursued against them individually in a direct action. The trial court agreed and dismissed Barnett’s complaint in its entirety, resulting in this appeal. The Court of Appeals affirmed in part the decision of the trial court, dismissing all of plaintiff’s claims except for his claim against the defendant shareholders for their alleged failure to account to him for his share of the corporate income or to pay the income over to him. The Court of Appeals reversed the trial court on this one claim, and remanded the claim for trial.

Barnett’s claim concerning corporate records was properly dismissed because Georgia law requires such claims to be brought against the corporation, not individual shareholders. As the Court of Appeals explained,

> By its plain terms and when read in conjunction with O.C.G.A. § 14-2-1602, O.C.G.A. § 14-2-1604 clearly contemplates an action by the shareholder *against the corporation* where there is a refusal of a demand to inspect and copy the corporate records. But Barnett voluntarily dismissed the corporation, Earthwise, as a party defendant prior to the trial court’s ruling on the Shareholder Defendants’ motion to dismiss for failure to state a claim. Because Barnett could not pursue his statutory claim for inspection and copying of the corporate records against the remaining individual defendants, the claim was properly dismissed.

306 Ga. App. at 151 (emphasis in original).

Similarly, Barnett's claims concerning alleged misappropriation of corporate assets were properly dismissed because these actions could only be pursued in a derivative shareholder action. The Court explained the rationale for shareholder derivative actions, noting that in a derivative action, the shareholder sues on behalf of the corporation for the harm done to it because the wrong at issue was sustained by the corporation, not the individual plaintiff, and the corporation is a beneficiary of any award of damages. In a direct shareholder action, however, the shareholder sues on his own behalf for injuries done to him in his individual capacity, and he benefits from any award of damages.

> "The determination of whether a claim is derivative or direct is made by looking to what the pleader alleged. It is the nature of the wrong alleged and not the pleader's designation or stated intention that controls the court's decision. . . . A shareholder may bring a direct rather than a derivation action in either of two circumstances.
>
> > First, a shareholder has standing to bring a direct action, seeking recovery on behalf of the shareholder individually, if the suit alleges a special injury separate and distinct from that suffered by other shareholders, or alleges a wrong involving a shareholder contractual right existing apart from any right of the corporation. Second, a direct action may be proper in the context of a closely held corporation where the circumstances show that the reasons for the general rule requiring a derivative suit do not apply.

Id. (quoting *Rosenfeld v. Rosenfeld*, 286 Ga. App. 61, 64, 648 S.E.2d 399 (2007); other citations omitted). With respect to Barnett's claims for misappropriation of assets, he failed to allege an injury separate from any other shareholder. Nor did he establish that the circumstances requiring a derivative suit did not apply under the exception to the derivative action rule recognized in *Thomas v. Dickson,* 250 Ga. 772, 301 S.E.2d 49 (1983), which permits shareholders in close corporations to bring direct actions if all the shareholders are parties or are represented in the proceeding. The Court noted that not all shareholders were party to the case. "As such, there is a risk of multiple suits and of possible prejudice to the rights of the other shareholders." *Id.* at 613. The claims thus had to be pursued on a derivative basis. The Court noted in passing that because derivative actions address a wrong to the corporation, the corporation is an indispensible party to the proceeding. Barnett had, however, dismissed the corporation from the suit. Barnett's claims for misappropriation of assets were therefore properly dismissed.

Finally, the Court reversed the trial court on plaintiff's one remaining claim. Barnett's allegation that the Shareholder Defendants failed to account for corporate income attributed to him in its corporate tax filing and their failure to pay that income over to him, alleged injuries done to him directly, and as a result alleged a special injury separate and distinct from that suffered by the corporation or the other shareholders. Under these circumstances, the Court found Barnett had standing to pursue that claim in a direct action.

***In re Integrity Bancshares, Inc.: Lubin v. Skow*, 382 Fed. App'x. 866 (11th Cir. 2010) – FDIC as receiver is exclusive owner of claims against officers of failed bank; trustee in bankruptcy can assert claims against bankruptcy holding company officers only for distinct holding company level conduct.**

The Eleventh Circuit Court of Appeals held in this case that where the Federal Deposit Insurance Corporation ("FDIC") is appointed receiver of a failed bank, the FDIC is exclusive owner of its claims against its former officers and directors and a Chapter 7 bankruptcy trustee for the bank's holding company lacks standing to assert them.

In February 2008, Integrity Bank was closed by the Georgia Department of Banking and Finance and placed into receivership. Its holding company, Integrity Bancshares, Inc., filed a Chapter 7 bankruptcy petition shortly thereafter. The Chapter 7 trustee filed suit against the bank's officers, who were also officers of the holding company. The FDIC intervened and asserted exclusive ownership of the claims against the bank's officers pursuant to 12 U.S.C. §1821(d)(2)(A)(i). The district court concluded that under this statute, the FDIC as receiver succeeds to all of the rights, titles, powers and privileges of the insured bank, and of any stockholder of the bank, with respect to the bank and its assets. The district court also determined that the FDIC was the owner of all shareholder derivative claims against the bank's officers. The Court of Appeals agreed with the district court and focused its analysis on whether the trustee's claims against the bank's officers were in fact derivative claims.

The Court first noted that where a shareholder alleges a drop in share price due to corporate mismanagement, the shareholder lacks standing to sue the corporate officers directly, and instead must bring a derivative action against the officers on behalf of the corporation. Generally, under Georgia law, where the harm arises from an alleged breach of fiduciary duty, the claim must be brought in the form of a derivative action. The trustee's complaint alleged that the bank's officers wasted the bank's assets, causing losses to the holding company that precipitated its bankruptcy filing. Because the FDIC succeeded to all of the bank's legal rights, only it could sue the bank officers for the alleged breach of fiduciary duty.

Under Georgia law, a direct claim can be distinguished from a derivative claim if the claimant can show that it is damaged in a way that is different from other shareholders or independent of the corporation. Therefore, if the trustee could establish a direct harm to the debtor holding company caused by the bank's officers, that harm could be separate from any derivative harm. However, that harm must be sufficiently pleaded. The trustee's complaint merely alleged harm resulting from the bank officers' management of the bank's assets, making the harm to the holding company inseparable from the harm done to the bank. The Court rejected the trustee's argument that harm resulting from the holding company's assumption of debt to finance the bank's operations converted the trustee's claim from a derivative claim to a direct claim. The Court held that the incurring of debt was not "an intrinsic harm," noting that the trustee conceded that the holding company's inability to repay its debt resulted from the bank's insolvency. It thus found that all claims alleged against the bank's officers were derivative and only the FDIC had standing to assert them.

With respect to the claims against the officers of the holding company, a different analysis was required. The 11th Circuit recognized that a bankruptcy trustee succeeds to all rights of the debtor and has standing to sue if the debtor itself would have standing to sue. The Court held that to state a claim for breach of fiduciary duty against officers of a Georgia corporation, a complaint must adequately plead the existence of a fiduciary duty, a breach of that duty, and damages proximately caused by the breach of the duty. The Court found that the trustee's complaint failed to sufficiently plead the alleged breach of duty by the holding company's officers because it merely identified the elements for breach of duty, but did not identify how the defendants actually breached their duty to the corporation. The Court observed that a mere recital of the amounts lost by the bank, combined with generalized statements that holding company officers caused, authorized, approved, ratified or otherwise allowed the bank's deficient condition and unsound practices, failed to establish a claim for breach of fiduciary duties to the holding company. The Court pointedly declined to express an opinion about whether or not the defendants might have breached their duties as holding company officers by failing to inform the holding company board of bank mismanagement, or by failing to influence the holding company board to respond to the mismanagement by replacing the bank management, because the complaint made no such allegations. The district court's granting of motions to dismiss the trustee's complaint was affirmed.

***Heard v. Perkins, 441 B.R. 701 (N. D. Ala. 2010)* – Deepening insolvency claims not cognizable under current Georgia law, because duties to creditors are limited to prohibition against self-preferential conduct; business judgment rule may be considered on a motion to dismiss breach of fiduciary duty claims under current federal pleading standards.**

Directors and officers of car dealership conglomerate appealed an order from the bankruptcy court denying their motion to dismiss the bankruptcy trustee's claims against them for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and waste of corporate assets. The district court reversed, holding that the trustee's claims were not cognizable given the lack of established law in Georgia on deepening insolvency and breach of fiduciary duty in the context of claims related to business strategy.

The bankruptcy trustee brought claims against former directors and officers of the debtors, Bill Heard Enterprises, Inc. ("BHE") and certain of its subsidiaries. The bankruptcy court denied the defendants' motion to dismiss the trustee's claims. The trustee conceded that the claims on appeal all revolved around the singular premise that William Heard, Jr. ("Heard"), the President, Chief Executive Officer, and Chairman of BHE, had "continued to pursue a faulty business strategy after it proved to be a failure," boiling down the legal issue before the court on appeal to whether "the officers and directors breached their fiduciary duty . . . by squandering corporate assets pursuing a business strategy that they knew had failed and had no chance of success."[1] The parties agreed that Georgia law provided the applicable substantive law.[2] Given that it was clear from the record that Heard exercised "total control" of the company and ignored expressions of concern and objections from other officers and directors, the Court focused solely on the conduct of Heard in reaching its determination that the claims against all of the defendants should have been dismissed.

In assessing the trustee's claims, the district court reviewed in detail the cases that the trustee had cited for the argument that Georgia law permits creditors to maintain breach of fiduciary duty claims against corporate directors and officers. Ultimately, the district court found the majority of the cases unavailing, with the exception of the 1958 *Ware v. Rankin* case, 97 Ga. App. 837, 104 S.E. 555 (1958), in which the Georgia Court of Appeals considered whether a board of an insolvent corporation breached its fiduciary duty when choosing to pay off loans for which a director and an officer were personally liable, to the detriment of other creditors. In *Ware*, the Georgia Court of Appeals summarized Georgia law by stating, "officers and directors may not . . . use their position for the purpose of preferring themselves over any creditor, and any scheme or device . . . to indemnify themselves against loss . . . constitutes legal fraud." 97 Ga. App. at 839.

The district court noted that while Georgia law "in effect" provides that officers and directors of an insolvent company have a duty to manage the remaining assets for the benefit of creditors, the fiduciary duty appeared limited to a prohibition against using their positions to prefer *themselves* to the detriment of other creditors per the holding in *Ware*. "Simply put, Georgia law prohibits corporate insiders of insolvent corporations from using corporate funds to prefer their own, personal interests over those of the creditors." 441 B.R. at 708. In light of this limited avenue, the district court found that there was nothing in the record to support the allegation that Heard had engaged in self-dealing to the detriment of BHE's creditors; thus the breach of fiduciary duty claim for deepening insolvency, dressed up as a claim for "pursuing a faulty business strategy," could not survive under Georgia law. The Court noted that "Creditors [presumably as distinguished from shareholders] have options other than total reliance on directors. They can cease credit if they observe a crash. They can attempt to obtain involuntary bankruptcy."

The district court accepted the recommendation of the bankruptcy court to take the analysis one step further and look at the claims under the Eleventh Circuit's recent opinion in *In re Far & Wide Corp.: Mukamal v. Bakes,* 378 Fed. App'x. 890 (11th Cir. 2010), which involved claims of mismanagement brought by a bankruptcy trustee under Florida and Delaware law. In *Mukamal*, the Eleventh Circuit had dismissed out of hand the claims of the trustee for breach of fiduciary duty asserting that, under Delaware law, directors and officers of an insolvent company must maximize the company's value for the benefit of creditors, who essentially become the company's shareholders in an insolvency setting. In rejecting those claims, the *Mukamal* court noted that the Delaware Supreme Court had already ruled that creditors of an insolvent company do not have a direct claim against directors and officers for breach of fiduciary duty and rejected the theory of liability for deepening insolvency.[3]

Given its ruling on the legal insufficiency of the trustee's allegations, the district court did not reach the merits of the defendants' second ground for appeal, namely:

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[1] The business strategy criticized by the trustee was the decision of Heard to continue high volume sales to low income purchasers – a strategy that had previously been immensely successful. The trustee challenged the continuation of that strategy after the subprime market collapsed.

[2] Curiously, the parties also agreed that "the Supreme Court of Georgia would find Delaware law to be persuasive if there is no previously established law on the matters at issue here." The Court clarified in its opinion that, "[t]he Trustee perhaps agrees to such persuasiveness only as to the 'internal affairs doctrine' or 'corporate governance.'"

[3] In *Mukamal*, the Eleventh Circuit also affirmed dismissal of claims for breach of the duty of care based on the board's failure to follow the advice of consultants: "To state a claim for breach of the duty of care under Delaware law, a plaintiff must allege more than that the directors and officers of a corporation received information from outside consultants, but decided not to follow this advice. . . . Here, the Individual Defendants discharged their obligations under the duty of care by hiring consultants and by considering the consultants' advice, even if they did not follow the advice." (*citing Cede & Co. v. Technicolor, Inc.,* 634 A.2d 345, 367-68 (Del. 1993))

> In light of the Supreme Court's decisions in *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 545 (2007) and *Ashcroft v. Iqbal,* 129 S. Ct. 1937, 1949 (2009) is the Amended Complaint required to set forth well-pled allegations sufficient to rebut the presumptions of the Business Judgment Rule in order to avoid dismissal under Federal Rule of Civil Procedure 12(b)(6)?

441 B.R. at 703. The Court did state in *dicta* that the trustee's claims could be subject to dismissal on that basis because *Twombly* and *Iqbal* "appear to expand the right to have business judgment considered pursuant to a motion to dismiss." *Id.* at 711. The district court noted that even though the defendants would carry the burden in proving their affirmative defense, the trustee's complaint could still be subject to dismissal under F.R. Civ. P. 12(b)(6) when the allegations in the complaint, on their face, reveal that an affirmative recovery would be barred.[4]

Decisions on Personal Liability of Corporate Officers for Corporate Conduct. Last year the courts issued a number of rulings addressing the liability of corporate officers for torts and violations of law by their corporation. Some of these deal with common law principles; others concern liability under particular federal and state statutes, such as the Fair Labor Standards Act and the Communications Act of 1934. These cases do not appear to break new ground, but are instructive in illustrating the efforts to hold corporate officers liable for the companies' obligations and the somewhat varying standards used to assess the level of involvement and authority required to impose liability. They are briefly discussed below:

***Barrs v. Acree,* 302 Ga. App. 521, 691 S.E.2d 575 (2010) – Founder and registered agent of company held not liable for company employee's conduct through agency by implication or ratification.**

In this case, Earl Barrs sued Russell Acree and Acree's brother-in-law, Wesley Hall for damage from a fire set on land adjacent to Barrs' property that burned out of control. Barrs alleged that Acree was liable for Hall's negligent acts, because Hall was either Acree's employee or agent when the act occurred. Acree filed a motion for summary judgment contending that Acree Investments, Ltd. owned the land and employed Hall. The Court of Appeals affirmed trial court's granting of Acree's motion for summary judgment and denied Barr's motion to substitute Acree Investments as a party defendant for Acree.

The Court concluded that while Acree was Acree Investments' registered agent and handled some of the company's affairs in a voluntary capacity, he was not an officer or employee of the company. The company was run by his children. In an exchange of correspondence during the efforts to resolve the matter amicably, Acree neither admitted liability nor denied Barr's statements that the fire was started by the acts of Acree's personal employee on

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[4] *See also Laddin v. Odom*, Civ. Action No. 1:09-cv-01293-ODE (N.D. Ga. June 30, 2010), for another recent decision dismissing claims against directors brought by a bankruptcy liquidating trustee against officers and directors of Verso Technologies, Inc., a Minnesota corporation headquartered in Georgia. The Court dismissed claims for alleged breach of a duty of candor and for "gross mismanagement," finding no self-standing duties separate from the fiduciary duties of care and loyalty under Minnesota, or by reference Delaware, law. The Court held that any duties of candor of the directors would have been owed to shareholders, which the liquidating trustee lacked standing to pursue. The Court dismissed the remaining claims against the directors because the liquidating trustee had failed to allege facts, as required by *Twombly* and *Iqbal,* supporting claims that were not barred by the exculpatory provisions of Verso's articles of incorporation. The trustee's conclusory allegations of a complete abdication of responsibility were insufficient to show the required "intentional dereliction of duty" and were belied by his factual allegations regarding their attendance at meetings and participation in decisions. The trustee also failed to allege "red flags" that the board knowingly disregarded. The Court also held that Verso, and therefore the liquidating trustee, did not have standing to assert proxy violation claims under section 14(a) of the Securities Exchange Act of 1934 because Verso was not a target of the proxy solicitations. Claims were permitted to proceed against certain officers of the corporation.

In addition, in the long-running Magnatrax Corporation liquidating trust litigation against a private equity shareholder based on a leveraged buy-out and subsequent acquisitions and loan transactions to a Delaware corporation, the Court recently dismissed the remaining breach of fiduciary duty claims, limiting the litigation trustee to claims for management fees and preference claims, *Kipperman v. Onex Corp.*, Civil Action File No. 1:05-cv-01242-JOF (N.D. Ga. Sept. 29, 2010); *see also* initial summary judgment decision, 411 B.R. 805 (N.D. Ga. 2009).

his land. Acree wrote his replies on his personal stationery and signed them individually. The Court did not find that an employer/employee or agency relationship existed between Hall and Acree, because the evidence showed that Hall was employed and paid by Acree Investments, Hall worked independently and Acree did not have any control over the time and manner of the burn and, in fact, testified that he did not know it was going to occur. The Court held that Barrs could not show agency by implication based solely on a proof of a past employment relationship between Acree and Hall or agency by ratification based on Acree's failure to identify Acree Investment as "the true principal" in his communications with Barrs after the fire. The denial of Barrs's motion to substitute Acree Investments as a defendant for Acree because the statute of limitations had lapsed was within the trial court's discretion. Acree identified "Acree Investments, LLC" as the owner of the property three months after suit was filed and two years before the statute of limitations ran. Barrs waited five years before moving to substitute. The fact that Acree incorrectly identified Acree Investments as a limited liability company did not excuse Barrs's delay, because "a simple search of the Georgia Secretary of State's website, http://www.sos.ga.gov/corporations/ would have revealed that Acree Investments is not a limited liability company."

***Alexander v. Hulsey Environmental Services, Inc.*; *LHR Farms, Inc. v. Alexander*, 306 Ga. App. 459, 702 S.E.2d 435 (2010) – Officers may be held personally liable for corporation's conduct constituting nuisance when they direct or participate in activity.**

In this case, neighbors brought nuisance action against a waste disposal facility, its executive officer and site manager and a facility customer. The trial court granted motions for summary judgment of the officer, manager and customer, but denied summary judgment to the facility. On appeal by the plaintiffs and the facility, the Court of Appeals reversed the grant of the motion for summary judgment as to the individual defendants because it found that genuine issues of material facts existed as to their liability, namely whether they "did indeed actively direct and participate in the alleged nuisance." 306 Ga. App. at 461. The Court affirmed the grant of summary judgment as to the customer because it found that the customer did not direct or control any aspect of the waste disposal operation.

***Goolsby v. Gain Technologies, Inc., et al.*, 362 Fed. App'x. 123 (11th Cir. 2010) – Officers held not personally liable for a corporate tort without directing or participating in the act.**

This appeal involves a pro se state action filed by a customer against a manufacturer of injection molds and three corporate officers, alleging negligence in failing to manufacture molds within the proposed timeline and specifications. The plaintiff alleged that the manufacturer used the wrong type of steel to manufacture his molds. The district court granted the defendants' motion for summary judgment. The Court of Appeals affirmed. The president and chief financial officer were not personally liable because Goolsby did not connect them specifically to the negligence alleged in this case. Relying on Georgia common law, the Court noted that "an officer of a corporation who takes no part in the commission of a tort committed by the corporation is not personally liable unless he specifically directed the particular act to be done or participated or cooperated therein," *citing Mitcham v. Blalock*, 214 Ga. App. 29, 447 S.E.2d 73 (1994). As to the corporation and the remaining officer, the Court found that the plaintiff's claims were for professional liability and required expert evidence to prove negligence, which the plaintiff failed to offer.

***Joe Hand Promotions, Inc. v. Blanchard*, 2010 WL 1838067 (S.D. Ga. May 3, 2010) – Personal liability under Communications Act of 1934 based on right and ability of supervision and financial interest.**

Plaintiff, Joe Hand as a promoter of a UFC#92 Program entered into agreements with various entities in Georgia to broadcast the program, but not with Hide-A-Way Sports Grill. After learning of the broadcast of the program, the plaintiff sued Parmax, Inc. d/b/a Hide-A-Way Sports Grill and defendant Blanchard individually for violating anti-piracy provisions of the federal Communications Act of 1934, 47 U.S.C. §§ 553 and 605. Defendants were served with process, but failed to respond. The Clerk entered default for failure to respond, and Joe Hand moved unopposed for a default judgment against both defendants. In ruling on that motion, the Court found that under section 605 of the Communication Act of 1934, Blanchard could be held "vicariously liable in his individual capacity and as officer, director, shareholder and or principal" of the company if he had a right and ability to supervise the violations and a strong financial interest the activity involved. By virtue of his default, Blanchard admitted that he had supervisory control over the company's decision to show the program and that he received financial benefit from it.

***Ojeda-Sanchez v. Bland Farms, LLC,* 2010 WL 3282984 (S.D. Ga. Aug. 18, 2010) – Personal liability for violations of Fair Labor Standards Act requires operational control.**

Plaintiffs, H-2A guest workers from Mexico of the defendant Bland Farms, asserted claims against their employer and its corporate officers individually for violations of the Fair Labor Standards Act ("FLSA") and for breach of contract. The Court found that the individual defendants were not liable for any of the contractual claims because they were not employers under the FLSA and consequently not employers under the H-2A regulations. The Court concluded that they were not employers under the FLSA because they lacked the operational control necessary for individual liability for unpaid wages.

***In re Haysman: Haysman v. State of Georgia,* 432 B.R. 336 (N.D. Ga. June 28, 2010) – CEO and 50% shareholder of corporate taxpayer held not liable for unpaid state sales and withholding taxes when actual role, authority and duties were inconsistent with corporate titles held.**

Haysman, a Chapter 7 debtor, sought to determine that he was not a "responsible person" liable to the State for a company's unpaid unemployment and sale taxes. Plaintiff was a 50% shareholder, Secretary and Chief Executive Officer of the entity. He had another full time job, was not on the entity's payroll, was not involved in the day-to-day operations, was not in control of the funds of the entity, and was unaware of the entity's tax deficiency. The State notified Plaintiff that the entity failed to pay state sales taxes and employer withholding taxes. The Bankruptcy Court found that since the role, duties and authority of the debtor were inconsistent with the titles he held as president, secretary and chief executive officer, he was not a "responsible person" under Georgia law. Furthermore, the Court concluded that even if he was a "responsible person," he was not shown to have "willfully" failed to collect and remit the company's employment and sales taxes, and therefore was not personally liable, noting that "willfulness requires either knowledge that required taxes are not being paid or recklessly ignoring a known risk that the taxes will not be paid."

B. CORPORATE STOCK OWNERSHIP AND RIGHTS.

***Rakusin v. Radiology Associates of Atlanta, P.C.,* 305 Ga. App. 175, 699 S.E.2d 384 (2010) – In statutory valuation and redemption of stock of deceased shareholder of a Georgia professional corporation under O.C.G.A. § 14-7-5(c) and § 14-2-1325(c), the estate was not deemed to have accepted the corporation's offer of payment when the executrix failed to respond within 30 days, because the offer was not contemporaneously accompanied by required financial information and was thus invalid.**

In this case, the Georgia Court of Appeals held that the failure to include financial information with an offer made pursuant to the dissenters' rights provisions of the Georgia Business Corporation Code, which are applicable to a statutory redemption of the shares of a deceased professional corporation shareholder, renders the offer invalid and not binding on the shareholder's estate.

Radiology Associates of Atlanta, P.C. ("RAA") filed suit against the executrix of the estate of a former employee and stockholder, seeking a declaratory judgment that it had made a valid offer of payment for the shareholder's stock. There was no provision in RAA's articles or bylaws and no shareholders' agreement providing for redemption of the decedent's stock. It was therefore subject to the special valuation and payment procedures set forth in O.C.G.A. § 14-7-5(c) of the Georgia Professional Corporation Act, which provides that the valuation and payment for the shares are to be made pursuant to O.C.G.A. § 14-2-1327, a provision of the dissenters' rights article of the Georgia Business Corporation Code. The professional corporation must begin the valuation process by making an offer of payment pursuant to O.C.G.A. § 14-2-1325. Under § 14-2-1325(c), if a shareholder (or a professional corporation shareholder's estate) fails to respond within 30 days, the shareholder (or estate) is deemed to have accepted the offer.

RAA sent the executrix checks for $750 and $25,620, dated February 28, 2007, which contained the respective notations "1500 Shares of RAA Stock Repurchase," and "Accounts Receivable Buy-Out." The executrix did not cash the checks, but hired counsel and discussions began regarding the stock redemption. On August 15, 2007, RAA sent another letter referencing the fact that the checks had been previously tendered and stating that information was enclosed pursuant to O.C.G.A. § 14-2-1325. The letter included copies of RAA's 2006 balance sheet, income statement and statement of changes in shareholder's equity and a copy of the Georgia dissenters' rights article. Over a year later, on September 25, 2008, the executrix's attorney sent a letter asserting that the executrix was making a timely demand for payment at her estimated fair value of $633,277. RAA argued that the September 2008 demand for payment was time-barred because the executrix had failed to respond to RAA's offer in February 2007.

The Georgia Court of Appeals held that RAA's February 2007 offer was unequivocally an offer of payment, but was invalid because it was not accompanied by the requisite information at the time it was made. The plain language of O.C.G.A. § 14-2-1325(b) expressly provides that a corporation's offer of payment "must be accompanied by" certain other information. The Court dismissed RAA's argument that it could satisfy the requirements by combining the actions of sending the checks and then providing the required information several months later and was unpersuaded by RAA's alternative argument that the August 2007 letter, standing alone, constituted a valid offer of payment. Because RAA's offer of payment was invalid, the Court held that the executrix's September 2008 letter making a demand for payment was not untimely and entitled the estate to valuation and payment for the decedent's stock.

***Graphic Packaging Holding Co. v. Humphrey*, 2010 WL 4608775 (11th Cir. Nov. 16, 2010) (not selected for publication in the Federal Reporter) – Corporation failed to show that valuing the restricted stock units of its retired president was a mistake because there was no past practice of valuing restricted stock units for key employees.**

This case involved an effort by a company to recover an alleged overpayment of $541,575.08 by mistake to a former executive for the value of his restricted stock units ("RSUs") on his retirement. Stephen M. Humphrey served as the President and CEO of Graphic Packaging Corp. and received awards of RSUs under the company's Stock and Incentive Compensation Plan, to be paid out when he retired. When Humphrey retired on December 31, 2007, all his RSUs had vested. However, his award agreements provided that since he was a "key employee" under Internal Revenue Code § 409A, there was a mandatory holding period of six months beyond the date of his retirement before he could be paid. Each RSU was the equivalent of one share of the company's stock, so the issue was whether the stock should be valued on the date of retirement or on the date the stock became payable (June 30, 2008). The price of the stock on December 31, 2007 was $3.69 and on June 30, 2007, it had fallen to $2.02 per share. The Plan was silent on the valuation date.

Upon Humphrey's retirement, he received repeated communications from the company that his RSUs would be valued and paid as of the date of his retirement. After the Graphic Packaging Legal Department brought the waiting period to the company's attention, it continued to tell Humphrey that his RSUs would be valued as of the date of his retirement. At the end of the waiting period, consistent with its prior statements, the company paid Humphrey $1,208,392.55 for his RSUs, using the price of the stock on the date of Humphrey's retirement to calculate the amount.

Humphrey's retirement was the first time a key employee had retired and the first time the six-month holding period was required, so there was no precedent for determining when the stock should be valued. For prior retirements, the date of payment and valuation had both been retirement date.

Several weeks after the payment, the Graphic Packaging Legal Department took the position that the proper valuation date was the date of distribution, and that Humphrey had been overpaid. Humphrey declined to refund the money and Graphic Packaging submitted the issue to the Compensation and Benefits Committee of the Graphic Packaging Board of Directors for final determination of the valuation date. Under the Plan, the Committee was given the authority and discretion to make binding and conclusive decisions on benefit awards, providing that "all interpretations and determinations made by the Committee shall be final and binding upon Participants." The Committee decided that the proper valuation date was the date of payment, and when Humphrey declined to return the money again, Graphic Packaging filed suit in Georgia state court to recover the amount of the alleged overpayment based on theories of money had and received and, alternatively, unjust enrichment, claiming that its overpayment was a mistake and Humphrey was not entitled to keep the money.

Humphrey removed the case to federal court and asserted counterclaims for breach of contract. The district court denied Graphic Packaging's motion for summary judgment with respect to its claims against Humphrey and granted Humphrey's motion for summary judgment with respect to Graphic Packaging's claims against him, holding that the company had failed to demonstrate that the overpayment was the result of a mistake. On appeal, Graphic Packaging argued that evidence of its historical practice of valuing RSUs on payment date precluded summary judgment. It also argued that the Committee's decision was binding and should be upheld unless it was tainted by bad faith or fraud, and, in the absence of both, Delaware law requires judicial deference to the Committee's decision. The 11th Circuit Court of Appeals disagreed, holding that Graphic Packaging's right of recovery depended on whether it had committed a mistake and it had the burden to produce evidence showing that it had, in fact, made a mistake. Since prior history did not involve key employees and waiting periods and since retirement and payment dates coincided, prior history did not constitute evidence of a mistake. Similarly, Graphic Packaging could not prove mistake simply by pointing to the Committee's ultimate conclusion, since there was nothing in the evidence of the Committee's decision that indicated that the company's valuation as of the date of retirement had been a mistake. The Court also noted that Graphic Packaging's Plan and award agreements did not provide that Humphrey's RSUs should have been valued on the date the holding period expired; they were silent on the date of valuation. Accordingly, "the district court correctly determined that Graphic Packaging failed to submit evidence showing that its valuation of Humphrey's RSUs on the date of his retirement was a mistake, and summary judgment was affirmed.

***Ansley v. Ansley*, 307 Ga. App. 388, 705 S.E.2d 289 (2010) – Statute imposing a 20-year limit on duration of shareholder agreements of non-publicly held corporations did not apply retroactively to shareholder agreement with no expiration date; four-year limitations period for breach of oral contract to devise stock to surviving shareholders began to run when shareholder died intestate; oral agreement resulted in shareholder's waiver of right to enforce buyout provision of prior written agreement.**

The Georgia Court of Appeals held that the trial court erred in granting partial summary judgment in an administrator's claim to enforce a buyout provision in a written shareholder agreement because the shareholders had made a subsequent oral agreement to execute wills devising their stock to the surviving shareholders.

The administrator of the estate of Kevin Ansley, one of three shareholders in a nonpublicly held corporation, Ansley & Sutton Construction Company ("A&S"), brought suit against the surviving shareholders and the corporation, seeking a judgment that the surviving shareholders and the corporation were required to purchase the shareholder's stock from the estate in accordance with the buyout provisions of a written shareholder agreement. The surviving shareholders, Michelle and Jeffrey Ansley, counterclaimed for the deceased shareholder's breach of oral promise to execute a will devising his stock to the surviving shareholders or to enforce oral promise.

A&S and its two original shareholders had entered into a Shareholders Agreement in 1987, which provided for purchase by A&S of the stock of a deceased shareholder. In 1992, three siblings Kevin, Jeffrey, and Michelle Ansley acquired A&S and entered into an addendum to the 1987 agreement in which they each agreed to be bound by the terms of that agreement. By early 1994, the shareholders became concerned about funding the buyout provisions of the 1987 agreement and agreed to devise their interest in A&S to the surviving siblings upon their deaths and agreed to execute wills to that effect. Jeffrey and Michelle executed wills containing such a provision; a similar will was drafted for Kevin at his request, but he never signed it. Even so, at a special meeting of A&S's board of directors in January 2008, all three siblings signed minutes stating that "to ensure the viability of the Company," they agreed that their spouses and children would not possess any interest in the company and that they agreed to have their wills updated "with this express desire" no later than December 2008. However, Kevin died intestate in August 2008.

After Kevin's death, his administrator sued Jeffrey, Michelle and A&S seeking to enforce the buyout provisions of the 1987 Shareholders Agreement, which was not for a specific duration. A&S contended that the agreement expired on November 19, 2007 by operation of O.C.G.A. § 14-2-732(b)(3), which provides that an agreement authorized by that Code section is valid for no more than 20 years.[5] The statute was enacted in 2000 and was not expressly retroactive. The court refused to apply it here in order to insert a material term into a 1987 agreement, the provisions of which were adopted by different parties in 1992. The court cited the rule that a "newly

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[5] O.C.G.A. § 14-2-732(b)(3) states: "An agreement authorized by this Code section shall be:…Valid for no more than 20 years. Failure to state a period of duration or stating a period in excess of 20 years shall not invalidate the agreement, but in either case the period of duration shall be 20 years."

enacted law cannot impair the obligations of an existing contract."[6] The Court noted that the defendants did not rely on predecessor code provisions in effect in 1987 and 1992 which likewise provided for a 20-year duration for shareholder agreements, *see*, *e.g.*, former of O.C.G.A. § 14-2-731(d), and observed that O.C.G.A. § 14-2-627(a), which authorizes shareholder agreements restricting the transfer of corporate securities, does not contain a limitation on duration.

The Court of Appeals agreed with A&S, Jeffrey, and Michelle, however, that the trial court erred in finding that the oral agreement to make a will was not enforceable because Jeffrey's and Michelle's claims were barred by the statute of limitations and because the oral agreement was superseded by the 2008 Shareholders Agreement. The court held that contracts to make a will are enforceable if supported by valuable consideration, and "[a]n oral contract to make a will also may be valid and enforceable if entered into before January 1, 1998."[7] The court also stated that Jeffrey and Michelle's counterclaims arising out of the alleged breach of the oral contract to make a will accrued upon Kevin's death and were not barred by the statute of limitations. The Court of Appeals also disagreed with the trial court's finding that the oral agreement merged into the "2008 Shareholders Agreement" and was not admissible as parol evidence to explain the written agreement. The court held that the 2008 Shareholders Agreement did not purport to be the entire agreement between the parties through inclusion of a merger clause or similar language, and it was not inconsistent with the oral agreement. Further, the alleged oral agreement's "independence and its lack of inconsistency with the written contract cause[d] it not to become merged with the written contract."[8]

The administrator also argued that the oral agreement was unenforceable because it conflicted with the 1987 Shareholder Agreement, which was incorporated into the 1992 addendum. However, the evidence was sufficient to show the mutual intent of the existing shareholders to devise their shares as an alternative to the buyout provision. Accordingly, a trier of fact could conclude that Kevin by his conduct waived his rights to enforce the prior written shareholders' agreement. The Court of Appeals concluded that the trial court erred in granting the administrator's motion for partial summary judgment.

***Vidalia Outdoor Products, Inc. v. Higgins*, 305 Ga. App. 836, 701 S.E.2d 217 (2010) – Given uncertainty in terms of a stock purchase agreement, whether the purchaser could rescind the agreement for material breach for the corporation's failure to issue a stock certificate was an issue of fact.**

This case addressed the question of whether a stock purchase agreement could be rescinded by the purchaser for the company's failure to issue a stock certificate. The issue could not be decided as a matter of law, given uncertainty in the contract terms and questions about whether the alleged breach was sufficiently material to defeat the object of the contract and to warrant rescission.

In this appeal, the Court of Appeals reversed a grant of summary judgment in favor of a buyer in a failed transaction for the purchase of interest in a corporation, finding that genuine issues of material fact remained as to the terms of the agreement and whether the alleged breach of contract was sufficient to allow for rescission of the contract. Scott Higgins and Vidalia Outdoor Products, Inc. ("Vidalia") entered into a contract in 2004 whereby Higgins was to purchase a one percent (1%) interest in Vidalia for $29,000. The contract also provided that Higgins was to represent Vidalia as an independent sales representative. According to Higgins, Tim Montgomery, Vidalia's president and sole shareholder, promised Higgins that he would receive a stock certificate and agreed to buy the stock back if Higgins became dissatisfied with the investment for any reason. However, the purchase contract contained no such language. (There is no mention whether the written agreement contained a merger clause.) Higgins never received a stock certificate, and Higgins's ownership interest in Vidalia was never noted on the company's tax returns or board minutes. According to Montgomery, Higgins attended and participated in corporate

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[6] *Citing Marek Interior Sys. v. White*, 230 Ga. App. 518, 520(1), 496 S.E.2d 749 (1998).

[7] *Citing Rushin v. Ussery*, 298 Ga. App. 830, 832(1), 681 S.E.2d 263 (2009). After January 1, 1998, under O.C.G.A. § 53-4-30, contracts to make a will must be in writing. *Id.* at n.3. Under Article 8 of the Uniform Commercial Code, which applies to stock in close corporations, *Thompson v. Kohl*, 216 Ga. App. 148, 453 S.E.2d 485 (1994); Official Comment 2 to U.C.C. § 8-103, no contract for the purchase or sale of an investment security is required to be in writing. O.C.G.A. § 11-8-113. Query whether a shareholders agreement requiring all parties to make wills providing for the devise of stock gratis to survivors would constitute a contract of sale under Article 8.

[8] *Citing Langenback v. Mays*, 205 Ga. 706, 54 S.E.2d 401 (1941).

meetings and discussed corporate finances, but owed Vidalia for some merchandise when Vidalia lost contact with him in early 2006.

In 2008, after obtaining and reviewing some company records, Higgins's counsel sent a letter purporting to rescind the contract based upon mutual mistake, fraudulent misrepresentation, and Vidalia's alleged non-performance. Shortly after Higgins filed suit, Vidalia issued a stock certificate to him and amended its tax returns and minutes.

The Court of Appeals found that issues of fact remained regarding whether Vidalia's alleged non-performance authorized Higgins to unilaterally rescind the contract. According to the Court, in order for rescission of a contract to be justified,

> there must be a material nonperformance of breach by the opposing party. . . . A breach is material when it is so substantial and fundamental as to defeat the object of the contract. In other words, to trigger the right to rescission, the act failed to be performed must go to the root of the contract. A breach which is incidental and subordinate to the main purpose of the contract does not warrant termination.

2010 WL 3470022 at * 2. Since the record before the Court was extremely limited, and the parties strongly contested the existence of the oral agreement to issue a stock certificate and buy back the stock, the Court found issues of fact remained as to whether Vidalia's failure to issue Higgins a stock certificate and notice his interest on its tax returns amounted to a breach "so substantial and fundamental as to defeat the object of the contract."

***In re Value Family Properties-West Atlanta, LLC; Value Family Properties-West Atlanta, LLC v. Harrison*, 2010 WL 2025592 (Bankr. N.D. Ga. March 30, 2010) – Equity claims are subject to subordination in bankruptcy even when they consist only of claims for unpaid past due interest.**

In *In re Value Family Properties*, the bankruptcy court considered whether an investor in the debtor asserting a claim against the debtor for past due interest payments owing under a subscription agreement would have his claim allowed as an unsecured claim or subordinated as equity in the debtor pursuant to 11 U.S.C. § 510.

The subscription agreement contained three operative provisions defining the investment. The first was that for each investment of $1,000,000, the investor would be credited with a 14% equity interest in the debtor and one of its affiliates. The second was that the investor would receive interest-only payments of 10% per year on his investment in the debtor and its affiliate, to be paid monthly. The third provision entitled the investor to receive a return on his capital investment if the debtor or its affiliate were sold. Based on the language in the subscription agreement, the bankruptcy court found that the investor had purchased a security and that he represented himself to be a "sophisticated investor" who qualified as an "accredited investor" as defined in Section 501 of Regulation D, promulgated under the Securities Act of 1933. In viewing the transaction as a whole, the Court also found that the investor "took on the risk and return expectations of a shareholder" when he bought an equity position in the debtor, including the promised return on his investment in the form of interest payments.

The debtor-in-possession objected to the claim on the grounds that it was based on an equity investment in the debtor and, therefore, the claim should be subordinated to general unsecured claims in accordance with section 510(b) of the bankruptcy code, which provides:

> For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

11 U.S.C. § 510(b). In response, the investor focused on the portion of the agreement providing for interest payments, which he alleged that he received regularly from 2005 until 2008, when he sold his equity interest in the debtor. The investor contended that, at the time of his sale of his interest, the debtor owed him $7,500 and that he

became a creditor the moment he transferred his equity interest, thereby excepting his claim from the reach of section 510(b) because his right to payment of accrued interest, at that point, was not created by the purchase or sale of the security.

The bankruptcy court rejected the investor's argument that the sale of the security "isolated or divorced" his claim from the security, citing *In re Med Diversified, Inc.*[9] In that case, the Second Circuit affirmed a bankruptcy court's decision to subordinate a claim of a former officer for damages stemming from the debtor's failure to issue common stock pursuant to a written agreement with the officer. The *Med Diversified* bankruptcy court had held that a claim, in order to be subject to section 510(b), "need not flow directly from the securities transaction, but can be viewed as 'arising from' the transaction if the transaction is part of the causal link leading to the injury." The Court also considered similar decisions out of the Ninth Circuit[10] and Third Circuit[11] subordinating claims of investors.

As in *Med Diversified*, the court held that the investor's claim, even if severable from his investment by the later sale of his equity interest, was "rooted in and arises from" his purchase of a security and his claim was thus subject to section 510(b). "But for" the causal link between the purchase of the security and the breach by the debtor of its obligation to pay interest, there would not have been a claim, and so the claim was subordinate to the claims of general unsecured creditors who did not stand to profit from their "investment" in the debtor.

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

***Bailey v. Stonecrest Condominium Association, Inc.*, 304 Ga. App. 484, 616 S.E.2d 462 (2010) – Action by condominium association board of directors motivated by racial discrimination held to constitute a breach of fiduciary duty.**

In this case, the Georgia Court of Appeals applied breach of fiduciary duty principles to the decision of a condominium association board facing claims of racial discrimination in proposing a change in association bylaws to prohibit leasing.

The plaintiff alleged that the association board acted with discriminatory intent by proposing a change in bylaws to prohibit all leasing of condominium units after she leased her unit to an African-American woman. She asserted that the board's action was motivated by racial discrimination in violation of the Georgia Fair Housing Act and in breach of their fiduciary duties. The Court of Appeals reversed the trial court's grant of summary judgment for the association board, finding genuine issues of material fact concerning whether the bylaws were in fact passed with a discriminatory intent and remanded the case for trial.

The Court found circumstantial evidence in the record supporting the plaintiff's allegations. The Court rejected arguments made by the association board that the bylaws were being discussed prior to the plaintiff's purchase of her unit and prior to her lease to an African-American woman. Specifically, the Court found that such arguments lacked credibility since the leasing issue was not mentioned in any of the minutes of the board's meetings for the years prior to plaintiff's purchase and that her real estate agent was not informed of such an issue by the board when she inquired about leasing upon the plaintiff's behalf. In making this determination, the Court specifically noted that "departures from normal procedures may afford evidence that improper purposes are playing a role in a decision making body's change of policy." 304 Ga. App. at 492. The Court also relied on evidence that the president of the association's board had informed the plaintiff that her leasing of the unit to an African-American woman had put tenants into an uproar and that the bylaw amendment was being proposed because of her tenant.

The Court also affirmed the "well settled" rules governing breach of fiduciary duty in the board context, noting that a claim for breach of fiduciary duty requires proof of three elements: (1) the existence of a fiduciary duty; (2) breach of that duty; and (3) damage proximately caused by the breach. *Id.* at 493. Regarding homeowners' associations specifically, the Court reaffirmed the Supreme Court of Georgia's holding that where decision-making authority is delegated "to a group and that group acts, the only judicial issues are whether the

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[9] *In re Med Diversified, Inc*., 461 F.3d 251 (2nd Cir. 2006).
[10] *In re Betacom of Phoenix, Inc.*, 240 F.3d 823, 830 (9th Cir. 2001).
[11] *In re Telegroup, Inc.*, 281 F.3d 133, 136 (3rd Cir. 2002).

exercise of that authority was procedurally fair and reasonable, and whether the substantive decision was made in good faith, and is reasonable and not arbitrary and capricious." *Id.* at 494, quoting *Sanders v. Thorn Woode Partnership L.P.*, 265 Ga. 703, 704(2), 462 S.E.2d 135 (1995). The Court found issues of fact on the substantive aspect of the board's decision and reversed the trial court's summary judgment, including as to the plaintiff's claims for attorneys' fees and punitive damages.

D. LIMITED LIABILITY COMPANY DEVELOPMENTS.

***Giacomantonio v. Romagnoli*, 306 Ga. App. 26, 701 S.E.2d 510 (2010) – Merger clause in operating agreement bars breach of fiduciary duty claims based on alleged misrepresentations.**

In this case, the Georgia Court of Appeals confirmed that contractual merger clauses in an LLC operating agreement can bar all tort claims based upon pre-contract misrepresentations, whether characterized as fraud or breach of fiduciary duty. The Court affirmed a summary judgment enforcing the involuntary withdrawal provisions of limited liability company operating agreements against one of its members.

Plaintiff and one of the defendants entered into three LLC operating agreements to own and manage multiple restaurants. The plaintiff had originally owned a 50% interest in each of three original LLCs. In order to avoid involving the businesses in his divorce, he divested himself of his interest in two of the LLCs. His divorce decree provided that his ex-wife would be entitled to part of any ownership interest in the two LLCs he had or might acquire. The defendants, one of whom was counsel to the LLCs, proposed a restructuring of the businesses and their ownership. The plaintiff signed the new operating agreements allegedly without understanding their provisions. Under the terms of the LLC operating agreements, plaintiff held 47.5 percent of the ownership and voting rights in each entity. They also provided for an involuntary withdrawal of a member if a divorce decree granted an ex-wife an interest in the companies. Several months after entering into the agreements, defendants alleged that plaintiff had triggered an involuntary withdrawal from the three LLCs based on the pre-existing divorce decree. Plaintiff then initiated this action, alleging that the involuntary withdrawal provisions were not enforceable due to fraud, negligent misrepresentation, civil conspiracy, breach of fiduciary duty, and breach of contract. Plaintiff sought a preliminary injunction either granting him an immediate 50 percent ownership interest in the LLCs or the appointment of a receiver to manage the LLCs' affairs. He did not sue for rescission of the restructuring or the new operating agreements, however. The parties agreed to a valuation of the plaintiff's interest in the event that he did not prevail on his fraud and breach of fiduciary duty claims, with payment to be made in accordance with the operating agreements. The trial court granted summary judgment on the fraud and breach of fiduciary duty claims, enforced the involuntary withdrawal provisions and held that in accordance with the operating agreements, the plaintiff would be paid that value of his interests over 10 years.

The Court of Appeals affirmed the rulings of the trial court on all counts, denying the plaintiff's preliminary injunction and granting summary judgment to the defendants. The Court reasoned that since the plaintiff had not appealed the trial court's ruling that the operating agreements were valid and enforceable, he could not then challenge the trial court's ruling denying the preliminary injunction since the grant of the preliminary injunction would have voided part of those agreements. Specifically, since the operating agreements only gave plaintiff 47.5 percent of the voting rights, to give plaintiff 50 percent of the voting rights would have been contrary to the operating agreements he conceded were valid. 306 Ga. App. at 31.

Regarding the issue of plaintiff's tort claims, the Court held that the merger clause contained in each of the new operating agreements operated as a disclaimer of all representations not made on the face of the contract. *Id.* at 31-32. As a result, all tort claims based on any alleged misrepresentations, including claims for breach of fiduciary duty, were barred. In reaching this determination, the Court relied on *Ekeledo v. Amporful*, 281 Ga. 817, 642 S.E.2d 20 (2007), a case in which the Georgia Supreme Court applied a merger clause to bar constructive trust claims based on an alleged breach of fiduciary arising duty out of a partnership by estoppel. The Court held that "where [an] allegedly defrauded party affirms a contract which contains a merger or disclaimer provision and retains the benefits, he is estopped from asserting that he relied upon the other party's misrepresentation[s] [in entering the agreement] and his action for fraud must fail." 281 Ga. at 820(2). The Court of Appeals interpreted *Ekeledo* as generally "indicat[ing] that this principle bars not only fraud claims based upon the alleged, pre-contract misrepresentation, but all tort claims based upon such misrepresentation, including claims for breach of fiduciary duty." *Id.* at 32. This interpretation may be a broad reading of the Supreme Court's decision, but it puts an increased emphasis on the importance of merger clauses in operating agreements and their effect on the ability to bring tort claims based on misrepresentation in the business organization context, as well as the importance of seeking rescission in transactions where the governing agreement contains a merger clause.[12]

***Kim v. First One Group, LLC*, 305 Ga. App. 861, 700 S.E.2d 729 (2010) – Oral resignation of manager held effective where LLC operating agreement does not contain provisions specifying resignation procedures.**

Plaintiff, a former manager of a adult day healthcare center admitted to the directors of the limited liability company operating the center that he and his wife committed Medicare fraud. As a result, pursuant to provision of the LLC's operating agreement, more than the required 2/3 majority of the non-managing members of the LLC voted to oust Kim. Kim accepted the vote, resigned and turned over his key, but failed to appear at a meeting a few days later and refused to turn over the signatory authority to the company account, which was frozen as a result of the fraud committed by Kim. The company sued the plaintiff for breach of duty and contract and moved for a temporary restraining order and an interlocutory injunction. The trial court granted the interlocutory injunction and ordered Kim to hand over the control of the company. The Court of Appeals affirmed the trial court's decision, holding that the manager's resignation itself supported injunction. The Court noted that the LLC operating agreement did not specify any procedure for resignation, and stated that the existence of a written employment agreement did not prevent Kim's resignation "by word, deed or both." The injunction was also warranted by the evidence of his fraud and was necessary to prevent harm to the company.

***Simmons Family Properties, LLLP v. Shelton*, 307 Ga. App. 361, 705 S.E.2d 258 (2010) – LLC members' request for judicial dissolution of LLC was not subject to arbitration clause in operating agreement; evidence of deadlock warranted finding under O.C.G.A. § 14-11-603 that the LLC was unable to carry on business in conformity with operating agreement.**

The Georgia Court of Appeals affirmed the trial court's judgment, after a bench trial, granting a petition to dissolve a limited liability company pursuant to O.C.G.A. § 14-11-603 and denying the respondent's motion to stay the proceedings and compel arbitration under the LLC's operating agreement.

DDE Properties, LLC ("DDE") was formed in 2005 and owned by Donnie Shelton, Edward Johnson, and Simmons Family Properties, LLLP ("SFP"). Under the operating agreement, each member owned a one-third economic and voting interest in DDE. In 2008, Shelton and Johnson filed a petition in superior court to dissolve DDE pursuant to O.C.G.A. § 14-11-603, which provides in part that on application by or for a member of a limited liability company, the court may decree dissolution of the company whenever it is not practicable to carry on the company's business in conformity with the articles of organization or a written operating agreement.[13] SFP contended that DDE's operating agreement required that the request for dissolution be handled by an arbitrator. The operating agreement stated that "any dispute, controversy or claim arising out of or in connection with, or relating to this Agreement or any breach or alleged breach hereof" shall be settled by arbitration. It also required an annual meeting of members and an 80% super majority to constitute a quorum for any meeting of members.

The court addressed the issue of whether the request for judicial dissolution of DDE was a claim "arising out of, in connection with, or relating to the operating agreement or any breach or alleged breach thereof." The court noted that Shelton and Johnson had tried repeatedly to hold meetings of members, but Simmons's failure to attend prevented a quorum. They also initially tried to dissolve the company as provided in the operating agreement, and when those efforts failed, they commenced the dissolution proceeding under O.C.G.A. § 14-11-603.

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[12] In another recent decision, *Pollman v. Swan*, 2010 WL 2684778 (Ga. App. July 8, 2010), a dispute regarding a residential real estate transaction that did not involve breach of fiduciary duty claims, the Court confirmed that a merger clause can bar a claim under the Georgia Racketeer Influenced and Corrupt Organizations Act, citing *Markowitz v. Wieland*, 243 Ga. App. 151, 532 S.E.2d 705 (2000).

[13] O.C.G.A. § 14-11-603(a) states: "On application by or for a member, the court may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or a written operating agreement. A certified copy of any such decree shall be delivered to the Secretary of State, who shall file it."

The court held that the statute provides an independent legal mechanism for judicial and administrative dissolution of a limited liability company. The operating agreement did not govern dissolution proceedings under O.C.G.A. § 14-11-603, and it expressly limited the parameters within which dissolution could be sought pursuant to its terms. The court held that the statutory dissolution effort did not arise out of, in connection with, or relate to the terms of the operating agreement or any alleged breach thereof, so the trial court properly determined that the issue of DDE's dissolution did not need to be submitted to arbitration.

SFP next claimed that the trial court erred in determining that it was not reasonably practicable for DDE to carry on business in conformity with the operating agreement under O.C.G.A. § 14-11-603. The court affirmed the trial court's finding that the lack of properly-noticed annual meetings was more than a formality, because annual meetings were "the primary venue" in the operating agreement for non-managing members to voice their views and "protect their investments by contributing to the direction of the company." The members of DDE were "effectively deadlocked over several issues" [not identified in the opinion] and "the situation seemed unlikely to change." Based on this evidence, the Court of Appeals affirmed the trial court's holding that it was not reasonably practicable for DDE to carry on business in conformity with the operating agreement, and the petition to dissolve the LLC was properly granted. A petition for a writ of *certiorari* is pending at this writing.

E. <u>PARTNERSHIP LAW DEVELOPMENTS</u>.

***Valone v. Valone*, 2010 WL 4437076 (N.D. Ga. Nov. 1, 2010) – Limited partnership could not be judicially dissolved when it was able to fulfill the purpose it was organized for, despite claim of deadlock among partners.**

Plaintiff James A. Valone, one of five general partners of the Bomeg Limited Partnership, a limited partnership organized under the Georgia Revised Uniform Limited Partnership Act, sought the judicial dissolution of the partnership. According to the Second Amended and Restated Limited Partnership Agreement, Bomeg's purpose was to conduct any lawful business under the Act, including "the acquisition, retention and disposition of any type of property for business or investment purposes." The other general partners of Bomeg were two trusts established by the Plaintiff's mother and father, and the Plaintiff's two siblings, Defendants Thomas Valone and Mary Ethel Bettendorf. Each trust owned a 49% interest in the partnership. The three siblings were the trustees of the two trusts. Each held two thirds of one percent of the ownership interest in Bomeg.

Bomeg and the two trusts provided that they were to be managed by majority vote and the Plaintiff's brother and sister effectively controlled the partnership "acting as a block." The partnership's assets consisted of a brokerage account, which had grown in value. No distributions of profits were made to the partners despite the annual income tax obligations on Bomeg's profits that passed through to the partners. The partnership agreement also contained restrictions on transfer, effectively preventing the Plaintiff from disposing of his interest. Because the Plaintiff was continuing to incur a tax liability from the partnership while seeing no prospect of receiving profits and because his siblings controlled the partnership and excluded him from any role in its management, he petitioned the court to dissolve Bomeg.

Plaintiff sought judicial dissolution under O.C.G.A. § 14-9-802, which states that the test for dissolution of a limited partnership is whether it is "not reasonably practicable to carry on the business in conformity with the partnership agreement." Although no Georgia courts have interpreted this language in the context of a limited partnership, the court noted that the language is clear and unambiguous. Further, the dissolution test in § 14-9-802 is identical to that found in § 802 of the Revised Uniform Limited Partnership Act ("RULPA"). Under O.C.G.A. § 14-9A-3, statutory language adopted from RULPA is to be interpreted to effect RULPA's purpose to make the law uniform where its provisions are enacted, and thus in interpreting the Georgia Code's limited partnership statutes courts should "look to the law of other jurisdictions considering the same question under the [RULPA]."[14]

The District Court discussed and distinguished decisions from other jurisdictions interpreting Section 802, stating that the decisions "have consistently held that when a business is organized for the purpose of operating at a profit, the relevant inquiry in an action for judicial dissolution is whether the business is still able to do so." *Id.* at *2.

[14] *Citing Hendry v. Wells*, 286 Ga. App. 774, 784, 650 S.E.2d 338 (2007).

The court noted that dissolution was granted under circumstances where the partnership could only be operated at a loss and conflicts among partners resulted in an operational deadlock, with no provision for breaking the deadlock. Where dissention does not prevent or imperil operation in accordance with the partnership agreement, judicial dissolution is not justified.

The court found that the Plaintiff failed to plead sufficient facts for the court to reasonably conclude that Bomeg could not continue to accomplish its purposes. The facts in the record showed that Bomeg's business was successful and its profits had been rising each year. The disagreements among the general partners did not create the sort of deadlock that justified dissolution:

> Defendants Thomas and Mary Ethel have consistently voted their interests in family business matters as a block, thereby overruling any opposition from Plaintiff. (Petition ¶ 23.) The business decisions of Defendants have allowed Bomeg to continue its operation without the sort of intractable deadlock that would imperil its operations. The fact that this leaves Plaintiff without managerial control over the direction of the partnership does not amount to any threat to the partnership itself.

Id. at *4. The court also noted that Plaintiff alleged no tortious conduct or breach of contract. Instead,

> Plaintiff merely seeks relief from inconvenient tax obligations and limitations of his right to transfer his partnership interest, both of which are risks Plaintiff knowingly assumed when he entered into the Agreement. Having done so, he cannot now seek the partnership's dissolution simply because the terms of the Agreement have become burdensome.

Id. The court held that Plaintiff failed to state a cause of action for dissolution under Georgia law because he did not point to any facts showing that the conflict among the parties would impact Bomeg's ability to continue operating at a profit. The court's decision appears to be generally consistent in analysis and approach with *Simmons Family Properties, LLLP v. Shelton*, 2010 WL 4835609 (Ga. App. Nov. 30, 2010), decided after *Valone.*

***Winchester v. Newlin*, 436 B.R. 236 (M.D. Ga. 2010) – Assignment by bankruptcy trustee of turnover claim under 11 U.S.C. § 542(a) against debtor for partnership payments held valid in sale of debtor's partnership interest to former partner; case properly remanded to state court.**

This decision involves an appeal of bankruptcy court rulings, reported at 416 B.R. 911 (Bankr. M.D. Ga. 2009), on jurisdictional and procedural issues in an extended dispute that arose between two partners in a dental practice after one of them filed for bankruptcy while the partnership continued in operation, leading to actions and claims by the debtor-partner's bankruptcy trustee. The bankruptcy trustee did not assume the Partnership Agreement and attempted to sell the debtor's partnership interest. The debtor, E. Murray Newlin, after receiving his discharge, sued his partner, James R. Winchester, in state court asserting claims for alleged post-petition breaches of fiduciary duty. The trustee intervened and Winchester removed the case to bankruptcy court. The trustee asserted a counterclaim against Newlin under 11 U.S.C. § 542(a) seeking to compel Newlin to turn over $185,000 in post-petition payments from the partnership that under 11 U.S.C. § 541(a)(6) belonged to the bankruptcy estate. Among other ensuing developments, the trustee arranged and obtained court approval to sell Newlin's "partnership interest along with any and all claims flowing therefrom" to Winchester. Winchester was substituted for the trustee in the removed action and the bankruptcy court remanded the case to state court. Both Winchester and Newlin appealed. Newlin challenged the validity of the assignment of the turnover claim. Citing *Tenet Healthcare Corp. v. Williams (In re Allegheny Health, Educational and Research Foundation*), 233 B.R. 671 (W.D. Pa. 1999), Newlin argued that § 542(a) claims can only be assigned to a representative of the bankruptcy estate and must be brought for the benefit of the estate. The court noted that the *Tenet Healthcare* decision also held that § 542(a) requires that the property be turned over to the estate, not to third parties, but pointed out that the parties had expressly agreed that the § 542(a) claims were not included in the sale of assets. Without further discussion, analysis or any citation to supporting authority, the court held that "such assignments are permissible under the circumstances of this case." The court also affirmed the remand order in Winchester's appeal, ruling that Winchester as substituted counterclaimant was seeking the turnover "to benefit himself, and not for the benefit of the estate; thus, the counterclaim can have no effect on the estate." *Id.* at 244.

Two other partnership cases in this Survey are *In the Matter of Conner; Davis v. Conner*, 2010 WL 1709168 (Bankr. M.D. Ga. April 23, 2010), which involves the question of whether claims against a partner for breach of fiduciary duty are nondischargeable in bankruptcy and *Westmoreland v. Jordan Partners, LLLP*, 306 Ga. App. 575, 703 S.E.2d 39 (2010), regarding whether a foreign limited liability partnership transacting business in Georgia can maintain an action without obtaining a certificate of authority to do business in the state. These decisions are discussed in the Litigation section of the Survey.

F. TRANSACTIONAL CASES.

***Trawick Construction Company, Inc. v. Georgia Department of Revenue*, 286 Ga. 597, 690 S.E.2d 601 (2010) – No Georgia income tax liability for a target Subchapter S corporation when selling shareholders elect to treat the sale as deemed sale of all corporate assets; decision legislatively overruled.**

The Georgia Supreme Court held in this case that where a Subchapter S corporation is acquired in a stock purchase from shareholders who elect under 26 U.S.C. § 338(h)(10) of the Internal Revenue Code to treat the sale of their stock as a "deemed sale" of all corporate assets, the acquired corporation is not liable under O.C.G.A. § 48-7-21(a) for the shareholders' gain, because the election was not made "by the corporate taxpayer" as the language of § 48-7-21(b)(7) requires. The acquired corporation, Trawick Construction Company, had shareholders in multiple states. Trawick was treated as a Subchapter C corporation for Georgia income tax purposes, apparently because not all shareholders were subject to tax in Georgia on their portion of Trawick's income as required by O.C.G.A. § 48-7-21(b)(7). The case arose in the context of a dispute between the Georgia Department of Revenue and Trawick on the share of gain from the transaction to be apportioned to the State of Georgia. The procedural history of the dispute and the Supreme Court's decision show the strong differences of opinion reached in the efforts to interpret the Georgia statute. The Department of Revenue assessed Trawick additional tax, an administrative law judge found the additional assessment erroneous, the State Revenue Commissioner reversed the administrative law judge, the Superior Court reversed the State Revenue Commissioner, the Georgia Court of Appeals reversed the Superior Court, 296 Ga. App. 275, 674 S.E.2d 350 (2009), and a divided Supreme Court reversed the Court of Appeals over a spirited dissent.

The decision turned on the phrase "elections made by corporate tax payers" in § 48-7-21(b)(7). In the acquisition Trawick had joined in the shareholder's § 338(h)(10) election to treat the transaction as a deemed sale of Trawick's assets, and it disclosed its intention to treat its assets as having a stepped-up basis. It contended that the election did not result in its assumption of tax liability for the transaction because for an unaffiliated Subchapter S corporation, the election cannot be made by the corporation, citing an IRS regulation stating that the election must be made by the acquiring company and the shareholders of the Subchapter S corporation, 26 C.F.R. § 1.338(h)(10)-1(c)(3). The majority ruled that the plain language of § 48-7-21(b)(7) limited the application of that subsection to elections made by the corporation. Trawick's joining in the shareholders' election was "irrelevant." It noted that the State had benefited from its years of treatment of Trawick as a Subchapter C corporation and did not find it unreasonable to require Subchapter C treatment of the acquisition. It did not decide the issue of whether Trawick would be entitled to a stepped-up basis for its assets, but suggested that the Department of Revenue "may be correct" in contending that Trawick would not be entitled to a stepped-up basis if the § 338(h)(10) federal election is excluded from the determination of the tax effects of the transaction.

The Georgia Legislature legislatively overrode the Supreme Court's ruling by enacting H.B. 1138, which was signed into law on June 3, 2010, as Act No. 627. As amended, Ga. Code Ann. §48-7-21(b)(5) now provides that all elections pursuant to IRC § 338 will apply in determining Georgia taxable income.

***Turner Broadcasting System, Inc. v. McDavid*, 303 Ga. App. 593, 693 S.E.2d 873 (2010) – An expired letter of intent conditioning an asset purchase transaction on execution of formal documentation does not preclude a subsequent binding oral contract.**

This is an appeal from a $281 million jury verdict in favor of David McDavid against Turner Broadcasting System, Inc. ("TBS") for breach of an oral agreement to purchase a controlling interest in the Atlanta Hawks and Atlanta Thrashers and related Philips Arena operating rights. The jury found that TBS breached the agreement when, immediately before the planned public announcement of the sale to McDavid, it sold the teams instead to Atlanta Spirit, LLC, a company in which TBS founder Ted Turner's son-in-law was a principal. The decision confirms that the statement "we have a deal" has potency even in a complex transaction contemplating formal documentation, with conditions yet to fill and some details not resolved.

In affirming the Superior Court judgment, the Georgia Court of Appeals engaged in a close review of the evidence. It found sufficient evidence to support the jury's verdict on (a) the parties' intent to be bound to the transaction in the absence of a written agreement, and (b) whether the parties had reached agreement on all material contractual terms. At an initial stage, the parties had signed a letter of intent outlining sale terms and providing for a 45-day exclusive negotiating period. The letter of intent provided that the parties would not be bound unless they had executed "Definitive Agreements." It further provided that, except for its confidentiality obligations, upon expiration its terms would "automatically terminate and be of no further force and effect." The Court of Appeals found that "[t]he jury was therefore authorized to conclude that upon expiration of the Letter of Intent the terms imposing the written agreement requirement also expired and had no effect." 303 Ga. App. at 879. When the letter of intent expired, TBS declined McDavid's request to renew it, but assured him, "You're our guy" and continued the negotiations. Six weeks later at what was hoped to be a final negotiating session, McDavid conceded on an unresolved tax loss allocation issue on the condition that it would resolve all issues and finalize the deal. The Court of Appeals took note that "TBS's CEO, Phil Kent, agreed and announced, 'we have a deal.'" 303 Ga. App. at 876. During the weeks that followed, while the parties and their counsel worked on a purchase agreement and other documentation, (a) TBS proposed to restructure the transaction, but not change the deal, because the "deal was done;" (b) TBS announced the transaction internally and planned a press conference; (c) TBS consulted with McDavid on the hiring of a new general manager for the Hawks and other team management decisions; and (d) the board of directors of TBS's parent company Time Warner approved the sale over Ted Turner's opposition. When a final agreement was reached on the remaining open items, TBS's principal negotiator reiterated, "[t]he deal is done," and proposed to meet early the following week for a press conference and closing.

In the meantime, however, TBS had been secretly negotiating with the Atlanta Spirit, which was prepared to purchase the teams on the same terms as McDavid and days later informed McDavid that the Atlanta Spirit would be the purchaser.

To TBS's argument that, under the Statute of Frauds, the complexity of the transaction required such an agreement to be in writing, the Court found that the oral contract in question was not among the contracts listed in the Georgia Statute of Frauds, O.C.G.A. § 13-5-30 and noted, "Even complex or expensive contracts may be oral, as long as the evidence establishes the parties' assent to all essential terms of the contract." 303 Ga. App. at 878; *see also id.* at 883. In this respect, the Court referred to the transaction as a sale of TBS assets; however, McDavid was purchasing an 85% interest in the assets. The Court did not focus on the form of the assets and how McDavid's interests would be structured, i.e., whether McDavid would be purchasing stock or membership interests in entities owning the two team franchises.[15]

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[15] There has not been a statutory provision specifying the requirements for an enforceable contract to purchase or sell securities since the repeal of the Statute of Frauds in Article 8 of the Uniform Commercial Code in 1998. O.C.G.A. § 11-8-113 now contains an anti-Statue of Frauds provision, which was not mentioned in the Court's decision:

> A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making.

While Article 8 applies to closely held corporate stock, <u>see</u> Official Comment No. 2 to O.C.G.A. § 11-8-103, it does not apply to a non-publicly traded LLC membership interest unless "its terms expressly provide that it is a security governed by this article." § 11-8-103(c). The author has searched without success for a common law rule establishing the requirements for a binding agreement to sell stock or limited partnership or LLC interests. While there are regularly decisions handed down on whether a particular agreement to purchase investment interests is enforceable, they are resolved, as this case, based on general contract principles.

With respect to mutual assent, the Court used "an objective theory of intent," which focuses on how a reasonable man would understand the other party's "manifestations of assent." The Court held that the evidence authorized the jury to find that both parties intended to be bound. It cited each of TBS's actions listed above, along with expert testimony on industry practices with regard to professional sports teams to the effect that a franchise purchaser would only be permitted to give "formal input" on team management decisions if the parties were committed to the sale. The Court also observed that the draft purchase agreement had a merger clause superseding oral agreements and thus the parties must have contemplated the possibilities of an oral agreement. The Court cited prior Georgia decisional authority holding that oral contracts may be enforceable even when the parties contemplate the execution of a formal written agreement. While the issue was disputed, the Court found that there was sufficient evidence to enable the jury to find that all material terms had been agreed upon. As to the requirement of sports league approvals, the Court held that this was a condition of contract performance, not of contract formation, i.e., a condition subsequent. The Court held that TBS bore the burden of proof on this issue and noted evidence that McDavid had previously been approved as an owner of another National Basketball Association franchise. Finally, the Court considered TBS's challenge to the amount of damages awarded as excessive. The parties agreed to a benefit-of-the-bargain measure of damages which was based on the difference between the contract price and fair market value at the time of the breach. The Court found that the factual evidence and the expert testimony amply supported the award.

***Deutsche Bank National Trust Company v. JP Morgan Chase Bank, N.A.*, 307 Ga. App. 307, 704 S.E.2d 823 (2010) – Under O.C.G.A. § 14-5-7(b) the release of a lien can be executed by any corporate officer.**

JP Morgan Chase sued Deutsche Bank National Trust Company after the two banks conducted competing foreclosure sales of the same DeKalb County real property. Each claimed title under an assigned security deed. JP Morgan foreclosed under a 2004 security deed, while Deutsche Bank based its foreclosure on a 2001 security deed. The dispute concerned the validity of a 2003 warranty deed from Deutsche Bank's predecessor reconveying the property to the owner and extinguishing its lien and whether JP Morgan was a bona fide purchaser for value based on that warranty deed. One issue addressed in the appeal was the proper interpretation of O.C.G.A. § 14-5-7 and its requirements for the conveyance of real property by a corporation.

In 2001, Rebecca Diaz acquired the property and executed a security deed that was assigned to IndyMac Bank. In 2003, Diaz received a notarized warranty deed from IndyMac purporting to reconvey the property in fee simple, which she recorded. That deed was executed by an individual who identified herself as an Assistant Vice President of IndyMac, although it was eventually determined that she had fraudulently assumed that authority. The property was thereafter conveyed to another owner who, in 2004, executed a security deed on the property that was assigned to Washington Mutual Bank. Also in 2004, IndyMac assigned its 2001 security deed to Deutsche Bank. Deutsche Bank immediately foreclosed and was the highest bidder at the foreclosure sale. In 2005, Washington Mutual also foreclosed on the property under the 2004 security deed and was the highest bidder at its sale. JP Morgan acquired Washington Mutual's interest in the property after Washington Mutual was closed.

The trial court granted summary judgment to JP Morgan and the Georgia Court of Appeals affirmed, holding that the IndyMac warranty deed to Diaz was not a forgery but was "signed by someone fraudulently assuming authority" and that JP Morgan qualified as a bona fide purchaser for value because the 2003 warranty deed was regular on its face and duly recorded. In the process, the court addressed the provisions of O.C.G.A. § 14-5-7, which specifies formalities required when corporations convey interests in real estate. The court held that the 2003 warranty deed on its face complied with O.C.G.A. § 14-5-7(b) which states:

> "Instruments executed by a corporation releasing a security agreement, when signed by one officer of the corporation or by an individual designated by the officers of the corporation by proper resolution, without the necessity of the corporation's seal being attached, shall be conclusive evidence that said officer signing is duly authorized to execute and deliver the same."

The court noted that IndyMac's only interest in the property was its security interest under the 2001 security deed and that "reconveyance of the Property by way of a warranty deed was a proper way to release that security interest." 307 Ga. App. at 310.

Deutsche Bank argued that the phrase "when signed by one officer of the corporation" in O.C.G.A. §-14-5-7(b) should be construed as requiring the signature of the corporate president or vice president. The Court of Appeals disagreed and held that "[t]he words of O.C.G.A. § 14-5-7(b) are unambiguous and do not lead to an unreasonable or absurd result if taken literally: any officer of the corporation has authority to sign the instrument releasing the security interest. There is no basis from the language of the statute to limit that authority to a subset of corporate officers such as a president or vice president." *Id.* at 311. The court contrasted the language of subsection (b) with the that of subsection (a) which generally validates "instruments executed by a corporation conveying interests in real property when signed by the president or vice president" and attested by a secretary or cashier or their assistants. In substance, the court was not permitting the more specific subsection (b) to be limited by the more general provisions of subsection (a).

The Court also rejected Deutsche Bank's argument that the Warranty Deed failed to comply with O.C.G.A. § 14-5-7(b) because "the statute should be construed as requiring the instrument to expressly state that it was 'releasing a security agreement,' and the Warranty Deed did not contain such express language." The Court held that "nothing in the plain language of O.C.G.A. §14-5-7(b) imposes an express language requirement, 'and the judicial branch is not empowered to engraft such a [requirement] on to what the legislature has enacted.'" *quoting Kaminer v. Canas*, 282 Ga. 830, 835(1), 653 S.E.2d 691 (2007). *Id.*

***Walker v. Amerireach.com*, 306 Ga. App. 658, 703 S.E.2d 100 (2010) – Contractual defenses held inapplicable to claims under the Georgia Sale of Business Opportunities Act; the Georgia Fair Business Practices Act creates a separate and distinct cause of action independent of other theories of recovery.**

In this case, the Georgia Court of Appeals addressed a reseller's claims against a health distribution company, Amerireach.com LLC ("AmeriSciences") and three of its corporate officers under the state Fair Business Practices Act ("FBPA")[16] and the state Sale of Business Opportunities Act ("SBOA").[17] The trial court granted AmeriSciences's motion for summary judgment on *res judicata* grounds based on a Texas court's default judgment, and granted the officers' motion to dismiss for lack of personal jurisdiction. The Court of Appeals reversed the trial court's decision, holding that because Plaintiff's claim was based on a statutory violation and not on breach of contract, AmeriSciences's contractual defenses are inapplicable. The court also held that the trial court had personal jurisdiction over the individual defendants, who could be held liable under the SBOA.

The plaintiff Carol Walker, a physician, participated in a "marketing program" selling nutritional supplements purchased from defendant AmeriSciences. She held $150,000 worth of inventory when she terminated her involvement in the program. In February 2009, Walker sent an antelitem notice to the company stating that the company had failed to disclose her right to require it to repurchase her inventory as required by O.C.G.A. § 10-1-415(d)(1) of the SBOA.[18] In February 2009, during the 30-day statutory waiting period under the FBPA's § 10-1-399(b), AmeriSciences filed a preemptive suit in Texas seeking a declaratory judgment that Walker's FBPA claims were subject to a forum selection clause in the parties' contract requiring suit to be filed in Harris County, Texas, and that an action for damages filed elsewhere would breach the contract.

In April 2009, Walker sued AmeriSciences and the individual defendants in the Superior Court of Gwinnett County claiming that they failed to disclose her right under Georgia law to require the company to repurchase her unsold, unopened inventory at any time. AmeriSciences stated in her contract and elsewhere that it would only repurchase her inventory within 30 days after she bought it. After default judgment was entered in Texas against

[16] The FBPA is found at O.C.G.A. § 10-1-390, *et seq.* Remedies are provided in § 10-1-399, subsection (b) of which requires an antelitem notice and imposes a 30-day waiting period.

[17] The SBOA is found at O.C.G.A. § 10-1-410, *et seq.* The SBOA's purpose is to prohibit fraudulent practices in the sale of business opportunities. *Hornsby v. Phillips*, 190 Ga. App. 335, 338, 378 S.E.2d 870 (1989). Section 10-1-417(a) provides remedies for violations of the SBOA. Section 10-1-417(b) also permits a multilevel distribution company participant to invoke the remedies provided under § 10-1-399 of the FBPA.

[18] O.C.G.A. § 10-1-415(d)(1) states, in relevant part: "If the participant [in a multilevel marketing plan] has purchased products or paid for administrative services while the contract of participation was in effect, the seller shall repurchase all unencumbered products, sales aids, literature, and promotional items which are in a reasonably resalable or reusable condition and which were acquired by the participant from the seller; such repurchase shall be at a price not less that 90 percent of the original net cost to the participant of the goods being returned."

Walker in June 2009, AmeriSciences argued Walker's claims were subject to the forum selection clause and barred by *res judicata*. The trial court agreed.

The Court of Appeals reversed the trial court's ruling on the *res judicata* issue because FBPA claims are not contract claims. The court noted that it had held in *Attaway v. Tom's Auto Sales*, 144 Ga. App. 813, 242 S.E.2d 740 (1978), that the FBPA "is in no way tied to contractual rights and is wholly self-sustaining" and that contractual defenses are irrelevant and inapplicable to claims under the FBPA. The court had reaffirmed and expanded that holding in *Hornsby v. Phillips*, 190 Ga. App. 335, 340, 378 S.E.2d 870 (1989), extending it to actions based solely on an alleged violation of the Sale of Business Opportunities Act. The court also cited *Hill v. Jay Pontiac*, 191 Ga. App. 258, 259(2), 381 S.E.2d 417 (1989), for a ruling that the FBPA "creates a separate and distinct cause of action, independent of other theories of recovery an injured party might have." Walker's complaint was not based on breach of contract but on violations of the SBOA, so the contractual defense of a forum selection clause did not apply and Walker's claims were not barred by *res judicata* based on the Texas default judgment.

Walker also challenged the trial court's ruling that she failed to allege that she sustained damages from AmeriSciences's failure to inform her of her buy-back rights under the SBOA.[19] Walker alleged that she relied on AmeriSciences to disclose her rights under Georgia law while AmeriSciences argued that Walker should not have relied on her written contract terms but should have investigated her repurchase rights under Georgia law. The Court of Appeals noted that the statute required AmeriSciences to inform its marketers about their cancellation rights and its obligation to repurchase inventory. The clause in AmeriSciences's contract that state laws would govern if they were inconsistent with the contract was insufficient to constitute compliance or to shift the burden to Walker to research her rights under Georgia law, especially since AmeriSciences told Walker that the company did not give refunds.

Next, Walker contended that the trial court erred in dismissing her complaint against the individual defendants for lack of personal jurisdiction. They were the company's CEO, operating chairman, and its general counsel when Walker became an AmeriSciences marketer. The trial court held that they were not present in Georgia in their personal capacities. AmeriSciences admitted it was a "multilevel distribution company" as defined in the SBOA, and that the provisions of O.C.G.A. § 10-1-415(c)(4), requiring disclosure of cancellation rights, applied to any agreement made in Georgia. It also admitted that the individual members were founding members of the company. The individual defendants admitted that Walker's cancellation rights under Georgia law were "generally known" to them. Based on these admissions, and without any further discussion or analysis, the Court of Appeals held that the trial court erred in dismissing claims against them for lack of personal jurisdiction.[20]

Finally, the Court of Appeals held that Walker's claim was sufficient to state a claim against the individual defendants because the Georgia Court of Appeals has held that a company's primary officers and shareholders are "sellers" under the SBOA. *Hornsby v. Phillips*, 190 Ga. App. at 337-338(2). O.C.G.A. § 10-1410(8) and -(10) define "seller" as "any multilevel distribution company or … any person who offers to sell to individuals any business opportunity, either directly or through any agent," and "person" to include anyone who "has a substantive interest in or effectively controls" the seller, as well as its "individual officers, directors, general partners, trustees, or other individuals in control." Thus the trial court erred in dismissing Walker's claims against the individual defendants.

The Georgia Supreme Court has granted a petition for a writ of *certiorari* in this appeal.

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[19] The SBOA provides that a participant in a multilevel marketing plan has a right to cancel at any time, and that this fact, along with the participant's cancellation rights must appear in the contract or an addendum "in ten-point boldface type." O.C.G.A. § 10-1-415(c)(3).

[20] The court noted early in the opinion that AmeriSciences "conducts substantial business activities in Georgia." Under O.C.G.A. § 10-1-416, multilevel company business opportunity "sellers" are deemed to appoint the Secretary of State as agent for service of process. The court did not make reference to this statute, however, connect the individual defendants to or explain how the individual defendants' positions, which constituted them as "sellers," their knowledge of Georgia requirements, and the alleged violations combined to create personal jurisdiction for a private action for damages.

G. LITIGATION ISSUES.

1. Jurisdictional Issues, Administrative Dissolution and Access to the Courts by Foreign Business Organizations. In several decisions the courts considered the effect of registering to do business and maintaining registrations, along with other jurisdictional issues.

***GC Quality Lubricants, Inc. v. Doherty, Duggan & Rouse Insurors*, 304 Ga. App. 767, 697 S.E.2d 871 (2010) – Under O.C.G.A. § 14-2-1410, administrative dissolution by Secretary of State bars corporation's assertion of all claims not brought with two years of dissolution.**

This case addresses the interplay of two provisions of the Georgia Business Corporation Code regarding administrative dissolutions by the Georgia Secretary of State for failure to file annual registrations and pay the associated fees – O.C.G.A. § 14-2-1410, the two-year survival statute, which requires any claims to be filed within two years of dissolution and § 14-2-1422(d), which makes a corporate reinstatement retroactively effective to the date of dissolution. GC Quality Lubricants, Inc. ("GCQL") appealed the trial court's grant of summary judgment in favor of Doherty, Duggan & Royse Insurors, Underwriters of Lloyd's, London, and Georgia Power Company in GCQL's action to recover for damage to its property caused by an electrical storm that occurred on July 5, 2005, because GCQL had been administratively dissolved and failed to file suit within two years of the dissolution. The Court of Appeals affirmed.

On July 9, 2005, GCQL was administratively dissolved by the Georgia Secretary of State for failing to pay "its corporate dues" pursuant to O.C.G.A. § 14-2-1420. On February 15, 2008, GCQL filed its suit to recover for the storm damage. Appellees moved for summary judgment asserting that GCQL's claims were barred because it had been administratively dissolved and the two-year survival statute for asserting claims of a dissolved corporation under O.C.G.A. § 14-2-1410 had run on July 9, 2007, over seven months before GCQL filed its lawsuit. In April 2009, GCQL applied for reinstatement of a dissolved corporation with the Georgia Secretary of State and its application was granted on April 28, 2009.

GCQL responded to Appellees' summary judgment motion by arguing that as a result of its reinstatement, its suit was validly filed pursuant to O.C.G.A. § 14-2-1422(d). This statute provides that when reinstatement is granted, it relates back to and takes effect as of the date of the corporate dissolution, validating the corporation's actions in carrying on its business as if it had never been administratively dissolved. The trial court granted Appellees' motion for summary judgment, noting that in order for GCQL to file a valid lawsuit while administratively dissolved, it should have done so within two years of dissolution pursuant to O.C.G.A. § 14-2-1410. Additionally, the trial court found that the four-year statute of limitations for property damage claims had expired on February 11, 2009, before GCQL applied for and obtained reinstatement by the Secretary of State. The trial court rejected GCQL's argument that the lawsuit was deemed timely filed upon GCQL's reinstatement, noting that to do so would render meaningless the survival statue contained in O.C.G.A. § 14-2-1410.

On appeal, GCQL asserted that the trial court erred by not finding that the reinstatement by the Secretary of State rendered the compliant filed during dissolution valid. The appeals court noted that O.C.G.A. § 14-2-1410 expressly states that the dissolution of a corporation does not take away the right or claim pending on the date of dissolution or that is commenced within two years after the date of dissolution. The key question, however, was whether the reinstatement retroactively validated GCQL's lawsuit when it lacked capacity to bring the suit when it was originally filed. The appellate court affirmed the trial court's determination that GCQL was not competent to initiate the action after the two-year survival statute expired, making the lawsuit a legal nullity. Additionally, because GCQL failed to obtain reinstatement prior to the expiration of the four-year statute, the lawsuit could not be timely because that would improperly extend the statute of limitations.

***Hall v. Sencore, Inc*., 302 Ga. App. 367, 691 S.E.2d 266 (2010) – Single Georgia transaction does not trigger foreign corporation registration requirement.**

The Georgia Court of Appeals in this case held that a foreign corporation alleged to have conducted a single transaction in Georgia was not required to obtain a certificate of authority from the Georgia Secretary of State in order to be able to pursue litigation in this State. Tim Hall appealed the trial court's grant of judgment on the pleadings in favor of Sencore, Inc. in Sencore's action to revive a dormant judgment. Sencore obtained a judgment against Hall on May 18, 1999. The judgment remained unsatisfied and became dormant in 2006. On March 20, 2009, Sencore brought an action to revive the judgment pursuant to O.C.G.A. § 9-12-61, under which the judgment holder may revive a dormant judgment within three years of the time it becomes dormant. Hall conceded that Sencore's action to revive the dormant judgment was timely, but nevertheless claimed that Sencore was not entitled to maintain a suit against him because Sencore was a foreign corporation transacting business in Georgia without a certificate of authority issued by the Secretary of State. As sole support for his contention, Hall argued that Sencore sold $9,000 of goods to him prior to filing its lawsuit. The appeals court noted that activity related to a single transaction, even one recently occurring, was insufficient on its own to establish that a foreign corporation was transacting business in Georgia. Additionally, the court observed that O.C.G.A. § 14-2-1501(b)(1) provides that a corporation is not considered to be transacting business in Georgia merely because it prosecutes or defends a lawsuit in the state. Hall's sole defense failed as a matter of law even when all of his allegations were taken as true and all of Sencore's denials were taken as false. The trial court's granting of Sencore's motion for judgment on the pleadings was affirmed.

***Westmoreland v. Jordan Partners, LLLP*, 306 Ga. App. 575, 703 S.E.2d 39 (2010) – Foreign limited liability partnership transacting business in Georgia could not maintain an action without obtaining a certificate of authority to do business in the state.**

In this case, the Georgia Court of Appeals held that a foreign limited liability partnership could not maintain an action in the court without obtaining a certificate of authority to transact business in the state under O.C.G.A. § 14-8-54(a). Jordan Partners, LLLP, an Arizona limited liability limited partnership, sued Michael Westmoreland claiming he had wrongfully installed utility lines across the partnership's property. Westmoreland moved to dismiss because Jordan Partners had not obtained a certificate of authority to do business in Georgia. The trial court held that Jordan Partners was, in fact, transacting business in Georgia, but denied the motion. The Court of Appeals held that the trial court should have granted Westmoreland's motion to dismiss on the grounds that Jordan Partners was a foreign limited liability partnership not authorized to transact business in the state and therefore could not maintain the suit.

O.C.G.A. § 14-8-54(a) states that "A foreign limited liability partnership transacting business in this state may not maintain an action, suit, or proceeding in a court of this state until it is authorized to transact business in this state."[21] The Court of Appeals distinguished *Health Horizons v. State Farm Mutual Auto. Ins. Co.,* 239 Ga. App. 440, 521 S.E.2d 383 (1999), a case interpreting O.C.G.A. § 14-2-1502(a), the counterpart statute in the Georgia Business Corporation Code. In that case, the court held that a foreign corporation's late registration to obtain a certificate of authority to conduct business in the state did not bar suit by the foreign corporation. However, there, the foreign corporation had obtained the certificate of authority by the time the motion to dismiss was filed and the court held that was sufficient. Jordan Partners had not obtained the certificate of authority at all, and the court held that the trial court could not simply ignore the requirements of the statute.

***Cashatt v. Merrimac Assoc., Inc.*, 2010 WL 3906856 (N.D. Ga. Sept. 30, 2010) – Transacting business under Georgia's Long Arm Statute.**

Plaintiff Rick Cashatt alleged that in December 2008 he was hired by Merrimac Associates, Inc. ("Merrimac"), a New Jersey corporation with its principal place of business in New Jersey, to serve as the Chief Operating Officer and later Chief Executive Officer of Enhanced Agriculture & Renewable Technologies Holding Corp. ("EARTH"), a Delaware corporation with its principal place of business also in New Jersey. In June 2009, Merrimac terminated his employment and Plaintiff filed suit against Merrimac and EARTH for breach of an employment contract or for *quantum meruit*. Merrimac and EARTH moved to dismiss for lack of personal jurisdiction. In his opposition, Cashatt challenged declaration testimony by one of the defendants' officers offered in support of the motion to dismiss. The court struck one of the declarant's statements and denied the motion to dismiss.

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[21] O.C.G.A. § 14-8-54(b) provides that "The failure of a foreign limited liability partnership to procure a certificate of authority does not impair the validity of any contract or act of the foreign limited liability partnership or prevent the foreign limited liability partnership from defending any action, suit, or proceeding in any court of the state."

Plaintiff argued that two statements in the declaration by defendants' officer stated legal conclusions rather than facts. The Court agreed with Cashatt and struck the statement that "Merrimac and EARTH were not joint employers of Rick Cashatt, and neither company is the *alter ego* of the other." This statement was stricken from the declaration because it was a legal conclusion. Plaintiff also challenged affiant's statement that "EARTH has never transacted any business in the state of Georgia" as a legal conclusion. The court denied this argument, holding that this was a factual statement in which the declarant was using "transacted business" in the "ordinary sense" and not the "legal sense."

The defendants claimed they did not have sufficient contacts with Georgia to support specific jurisdiction under the Georgia Long Arm Statute. O.C.G.A. § 9-10-91.[22] However, the court found that the defendants had transacted business in Georgia and that the services Cashatt rendered in participating in the defendants' transaction of that business related to his claims. The defendants purposely availed themselves of Georgia through various contracts and presentations where, among other things, they presented technologies to and attempted to solicit funding from Georgia agencies. The defendants' technology was also tested and modified in Georgia. Plaintiff also arranged for the President of Merrimac to meet with the owner of a Georgia corporation and through that meeting EARTH signed an agreement with the Georgia corporation to exchange services for investment capital. These and other contacts with the state involved plaintiff as defendants' agent, as well as members of defendants' Board of Directors and management. The court found that there was sufficient evidence that the defendants transacted business in Georgia. Further, those transactions were related to Cashatt's claims because he was seeking to recover for services he rendered in soliciting, presenting, and forming contracts which comprised and established defendants' contacts with the forum.[23]

2. Director and Officer Liability Insurance Decisions – Cox Communications Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa., Southwest Georgia Financial Corp. v. Colonial American Casualty and Surety Co. and MedAssets, Inc. v. Federal Insurance Company. The federal courts have issued decisions in three D&O insurance coverage cases. The Cox Communications decision could have adverse implications for coverage in the future in cases brought by bankruptcy trustees and their assignees. The Southwest Georgia Financial decision could affect coverage in certain failed bank director and officer liability cases.

***Cox Communications Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa.*, 708 F. Supp. 2d 1322 (N.D. Ga. 2010), *on motion for reconsideration*, 2010 WL 5092282 (N.D. Ga. Dec. 8, 2010) – Definition of claim, prior notice exclusion and exclusion for claims by outside entities in outside directors coverage under directors and officers insurance policy.**

In this directors and officers liability insurance coverage case, the Court rejected the insurer's efforts to deny coverage based on prior litigation against other companies to which it had issued policies. The Court determined that under the policy each new proceeding created a new claim, that a policy held by one company could not represent a prior policy with respect to a policy held by a separate defendant company, and that a Bondholder Committee is a separate entity from the bankrupt insured company for the purposes of an insured vs. insured-type exclusion under the policy's outside director coverage.

Plaintiff Cox Communications, Inc. was a wholly-owned subsidiary of Cox Enterprises, which had purchased directors and officers liability insurance from National Union Fire Insurance Company of Pittsburgh, Pa. ("National Union") covering Cox Enterprises, its subsidiaries, and the executives of Cox Enterprises and its subsidiaries for a policy period from January 1, 2002 to January 1, 2003 (the "2002 Cox Policy" or the "Policy"). At Home Corporation was an internet service provider that provided internet access to customers of Cox Communications and other companies. At Home's board of directors included an executive of Cox Communications, David Woodrow, who had been selected to serve on the board by Cox Communications in

[22] Jurisdiction exists under the "transacting business" prong of the long-arm statute if "(1) the nonresident defendant has purposefully done some act or consummated some transaction in [Georgia], (2) the cause of action arises from or is connected with such act or transaction, and (3) the exercise of jurisdiction…does not offend traditional fairness and substantial justice." *Citing Aero Toy Store, LLC v. Grieves*, 279 Ga. App. 515, 631 S.E.2d 734, 737 (Ga. App. 2006).

[23] For another long arm jurisdiction decision, s*ee also Walker v. Amerireach.com*, 306 Ga. App. 658, 703 S.E.2d 100 (2010), discussed in Section F, above.

accordance with certain service distribution agreements between At Home, Cox Communications, Tele-Communications and Comcast. At Home was listed as an outside entity under the Cox Policy for purposes of extending coverage to Woodrow as an At Home director under the Cox Policy's outside director coverage for Cox executives who served on other corporate boards.

In March 2000, representatives of At Home, Cox Communications, Comcast and AT&T, Inc. (which had purchased Tele-Communications) negotiated several new service distribution agreements. Two months later, shareholders filed two derivative actions in California against Woodrow, Cox Communications, Comcast, AT&T and other defendants, alleging that the defendants had breached their fiduciary duties to At Home by negotiating and approving the March 2000 agreements. Cox Communications never timely reported the California actions to National Union under its prior D&O policies. However, At Home was also insured by National Union, and it did report the May 2000 shareholder derivative actions under its policy.

In September 2001, At Home filed for bankruptcy protection, and in June 2002, the Bondholders Committee, which had been appointed by the Bankruptcy Court to prosecute any action arising out of the March 2000 agreements, obtained injunctions against the California shareholder actions and later brought its own action in Delaware against Woodrow, Cox Communications, Comcast and other defendants. The Bondholders Action alleged that the defendants violated federal securities laws and breached their fiduciary duties to At Home by negotiating and approving the March 2000 agreements. Cox Communications reported this action to National Union for coverage under the 2002 Cox Policy, which National Union denied. The defendants ultimately settled, with Cox Communications paying $40 million on behalf of itself and Woodrow.

In addition to the Bondholders' action, shareholders also filed their own class actions in July 2003 and June 2005 (the "Shareholder Class Actions"), alleging that the defendants violated federal securities laws by making false and misleading statements about the March 2000 agreements. Cox Communications reported the Shareholders Class Actions to National Union, which again denied coverage. Cox Communications ultimately paid $13,000 in settlement and incurred $200,000 in legal fees for the Shareholders Class Actions.

Cox Communications then filed suit against National Union, alleging breach of contract and seeking to recover its policy limit of $30 million. National Union moved for summary judgment as to the claims involving the Bondholders Action, arguing that those losses were not covered under the policy. Specifically, National Union argued that (1) the losses did not satisfy a condition of coverage that the claims must be "first made" during the policy period and that the claims were excluded by the Policy's (2) prior notice exclusion and an insured-versus-insured exclusion in the Policy's outside director coverage that would bar coverage for suits by the outside entity.

First, as to the "first made" condition of coverage, National Union argued that the breach of fiduciary duty claims involving the March 2000 agreements were "first made" against the Plaintiff in May 2000 in the California shareholder derivative actions, and that thus there was no coverage for the Bondholders Action under the 2002 Cox Policy. The Court found that the argument was inconsistent with the Policy's definition of a claim, which referred to service of a complaint. In other words, the plain language of the Policy indicated that each new proceeding created a new claim and that the Bondholders Action was therefore a claim first made in September 2002. The Court pointed out that had the plaintiff provided proper notice of the California actions in 2000, when they were filed, then the Bondholders Action would be considered related to the California actions under the Policy's related claims provision. However, that did not happen in this case.

Next, National Union argued that coverage was excluded under the Policy's prior notice exclusion, which provided that the insurer was not liable for losses in connection with any claim made against an insured that was related to any claim that had been previously reported under any policy of which the current policy was a renewal or replacement or which it may "succeed in time." Because National Union had also insured At Home and because At Home had reported the California actions to National Union in 2000, it argued that the 2002 Cox Policy succeeded in time At Home's 1999-2000 policy and that the losses were excluded by virtue of At Home's prior notice.

The Court found that the meaning of "succeed in time" was ambiguous and utilized the rule of *ejusdem generis*[24] as well as general principles of insurance law to determine that the 2002 Cox Policy could only succeed in time to a policy previously issued to Cox. Since At Home was a different company with a different policy than Cox Communications, the Cox Communications 2002 policy could not "succeed in time" the At Home policy.

Finally, National Union argued that Woodrow was not entitled to be covered for his service as a director of At Home because of an exclusion in the outside director coverage provisions for claims asserted by the outside entity applied and barred coverage for claims by At Home against Woodrow. The Court noted that this exclusion is similar to an insured-versus-insured exclusion. National Union contended that the Bondholders Action was asserting claims that had belonged to the At Home estate and that the suit was therefore in actuality brought by At Home. The Court held that the Bondholders Committee was not the same entity as At Home, and thus the claims were not excluded by the outside entity exclusion. The Court found that the defendant's argument was inconsistent with the principles of bankruptcy law, which hold that a bankruptcy trustee and an insured company are separate entities. The Court distinguished the language in the outside entity exclusion before it ("by the Outside Entity") from decisions upholding the denial of coverage where the language was broader ("by or on behalf of the Company"). The Court disagreed with a prior Northern District of Georgia decision reaching the opposite result in which the language was identical to the Cox Policy, *National Union Fire Insurance Co. of Pittsburgh, PA v. Olympia Holding Corp.*, No. 1:94-CV-2081, 1996 WL 33415761, at *7 (N.D. Ga. 1996). The Court disagreed with the holding in *Olympia* that "for purposes of this litigation, there is no legal distinction between [the insured company] and . . . [the] Trustee for the bankruptcy estate," finding that reasoning to be unpersuasive. The Court appears to have been unaware that the *Olympia* decision was affirmed on appeal without opinion by the Eleventh Circuit, 148 F.3d 1070 (Table) (11th Cir. June 19, 1998). In any case, the Court, in finding coverage by distinguishing cases with broader exclusionary language, can be read as supporting the opposite conclusion where the broader language is present. Unfortunately, that broader language is quite prevalent in insured-versus-insured clauses and insureds should expect that the *Cox Communications* case will be distinguished by insurers in bankruptcy coverage litigation involving insured-versus-insured clauses with "by or on behalf of" language.[25]

Defendants filed a motion for reconsideration of the court's decision, which was denied in a separate opinion. In order to prevail on a motion for reconsideration, the defendant must show an intervening change in controlling case law, the availability of new evidence, or clear error by the court. The defendant asked the court to consider a Delaware Supreme Court decision handed down after the court denied summary judgment. The Delaware case, *Axis Reinsurance Co. v. HLTH Corp.*, 993 A.2d 1057 (Del. 2010), addressed similar facts but applied Delaware law, and the Court noted that Georgia law governs this case. The Court stated that *Axis* was not a change in controlling case law, pointing out that in its earlier ruling it had considered and rejected the lower court's decision in *Axis*, which the Delaware Supreme Court affirmed. The Court stated that defendant failed to show that the Court committed clear error in denying summary judgment. In *Axis*, the Delaware court found the term "succeeds in time" to be plain and unambiguous and the Court observed that "National Union argues that the reasoning in *Axis* is superior to this Court's reasoning." The Court stated that it had carefully addressed the meaning of "succeeds in time" in the Policy's prior notice exclusion and found that it was so broad that it created ambiguity under Georgia contract law. The Court stated that even if this interpretation was erroneous, it was "not the sort of clear and obvious error which the interests of justice demand that [the court] correct."[26] The Court denied defendants' motion for reconsideration, stating that the defendants merely repackaged "familiar arguments to test whether the Court will change its mind." *Brogdon v. National Healthcare Corp.*, 103 F. Supp. 2d 1322, 1338 (N.D. Ga. 2000).

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[24] The court defined *ejusdem generis* as a rule of construction that, "when a statute or document enumerates by name several particular things, and concludes with a general term of enlargement, this latter term is to be construed as being [of the same kind or class] with the things specifically named, unless, of course, there is something to show that a wider sense was intended." 708 F. Supp. 2d at 1328 (citations omitted).

[25] The insured-versus-insured clauses in many D&O insurance policies contain a "carve-back" that expressly excepts suits by bankruptcy trustees, creditors' committees and their assignees from the exclusion. It is not common, however, to see that carve-back in the outside director coverage provisions of the policy.

[26] Citing *American Home Assurance Co. v. Glenn Estess & Assocs.*, 763 F.2d 1237, 1239 (11th Cir. 1985).

***Southwest Georgia Financial Corp. v. Colonial American Casualty and Surety Co.*, 397 Fed. App'x. 563 (11th Cir. 2010) – D&O coverage for lead lender's settlement payments to participating banks held barred by loan carve-out from definition of "loss."**

In this case, an insured bank holding company and its wholly-owned mortgage lender subsidiary sued their insurer for breach of contract and bad faith denial of coverage for payments made in settlement to banks that purchased participations in real estate development loans the mortgage lender made without satisfying conditions represented in the credit offering reports. The participant banks asserted claims against the mortgage lender for the shortfall in foreclosure proceeds when the loans subsequently defaulted. In coverage litigation with the holding company and mortgage lender's director and officer liability insurer, the 11th Circuit Court of Appeals, in an unpublished decision, affirmed a summary judgment holding that settlement payments were not covered by the policy.

Southwest Georgia Financial Corp. is a Georgia bank holding company. Its wholly-owned subsidiary, Empire Financial Services, Inc. originates, sells, and services commercial real estate loans. Defendant Colonial American Casualty issued a "D & O Selectplus Insurance Policy" to Southwest Georgia Financial, and Empire was an insured under the policy. In March 2006, Empire made loans of $21,735,000 and $15,900,000 to entities controlled by real estate developer Farbod Zohouri. The loan proceeds were to be used to purchase two apartment complexes in Atlanta and convert them to condominiums. Empire sold undivided ownership interests in the loans to participating banks using credit offering reports stating that the loans would only be closed if certain pre-sale requirements were met. Each participating bank was entitled to receive its pro-rata share of monthly payments received and any foreclosure proceeds.

The loans were closed without meeting the pre-sale requirements. Zohouri defaulted on the loans in October 2006. Empire foreclosed on both loans, sold the properties for $14,750,000.00 and distributed the proceeds pro rata to the participants. After the participating banks made demands, Southwest Georgia Financial forwarded the demands to Colonial, notified them that Empire intended to enter into settlement agreements with the banks, and requested its consent to the settlement agreements. Each bank received the difference between its principal investment and pro rata share of the sale proceeds. Colonial notified Southwest Georgia Financial that it would not raise lack of consent to the settlement as a defense to coverage but reserved all other coverage defenses.

The policy carved out from the definition of "loss" covered under the policy, in effect excluding indemnity coverage for "any principal, interest or other monies paid, accrued or due as the result of any loan, lease or extension of credit." Colonial covered defense costs incurred in litigation with one of the participant banks, but denied coverage for the settlement payments, concluding that they were unpaid loan balances and thus not a "loss" within the meaning of the policy.

The Court of Appeals interpreted the terms of the insurance policy under Georgia law. The plaintiffs argued that the loan carve-out from loss did not apply because Empire did not extend credit to the participating banks and because the settlement payments were not made as a result of the loans because they were made after the loans were extinguished. The court found that the term "any" should be broadly construed to mean "all." The court held that the payments did fall within the loss exception because if no default on the loans had occurred, the participating banks would have received those same funds from their share of the monthly loan payments. The payments were thus made "as a result of" the loans. The exception was not limited to loans or extensions of credit made by the insured. The court affirmed summary judgment in Colonial's favor.

***MedAssets, Inc. v. Federal Insurance Company*, 705 F. Supp. 2d 1368 (N.D. Ga. 2010) – Intellectual property exclusion in D&O policy does not bar coverage for claims for misappropriation of confidential information; an insured may obtain judgment against insurer in excess of policy limits for breach of duty to defend as consequential damages.**

Does an insurer have a duty under a directors and officers liability ("D&O") insurance policy to defend claims brought against its insured for misappropriation of confidential pricing information when the policy excludes misappropriation of trade secrets? Held, yes.

Plaintiff MedAssets, Inc. is in the business of assisting healthcare providers to implement strategies to improve their financial and operational strength and efficiency. MedAssets held a D&O insurance policy and an errors and omissions policy issued by defendant Federal Insurance Company ("Federal"), both of which included MedAssets' subsidiaries as insureds and allocated the duty to defend to Federal. One of MedAssets subsidiaries, Aspen Healthcare Metrics, LLC ("Aspen"), assists hospitals with minimizing the price paid for medical products by researching historical purchasing data obtained primarily through directly interviewing the customers of marketplace vendors.

In August 2004, Cardiac Pacemakers, Inc. ("CPI"), a manufacturer of medical devices, and Guidant Sales Corporation ("GSC"), which contracts with healthcare providers to sell CPI products, brought a lawsuit against Aspen, alleging that it wrongfully induced some of GSC's customers to disclose confidential pricing information.[27] The complaint asserted four causes of action against Aspen, three of which alleged interference with contract claims and the fourth a claim for misappropriation of trade secrets.

Federal denied coverage for the GSC lawsuit under both policies. As to the D&O policy, Federal cited an intellectual property exclusion in that policy barring coverage for, among other things, misappropriation of trade secrets, and contending that all the other claims were based on the alleged trade secret violations. MedAssets sued Federal claiming that Federal had a duty to defend under both policies. The parties filed cross-motions for summary judgment.

With respect to coverage under the D&O policy, Federal relied on the IP exclusion of claims for "misappropriation of ideas or trade secrets." The Court found that the denial of coverage for this reason was unfounded because there were three claims in the lawsuit that, while based upon the same factual allegations, did not assert misappropriation of trade secret as a basis for recovery. In interpreting the duty to defend under a D&O policy, the Court relied on general Georgia insurance principles that "an insurer is obligated to defend even where the allegations of the complaint against the insured are ambiguous or incomplete with respect to the issue of coverage," citing *Fireman's Fund Ins. Co. v. Univ. of Ga. Athletic Assn., Inc.*, 288 Ga. App. 355, 356, 654 S.E.2d 207 (2007). The Court emphasized that Federal had instead employed a "strained interpretation" of the GSC complaint to reach its conclusion that the claims were not covered. The Court noted that the complaint alleged misappropriation of confidential information, as well as trade secrets, in the alternative and stated that information could be confidential yet not rise to the level of being a trade secret. It held that Federal had a duty to defend.

Federal also sought a determination from the Court that it could not be held liable in excess of policy limits in the event it found that Federal had a duty to defend because MedAssets had not alleged that Federal had acted in bad faith. Citing Georgia appellate decisions authorizing recovery of damages in excess of policy limits, the Court held that this was a jury question and declined to rule on this issue because the parties had not had an opportunity to engage in discovery concerning damages.

3. <u>Derivative Action Procedure</u>. *Pounds v. Brown*, 303 Ga. App. 674, 695 S.E.2d 66 (2010) – Derivative action settlement prevents a corporation's board from taking action inconsistent with terms of the settlement agreement.

This case involved the enforcement of a settlement agreement between derivative action plaintiff/shareholders and the corporation's board of directors, with the Court determining that the board was not allowed to amend the bylaws without advance notice to the plaintiffs and was not allowed to distribute its own resolution to be voted on when the settlement agreement only provided for the presentation of one proposed resolution by the derivative plaintiffs.

Several members of a Cobb Electric Membership Corporation ("Cobb EMC") brought a derivative action against the corporation, its officers, and board of directors, alleging causes of action for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment. The parties entered into an agreement settling the litigation.

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[27] The suit was actually brought against Aspen II Holding Co. d/b/a Aspen Healthcare Metrics ("Aspen II"), which was not a MedAssets' subsidiary. However, Aspen answered on behalf of Aspen II, denying liability, and the Court treated it as a proper party.

The settlement agreement required that a meeting of the members of Cobb EMC would be held within 60 days of the approval of the settlement agreement by the trial court. At that meeting, the members would be presented with a resolution, proposed by the derivative plaintiffs, seeking to allow members to vote by mail-in ballots. However, prior to the required meeting, the board of directors amended the bylaws, providing for proxy voting at future meetings and distributed its own resolution to be voted on at the meeting of members.

The Court of Appeals held that both actions by the board of directors violated the clear and unambiguous terms of the settlement agreement. Regarding the amendment to the bylaws, the Court noted that although Georgia law may not require the board to notify the derivative plaintiffs prior to amending the bylaws, the trial court's order concerning enforcement of the settlement agreement specifically required Cobb EMC "to cooperate fully" with the derivative plaintiffs. Since the amended bylaws would have affected the special meeting required by the settlement agreement, full cooperation by Cobb EMC would have required advance notice. 303 Ga. App. at 677. Similarly, regarding the submission of competing resolutions to the members at the special meeting, the Court found that the specific language of the settlement agreement provided only for the presentation of a resolution by the derivate plaintiffs. According to the Court, Georgia courts must construe contracts "under the maxim that the express mention of one thing implies the exclusion of another." 303 Ga. App. at 678. Had Cobb EMC wanted to offer its own resolution regarding the future election of directors at the special meeting, it should not have agreed that "a" proposed resolution would be presented. The Court of Appeals remanded the case for the trial court to enforce the terms of the settlement agreement consistent with the Court of Appeals' decision. A petition for *certiorari* is pending at this writing.

4. <u>Nondischargeability of Breach of Fiduciary Duty Claims</u> – *Davis v. Conner* and *Lou Robustelli Marketing Services, Inc. v. Robustelli.* The Georgia bankruptcy courts have handed down two decisions addressing the nondischargeability of claims for breach of fiduciary duty against business organization fiduciaries. Both decisions found that the debtor could be denied a discharge under 11 U.S.C. § 52(a)(6).

***In the Matter of Conner; Davis v. Conner*, 2010 WL 1709168 (Bankr. M.D. Ga., April 23, 2010) – Intentional breaches of fiduciary duty by a partner held nondischargeable in the partner's bankruptcy proceeding under 11 U.S.C. § 523(a)(6), not under § 523(a)(4).**

In this bankruptcy adversary proceeding, plaintiff Davis ("Davis") filed a motion for summary judgment seeking to have his claim against his former business partner, Conner ("Conner"), declared nondischargeable under 11 U.S.C. § 523(a)(4) and -(6). Subsection 523(a)(4) authorizes determination of nondischargeability for a liability "for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny;" subsection 523(a)(6) "for willful and malicious injury by the debtor."

Prior to the filing of the bankruptcy case, Davis filed a complaint in the Superior Court of Franklin County against Conner. In the complaint, Davis contended that he and Conner had been partners in the used car business and that he had made several loans to Conner and the business. Additionally, Davis contended that he and Conner had agreed to share the profits of the partnership equally, and that Conner failed to pay him his share of the profits from the business. Davis's complaint sought judgment for breach of contract, breach of fiduciary duty, conversion, attorneys' fees and litigation expenses, plus punitive damages. Davis filed a motion for summary judgment as to his claims, and the Superior Court awarded judgment against Conner and the business in the amount of $119,202.19.

After the entry of judgment, Conner and his wife filed a joint bankruptcy petition under Chapter 7 of the Bankruptcy Code. Davis thereafter filed a complaint under sections 523(a)(4) and (6) of the Bankruptcy Code objecting to the dischargeability of Conner's liability for the judgment. In the nondischargeability action, Davis asserted that Conner breached his fiduciary duty as a partner and intentionally deprived Davis of his equal share of partnership profits, thereby making the obligation arising from the state court judgment nondischargeable.

Davis's position in his summary judgment motion was that Connor could not challenge the state court judgment due to collateral estoppel – Davis alleged that the trial court had already determined the nature of Conner's liability and its nondischargeability in bankruptcy. Citing Eleventh Circuit authority and noting that principles of collateral estoppel were applicable to dischargeability actions, the bankruptcy court held that while collateral estoppel may bar the bankruptcy court from relitigating factual issues previously decided by a state court, the issue of dischargeability is a legal question within the exclusive jurisdiction of the bankruptcy court.

The bankruptcy court further observed that section 523(a)(4) does not apply to every fiduciary duty, but requires a technical or express trust voluntarily created by a contract or statute and the trust must arise prior to the alleged fraudulent act. The court noted that while federal law would be determinative as to the existence of a fiduciary relationship, state law would be determinative as to the existence of a trust obligation. The breach of a fiduciary duty, in the absence of a trust obligation, does suffice for nondischargeability under section 523(a)(4). Thus, even though it was undisputed that the partners owed a fiduciary duty to one another, the court found that Davis did not allege in his state court action that a technical, express or statutory trust existed between Conner and himself; accordingly, the state court judgment finding that Conner breached his fiduciary duty to Davis did not support a summary judgment as to nondischargeability under 11 U.S.C. § 523(a)(4).[28]

Davis also contended that Conner converted to his own use Davis's share of the partnership profits and that the conversion claim was nondischargeable under 11 U.S.C. §§ 523(a)(4) and (6). The bankruptcy court's review of the terms of the state court judgment revealed that the state court never ruled on Davis's conversion claim, thereby making collateral estoppel inapplicable to the issue.

Finally, Davis asserted that Conner's obligation was nondischargeable under 11 U.S.C. § 523(a)(6) because Conner willfully and maliciously caused Davis or his property injury. The bankruptcy court found that in both Davis's adversary proceeding and the state court action, the complaint was based at least partially on Conner's intentional breach of fiduciary duty arising from his failure to equally share the profits of the partnership. Because the only evidence of the breach of fiduciary duty before the state court was the evidence of the intentional acts of Conner, the bankruptcy court found that the issue of an intentional act by Conner was previously litigated and decided in Davis's favor by the state court. Therefore, collateral estoppel would bar re-litigation of the issue before the bankruptcy court, and the state court judgment for breach of fiduciary duty would thus be nondischargeable under section 523(a)(6). However, an issue of material fact remained as to how much of the damages and attorney's fees awarded in the state court judgment were attributable to Davis's claim for intentional breach of fiduciary duty and attorneys' fees.

This decision illustrates that breaches of fiduciary duty by officers, directors, partners and managers – although subsection 523(a)(4) does not apply – can be held nondischargeable under subsection 523(a)(6), where the misconduct is found to be intentional.[29]

***In re Robustelli; Lou Robustelli Marketing Services, Inc. v. Robustelli*, 430 B.R. 709 (N.D. Ga. 2010) – Misappropriation of corporate assets held nondischargeable under 11 U.S.C. § 523(a)(6).**

The *In re Robustelli* case addresses claims of corporate usurpation of opportunity and breach of fiduciary duty for conversion of corporate assets against a corporate officer in his personal bankruptcy proceeding. The bankruptcy court ruled on the issues of whether these claims were viable and nondischargeable. Like *Davis v. Conner* discussed above, the claims were initially litigated in state court and resulted in a judgment there that the bankruptcy court was required to assess.

In 1978, Lou Robustelli and his wife Helen opened a sports marketing business in Samford, Connecticut called Lou Robustelli Marketing Services, Inc. ("LRMS"), which provided programs around various sporting events, including the Super Bowl, the U.S. Open, and the Masters Tournament in Augusta, Georgia. The Masters

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[28] The interpretation requiring a "technical trust" for section 523(a)(4) nondischargeability does not apply to bank directors who are alleged to have breached their fiduciary duties. Subsection 523(e) provides: "Any institution-affiliated party of an insured depository institution shall be considered to be acting in a fiduciary capacity with respect to the purposes of subsection (a)(4) or (11)." Subsection 523(a)(11) shores up subsection 523(a)(4) by rendering nondischargeable judgments and settlements "arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union."

[29] Subsection 523(a)(4) does not require a breach of fiduciary duty in cases of "embezzlement" and "larceny." The Court denied Davis's effort to obtain a determination of nondischargeability under that subsection on his claims for conversion, because they had not been decided in state court and would thus have to be litigated in bankruptcy court.

Tournament programs and promotions were the bread and butter of LRMS. Lou Robustelli's son, Jim Robustelli, joined the company about a year after it was formed, where he worked for his father until 1988, when Lou "semi-retired." In 1994, Jim became president of the company, and he and his wife, Sandy, moved the company to Atlanta where they reincorporated the business as a Georgia corporation with Lou's approval. By this time, Lou and Helen spent most of their time in California, and were not involved with the day-to-day operations of the company, which fell to Jim. In 1997, a dispute arose between Lou and Jim as to the sale of the business to Jim. When the two could not reach an agreement, in October 1997, Jim resigned as president of LRMS and formed a new company, Robustelli Sports & Events Marketing, Inc. ("RSEM"), which engaged in the same type of business. When Jim left, he took with him LRMS's address book, telephone number, and client list without paying LRMS or Lou for the compilations or phone number. LRMS did not operate after Jim resigned. Lou testified that although he was capable of running LRMS after Jim left, he was not able to do so once Jim resigned because Jim took the business without identifying to Lou who the current clients of LRMS were.

In 2001, LRMS filed a lawsuit in the State Court of Fulton County against Jim, Sandy, and RSEM for various claims, including breach of fiduciary duty and usurpation of corporate opportunities belonging to LRMS. The jury retuned verdicts against Jim and Sandy for $31,653 for breach of fiduciary duty, $12,650.30 for conversion, and $92,000 for attorneys' fees and litigation expenses. The Georgia Court of Appeals affirmed the verdict against Jim and Sandy on the conversion claim, and against Jim on the breach of fiduciary duty, but reversed as to the breach of fiduciary claim against Sandy because she was not an officer or director of LRMS. Because the Court of Appeals could not determine what portions of the jury award were based upon the proper claims against Jim, it vacated the damages award for breach of fiduciary duty altogether, and remanded for a new trial limited to the question of Jim's liability for breach of fiduciary duty. The Court of Appeals did not address the issue of whether Jim misappropriated corporate opportunities of LRMS.

Before the new state court trial could get underway, on June 17, 2008, Jim filed bankruptcy under Chapter 7. LRMS filed a nondischargeability adversary proceeding against Jim pursuant to 11 U.S.C. § 523 (a)(2)(A), (a)(4), and (a)(6). Following pre-trial briefings in the bankruptcy court, the parties agreed that the bankruptcy court should determine all issues as to Jim's liability for breach of fiduciary duty, other than damages, based upon a stipulated record in accordance with Fed. R. Bankr. P. 7052(a), which permits the bankruptcy court to enter *de novo* findings of fact and conclusions of law following consideration of the evidence.

The bankruptcy court charged itself with determining what specific conduct, if any, Jim committed that constituted a breach of his fiduciary duty. In reaching its decision about whether LRMS was entitled to damages for Jim's breach of fiduciary duty and, in turn, whether any such damages were dischargeable, the bankruptcy court looked at two principal theories of recovery. The first was whether Jim had converted the $202,000 that LRMS made in connection with the 1997 Masters program, and the second was whether Jim was liable to LRMS under a usurpation of corporate opportunity theory for the profits made by RSEM in 1998. LRMS asserted that the liability of Jim on either claim was excepted from discharge under § 523(a)(2) because Jim committed actual fraud, or under § 523(a)(6) because Jim's conduct constituted willful and malicious injury to LRMS' property.

The bankruptcy court concluded that the Court of Appeals' remand of only the claim against Jim for breach of fiduciary duty did not revive any claims of LRMS for conversion, because such claim was subsumed in the conversion claim on which LRMS prevailed at trial. In other words, LRMS's first theory of recovery as to the money made from the 2007 Masters Program no longer existed, and Jim could not be held liable for breach of fiduciary duty based upon any conduct related to taking money that belonged to the company.

After considering the evidence and the issues submitted to the jury at trial, the bankruptcy court concluded that the only conduct left in the Court of Appeals' decision supporting the verdict against Jim for breach of fiduciary duty was his taking of LRMS' address book, telephone number, and copying of LRMS' client list. In weighing whether this conduct could support a misappropriation claim, the Court concluded that LRMS did not intend to continue operating its business and, even if it did, no customer of LRMS had any obligation to continue to do business with LRMS. Ultimately, the bankruptcy court held that this conduct could not give rise to a misappropriation of corporate opportunity claim because there was ample evidence in the record to support the findings that, "LRMS did not have an interest or expectancy growing out of preexisting right or relationship with regard to future Masters programs" and "LRMS did not attempt to pursue any opportunities that it may have had."

This left the bankruptcy court with determining whether LRMS had a claim for damages based upon the value of the telephone number, address book, and client list taken by Jim. The court found that even though this property had no value to LRMS because it was not operating, the items did have value to Jim and his new company. As a previous officer of LRMS, Jim should have compensated LRMS for the records and phone number even though he was entitled to take with him the information he acquired while working for LRMS to generate future business. As to whether Jim's liability to LRMS for breach of fiduciary duties in retaining the telephone number and address book and in copying the client list was nondischargeable, the bankruptcy court concluded that Jim's decision not to compensate LRMS could not be fraudulent under § 523(a)(2) because Jim neither made any false representations nor did he intend to deceive LRMS, but that his conduct was "malicious" within the meaning of § 523(a)(6) because he intentionally used LRMS' assets without paying for them, thereby causing LRMS injury.

5. Receivership Decisions. The following decisions concern issues raised in litigation with the FDIC as receiver for a failed financial institution outside the context of director and officer liability claims.

***Silverton Mortgage Specialists, Inc. v. Silverton Financial Services, Inc.*, 2010 WL 2490955 (N.D. Ga. June 15, 2010) – Failed bank litigation: bridge bank is permitted to reopen default in trademark infringement action; receiver is substituted for failed bank.**

The Plaintiff in this case filed suit alleging a series of trademark-related claims arising from defendants' use of the Silverton mark. A default judgment was entered against defendant Silverton Bridge Bank, N.A. (the "Bridge Bank"), a bank formed at the time that Silverton Bank, N.A. ("Silverton Bank") was closed and placed into receivership. The Bridge Bank filed a motion to set aside default, which the court granted over the plaintiff's objection.

The President of the Bridge Bank filed a declaration in connection with the motion in which he stated that the Bridge Bank is a temporary, but full-service national bank chartered by the Office of the Comptroller of the Currency ("OCC") and organized by the Federal Deposit Insurance Corporation ("FDIC") to take over and maintain banking services of the closed Silverton Bank. The Bridge Bank's purpose was to find a buyer for Silverton Bank or to migrate Silverton Bank's customers (that were also banks) to other "banker's banks." The Bridge Bank learned of the suit when it was served but Silverton Bank was also a named defendant at that time and the Bridge Bank knew that the plaintiff could not pursue its claims against Silverton Bank until it had exhausted all administrative remedies through the FDIC. The plaintiff, however, voluntarily dismissed Silverton Bank after the FDIC filed a motion to stay. The Bridge Bank was to be dissolved in December 2009, but that date was pushed back in order to avoid disruption of "the operations of the banking customers" and again because of delay in obtaining formal approval by the FDIC's Board of Directors of the Bridge Bank's dissolution. On the Bridge Bank's dissolution, the FDIC would be appointed its receiver, as well. Because the Bridge Bank was a temporary entity to facilitate the FDIC's receivership of Silverton Bank, and knowing that the FDIC would move to stay the litigation pending exhaustion of administrative remedies, the Bridge Bank decided not to incur the cost of defending the civil action. The Bridge Bank asked the court to set aside the default judgment under these circumstances.

The plaintiff argued that the defendant did not show good cause to set aside the default because it was aware of the complaint at the time it was filed and made the strategic decision not to respond.[30] The court found that under the circumstances, the decision to forego filing an answer was not willful "flaunting" of the judicial process, and the defendant had acted promptly to correct the default. The court emphasized that its decision here was driven by the unique procedural posture of the case and the role of the FDIC and OCC, as well as the Bridge Bank's unique temporary status. The court found several of the Bridge Bank's proposed defenses and a lack of prejudice to the plaintiff. Under these circumstances, the court granted the Bridge Bank's motion to set aside default.

In its order, the court also addressed the FDIC's motion to dismiss claims against Silverton Bank, which the plaintiff had re-filed in a separate suit. The court dismissed Silverton Bank and substituted the FDIC as receiver as

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[30] F.R.C.P. 55(c) provides that "[f]or good cause shown the court may set aside an entry of default." In determining good cause, the court may consider (1) whether the party has a meritorious defense, (2) how promptly the party acted to cure the default, (3) whether the default was willful, and (4) whether the non-defaulting party would be prejudiced. *Compania Interamericana Export-Import v. Compania Dominicana de Aviacion*, 88 F.3d 948, 951 (11th Cir. 1996).

the real party in interest. The court held that the "FDIC-R stepped into the shoes of Silverton Bank and has assumed the assets and liabilities of the bank, to the extent described under the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)."[31] The court then consolidated the two proceedings.

***McClelland v. First Georgia Community Bank*, 2010 WL 3199349 (M.D. Ga. Aug. 12, 2010) – Judicial review of FDIC's decisions under its receivership administrative claims procedure denying a former bank director's claims for compensation, including whether the director included all his claims in the administrative claim filed in the bank's receivership.**

This decision addresses judicial review of the requirements and outcome of the administrative claims procedure instituted under FIRREA for creditors of closed insured depository institutions.

The plaintiff served as director for the First Georgia Community Bank (the "Bank"), a bank that was closed and in an FDIC receivership at the time that the plaintiff filed suit. As director, the plaintiff agreed to defer both his compensation and payment of his bank-owned life insurance ("BOLI") until he requested payment at a later date. Plaintiff purchased stock from the Bank's holding company, some of which he purchased with funds borrowed from the holding company. In July 2008, the Plaintiff requested his compensation and BOLI funds and the Bank refused to pay. Six months later, the Plaintiff requested the funds again and again the Bank refused to pay. By March 2009, the Bank had failed and the FDIC had been named receiver.

The Plaintiff then initiated administrative proceedings to pursue his claims. In accordance with the administrative claims procedure set forth in FIRREA, Plaintiff submitted a proof of claim to the FDIC as receiver of the Bank ("FDIC-R") for the unpaid "collateral" and "BOLI and deferred compensation." The FDIC-R rejected Plaintiff's claims and Plaintiff filed a request for review in the Middle District of Georgia against the FDIC-R and the Bank. Plaintiff's amended complaint asserted seven counts against the FDIC-R, including claims for breach of contract, failure to preserve the collateral, breach of duty of good faith to notify Plaintiff of the declining value of the collateral and claims for litigation costs incurred in the claims procedure.[32]

As an initial matter the court found that given the receivership, the FDIC-R was the only proper defendant. As to the claims against the FDIC-R, the FDIC-R first argued that Plaintiff's claims for breach of duty to preserve the collateral, breach of duty of good faith to notify Plaintiff of declining collateral value, breach of ratified agency contracts, and litigation costs should be dismissed because Plaintiff failed to exhaust his administrative remedies under FIRREA.[33] The court found that it was first required to determine whether the challenged claims had in fact been asserted through the administrative claims procedure. If so, then the court would have jurisdiction over them. If the claims were not asserted in the administrative proceedings, then the court was required to determine whether the claims fell within one of four types of claims for which administrative remedies were required to be exhausted: "(1) claims for payment from assets; (2) actions for payment from assets; (3) actions seeking a determination of rights; and (4) a claim relating to any act or omission." *Id.* at *2, *citing* 12 U.S.C. § 1821(d)(13)(D).[34] The court

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[31] For a general description of the process of taking over and potentially liquidating a failed bank, the court cited to *Texas American Bancshares, Inc. v. Clarke*, 954 F.2d 329, 333 (5th Cir. 1992).

[32] For general unsecured creditors, an allowed claim would be subject to the Federal Deposit Insurance Act's depositor preference statute, which subordinates unsecured claims to receivership administrative expenses and the claims of depositors and the rights of the FDIC in its corporate capacity as subrogee to the extent of its payment of deposit insurance. 12 U.S.C. § 1821(d)(11).

[33] When asserting claims to failed bank assets against the FDIC-R, a plaintiff must first exhaust administrative remedies pursuant to FIRREA in order to "dispose of the bulk of claims against failed institutions expeditiously and fairly…without unduly burdening the District Courts." *FDIC v. Lacentra Trucking, Inc.*, 157 F.3d 1292, 1299 (11th Cir. 1998), *see* 12 U.S.C. § 1821(d)(3)-(7). Only after the administrative claims procedure is exhausted can a district court review an administrative decision *de novo*." *See* 12 U.S.C. § 1821(d)(13)(D); *Lacentra*, 157 F.3d at 1294.

[34] 12 U.S.C. § 1821(d)(13)(D) provides:

> (D) Limitation on judicial review.
> Except as otherwise provided in this subsection, no court shall have jurisdiction over--
> (i) any claim or action for payment from, or any action seeking a determination of rights with respect to, the assets of any depository institution for which the Corporation has been appointed receiver, including assets

would not have jurisdiction over claims falling within these categories if they were not asserted in the administrative proceedings.[35]

The court held that Plaintiff did not assert any of the challenged four claims during the administrative process. Plaintiff's proof of claim included two general claims requesting only the collateral, BOLI payments, and his deferred compensation. Those claims did not encompass the four additional claims he asserted in this case. The court held that three of the claims – the Plaintiff's claims for breach of duty to preserve held collateral, breach of duty of good faith to notify Plaintiff, and breach of ratified agency contracts – fell within the statute and were barred by FIRREA. Plaintiff's claims for litigation costs did not fall within the statutorily mandated claims, and therefore did not warrant dismissal for failure to exhaust administrative remedies.

The FDIC-R challenged the unjust enrichment claim and claim for litigation costs under Fed. R. Civ. P. 12(b)(6). Plaintiff's unjust enrichment claim was dismissed because the facts alleged did not indicate that the plaintiff conferred any benefit to the Bank. The facts alleged merely that Plaintiff purchased stock from the Bank's holding company. The court stated that "a lost stock venture is not a sufficient basis for an unjust enrichment claim" and dismissed that claim. Plaintiff's claim for recovery of litigation costs was dismissed because Plaintiff failed to allege any facts that support the conclusion that "defendant has acted in bad faith, has been stubbornly litigious, or has caused the plaintiff unnecessary trouble and expense," as required under O.C.G.A. § 13-6-11.

The court declined to dismiss the plaintiff's contract claims as duplicative of claims in litigation pending in the Northern District of Georgia. That suit was filed by the FDIC-R to collect on promissory notes, whereas the claims before the court involved the plaintiff's attempt to recover compensation allegedly owed him as a director and BOLI payments.[36]

6. ***Alter ego*****, Piercing the Corporate Veil and Other Forms of Secondary Liability.** 2010 brought the usual supply of *alter ego* cases which illustrate the principles involved, but do not break any new ground.

Guarantee Insurance Co. v. Merchants Employer Benefits**, 2010 WL 3937325 (M.D. Ga. Sept. 30, 2010) – Evidence held sufficient to find that a company's owner used the company as an *alter ego* without regard for its separate corporate entity**.

This case came before the court on the defendants' motion for summary judgment on contract and tort claims that the plaintiff Guarantee Insurance Company asserted in an effort to recover unpaid workers compensation insurance premiums that it claimed the defendants owed, along with a claim to pierce the veil of the corporate defendant Merchants Employer Benefits, Inc. and recover from its owner and president Jimmy J. Selph. Merchants was a "Professional Employer Organization" ("PEO") that provides staffing and human resources services to other businesses. Guarantee was an insurance company that issues workers' compensation policies to PEOs. The primary claim was a breach of contract claim arising from a program for Guarantee to provide workers' compensation insurance for the employees that Merchants "leased" to its clients.

In Count Six of its Complaint, Guarantee sought to disregard the corporate entity of Merchants so that it could reach Jimmy Selph's personal assets and assets of other corporations owned by Selph. Noting the admonition that "courts should exercise 'great caution' in disregarding the corporate entity,"[37] the court held that the evidence submitted by Plaintiff was sufficient to create genuine issues of material fact concerning Selph's operation of Merchants and to permit a reasonable jury to find that Selph used Merchants as an *alter ego* without due regard for its separate corporate identity. Evidence to show disregard of a corporate entity may include the "commingling [of funds] on an interchangeable or joint basis or confusing the otherwise separate properties, records [,] or control."[38]

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which the Corporation may acquire from itself as such receiver; or

(ii) any claim relating to any act or omission of such institution or the Corporation as receiver.

35 *Citing Am. First Fed. Inc. v. Lake Forest Park, Inc.*, 198 F.3d 1259, 1263 (11th Cir. 1999).

36 For another FDIC failed financial institutions decision, see *In re Integrity Bancshares, Inc.: Lubin v. Skow*, 382 Fed. App'x. 866 (11th Cir. 2010), *supra.*

37 *Citing J-Mart Jewelry Outlets, Inc. v. Standard Design*, 218 Ga. App. 459, 460, 462 S.E.2d 406 (1995).

38 *Citing Anthony v. Gator Cochran Constr., Inc.*, 299 Ga. App. 126, 142, 682 S.E.2d 140 (2009).

Plaintiff presented cash receipts journals from JJ Selph Construction, Inc., another corporation owned by Selph, that included numerous entries for reimbursement of expenses paid by Merchants or other companies owned by Selph.

The court found even more significant evidence of an admission by Selph that he had diverted funds from premium payments made by Merchants' clients, that should have been remitted to Guarantee, to finance instead a new PEO business started with his wife. The court held that "[b]ased on this evidence, a jury could conclude that Selph disregarded the corporate separateness of Merchants and used it as an instrumentality to transact his own affairs, in such a way as to defeat justice or evade contractual responsibilities." The defendants' motion for summary judgment was denied on this count.

***Ramcke et al. v. Georgia Power Co.*, 306 Ga. App. 736, 703 S.E.2d 13 (Oct. 18, 2010) – Parent corporation could not be held liable for negligence of subsidiaries because there was insufficient evidence to pierce the corporate veil or show that parent corporation acted as subsidiaries' *alter ego*.**

Georgia Power, a subsidiary of The Southern Company, owned the Plant Bowen premises and hired Brad Cole Construction Co. as an independent contractor to perform site preparation services. Another subsidiary of The Southern Company, Southern Company Services, engineered and designed the project, and drafted and enforced the contract between Georgia Power and Brad Cole. Robert Podorsky died in an accident while working for a subcontractor of Brad Cole and the administrator of his estate sued Georgia Power, Southern Company Services, Inc. and The Southern Company, alleging they were liable for Podorsky's death because they negligently failed to keep the project premises safe for invitees. As to the Southern Company the administrator alleged that it occupied the project site because it acted with its subsidiaries in a joint venture or they acted as *alter egos* or agents of one another in directing and controlling the project. The trial court granted directed verdicts to all three defendants, which the Georgia Court of Appeals affirmed.

As to The Southern Company, the trial court had correctly found no evidence that it occupied or controlled the project. The Court of Appeals stated the general rule that parent company's are not liable for subsidiaries' negligence and the "intertwined" exceptions to that rule for piercing the corporate veil, apparent or ostensible agency or joint venture. It held that the administrator was unable to point to "evidence sufficient to show" that any of the exceptions applied. 306 Ga. App. at 739.

7. <u>Professional Liability Claims in Business Organization and Transactional Context</u>

***Alston & Bird LLP v. Mellon Ventures II, L.P., et al.*, 307 Ga. App. 640, ___ S.E.2d ___, 2010 WL 5116611 (Dec. 16, 2010) – Venture capital investor's claims for legal malpractice in drafting tag-along clause held subject to comparative negligence defense where investor and its attorney reviewed the clause prior to closing.**

This decision arose from the defendants' appeal in a legal malpractice action from the trial court's summary judgment order striking several affirmative defenses, including alleged comparative negligence and failure to mitigate damages.

In 2000, Mellon Ventures II, L.P. was the lead investor venture capital ("VC") financing of a Georgia computer software company, and Mellon hired Georgia counsel to draft the deal documents. The court noted that it was common for the attorney retained by the lead venture capital investor to represent co-investors, two of which were Noro-Moseley Partners IV-B, L.P. and SBK Capital, LLC. In the transaction, the VC investors were to receive voting control. The co-investors demanded additional terms, including a lock-up that would prevent management from selling their shares, except in an initial public offering, even if they were terminated. A day before closing, the managers of the software company requested a change to the contract to provide themselves additional protection in the event the investors decided to sell out to new investors with whom the managers might not feel comfortable. Mellon agreed on behalf of all the investors and the attorneys revised the draft contract to include a "tag-along" clause in the Shareholders Agreement.

The tag-along clause conflicted with the waterfall provision of the corporate charter. The court stated that it was undisputed that the VC investors' Georgia deal counsel had "cut and pasted" the tag-along clause from a prior financing contract for the company. For reasons not explained in the opinion, the clause was not appropriate for the economics of the new VC financing. The mistake was not discovered until after closing. The investors concluded that the error affected the value of their investment and made it difficult for them to sell. After they were unable to reach a resolution with the managers, the VC investors filed suit to reform the contract. In settling that suit, the investors paid the managers approximately $5.4 million to obtain a redrafted tag-along clause. The investors then sued their Georgia deal counsel for legal malpractice to recover the loss.

The trial court appointed a special master, who prepared a report and recommendation on cross motions for summary judgment. The trial court adopted the special master's report and recommendation, denying the defendants' motion for summary judgment on proximate cause and granting summary judgment against the defendants on several of their affirmative defenses.

Appellants first claimed that the trial court erred in denying their motion for summary judgment because appellees could not prove proximate cause as a matter of law. The trial court concluded that appellants' motion should be denied because their arguments hinged primarily on the testimony of one of the software company managers, whose credibility was vigorously disputed.

The trial court granted partial summary judgment striking the defendants' comparative negligence defense as to two of the co-investor groups. The Court of Appeals reversed the trial court's ruling as to the Noro-Moseley investors because there was evidence that both the investors and their attorney had reviewed the tag-along clause before closing. Thus, the defendants would be permitted to pursue that defense at trial. As to the SBK group of investors, the defendants cited evidence that was not properly filed prior to the hearing on the motion, and the trial court did not abuse its discretion in refusing to consider that evidence.

The Court of Appeals affirmed summary judgment on mitigation of damages, agreeing with the trial court that

> "[A]ppellants failed to present any evidence that the investors did not mitigate their damages as far as practicable by the use of ordinary care and diligence; failed to present evidence of the amount by which damages could have been mitigated; failed to present evidence that reasonable mitigatory options existed in fact and not merely in theory; and failed to present evidence that appellees could have avoided or lessened their damages without undue risk, burden, or humiliation."

2010 WL 5116611 at *4. A *certiorari* petition is pending at this writing.

***Kitchen v. Hart*, 307 Ga. App. 145, 704 S.E.2d 452 (2010) – Attorney's alleged negligence in drafting collateralization agreement with respect to clients' obligations on three promissory notes was not proximate cause of purchasers' joint and several liability on entire debt; clients failed to offer expert and fact evidence sufficient to support claim for lost profits.**

In this case, clients sued their attorney for legal malpractice based on the attorney's alleged negligence in drafting a collateralization agreement and a stock purchase agreement for their purchase of companies involved in commercial real estate development. The trial court entered summary judgment in favor of the attorney and the Court of Appeals affirmed.

The dispute stemmed from a contract to buy two companies which were part of a group of companies known as the Adams Group. The companies were involved in the business of construction, renovation, and interior design of commercial properties. Plaintiffs Charlotte and Harry Kitchen were real estate developers who purchased a one-third interest in two of the Adams Group companies, "Parker" and "MSA."[39] The law firm served as legal counsel for both the buyers and the sellers. No conflict of interest waiver was signed. The deal involved three loans from SunTrust Bank totaling $3.6 million. SunTrust made a $2.7 million loan to the Kitchens and two of the sellers, Anthony Adams, Sr. and John McEachern. The borrowers executed a promissory note under which they were all jointly and severally liable for the loan. The same four individuals borrowed $600,000 under a separate note, which

[39] The Court of Appeals' opinion does not provide the full names of the two acquired companies or the plaintiffs' own company, "Foxfield."

was guaranteed and collateralized in the same way as the $2.7 million loan. A third loan for $300,000 was made to one of the sellers' companies, but the Kitchens each executed unlimited personal guarantees for that loan, as well as a separate limited guaranty by their own company, "Foxfield." The Kitchens pledged a $950,000 certificate of deposit as security, which would later be substituted with 2.2 acres of property that Foxfield was to purchase with the funds. The Kitchens also executed a Cross Default and Cross Collateralization Agreement binding them and their collateral under all three notes.

The buyers and sellers later disputed whether the Kitchens were supposed to be jointly and severally liable for the entire loan amount or just $950,000, which they calculated to be one-third of the loan. The Kitchens admitted on deposition that they did not read the loan documents. Mr. Kitchen said he relied on the law firm to limit their liability to one-third of the loan amount. Mrs. Kitchen signed without reading because "my children were in the car."

In May of 2000, the Kitchens reached new agreements with McEachern and Adams whereby they would purchase McEachern's and Adams's remaining stock interests in Parker and MSA. In exchange, the Kitchens agreed to "indemnify and hold harmless Seller from any claim by SunTrust Bank Savannah, N.A…." The Kitchens would also pay them cash payments totaling $1 million each in consulting fees. A condition precedent to the transaction required "the fulfillment and satisfaction at the time of closing and the obtaining of a release of the Seller of certain promissory notes, real estate, personal collateral, and personal guarantees…" The law firm drafted the stock purchase agreements, but SunTrust did not agree to the proposed releases.

The Kitchens settled their lawsuit against McEachern in November 2000 by renegotiating his 2000 buyout agreement. McEachern agreed to convey all his ownership interests in Parker and MSA, and the Kitchens agreed again to indemnify and hold him harmless from all claims by SunTrust for the loans. Shortly thereafter, the companies began to fail and the original loans went into default. The parties eventually settled with SunTrust for $2.9 million. The Kitchens paid $2.1 million and Adams only paid $800,000.

The Kitchens then brought this action against the law firm alleging negligence and breach of fiduciary duty. On appeal, the Kitchens argued that the trial court erred in granting summary judgment to the law firm regarding their claim that they should have only been liable for one-third of the SunTrust loan. The trial court concluded that "the Plaintiffs' own actions negated any damages they might have suffered from Defendants' alleged negligence" by later voluntarily assuming full responsibility for the SunTrust loan. The Court of Appeals agreed that the "Kitchens' later conduct precluded them from holding [the law firm] responsible for the difference between one-third and full liability for the SunTrust loan." 307 Ga. App. at 152. The Court rejected the Kitchens' argument that their settlement was an effort to mitigate their losses because the record showed that at the time of the settlement they still believed that they were only liable for one-third of the loans.

The Kitchens argued further that their liability for the entire debt might have been voided by the "fraudulent or other willful, intentional conduct" of McEachern, who had represented that his house, which he pledged as collateral, was unencumbered when in fact Wachovia Bank held a prior lien which was superior to SunTrust's interest. The Kitchens argued that their assumption of full responsibility for the loan should not sever proximate cause with regard to the law firm's conduct. The Court of Appeals held that the trial court correctly rejected that argument because "the record shows that the Kitchens knew the facts surrounding their fraud claim at the time they agreed to assume full responsibility for the loan." *Id.*

With regard to the Kitchens' claims for lost profits, the Court of Appeals held that the trial court correctly concluded that there was "insufficient evidence to show that the companies had a record of profits. There was no expert testimony regarding the financial status of MSA prior to or after the execution of the stock purchase agreements. There is limited fact testimony from any other witnesses on this issue as well…the financial information provided, along with the testimony that Plaintiffs would have used their experience to make MSA successful, falls below the threshold requirement for specificity…and…the 'definite, certain, and reasonable data' required to ascertain lost profits." *Id.* at 153.[40]

[40] The court cited *KAR Printing v. Pierce*, 276 Ga. App. 511, 512, 623 S.E.2d 704 (2005), which stated that "to recover lost profits one must show the probable gain with great specificity as well as expenses incurred in realizing such profits. In short, the gross amount minus expenses equals the amount of recovery."

H. 2010 DECISIONS FROM THE GEORGIA BUSINESS COURT.

Selected decisions by the Georgia Business Court are now available on line at a website maintained by Georgia State University at **http://digitalarchive.gsu.edu/col_businesscourt/.** Among the Georgia Business Court decisions reported for 2010, the following decisions contain rulings bearing on business organization issues within the scope of this survey:

***Payless Car Rental Systems, Inc. v. PRG Group, LLC*, Civil Action No. 2007-CV-129218, Superior Court of Fulton County (Jan. 7, 2010, Bonner, J.) – Summary judgment granted on veil piercing and fraudulent transfer claims against sole managing member of LLC.**

This action was brought by a retail car rental franchisor against a franchisee, a Georgia LLC, and its principal and sole managing member Anthony Elkik, for breach of the franchise agreement. The court granted summary judgment to Elkik on the plaintiffs' *alter ego* claims, ruling that the plaintiffs failed to present evidence that Elkik disregarded the LLC form or conducted personal and LLC business "on an interchangeable basis." The court also found that allegedly fraudulent transfers were made by the LLC and not the managing member individually and that as a result the managing member could not be held individually liable on a fraudulent transfer theory. On the franchisor's appeal, the Georgia Court of Appeals reversed the trial court on a summary judgment for the franchisee, *Payless Car Rental System, Inc. v. Elkik*, 306 Ga. App. 389, 702 S.E.2d 697 (2010), however Elkik had filed for bankruptcy and the appeal was stayed as to his issues.

***ING USA Annuity and Life Insurance Company v. J.P. Morgan Securities Inc.*, Civil Action No. 2007-CV-135490, Superior Court of Fulton County (Aug. 11, 2010, Bonner, J.) – Disclaimer in private placement memorandum and plaintiff's extensive due diligence held not to preclude reliance on misrepresentations, denying summary judgment to defendants.**

In this suit by an investor in two private placements of debt securities for alleged Georgia Securities Act of 1973 and Georgia RICO Act violations, common law fraud and negligent misrepresentations against a investment banker, the court denied the defendants' motion for summary judgment, ruling, among other things, that cautionary language in the private placement memorandum did not preclude reasonable reliance. A "standard disclaimer" that the investment banker "neither offer[s] an opinion as to nor assume[s] responsibility for the adequacy, accuracy, or completeness of any information contained herein," where the misrepresentations and omissions were allegedly knowingly false. Op. at 4-6. The court also rejected arguments that the plaintiffs relied on their own due diligence and not on the alleged misrepresentations and omissions. The court stated, "simply because a plaintiff conducts extensive due diligence, yet fails to detect the alleged fraud, does not mean that the plaintiff has not relied on misrepresentations or omissions by the defendant." Op. at 6.

***ING USA Annuity and Life Insurance Company v. J.P. Morgan Securities Inc.*, Civil Action No. 2007-CV-135490, Superior Court of Fulton County (Aug. 11, 2010, Bonner, J.) –Rescission under former Georgia Securities Act was unavailable against an investment banker because it was not a party to the transaction; two private placements held to be separate transactions that could constitute a pattern under Georgia RICO.**

In this separate order ruling on the plaintiff's motion for partial summary judgment, the court rejected the plaintiff's argument that it need not prove causation of damages under the former Georgia Securities Act because it was seeking rescission. The Court held that rescission was not available against the investment banker, because it was not a party to the transaction. The Court denied summary judgment on the plaintiff's fraud and negligent misrepresentation claims, finding there were disputed questions of fact on the various elements of those claims, as well as on the plaintiff's Georgia RICO claims. It ruled in the plaintiff's favor on the defendants' contention that the private placements constituted a single transaction, holding that the two private placements were separate transactions and that a jury could find that they constituted a pattern under Georgia RICO.

***Cannon v. H&R Block Inc.; Cain v. H&R Block Inc.* Civil Action Nos. 2007-CV-137010 and 2009-CV-162592, Superior Court of Fulton County (Feb. 24, 2010, Bonner, J.) – Minority shareholder claims for breach of fiduciary duty and fraud not barred by exclusive, binding valuation provisions of shareholders agreement; claims by option holders allegedly fraudulently dissuaded from exercising options.**

Minority shareholders allegedly discovered fraud and breach of fiduciary duty upon exercising their rights under a shareholder agreement to put their stock to the company. The court held that their claims were not barred by the provisions in the shareholders agreement establishing an "exclusive procedure" for a "final and binding" appraisal process, because those provisions were a method for determining the value under the agreement that was "not intended as the means by which to challenge Defendants' alleged purposeful misstatement or manipulation of the figures used to determine fair market value." Op. at 3 (emphasis in original). The court also denied summary judgment as to option-holder claims that they were fraudulently induced not to exercise their options. The court rejected the defendants' argument that the options were unenforceable promises of future compensation, finding instead that the stock options constituted a "continuing offer" to sell stock at a certain price within a certain time period. The court also rejected an argument that an employer buy-back right after the issuance of the option stock at an indeterminate price rendered the fraud claims too indefinite. The court noted that the option-holders' claims were not based on the buy-back provision and the fact that the option-holders had not exercised their options rendered the argument "speculation." The court also rejected arguments that the option-holders' damages were too remote and speculative to support a claim. Op. at 6-8

***SCS Fund, LP v. Odom,* Civil Action No. 2008-CV-152062, Superior Court of Fulton County (April 23, 2010, Long, J.), *aff'd.*, Appeal No. A-10A-2161 (Ga. App. Mar. 4, 2011),[41] *cert. petition filed Mar. 24, 2011* – Claims for fraud, negligent misrepresentation and securities fraud in exchange of assets for stock and holding claims failed for lack of actionable misrepresentations, material omissions or a duty to disclose.**

The plaintiff, through an acquisition vehicle, purchased assets of Verilink Corporation out of bankruptcy and then offered the assets to Verso Technologies, Inc., exchanging them for $5.8 million in Verso common stock.[42] Two years later it sold the stock for $403,165 and sued Verso's former chief executive officer for "securities fraud under Georgia law" (i.e., the Georgia Securities Act of 1973), common law fraud and negligent misrepresentation. The plaintiff alleged misrepresentations and omissions of material fact in connection with the purchase, as well as misrepresentations in the ensuing two years which convinced the plaintiff, Verso's largest shareholder, not to sell its stock. The court examined each of the alleged representations and found them to be either true, representations of future actions or events or statements of opinion. As to alleged non-disclosures, the court found one allegedly omitted fact to have been, in fact, disclosed in Verso's Securities and Exchange Commission filings. A second non-disclosure concerned "channel stuffing." The plaintiff cited a single sale to a distributer for $514,615.08 that should have been recognized in a later period. The court found that single incident of channel stuffing, "even if true," to be immaterial as a matter of law in the context of the case. It also held that since there was no confidential relationship between the plaintiff and the CEO, the transaction was an arms-length business transaction and no duty to disclose existed. The court held that the plaintiff's holding claims were based on statements of opinion and hope and non-actionable representations and also failed to qualify under the requirements of *Holmes v. Grubman*, 286 Ga. 636, 691 S.E.2d 196 (2010), for holding claims involving publicly traded securities,[43] because the plaintiff had not shown that the alleged misrepresentations had caused the plaintiff's loss, by showing that the facts allegedly concealed by the defendant had caused a drop in Verso's stock price upon being disclosed.

***Hawk v. Odom,* Civil Action No. 2009-CV-162588, Superior Court of Fulton County (April 23, 2010, Long, J.), *aff'd.*, Appeal No. A-10A-2213 (Ga. App. Feb. 24, 2011),[44] *cert. petition filed Mar. 16, 2011* – Claims for fraud, negligent misrepresentation and securities fraud in sale of stock failed where plaintiffs could not prove reliance on misrepresentations and defendant owed no duty to disclose because it was an arms-length business transaction.**

In this case, the court granted summary judgment against three stock purchasers, one of whom was apparently an existing shareholder, who purchased stock in Verso Technologies, Inc., in a private placement. The court found that the plaintiffs' deposition testimony showed that they had not relied on the alleged misrepresentations. As to non-disclosures, the court held that there was no confidential relationship between the

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[41] The Georgia Court of Appeals opinion affirming this decision is unavailable at this writing.

[42] See n. 4, *supra* for discussion of the claims asserted by the trustee in bankruptcy of Verso Technologies, Inc. against former directors and officers of that company.

[43] See discussion of *Holmes v. Grubman* and holding claims, *supra* at 7-9.

[44] The Georgia Court of Appeals opinion affirming this decision is unavailable at this writing.

plaintiffs and the defendant, Verso's former chief executive officer and that, as a result, the stock sale was an arms-length business transaction, and the CEO owed the plaintiffs no duty of disclosure. In so ruling, the court did not address the question whether the Georgia Securities Act of 1973 imposed duties of disclosure in the absence of confidential relationships or whether a corporate officer had any duties of disclosure when selling stock to an existing shareholder.

***An v. Hanna,* Civil Action No. 2009-CV-178060, Superior Court of Fulton County (Aug. 16, 2010, Long, J.) – Limited discovery permitted in derivative action where defendants file a motion to dismiss under O.C.G.A. § 14-2-744(a) based on decision of special litigation committee not to pursue claim.**

In this derivative action, brought by a shareholder on behalf of CompuCredit Corporation the defendants filed a motion to dismiss under O.C.G.A. § 14-2-744(a) which provides:

> (a) The court may dismiss a derivative proceeding if, on motion by the corporation, the court finds that one of the groups specified in subsection (b) of this Code section has made a determination in good faith after conducting a reasonable investigation upon which its conclusions are based that the maintenance of the derivative suit is not in the best interests of the corporation. The corporation shall have the burden of proving the independence and good faith of the group making the determination and the reasonableness of the investigation.

The defendants then filed a motion for a protective order staying discovery under O.C.G.A. §§ 9-11-12(j) and 26(c). Citing *Thompson v. Scientific Atlanta, Inc.*, 275 Ga. App. 680, 621 S.E.2d 796 (2005), the court held that the plaintiff was entitled to discovery limited to the independence and good faith of the special litigation committee and the reasonableness of its investigation, including the production of documents relied on in preparing the special litigation committee report and communications relating to the committee's investigation. All other discovery was stayed until the court ruled on the motion to dismiss.

***Ragland v. Sevex North America, Inc.,* Civil Action No. 2008-CV-153555, Superior Court of Fulton County (Jan. 25, 2010, Long, J.) – Dispute resolution process in stock purchase agreement held not to bar suit.**

Selling shareholders, through their attorney-in-fact brought suit to contest the purchaser's calculation of EBITDA which was to be used to calculate a purchase price adjustment. The Stock Purchase Agreement provided that the purchaser's calculations were final and binding unless the sellers objected and, if they did object, the agreement provided that the sellers "may" retain a specified accounting firm at their expense and follow a dispute resolution procedure with that firm. When the sellers did not follow the contractual accounting dispute resolution procedure, but filed suit, the purchaser claimed that its EBITDA calculation became binding. The court compared the EBITDA calculation provision with a provision requiring accountants to decide a dispute regarding the definition of EBITDA and found that by using the term "may" in the EBITDA calculation provision the agreement failed to specify what should occur if the sellers objected, but did not retain the specified firm. The court concluded that the sellers were entitled to file suit to enforce the agreement rather than retain the accounting firm and utilize the contractual dispute resolution procedure. The court dismissed the sellers' fraud claim as pleaded, however, because they could not show that they had relied on the defendants' EBITDA calculation if they had promptly objected to it.

GEORGIA'S BUSINESS COURT CELEBRATES ITS FIFTH ANNIVERSARY

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Last October marked the fifth anniversary of Georgia's dedicated business court.[1] The Business Court was established to provide an efficient and dedicated forum to resolve complex commercial and business cases, with heightened efficiency and judicial case management. It has succeeded in meeting these objectives, as measured by the increased caseload of the Business Court over the past five years. The Business Court handled over 60 cases in 2010 alone, with more than a third of those cases being closed by the end of the year.

The benefits of the Business Court include a judicial bench with a particular focus and expertise in complex commercial and business law issues and customized case management. Other features of the Business Court include:

- A docket dedicated solely to Business Court cases
- Specially set hearings and timely trial dates
- Active Judicial management of case schedules, discovery issues, and documentary evidence
- Case Management Conferences held within 30 days of transfer to the Business Court
- Motions ruled upon within 30 days
- Judges and Staff Attorney who attend monthly seminars on business law topics
- Judges who have continuous exposure to the substantive areas of the law
- Online access to selected Business Court opinions

The business court pilot program was authorized on June 3, 2005 through the adoption of Atlanta Judicial Rule 1004 ("Rule 1004") by the Supreme Court of Georgia. Rule 1004 authorized the Judges of the Fulton County Superior Court to create a "Business Case Division," commonly referred to as the "Business Court," which began operations on October 11, 2005. In February 2010, the Business Court was approved as a permanent division of the Fulton County Superior Court. The current Business Court Judges are the Honolrable Melvin K. Westmoreland, the Honorable Elizabeth E. Long, and the Honorable Alice D. Bonner.

The docket of the Business Court became significantly more active in 2007, after the adoption of the Amended Rule 1004, which alowed for the assignment of cases to the Business Court by motion of one party or at the request of the Superior Court Judge assigned to the case.[2] Prior to this amendment, assignment to the Business Court required the consent of all parties.[3]

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[1] For a detailed discussion of the Fulton County Business Court and other business court models, *see* Anne Tucker Nees, *Making a Case for Business Courts: A Survey of and Proposed Framework to Evaluate Business Courts*, 24 Ga. St. U. L. Rev. 477 (2007).
[2] The caseload more than doubled from 2007 to 2008.
[3] Atlanta Judicial Rule 1004 was adopted in its initial form on June 3, 2005, by the Supreme Court of Georgia. Amended Rule 1004 was adopted on June 6, 2007.

In 2008, the President of the Georgia State Bar formed the Business Court Committee to review and report to the Executive Committee and Board of Governors of the State Bar regarding the performance of the Business Court. At that time, the most immediate and critical issue facing the Business Court related to the pending budget cuts, which presented an immediate threat to the continued viability of the Court. The Committee studied the issue, consulted with the business community and members of the bar, and proposed a further amendment to Rule 1004 to address the funding issue. In 2009, Rule 1004 was thus amended to (i) implement a fee of $1000.00 to transfer a case to the Business Court,[4] and (ii) eliminate the requirement that only Senior Judges serve on the Business Court. These measures thereby helped to reduce the funding shortfall facing the Business Court at that time.[5]

In 2010, the Georgia Supreme Court approved other amendments to Rule 1004, which changed the Rule in two primary respects. The most significant change in the 2010 amendment expanded the types of cases that parties may transfer to the Business Court. Previously, the Business Court had discretion to hear only cases within certain enumerated statutes under the Georgia Code and if they also met a threshold amount of $1,000,000 in alleged damages.[6] The 2010 amendment eliminated the $1,000,000 in controversy requirement for those cases that are within the specific Georgia Code sections enumerated in Rule 1004. For example, the Business Court may now entertain cases, such as books and records requests or petitions to hold stockholders' meetings, that are classic business disputes, but which previously could not be considered by the Business Court due to the $1,000,000 threshold. The amended Rule 1004 maintains the $1,000,000 in controversy threshold for injunction cases[7] and for any other cases that the Business Court may determine are appropriate for the Business Court. These types of cases "include, but are not limited to large contractual and business tort cases as well as other complex commercial litigation . . .including issues concerning governance, involuntary dissolution of a corporation, mergers and acquisitions, breach of duty of directors, election or removal of directors, enforcement or interpretation of shareholder agreements, and derivative actions."[8]

The 2010 amendment to Rule 1004 also now requires lead counsel for each party to meet in person prior to the initial case management meeting with the Judge to discuss discovery and mediation, among other matters, and requires the parties to submit a proposed case management order to the Judge at the initial meeting.

The most recent enhancement to the Business Court is the publication of Business Court opinions. Online access to selected Business Court opinions is now available on the website of Georgia State University College of Law at http://law.gsu.edu/businesscourt. The opinions are searchable by case number, party, and key word. Publication of the Business Court opinions will foster the continued development of a consistent body of business law in Georgia.

Additional information about the Business Court, including the current version of Rule 1004, can be located at http://www.fultoncourt.org/sca200807/ offices/business-court.html.

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4 The fee is only payable by the parties moving for transfer.

5 In August 2008, the State of Georgia imposed certain budget cuts, which included reduction of the operating budget of the Council of Superior Court Judges and the subsequent elimination of funding for Senior Judges. The budget cuts resulted in a restriction on the use of Senior Judges.

6 The specific code sections are: (i) Georgia Securities Act of 1973, as amended, O.C.G.A. § 10-5-1, et seq.; (ii) Uniform Commercial Code, O.C.G.A. § 11-1-101, et seq.; (iii) Georgia Business Corporation Code, O.C.G.A. § 14-2-101, et seq.; (iv) Uniform Partnership Act, O.C.G.A. § 14-8-1, et seq.; (v) Uniform Limited Partnership Act, O.C.G.A. § 14-9A-1, et seq.; (vi) Georgia Revised Uniform Limited Partnership Act, O.C.G.A. § 14-9-100, et seq.; and (vii) Georgia Limited Liability Company Act, O.C.G.A. § 14-11-100, et seq.

7 In the case of injunction relief, the amount is measured by the value of the relief sought or cost of not getting the relief in this threshold amount.

8 Amended Rule 1004.

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