The State Bar of Georgia

BUSINESS LAW SECTION

Newsletter

Walter Jospin, Chair **January 2008** **Sterling A. Spainhour, Jr., Editor**

REPORT FROM CHAIR OF BUSINESS LAW SECTION

By: Walter Jospin, Esq.
Paul, Hastings, Janofsky & Walker LLP

It is my pleasure to greet you as the Chair of the Business Law Section of the State Bar of Georgia. Our Section is the fifth largest of the State's 38 Bar Sections, with almost 1,700 members. Our Section has been very active, primarily in the areas of preparing and advising on business related legislation, assisting the Business Law Court of Fulton County in its Continuing Judicial Education programs, and conducting lawyer training programs. As a result of our activity, the State Bar recently chose us as the Section of the Year. We are very proud of that award.

Over the past year, our Section sponsored six CLE programs, including the annual Business Law Institute and programs on Secured Lending, Securities Regulatory Litigation, Negotiated Corporate Acquisitions and Advanced Securities Law. These programs were well attended and received high marks from attendees.

Our Section is currently active on the legislative front as well, including efforts by the Corporate Code Committee to address Code provisions relating to majority voting and director selection reform. Bruce Wanamaker and Alan Prince have done an extraordinary job in shepherding the proposed legislation through the legislative process. The Securities Committee is, once again, reviewing the advisability of adopting all or a portion of the Revised Uniform Securities Act at the request of the Secretary of State.

At the request of the Business Law Court of Fulton County, the Section has conducted a series of educational programs for the judges of the Business Court and Fulton County Superior Court that address corporate law issues. Bob Pile and Beth Tanis have organized these educational programs, and lawyers from many law firms have given of their time to provide high quality presentations to our judges.

The Section has also formed a Business Litigation Committee, ably led by Beth Tanis. The Committee already has a substantial membership comprised of some of the leading corporate and securities litigators in the State.

I want to invite every member of the Section to consider active participation in one or more of our committees. Our committees are important in providing legislative proposals to address corporate questions, providing a venue for the interchange of information among practitioners, and addressing issues of concern to all business lawyers. The committees are also a wonderful way to get to know your colleagues at the Bar. We would also like very much for business lawyers throughout the State to get involved with the Section. If you are interested in participating on any committee, please contact the chair of that committee, or any officer of the Section, all of whom are listed below.

BUSINESS LAW SECTION
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2007 GEORGIA CORPORATION AND BUSINESS ORGANIZATION CASE LAW DEVELOPMENTS

By: Thomas S. Richey, Esq.
Powell Goldstein LLP

The purpose of this survey is to track case law developments in Georgia state and federal courts dealing with corporate and business organization law issues. Some of the cases reviewed in this survey address important, previously unresolved questions. These include the Georgia Court of Appeals' conflicting decisions on the standard of care for directors and officers of Georgia corporations. Other decisions involve elusive issues, such as the validity of an election of directors of a Georgia membership nonprofit corporation that lacks the officers or the bylaws to authorize a meeting of members. We have included still other decisions, such as those concerning piercing the corporate veil, because they illustrate and confirm settled points of law.

In general, the survey is organized by type of entity - corporations, partnerships and limited liability companies, with decisions organized by subject matter within those categories. Due to space limitations in the newsletter, my discussion of several areas - statute of limitations for breanch of fiduciary duty, the Business Records Act, director and officer liability insurance and other special issues is not included herein, however, the full article which discusses these cases can be found by accessing our website at www.pogolaw.com or contacting me via email (trichey@pogolaw.com).

The remainder of this section is a brief overview of the cases. It is followed by a generally more extensive discussion of each of the cases, listed for ease of navigation in the same order as the overview.

Business and Nonprofit Corporations. In Flexible Products Co. v. Ervast, 284 Ga. App. 178, 643 S.E.2d 560 (2007) and Rosenfeld v. Rosenfeld, 286 Ga. App. 61, 648 S.E.2d 399 (2007), different divisions of the Georgia Court of Appeals

addressed whether corporate officers and directors are subject to an ordinary negligence standard of care, reaching opposite results. The Flexible Products Co. case, holding that ordinary negligence is not actionable, was decided unanimously and, under the Court of Appeals' Rule 33, is binding precedent, whereas the Rosenfeld decision, holding the standard to care is ordinary negligence, was not unanimously decided and is only physical precedent.

The Eleventh Circuit Court of Appeals in TSG Water Resources, Inc. v. D'Alba & Donovan, Certified Pub. Accountants, P.C., 2007 WL 4455386 (11th Cir., Dec. 20, 2007) (not published in the Federal Reporter) addressed the business judgment rule as to claims against a Georgia corporate officer, along with the test for corporate citizenship for diversity jurisdiction and issues of reasonable reliance and scienter for common law fraud and fraud under the Georgia securities laws.

In three instructive decisions, Impreglon, Inc. v. Newco Enterprises, Inc., and W. Curt Jarrell, 2007 WL 1020834 (N.D. Ga., March 30, 2007), Lou Robustelli Mktg. Servs., Inc. v. Robustelli, 286 Ga. App. 816, 650 S.E.2d 326 (2007), and Hilb, Rogal & Hamilton Co. of Atlanta, Inc. v. Holley, 284 Ga. App. 591, 644 S.E.2d 862 (2007), the courts ruled on claims for breach of fiduciary duty by departing personnel, among other things, examining in Impreglon whether advance planning is a breach of fiduciary duty and in Hilb, Rogal and Lou Robustelli Marketing whether particular corporate personnel had fiduciary duties, focusing on whether an officer or employee had authority to bind the corporation.

Several decisions concerned the capacity, authority, rights and liabilities of corporate officers, directors and shareholders in other contexts. The Georgia Court of Appeals' decision in Keane v. Annice Heygood Trevitt Support Trust, 285 Ga. App. 155, 645 S.E.2d 641 (2007) dealt with the capacity in which a guarantee of a corporate indebtedness was executed, rejecting arguments that the defendant could not be personally liable because he executed the guarantee in his capacity as a shareholder or as a director. In Clay v. Oxendine, 285 Ga. App. 50, 645 S.E.2d 553 (2007), the Court of Appeals held that corporate officers could not escape personal liability under Georgia's anti-payday lending statute and the Georgia Industrial Loan Act by arguing that their acts were those of the corporation. The case of Hinely v. Alliance Metals, Inc. of Atlanta, 285 Ga. App. 230, 645 S.E.2d 584 (2007) involves claims by a corporate executive that his employer breached his employment contract by, among other things, engaging in allegedly illegal activity. In McKenna v. Capital Resource Partners, IV, L.P., 286 Ga. App. 828, 650 S.E.2d 580 (2007), the Court of Appeals found a triable issue of fact as to the authority of a controlling shareholder to reach an agreement with minority shareholders that could be binding on the corporation without action by its board of directors. The Court of Appeals in Huffman v. Armenia, 284 Ga. App. 822, 645 S.E.2d 23 (2007) held that a corporate president lacked the capacity to file a bankruptcy petition pro se on behalf of the corporation and the filing was also beyond his authority because it was not approved by the board of directors prior to filing.

Three decisions addressed issues of corporate stock valuation and dissenting shareholders' appraisal proceedings. The Georgia Supreme Court in Barton v. Barton, 281 Ga. 565, 639 S.E.2d 481 (2007) held as a matter of first impression that, for purposes of dividing marital property, a wife in divorce proceedings is not bound by the valuation of her husband's corporate stock in a shareholder buy-sell agreement. In Suzie Schutt Irrevocable Family Trust v. NAC Holding, Inc., 283 Ga. App. 834, 642 S.E.2d 872 (2007), the Georgia Court of Appeals held that the sole remedy available to a shareholder of a Delaware corporation under the Delaware short-form merger statute is an appraisal hearing before the Delaware Court of Chancery. In Fansler Foundation v. American Realty Investors, Inc., 2007 WL 2695630 (E.D. Cal., Sept. 11, 2007), a case involving a preferred shareholder's allegations of fraud and breach of fiduciary duty regarding promises to list a Georgia corporation's shares on a stock exchange allegedly made to enlist shareholder support for a reorganization, a California federal district court rejected the defendants' efforts to characterize the claims as claims for fair value governed by the Georgia dissenters' statute.

The Georgia Court of Appeals in Nyugen v. Tran, 287 Ga. App. 888, 652 S.E.2d 881 (2007), for purposes of an interlocutory injunction, upheld the actions of a majority of members of a Georgia nonprofit corporation with no officers, directors or bylaws, in calling a meeting of members and electing a board of directors, despite the lack of specific statutory authority for members to call a meeting under those circumstances.

The courts handed down two decisions involving administrative dissolution of Georgia corporations – Foster v. Clayton County Judicial Circuit of the State of Georgia, et al., 2007 WL 569851 (N.D. Ga., February 20, 2007), in which it was held that an administratively dissolved corporation cannot undertake new corporate obligations, and Williams v. Martin Lakes Condominium Association, Inc., 284 Ga. App. 569, 644 S.E.2d 424 (2007), in which it was held that reinstatement of an administratively dissolved nonprofit corporation can take place at any time and enable the corporation to pursue litigation filed during the period of its dissolution.

In B&B Quick Lube, Inc. v. G&K Services Company, 283 Ga. App. 299, 641 S.E.2d 198 (2007), the Georgia Court of Appeals applied O.C.G.A. § 14-2-504, an alternative method for serving process on a Georgia Corporation with requirements that differ from those of the Georgia Civil Practice Act. The Court of Appeals in Wright v. AFLAC, Inc., 283 Ga. App. 890, 643

S.E.2d 233 (2007) discussed a corporate issuer's recordkeeping responsibilities and its burden of proof with respect to claims to ownership of its stock.

Partnerships. In Bloomfield v. Bloomfield, 282 Ga. 108, 646 S.E.2d 207 (2007), the Georgia Supreme Court held that where the general partner had improperly transferred the sole asset of a family limited partnership, the limited partners were entitled to recover the their pro rata share of the value of the property lost, not an award of an undivided interest in the property itself. French v. Sellers, 2007 WL 891306 (M.D. Ga., Mar. 21, 2007) addressed claims that a general partner of an LLLP breached his fiduciary duties in arranging for the purchase of a limited partner's interest by failing to disclose negotiations and offers received for the purchase of the partnership. In re Newlin, 370 B.R. 870 (Bankr. M.D. Ga., June 29, 2007) held that a bankruptcy trustee who fails to assume the executory provisions of a partnership's buy-sell agreement cannot enforce the agreement. In Hendry v. Wells, 286 Ga. App. 774, 650 S.E.2d 338, (2007), the Georgia Court of Appeals used a "special injury" rule analysis to decide that certain claims by limited partners of a limited partnership still governed by the now-superseded Uniform Limited Partnership Act were derivative in character and subject to dismissal. Ellison v. Hill, ___ Ga. App. ___, 654 S.E.2d 158 (2007) ruled that it is not necessary to offer expert evidence of profitability in accordance with generally accepted accounting principles in order to establish a claim for a share of partnership profits. The Eleventh Circuit Court of Appeals in Optimum Techs., Inc. v. Henkel Consumer Adhesives, Inc., 469 F.3d 1231 (11th Cir. 2007) held that the relationship between a manufacturer and distributor did not constitute a partnership or joint venture and did not give rise to fiduciary duties or duties of disclosure. In Leevers v. Bilberry, 2007 WL 315344 (M.D. Ga., Jan. 31, 2007), the court held that a property manager was not an agent of the partnership that owned the property and was not bound by the arbitration provisions of the partnership agreement. The Court of Appeals in Dalton Point, L.P. v. Regions Bank, Inc., 287 Ga. App. 468, 651 S.E.2d 549, (2007), rejected an effort by a limited partnership to hold a depository bank liable for the embezzlement of funds by the partnership's bookkeeper, when the "corporate" resolution expressly authorized the use of partnership funds for personal obligations.

Limited Liability Companies. Megel v. Donaldson, ___ S.E.2d ___, 2007 WL 4126886 (Ga. App., Nov. 21, 2007) rejected claims of breach of fiduciary duty against a majority member of a limited liability company because a development agreement among the members precluded fiduciary duties from arising. A Tennessee bankruptcy court decision, In re Wheland Foundry, LLC, 2007 WL 2934869 (Bkrtcy. E.D. Tenn., Oct. 5, 2007), addressed whether two LLC members' claims against a third were direct or derivative, applying Georgia's special injury rule and finding Georgia's direct action exception for closely held entities to be inapplicable.

Statute of Limitations for Breach of Fiduciary Duty. In four cases handed down in July 2007, Hamburger v. PFM Capital Mgmt., Inc., 286 Ga. App. 382, 649 S.E.2d 779 (2007); Cochran Mill Assocs. v. Stephens, 286 Ga. App. 241, 648 S.E.2d 764, (2007); Hendry v. Wells, 286 Ga. App. 774, 650 S.E.2d 328 (2007); In re Pac One, Inc., 2007 WL 2083817 (N.D. Ga., July 17, 2007), the courts addressed statutes of limitations for breaches of fiduciary duty in corporate and partnership contexts, reaching conflicting results as to the applicable limitations period for partnership fiduciary breaches.

Business Records. In four cases the Georgia Court of Appeals has addressed the admissibility of documents under the Georgia Business Records Act. In Ishak v. First Flag Bank, 283 Ga. App. 517, 642 S.E.2d 143 (2007) permitting a loan summary to be introduced through an officer who did not prepare it, in Walter R. Thomas Assocs., Inc. v. Media Dynamite, Inc., 284 Ga. App. 413, 643 S.E.2d 883 (2007) allowing invoices from a third party vendor to be treated as the recipient's business records, and in Boyd v. Calvary Portfolio Services, Inc., 285 Ga. App. 390, 646 S.E.2d 496 (2007) and Jenkins v. Sallie Mae, Inc., 286 Ga. App. 502, 649 S.E.2d 802 (2007), permitting introduction of loan records from predecessor lenders.

Corporate Veil Decisions. The decisions of Powell Co. v. McGarey Group, LLC, 2007 WL 951759 (N.D. Ga., March 28, 2007), BMC-The Benchmark Mgmt. Co. v. Ceebraid-Signal Corp., 2007 WL 2126272 (N.D. Ga., July 23, 2007) and Adams v. Unum Life Ins. Co. of America, 2007 WL 2681729 (N.D. Ga., Sept. 10, 2007) rejected efforts to pierce the corporate veil for lack of evidence. The BMC-The Benchmark Mgmt. Co. decision also declined to recognize the theory of aiding and abetting fraud as viable under Georgia law. The Adams case rejected a joint venture basis for liability. Horton Homes, Inc. v. Bandy, 2007 WL 4571251 (M.D. Ala., Dec. 26, 2007) addressed veil-piercing in the context of arbitration agreements and Lollis v. Turner, ___ Ga. App. ___, 654 S.E.2d 229 (2007) refused to permit "outsider reverse veil-piercing."

Insurance Issues. In Executive Risk Indemnity, Inc. v. AFC Enterprises, Inc., 2007 WL 2791117 (N.D. Ga., Sept. 26, 2007), the court rejected a director and officer liability insurer's efforts to rescind its policy. The Court of Appeals in Fireman's Fund Ins. Co. v. University of Georgia Athletic Assn., Inc., ___ Ga. ___, 654 S.E.2d 207 (2007), held that exclusions in a nonprofit corporation D&O insurance policy for failure to effect or maintain insurance and for bodily injury did not bar coverage for the organization's failure to obtain disability insurance for a student athlete.

Transactional Cases. The decision in Paul v. Smith, Gambrell & Russell, 283 Ga. App. 584, 642 S.E.2d 217 (2007), concerns a duty-to read-defense in a legal malpractice action involving the unanimity needed for a shareholders consent to a merger. Duvall v. Galt Med. Corp., 2007 WL 4207792 (N.D. Cal., Nov. 27, 2007) rejected third party beneficiary claims against an acquiring company by a former employee whose promised stock options were not included in the acquisition. In Automated Print Inc. v. Edgar, ___ S.E.2d ___, 2007 WL 3293254 (Ga. App., Nov. 8, 2007), stock purchase price adjustment provisions in a promissory note were held not to be a matter of setoff or recoupment and evidence should have been allowed of events requiring the price to be adjusted.

Other Issues. The Court of Appeals in Slater v. Cox, 287 Ga. App. 738, 653 S.E.2d 58 (2007) decided the applicable deadline for filing an appeal to superior court from an administrative ruling by the Georgia Securities Commissioner is the 20-day period specified in O.C.G.A. § 10-5-17, not the 30-day period allowed under Georgia's Administrative Procedure Act.

In Scouten v. Amerisave Mortgage Corp., 284 Ga. App. 242, 643 S.E.2d 759 (2007), the Court of Appeals denied standing under Georgia's RICO statute to a whistle-blower who was not directly injured by the alleged predicate acts.

In Marcum v. Gardner, 283 Ga. App. 453, 641 S.E.2d 678 (2007), a dispute regarding whether a transaction was intended as an investment or a loan, the Georgia Court of Appeals held that a check denoted as a "1/3 investment" did not decide the character of the transaction, given testimony that it was intended to be a loan.

Finally, in First Support Services, Inc. v. Trevino, ___ S.E.2d ___, 2007 WL 3407720 (Ga. App., Nov. 16, 2007), the Georgia Court of Appeals held that the purchaser of a manufacturer was not strictly liable as a "successor corporation" for purposes of O.C.G.A. § 51-1-11(b)(1) because there was no evidence of a merger, assumption of liabilities, commonality of ownership or attempt to commit fraud.

DISCUSSION OF CASE LAW DEVELOPMENTS

A. CORPORATIONS.

1. Standard of Care for Corporate Officers and Directors: *Flexible Products Co. v. Ervast,* 284 Ga. App. 178, 643 S.E.2d 560 (2007) and *Rosenfeld v. Rosenfeld,* 286 Ga. App. 61, 648 S.E.2d 399 (2007)

In Flexible Products Co. v. Ervast, 284 Ga. App. 178, 643 S.E.2d 560 (2007), the Georgia Court of Appeals took a major step in resolving the uncertainty regarding the standard of care for officers and directors of Georgia corporations, holding as a matter of first impression that under the business judgment rule and Georgia's statutory provisions on directors' and officers' duties, they cannot be held liable for ordinary negligence. The Court reasoned:

> Georgia's business judgment rule relieves officers and directors from liability for acts or omissions taken in good faith compliance with their corporate duties. OCGA §§ 14-2-830(d) and 14-2-842(d). Such rule forecloses liability in officers and directors for ordinary negligence in discharging their duties. See OCGA §§ 14-2-830(a)(2) and 14-2-842(a)(2) (allowing officers and directors to discharge their duties under an ordinarily prudent man standard to the extent they reasonably rely on the advice of counsel, without independent knowledge, rendering such reliance unwarranted). "[O]rdinary negligence or negligence is what an ordinarily prudent man would do under the same circumstances...." *Western & A.R. Co. v. Vaughan*, 113 Ga. 354, 38 S.E. 851 (1901). Given that officers and directors thus are protected from liability for ordinary negligence, the trial court erred in refusing to direct a verdict for Flexible on Ervast's ordinary negligence claim.

284 Ga. App. at 181, 643 S.E.2d at 565.

This ruling is an important one. The uncertainty regarding the standard of care has represented an unresolved issue in Georgia corporate governance litigation for decades,[1] and a subcommittee of the Corporate Code Revision Committee of the Business Law Section of the State Bar has been attempting for several years to decide how best to address it legislatively.[2]

[1] By contrast, the Delaware courts have long held directors to a less stringent gross negligence standard of care. See Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

[2] Directors' liability for damages for negligence can be eliminated by inclusion of exculpatory language in the articles of incorporation, O.C.G.A. § 14-2-202(b)(4), but there is no similar provision for exculpation of officers. Officers, as well as

Because of the Court's abbreviated treatment of the issue, the Flexible Products Co. decision raises a lot of questions. For example, although basing its decision in part on the business judgment rule, the Court does not distinguish between claims based on board decisions and claims based on alleged failures by directors to monitor company affairs and supervise management. Instead, it categorically states that officers and directors are protected from liability for ordinary negligence, leaving the implication that it is adopting a gross negligence standard of care across the board. The decision appears to equate the common law business judgment rule with the statutory protection from liability for directors who meet the statutory standard of care, when the drafters of O.C.G.A. § 14-2-830 were careful to state that they were not codifying the business judgment rule. See Comment to § 14-2-830.[3] In fact, the language quoted above comprises almost the Court's entire discussion of the issue. Still, this is one of the most important decisions to come down from the Georgia appellate courts in the corporate governance area for many years.

The case arises out of Flexible Products Co.'s purchase of a terminated employee's stock pursuant to a mandatory repurchase obligation. The plaintiff asserted that the Company should have disclosed pending merger discussions because it would have increased the value of his stock. The Court of Appeals' decision followed a jury trial, a plaintiff's verdict and judgment against Flexible Products Co. and two of its officers for $2,729,691, which the Court reversed, ordering a new trial.[4]

In addition to its ruling on the standard of care, the Flexible Products Co. opinion is also noteworthy for other rulings, particularly:

- The Court held that the company had a common law duty to the plaintiff shareholder to disclose its pending merger discussions, even when purchasing his stock pursuant to a mandatory repurchase obligation, because the plaintiff had the option to decide when to sell his shares back to the company over an extended period of time after his termination.
- There was also an important ruling that expert testimony should not have been permitted on the issue of the "materiality" of the undisclosed information concerning merger discussions. The decision on materiality is to be reserved for the jury.
- The opinion also dealt with corporate directors' statutory reliance defense, specifically upholding the express statutory right of corporate directors and officers to rely on advice of counsel under O.C.G.A. §§ 14-2-830(b)(2) and 14-2-842(b)(2).

However, the key ruling is the one on the standard of care, in which the Court held that corporate officers cannot be held liable for ordinary negligence as a matter of law.

On May 24, 2007 another Georgia Court of Appeals panel in another case reached exactly the opposite conclusion. Rosenfeld v. Rosenfeld, 286 Ga. App. 61, 648 S.E.2d 399 (2007). Here is the Court's ruling on the issue in Rosenfeld, in its entirety and verbatim:

(continued…)

Directors, can receive protection from negligence claims through indemnification provisions. See O.C.G.A. §§ 14-2-856(a) and -(b), 14-2-857(a) and 14-2-859(f).

[3] The court also fails to discuss any of the case law from other Model Act states, which is divided on whether the language currently in O.C.G.A. § 14-2-830 imposes liability for ordinary negligence. See FDIC v. Stahl, 89 F.3d 1510, 1516 (11th Cir. 1996) (interpreting former Florida law with wording similar to § 14-2-830 to impose liability for simple negligence). There is also no mention of unpublished conflicting Georgia federal court decisions on the issue. Compare RTC v. Artley, Civ. Action No. CV492-209 (S.D. Ga. 1993) (unpublished) (holding Georgia directors to an ordinary negligence standard under Georgia law), rev'd. on other grounds, 28 F.3d 1099 (11th Cir. 1994); with Medserv Corporation v. Nemnom, Civ. Action No. 1:95-cv-0462-TWT (N.D. Ga., Sept. 23, 1997) (unpublished) ("It has been held that an action for breach of fiduciary duty by a corporate officer requires a showing of more than mere negligence or careless performance of his duties," citing Mansfield Hardwood Lumber Co. v. Johnson, 268 F.2d 317 (5th Cir. 1959) (applying Louisiana law)).

[4] The case also had an extended pre-trial history. The defendants initially removed the case to federal court, arguing that because the plaintiff owned a large portion of his shares through an employee stock ownership plan, his Georgia law claims were preempted by ERISA and the case was required to be litigated in federal court. The district court denied Ervast's motion to return the case to state court, but the federal court of appeals disagreed, holding that Ervast's claims involved the state law duty of a majority shareholder to disclose material information to a minority shareholder selling his shares and was not preempted by ERISA. Ervast v. Flexible Products Co., 346 F.3d 1007 (11th Cir. 2003), cert. denied, 543 U.S. 808, 125 S. Ct. 30, 160 L. Ed. 2d 10 (2004).

> In his seventh enumeration of error, the husband contends that the court erred in charging the jury that a corporate officer's fiduciary duty towards the corporation and its shareholders required him to exercise "all due care and diligence." He argues that the relevant standard of care found in OCGA § 14-2-842(a)(2) is a lesser standard, requiring the officer to act "[w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances."
>
> We hold that there is no meaningful difference between the two standards. The latter standard essentially sets forth the ordinary diligence or negligence standard referenced in OCGA § 51-1-2 ("ordinary diligence is that degree of care which is exercised by ordinarily prudent persons under the same or similar circumstances"), which has been held to require the defendant to exercise "all due care and diligence." *Atlantic Coast Line R. Co. v. Anderson.*[FN19] Indeed, even in this case, the court first charged the standard as worded in OCGA § 14-2-842 (care of ordinarily prudent person) and then simply explained this standard further as referring to "all due care and diligence." We discern no error.
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> FN19. *Atlantic Coast Line R. Co. v. Anderson,* 75 Ga. App. 829, 834(3) (44 S.E.2d 576) (1947).

The Rosenfeld case involved a dispute between a divorced couple concerning, among other things, a close corporation, the assets of which both parties had used for personal expenses prior to the divorce. After the divorce, the husband allegedly "continued to use those assets for his personal use thereafter to her exclusion." Id. at *3. The husband appealed from a judgment on an adverse jury verdict, which the Court of Appeals affirmed.

The Rosenfeld opinion and the Court's reasoning on the standard of care issue are notable in several respects. First, there is no mention of the Flexible Products Co. decision. Rosenfeld creates a conflict that either the Court of Appeals or the Georgia Supreme Court must resolve.[5]

Second, the Court does not appear to have even considered whether the standard of care might be gross negligence, rather than ordinary negligence. Instead, the issue appears to be whether the standard is ordinary negligence or something even more stringent.

Third, the Court sets the standard of care by reference to a statutory definition of "ordinary diligence" and "ordinary negligence" from the Georgia Code's Title 51, which provides general principles governing Georgia tort law for matters ranging from traffic accidents, slip and fall cases, and products liability to financial transactions. The Court did not consider whether the governance of a business corporation's internal affairs, the roles, responsibilities and relationships of officers and directors, and shareholder expectations of profits and entrepreneurial risk-taking do not require more latitude than the law of stop-lights, banana peels, flammable fabrics and dishonored checks affords.

Fourth, there is no recognition that the statutory formulation of the duties and standard of care for Georgia corporate officers and directors, O.C.G.A. §§ 14-2-730 and 14-2-842, was adapted not from Title 51, but rather from outside the Georgia Code altogether. It derives, instead, from the Model Business Corporation Act. The opinion also reflects no consideration of the judicial interpretations of this language by courts in other Model Act states, albeit with varying results.[6]

Fifth, the Court reintroduces the concept of "diligence" into the standard of care, a concept discarded by the Georgia Legislature when it amended the 1968 Georgia Business Corporation Code in 1987.[7]

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[5] A review of the appellate briefs shows that the standard of care issue under § 14-2-842 had not been raised by the parties in the Rosenfeld appeal. The issue instead was the question whether the phrase "all due care and diligence" set a more exacting standard than § 14-2-842. The Flexible Products Co. decision was handed down after the briefing in Rosenfeld was complete. There was no oral argument in Rosenfeld.

[6] Compare Resolution Trust Corp. v. Hecht, 818 F. Supp. 894 (D. Md. 1992) (gross negligence standard of care), and In re Integrated Resources, Inc., 147 B.R. 650 (S.D.N.Y. 1992) (gross negligence standard of care), with Resolution Trust Corp. v. Rahn, 854 F. Supp. 480 (W.D. Mich. 1994) (simple negligence standard of care), and Theriot v. Bourg, 691 So. 2d 213 (La. Ct. App. 1997) (simple negligence standard of care).

[7] Former Ga. Code Ann. § 22-713 provided: "Directors and officers shall discharge the duties of their respective positions in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions." (Ga. L. 1968, p. 565). See Boddy v. Theiling, 129 Ga. App. 273, 276, 199 S.E.2d 379, 382 (1973). Former O.C.G.A. § 14-2-152.1, Ga. L. 1987, p. 849 § 1, enacted in 1987, deleted the references to "diligence" and "skill"

Sixth and finally, there is no mention of the deference to be accorded to director and officer decision-making under the business judgment rule, a factor considered important by the Court in setting the standard of care in the Flexible Products Co. case.

At the author's request, one of the counsel in Rosenfeld brought the Flexible Products Co. decision to the attention of the Rosenfeld panel, suggesting that its opinion be modified so that it would not conflict with Flexible Products Co. The Rosenfeld panel rejected that suggestion, arguing that the cases were factually distinguishable and strongly adhering to its original position. The conflict, however, is in the pure statements of law in these two decisions, so factual distinctions are, in the author's judgment, irrelevant. The panel's supplemental opinion on rehearing stated:

> Appellee Mary K. Rosenfeld has also suggested to this Court that we ought to revise Division 7 of our opinion, in which we address a jury charge regarding a corporate officer's fiduciary duty towards the corporation and its shareholders. OCGA § 14-2-842 (a) (2) sets forth this duty statutorily as requiring an officer to exercise "the care an ordinarily prudent person in like position would exercise under similar circumstances." Citing *Flexible Products Co. v. Ervast*, the wife argues that the standard of care is not ordinary diligence and that an officer need only act in good faith to avoid liability.
>
> This is inaccurate. OCGA § 14-2-842 (a), which governs, requires that to avoid liability, an officer must act in good faith ("[i]n a manner he believes in good faith to be in the best interests of the corporation") *and* with due care ("[w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances"). See *Parks v. Multimedia Technologies*. As we state in our opinion above, this due care is in all material respects identical to the ordinary diligence defined in OCGA § 51-1-2 ("ordinary diligence is that degree of care which is exercised by ordinarily prudent persons under the same or similar circumstances"). *Flexible Products*, supra, is distinguishable on its facts and is inapplicable. Accordingly, the appellee's suggestion to revise the opinion is also denied.

(Internal footnotes omitted.)

Because the Rosenfeld opinion was not unanimous, it is physical precedent only. Rule 33(a), Rules of the Court of Appeals of Georgia. The panel's adamant unwillingness to defer to another panel's binding precedent, however, indicates that there are judges in the Court of Appeals who strongly support a simple negligence standard and would be prepared to do so if the issue were presented en banc there. The statutory definitions and equations involving ordinary prudence, diligence, care and negligence in § 51-1-2 were not considered in Flexible Products Co.

The standard of care required of officers and directors is a pervasive issue that affects every single Georgia business corporation and every aspect of its management in every area of its business and affairs. It is not merely an abstract matter of corporate governance and accountability, but an issue of very practical significance. Simply put, if the standard of care is ordinary negligence, corporate officers and directors would be more likely to be held personally liable for losses that the corporation or its shareholders suffer.

A petition for certiorari in Rosenfeld to the Georgia Supreme Court was denied on September 10, 2007, leaving the conflict between Rosenfeld and Flexible Products Co. unresolved, but with the Flexible Products Co. under the Court of Appeals' rules the only binding one, at least for the present.

2. Business Judgment Rule, Principal Place of Business and Georgia Securities Fraud: *TSG Water Resources, Inc. v. D'Alba & Donovan, Certified Publ. Accountants, P.C.*, 2007 WL 4455386 (11th Cir., Dec. 20, 2007)

In an unpublished decision, the United States Court of Appeals for the Eleventh Circuit in TSG Water Resources, Inc. v. D'Alba & Donovan, Certified Pub. Accountants, P.C., 2007 WL 4455386 (11th Cir., Dec. 20, 2007) (not published in the Federal Reporter) addressed application of the business judgment rule to a Georgia corporate officer, along with other issues of interest –

(continued…)

for actions occurring after July 1, 1987. See cmt. (i) to § 14-2-152.1.

the test for corporate citizenship for diversity jurisdiction, and issues of reasonable reliance and scienter for common law fraud and fraud under the Georgia securities laws.[8]

In TSG, a Georgia corporation and certain of its investors sued its chief financial officer and auditing firm for errors in financial statements that allegedly caused the board of directors to believe that the corporation's business model was working and that cash flow problems were temporary. As a result, the board failed to take prompt remedial action, and both inside and outside investors made additional investments in the corporation. The plaintiffs asserted claims for breach of fiduciary duty, common law fraud, Georgia securities fraud, and breach of contract against both defendants and professional liability and negligence claims against the auditor.

The District Court granted summary judgment to the CFO on all claims and granted the auditing firm's motion for summary judgment as to all but the professional liability claims. The District Court set aside a jury verdict against the auditor based on an exculpatory clause in its engagement agreement. The 11th Circuit reversed the CFO's summary judgment, but affirmed the judgments in favor of the auditor.

In addressing diversity jurisdiction, the Court reviewed the "total activities test" followed by the 11th Circuit in determining the state in which a corporation's principal place of business is located, which, along with the state of incorporation, is a state in which a corporation is held to be a citizen. The "total activities test" entails a "somewhat subjective" comparison by the district court of the results of (i) a "place of activities" analysis, i.e., the location of most of the corporation's production and sales and (ii) the identification of its "nerve center," i.e., its corporate offices. The Court upheld the District Court's finding that the corporation's principal place of business was in Georgia.

On the breach of fiduciary duty claim, the District Court found that the CFO was entitled to rely on the auditor and was protected by the business judgment rule. The Appellate Court reversed, holding that the fact that the CFO consulted with outside experts was not by itself dispositive and that material issues of fact existed both as to his reliance on the auditor and as to whether he "abused his discretion" or acted in bad faith in failing to disclose the accounting errors to the Board after they came to light.

The District Court also granted summary judgment to both defendants on the common law fraud and securities fraud claims,[9] finding that there was no evidence of justifiable reliance, intent, or proximate cause.[10] The Court of Appeals reversed as to the CFO, holding that material issues of fact remained as to all three factors. The Court differentiated between scienter for common law fraud and under the Georgia securities laws, finding that common law fraud required an affirmative intent to deceive, while severe recklessness would suffice for scienter under the Georgia securities laws.

3. Breach of Fiduciary Duty – Competition and Corporate Opportunity: *Impreglon, Inc. v. Newco Enterprises, Inc., and W. Curt Jarrell,* 2007 WL 1020834 (N.D. Ga., March 30, 2007); *Lou Robustelli Mktg. Servs., Inc. v. Robustelli,* 286 Ga. App. 816, 650 S.E.2d 326, (2007); *Hilb, Rogal & Hamilton Co. of Atlanta, Inc. v. Holley,* 284 Ga. App. 591, 644 S.E.2d 862 (2007)

In three decisions in 2007, the courts addressed corporate fiduciary duties in the litigation involving claims of misappropriation of corporate opportunities and confidential business information by departing personnel.

In Impreglon, Inc. v. Newco Enterprises, Inc. and W. Curt Jarrell, 2007 WL 1020834 (N.D. Ga., March 30, 2007), Impreglon, a Georgia corporation, sued Newco Enterprises and its employee, Curt Jarrell, for breach of fiduciary duty. Newco was a significant customer of Impreglon, and Jarrell was formerly Impreglon's President and CEO. While still employed by Impreglon, Jarrell discussed with Newco the possibility of joining Newco, formed a company of his own that would compete with

[8] Under F.R. App. P 32.1(a), the U.S. Courts of Appeal cannot restrict the citation of unpublished decisions that are issued after January 1, 2007. Eleventh Circuit Local Rule 36-2 states that "[u]npublished opinions are not considered binding precedent, but they may be cited as persuasive authority."

[9] The Court did not mention the Georgia Securities Act of 1973 by name or cite any specific provision of the Act.

[10] The Court relied on GCA Strategic Inv. Fund v. Joseph Charles & Assocs., ___ Ga. App. ___, 537 S.E.2d 677 (2000) in holding that "Georgia securities fraud claims" require scienter, proximate cause and the exercise of due diligence by the plaintiff. See also Keogler v. Krasnoff, 268 Ga. App. 250, 601 S.E.2d 788 (2004).

Impreglon, and obtained written assurances from Newco that his new company, instead of Impreglon, would receive Newco's business upon his leaving Impreglon.[11]

Impreglon filed a motion for summary judgment as to liability, which the Court granted in part. The Court noted that fiduciary obligations do not serve as an "absolute bar" to competition between an officer and corporation (citing Gresham & Associates, Inc. v. Strainese, 265 Ga. App. 559, 595 S.E. 2d 82, 84 (2004)), and merely planning to enter a competing business is not a breach of fiduciary duty. The Defendant's extensive negotiations with Newco regarding his employment, incorporation of a new company to compete with Impreglon, and his extensive discussion of various lease options were "mere preparation for competition," that did not rise to the level of a breach of fiduciary duty. However, his attempts to secure the business of Impreglon's customers during his employment with Impreglon constituted a breach of Mr. Jarrell's fiduciary duty as a matter of law.

Similarly, the Lou Robustelli Mktg. Servs., Inc. v. Robustelli, 286 Ga. App. 816, 650 S.E.2d 326 (2007), the Georgia Court of Appeals held that a former employee of a family business, who served as president, owed and violated fiduciary duties to the company upon resigning, but that the former employee's wife, who only performed clerical work for the company and was not an officer, director or agent of the company, did not.

The defendants worked for a Georgia affiliate of a Connecticut-based family company. The husband served as president of the affiliate corporation and the wife performing clerical work for the business, but was neither an officer, director nor agent of the company. They were alleged to have converted funds and taken a customer list on leaving the company.

The Georgia Court of Appeals upheld the jury's verdict that the husband had breached his fiduciary duties and converted company property. The Court also upheld the jury's verdict against wife for conversion. However, it reversed the verdict against her for breach of fiduciary duty because she was not an officer, director, or agent of the company. The Court determined she was not an agent because she lacked the authority to create binding obligations on behalf of the company by contracting with third parties.

In Hilb, Rogal & Hamilton Co. of Atlanta, Inc. v. Holley, 284 Ga. App. 591, 644 S.E.2d 862 (2007), the Georgia Court of Appeals held that material issues of fact existed as to whether a corporate vice president owed a fiduciary duty to a former employer and whether he breached that duty and a duty of loyalty by failing to tell the employer of an acquisition opportunity and disclosing it to a competitor instead. As its sole legal authority, the Court cited Tronitec, Inc. v. Shealy, 249 Ga. App. 442, 452(8), 547 S.E.2d 749 (2001), overruled on other grounds, Williams Gen. Corp. v. Stone, 279 Ga. 428, 614 S.E.2d 758 (2005), a decision holding that at-will employees could have fiduciary duties if they have the power to bind the corporation. While not stated in the opinion, the inescapable implication of the decision is that officer status does not necessarily carry with it fiduciary duties and that the touchstone is the same for agency, namely, whether the officer has authority to bind the corporation.

Contracting authority understandable should carry with it fiduciary duties, but that is only one of the responsibilities with which corporate officers may be entrusted. To focus narrowly on contracting authority or even decision-making power, in the author's opinion, would be to ignore other critical functions, e.g., advisory, custodial or supervisory roles, in which corporations must place trust and confidence in their officers.

4. Representative Capacities and Individual Liabilities: *Keane v. Annice Heygood Trevitt Support Trust,* 285 Ga. App. 155, 645 S.E.2d 641 (2007); *Clay v. Oxendine,* 285 Ga. App. 50, 645 S.E.2d 553 (2007)

In Keane v. Annice Heygood Trevitt Support Trust, 285 Ga. App. 155, 645 S.E.2d 641 (2007), the Georgia Court of Appeals held that a guarantor of a corporate debt cannot sign the guarantee agreement in a "representative capacity" as a shareholder or director of the corporation.

Keane, a shareholder and director of DQDAL, Inc., signed a guarantee of a promissory note in which Keane promised to pay DQDAL's obligations to the plaintiff Trust in the event that DQDAL failed to do so. The Trust filed suit when Keane did not honor the guaranty.

Keane argued that he was not personally liable under the Guaranty because he signed it in a representative capacity as (1) a shareholder of DQDAL, and alternatively, (2) a director of the corporation. The Court of Appeals upheld the trial court's grant of summary judgment for the Trust, rejecting both of Keane's arguments. First, the court of appeals rejected Keane's argument that

[11] Jarrell's plans to conduct business through his own company fell through and he went to work for Newco instead.

he signed the guaranty in his capacity as a shareholder, expressing doubts that any contract can be signed "by one in the lone capacity of a shareholder." Second, the Court rejected Keane's argument that he signed the guaranty in his capacity as a director, reasoning that the guaranty would be rendered worthless if Keane signed it as a director, because the corporation was already liable for the debt under the promissory note and would be guaranteeing its own indebtedness.

In Clay v. Oxendine, 285 Ga. App. 50, 645 S.E.2d 553 (2007), the Georgia Court of Appeals held that a cash advance business' "sale/leaseback" program violated the Georgia anti-payday lending statute and the Georgia Industrial Loan Act, and held the corporate officers personally liable for participating in the program's activities. It rejected the officers' arguments that their conduct constituted the actions of the corporation for which they should not be held personally liable.

John Oxendine, the Industrial Loan Commissioner for the State of Georgia, sued several individuals and corporations for alleged violations of the anti-payday lending statute, O.C.G.A. § 16-17-1, and the Georgia Industrial Loan Act, O.C.G.A. § 7-3-1. A 2002 state investigation that found that the defendants were engaging in illegal payday lending. In response to a change in the law in 2004, the defendants began engaging in "sale/leaseback" transactions with their customers. The Court determined that the "sale/leaseback" program was in fact a sham to disguise an illegal payday loan scheme.

The Court held that the individual defendants "took part in, specifically directed, participated or cooperated in the payday lending activities." Id. at 58, 645 S.E.2d at 559. The Court rejected the individual defendants' efforts to shield themselves from liability by claiming that their acts were acts of the corporations and not their own personal actions. It determined that they were personally liable for liable for the payday lending violations because they controlled and dominated the corporations.

5. Executive Compensation and Agreements: *Hinely v. Alliance Metals, Inc. of Atlanta,* 285 Ga. App. 230, 645 S.E.2d 584 (2007)

In Hinely v. Alliance Metals, Inc. of Atlanta, 285 Ga. App. 230, 645 S.E.2d 584 (2007), a case involving parallel state and federal proceedings, the Georgia Court of Appeals addressed claims that a company founder and president asserted against his former employer and its acquirer for allegedly breaching his employment agreement by engaging in illegal price-fixing in violation of federal antitrust laws. The executive claimed that the illegal conduct prevented him from performing his duties without participating in the wrongdoing. He notified the United States Justice Department, and the owner of the acquiring company eventually pleaded guilty to criminal antitrust violations. After experiencing an allegedly retaliatory reduction in his responsibilities, the plaintiff resigned and filed suit in the State Court of Fulton County for breach of contract, fraudulent inducement, tortious interference with a contract and breach of the implied covenant of good faith and fair dealing.

The former employer responded by filing suit in federal court claiming that the executive, after leaving the company, committed trademark violations and breached a non-competition agreement. The executive defended the federal claims based on the illegal conduct alleged in his state action which he argued barred the company from enforcing his employment contract. The federal courts held in favor of the former employer on both claims, Alliance Metals v. Hinely Indus., 1998 WL 34300554 (N.D. Ga., Feb. 19, 1998), aff'd, 222 F.3d 895 (11th Cir. 2000). Considering defenses of collateral estoppel and res judicata, the Georgia Court of Appeals found, however, that certain breach of contract issues could be re-litigated because the federal courts' ruling was reached in a preliminary injunction order, not in a final judgment. Res judicata did not apply because the plaintiff had filed his state court action first and he had only raised the breach of contract claim in the federal case as a voluntary defense and not a compulsory counterclaim.

Claims dealing with calculations of incentive compensation, however, were barred by the plaintiff's failure to submit them to arbitration as the employment contract required. The trial court rejected the executive's pivotal argument that the former employer breached the employment contract by engaging in the alleged illegal scheme; it held that the plaintiff could have continued to perform his job without violating the law and also held that the employment contract itself was not illegal and void. The Court of Appeals noted these rulings, but did not express agreement or disagreement.

6. Contract, Authority and Agency Issues: *McKenna v. Capital Res. Partners, IV, L.P.,* 286 Ga. App. 828, 650 S.E.2d 580 (2007); *Huffman v. Armenia,* 284 Ga. App. 822, 645 S.E.2d 23 (2007)

In McKenna v. Capital Res. Partners, IV, L.P., 286 Ga. App. 828, 650 S.E.2d 580 (2007), a private equity dispute, the Georgia Court of Appeals reversed a summary judgment entered against the plaintiff minority shareholders of Loyaltyworks, Inc., a Georgia corporation, who were seeking to enforce an alleged oral agreement with the majority shareholder to purchase their shares. The Court found that there were issues of material fact regarding whether a representative of Loyaltyworks' majority shareholder had apparent authority to bind the corporation to the transaction which required Loyaltyworks to cancel a promissory note owed by one of the minority shareholders, when Loyaltyworks' board of directors had never approved the cancellation. The

Court also found that there were issues of material fact as to (a) whether the majority shareholder had entered into a binding agreement to purchase the minority shares when a letter beginning the negotiations expressly conditioned the enforceability of any deal on the execution of a written agreement, and (b) whether the changes requested by minority shareholders' counsel to a draft of the stock purchase contract were material changes indicating the lack of agreement on essential terms.

When the majority shareholder decided to back out of the deal, the minority shareholders sued to enforce the alleged oral agreement to sell their shares and to cancel the shareholder note. Loyaltyworks denied that it had agreed to the settlement or that the majority shareholder's representative had authority to bind it to the oral agreement. It counterclaimed on the promissory note, arguing that it had never agreed to cancel it.

The Georgia Court of Appeals found material issues of fact as to whether the stock purchase agreement was contingent on executing a written agreement, and if not, whether the parties had a binding oral agreement that contained all material terms. The Court also found a dispute as to whether the majority shareholder's representative had authority to bind Loyaltyworks or to speak for Loyaltyworks board of directors of based on his position as a managing partner of the majority shareholder. With respect to cancellation of the shareholder note the Court stated, "That the board never actually voted on the issue is not dispositive, especially as Jenks changed his mind about buying the plaintiffs' stock." This statement necessarily implies that the majority shareholder's representative could have bound Loyaltyworks, without board approval, to cancel the note. Compare O.C.G.A. § 14-2-621(b) and -(c) (board may authorize acceptance of notes as consideration for issuance of stock, but must determine that consideration is adequate).

In Huffman v. Armenia, 284 Ga. App. 822, 645 S.E.2d 23 (2007), the Court of Appeals affirmed civil contempt citations against a corporate president, where the president attempted to thwart a temporary restraining order and receivership appointment obtained by minority shareholders by his pro se filing of a bankruptcy petition on behalf of the corporation that had not been authorized in advance by the corporation's board of directors. The Court noted that the president as a non-lawyer "lacked the capacity" to file the bankruptcy petition on behalf of the corporation. The Court rejected the argument that any order barring access to federal bankruptcy proceedings is invalid because the TRO did not prevent any authorized party from pursuing bankruptcy protection and because the president's filing had been improper and unauthorized.

7. Shareholder Buy-Sell Agreement Valuation Issue: *Barton v. Barton,* 281 Ga. 565, 639 S.E. 2d 481 (2007)

In Barton v. Barton, 281 Ga. 565, 639 S.E. 2d 481 (2007), the Georgia Supreme Court, in a matter of first impression, addressed the issue of whether in valuing the stock of a closely-held corporation for purposes of dividing marital property, the Court is bound by the value established in a buy-sell provision of a shareholder agreement.

In Barton, the trial court had adopted the decision of an arbitrator dividing the marital assets. The husband appealed, claiming error in the division of marital property, specifically his 50% interest in a closely-held corporation. The buy-sell provision of the stockholder agreement provided that in the event of any of the triggering events, the other shareholder had the right to purchase the husband's stock at a price to be determined by a formula. Under the formula, the stock would have been valued at $342,000. However, the arbitrator valued the stock at $508,000 based on a fair market valuation. The Supreme Court affirmed the trial court's decision to adopt the Arbitrator's decision. The Court recognized the split of authority in other states on the issue. It adopted the majority view that the value established in the buy-sell agreement of a closely-held corporation is not binding on the non-shareholder spouse who has not signed the buy-sell agreement.

8. Direct versus Derivative Actions and Exclusivity of Appraisal Remedy under Delaware Law: *Suzie Schutt Irrevocable Family Trust v. NAC Holding, Inc.*, 283 Ga. App. 834, 642 S.E.2d 872 (2007); *Fansler Foundation v. American Realty Investors, Inc.*, 2007 WL 2695630 (E.D. Cal., Sept. 11, 2007)

In Suzie Schutt Irrevocable Family Trust v. NAC Holding, Inc., 283 Ga. App. 834, 642 S.E.2d 872 (2007), the Georgia Court of Appeals held that a shareholder's sole remedy under section 253 of the Delaware General Corporation Law, the short-form merger statute, is an appraisal hearing before the Delaware Court of Chancery.

Delaware's short-form merger statute allows a parent corporation to merge with one of its subsidiaries without shareholder approval where the parent owns at least 90% of the subsidiary's stock. The defendant shareholders in the present case owned 99.76% of NAC Holding, Inc.'s ("NAC") stock. They effected a section 253 merger of NAC with its parent corporation, El Dorado, offering NAC's minority shareholders one cent per share. The minority shareholders filed a motion to enjoin the merger, but the trial court denied the request because the shareholders' "core concern" was their dissatisfaction with the amount NAC offered for each share.

The Georgia Court of Appeals affirmed the trial court's decision, holding that, pursuant to section 253(d), the shareholders had only one remedy: an appraisal hearing before the Delaware Court of Chancery. Further, the shareholders' failure to seek an appraisal hearing in the method prescribed by the Delaware General Corporation Law and their lack of standing to assert either direct or derivative claims against NAC left them without any remedy. *See* DEL. CODE. ANN. tit. 8, § 262 (2007). The part of the Court's ruling on exclusivity of Delaware Chancery Court jurisdiction may be erroneous, however, since the statute can be read merely to require that within Delaware, the Chancery Court, rather than the Superior Court, has jurisdiction over an appraisal proceeding.

A California federal district court in Fansler Foundation v. American Realty Investors, Inc., 2007 WL 2695630 (E.D. Cal., Sept. 11, 2007), denied a motion for partial summary judgment based on the defendants' efforts to characterize the plaintiffs' claims as dissenters' claims for fair value. Plaintiff was a non-profit charitable foundation that sold its interest in four hotel properties to American Realty Trust ("ART") in exchange for cash and convertible preferred Series F stock of ART. In 1999, ART merged with an affiliate through the creation of a holding company, American Realty Investors, Inc. ("ARI"). The Plaintiff foundation eventually approved the merger and received Series A convertible, preferred stock of ARI in exchange for its existing ART preferred stock. When ARI began to delay making the required dividend payments, the foundation sued, alleging that it was fraudulently induced to approve the merger by ARI's promise to list the ARI Series A shares on the New York Stock Exchange. ARI defended, arguing that the suit was merely Plaintiff's belated attempt to exercise its dissenters' rights to receive "fair value" for a merger that had already happened, in violation of the 3-year statute of limitations in O.C.G.A. § 14-2-1332. The Court held that the "gravamen" of the suit was in reality an action for fraudulently inducing the foundation *not* to exercise its rights. The Court went on to note that even if the "gravamen" of the suit were the exercise of dissenters' rights, it was not barred under Georgia law because the Plaintiffs had set forth facts evidencing that its approval of the merger was procured through fraud.

9. Nonprofit Corporation Board Election: *Nyugen v. Tran*, 287 Ga. App. 888, 652 S.E.2d 881 (2007)

The Georgia Court of Appeals in Nyugen v. Tran, 287 Ga. App. 888, 652 S.E.2d 881 (2007) provisionally upheld the validity of an election of a board of directors by the membership of a Georgia nonprofit corporation where, at the time of the election, the corporation lacked officers, directors and bylaws through which a meeting of the membership could be called. The case involved a battle for control over a Buddhist temple. The faction in control had held a meeting of the congregation at which a meeting of members was scheduled. They provided notice of the meeting to the temple's entire membership. A majority of the membership attended the meeting and unanimously elected the faction leaders as the new Board. The trial court found the meeting and election to have been validly conducted and entered an interlocutory injunction barring the insurgent faction's representatives from holding themselves out as authorized to act for the temple. The Court of Appeals reviewed the provisions of the Georgia Nonprofit Corporation Code requiring an annual meeting, O.C.G.A. § 14-3-701, and the provisions for calling special meetings of members, O.C.G.A. § 14-3-702. The Court noted that there was no express statutory procedure for members to call a meeting unless authorized by the bylaws or unless a written demand is delivered to a corporate officer – neither of which conditions existed at the time the meeting was called. Finding the notice of the meeting to be adequate and noting the attendance by a majority of members and the unanimity of the election, the Court of Appeals upheld the validity of the election for purposes of the interlocutory injunction, pointing out that the decision was not final.

10. Administrative Dissolution: *Foster v. Clayton County Judicial Circuit of the State of Georgia, et al.*, 2007 WL 569851 (N.D. Ga., February 20, 2007); *Williams v. Martin Lakes Condominium Association, Inc.*, 284 Ga. App. 569, 644 S.E.2d 424 (2007)

In Foster v. Clayton County Judicial Circuit of the State of Georgia, et al., 2007 WL 569851 (N.D. Ga., February 20, 2007), the United States District Court for the Northern District of Georgia denied relief against an administratively dissolved corporation because under Georgia law it could only conduct business activities that are necessary to wind up and liquidate its business and affairs. O.C.G.A. § 14-2-1421(c).[12]

[12] "A corporation administratively dissolved continues its corporate existence but may not carry on any business except that necessary to wind up and liquidate its business and affairs under Code Section 14-2-1405. Winding up the business of a corporation administratively dissolved may include the corporation's proceeding, at any time after the effective date of the administrative dissolution, (1) in accordance with Code Section 14-2-1406 to notify known claimants, and (2) to mail or deliver, with accompanying payment of the cost of publication, a notice containing the information specified in subsection (b) of Code Section 14-2-1407 for publication in accordance with subsection (b) of Code Section 14-2-1403.1. Upon such notice, claims against the administratively dissolved corporation will be limited as specified in Code Sections 14-2-1406 and 14-2-1407, respectively."

The plaintiff, a convicted prisoner, sued Center for Prisoners' Legal Assistance, P.C. ("CPLA"), an administratively dissolved Georgia corporation, to obtain assistance in overturning his conviction. CPLA failed to answer the complaint and default was entered against it. The plaintiff asked the Court to enter a default judgment ordering CPLA 1) to hire counsel on his behalf to defend him in a yet-to-be-filed state habeas corpus action, and 2) to pay all costs associated with that action and his criminal appeal pending in the 11th Circuit. The Court rejected the plaintiff's request because, as an administratively dissolved corporation, CPLA was barred by O.C.G.A. § 14-2-1421 from performing the services that the Plaintiff asked the Court to order.

Although not expressly stated in the opinion, the necessary implication of the ruling is that the relief requested was not in furtherance of winding up and liquidating the corporation and thus fell outside the limited scope of the business which an administratively dissolved corporation is permitted to conduct.

In Williams v. Martin Lakes Condominium Association, Inc., 284 Ga. App. 569, 644 S.E.2d 424 (2007), the Georgia Court of Appeals, in what it denoted a matter of first impression, addressed the issue of whether a nonprofit corporation that has been administratively dissolved, but later reinstated, has the capacity to bring legal action during the period of its dissolution.

In Georgia, a nonprofit corporation can be administratively dissolved by the Secretary of State pursuant to O.C.G.A. § 14-3-1421. The most common reason for administrative dissolution is the corporation's failure to file its annual report with the Secretary of State. The corporation can file for reinstatement by following the procedures set out in O.C.G.A. § 14-3-1422. There is no time limit on the period during which a dissolved corporation can apply for reinstatement. O.C.G.A. § 14-3-1422(d) provides:

> "When the reinstatement is effective, it relates back to and takes effect as of the effective date of the administrative dissolution and the corporation resumes carrying on its business as if the administrative dissolution had never occurred."

In Williams, Martin Lakes Condominium Association, Inc. ("Martin Lakes") was administratively dissolved in 1993, but its corporate charter was reinstated in 2000. In 1999, Martin Lakes filed suit against Williams, a condominium owner, to recover past-due fees and assessments. Williams argued that Martin Lakes did not have the legal capacity to bring legal action in 1999 because the corporation was dissolved at that time.

The Court of Appeals disagreed, stating that reinstatement of an administratively dissolved corporation validates the corporation's existence and privileges back to the date of the dissolution. Thus, under Georgia law, a reinstated corporation effectively does have the capacity to bring legal action during the period of time between its dissolution and reinstatement, no matter how long that period lasts.

The Georgia Business Corporation Code provisions for reinstatement of administratively dissolved corporations in O.C.G.A. § 14-2-1422 are identical with those of the Georgia Nonprofit Corporation Code, so it is likely that this decision will be considered as authority in interpreting § 14-2-1422.

11. Service of Process under O.C.G.A. § 14-2-504: *B&B Quick Lube, Inc. v. G&K Services Company,* 283 Ga. App. 299, 641 S.E.2d 198 (2007)

In B&B Quick Lube, Inc. v. G&K Services Company, 283 Ga. App. 299, 641 S.E.2d 198 (2007), the Georgia Court of Appeals upheld service of process under O.C.G.A. § 14-2-504, the special statutory provision in the Georgia Business Corporation Code for service of process on corporations, as an alternative to O.C.G.A. § 9-11-4, the Georgia Civil Practice Act's rule on service of process.

G&K Services Company sued B&B Quick Lube, Incorporated for breach of contract. G&K employed the Fulton County Sheriff to serve process on B&B's registered agent at the address listed with the Secretary of State. The Sheriff unsuccessfully attempted service on B&B three times at that address. G&K proceeded to mail copies of the complaint via certified mail to B&B at the same address and thereafter obtained confirmation that the package had been received.

B&B failed to respond to the complaint, and G&K obtained default judgment. B&B appealed the default judgment arguing that service of process was ineffective in two ways: (1) G&K did not act with reasonable diligence in attempting to serve B&B's registered agent, and (2) an employee, rather than a corporate officer, received the complaint when it was mailed to B&B.

The Court of Appeals disagreed with B&B, holding that process was sufficient pursuant to O.C.G.A. § 14-2-504. Section 14-2-504, the Georgia Business Corporation Code's service of process statute, is an alternative to O.C.G.A. § 9-11-4, the Civil Practice Act's service of process statute. Typically, plaintiffs serve process on a Georgia corporation pursuant to O.C.G.A. § 9-11-

4(e)(1), under which a plaintiff must serve process on the president or an officer, secretary, managing agent, cashier or other agent of the corporation. If such service cannot be effected, O.C.G.A. § 9-11-4(e)(1) provides that the Secretary of State is the corporation's agent for service of process. By contrast, O.C.G.A. § 14-2-504(b) authorizes service of process via registered, certified, or statutory overnight mail where a Georgia corporation does not have a registered agent or where the plaintiff, after exercising reasonable diligence, cannot serve the corporation at its listed address. O.C.G.A. § 14-2-504 provides an alternative, permissible way to serve process on a Georgia corporation.

The Court of Appeals in B&B held that G&K's three service attempts at B&B's listed address constituted "reasonable diligence" under O.C.G.A. § 14-2-504(b). The Court further held that under O.C.G.A. § 14-2-504(b), statutorily mailed service is effective even when received by an employee because this statute does not require receipt by a registered agent or a corporate officer.

12. Disputes over Stock Ownership or Investments. *Wright v. AFLAC, Inc.*, 283 Ga. App. 890, 643 S.E.2d 233 (2007)

In Wright v. AFLAC, Inc., 283 Ga. App. 890, 643 S.E.2d 233 (2007), the Georgia Court of Appeals addressed the evidentiary requirements of proving stock ownership where the stock has been transformed over time due to changes in entity control.

The plaintiffs brought action against AFLAC, Inc., claiming that stock they purchased from a salesman in 1957 had transformed, over the years, into AFLAC stock. The Wrights testified that they "believed" their stock was now AFLAC stock because a friend, who had purchased stock from the same salesman in the 1950s, informed them that her stock had been converted into AFLAC stock. The Georgia Court of Appeals upheld the trial court's grant of summary judgment for AFLAC, because the Wrights' mere "speculation" was not sufficient to create a triable issue on whether the stock they purchased in 1957 had been transformed into AFLAC stock.

The significance of the Wright decision is that, if the Wrights had presented evidence sufficient to create an issue of fact, AFLAC would then have had the burden to prove that the Wrights' stock had not transformed into AFLAC stock. Georgia statutory law places an affirmative duty on corporations to maintain stock ownership records in an appropriate manner; the records must be maintained in "a form that permits preparation of a list of the names and addresses of all shareholders, in alphabetical order by class of shares showing the number and class of shares held by each." O.C.G.A. § 14-2-1601(c).

B. PARTNERSHIPS.

13. Limited Partner Remedies for General Partner's Misappropriation of Partnership Property: *Bloomfield v. Bloomfield,* 282 Ga. 108, 646 S.E.2d 207 (2007)

Bloomfield v. Bloomfield, 282 Ga. 108, 646 S.E.2d 207 (2007). In this divorce action, the Supreme Court of Georgia found that trusts established for the benefit of the parties' three children were inappropriately awarded direct ownership interests in real property transferred out of a family limited partnership in which the trusts were limited partners. The children's trusts were entitled to cash compensation for the value of the property, instead.

The wife's father originally purchased a Ponte Vedra home and placed it into a family limited partnership as the partnership's sole asset. The wife's father then gave limited partnership interests to the wife, her siblings and trusts for the benefit of her children. The wife's father also gave his 1% controlling interest as general partner of the partnership to the husband. Husband and wife bought out the limited partnership interests of the wife's siblings, but not the interests of their children's trusts. The husband later transferred the property into the couple's names jointly, without paying the partnership for the property. The husband admitted in his testimony that his children's trust should be compensated for their partnership interest. The trial court awarded the trusts a pro rata interest in the transferred property.

The Court began by noting that under O.C.G.A. § 14-9-701, the limited partnership interests were personal property and did not convey a direct interest in the assets of the partnership. The partnership documents stated that "[n]o partner shall have the right to demand property other than cash in return for his contribution to the partnership," which is in accordance with O.C.G.A. § 14-9-605. The partnership agreement also provided that upon sale or transfers of the real property interest, limited partners were entitled to the proceeds. The Court found that under both the Georgia statute and the partnership agreement, the children's trusts are entitled to cash compensation, not an ownership interest in the transferred real property. There did not appear to be any question about whether the husband was able to pay the partnership for the value of the property. Perhaps for that reason, the

Court did not consider the question of whether the trial court in an appropriate case could grant specific equitable relief with regard to the property.

14. Breach of Fiduciary Duty in Purchase of Limited Partnership Interest: *French v. Sellers*, 2007 WL 891306 (M.D. Ga., Mar. 21, 2007)

In French v. Sellers, 2007 WL 891306 (M.D. Ga., Mar. 21, 2007), the United States District Court for the Middle District of Georgia denied summary judgment to a general partner and majority interest-holder of a limited liability limited partnership on claims of breach of fiduciary duty and fraud, finding that there were issues of material fact as to whether the general partner had made material misrepresentations or omissions in connection with his purchase of a limited partnership unit for $15,000 when he was currently in negotiations to sell the limited partnership for what eventually amounted to $180,000 per limited partnership unit.

Barry Sellers was the general partner and majority interest holder in Wilkinson Kaolin Associates, LLP ("WKA").[13] In 1982, he sold a one-unit limited partnership interest to Flora French for $32,500. Between 1982 and 2002, Sellers sent information to French and other investors that "painted a decidedly mixed picture" of the partnership's finances, both in the past and with regard to future prospects.

Beginning in 2001, Sellers was interested in expanding or selling WKA, and he hired an investment banker to evaluate the value of the business. He obtained a valuation and offered the business for sale in early 2002 and had received two offers by August of 2002 to purchase the business for between $10 million and $14 million. In November of 2002, French, who knew nothing of Sellers' plans for the business, decided to sell her partnership unit. She had her husband call Sellers to discuss the feasibility of a sale. Sellers allegedly told Mr. French that he was not sure whether there was any market for the unit. He did not mention anything about selling the business or the offers and later that day forwarded an "Assignment of Limited Partnership Unit" to French to sign. The agreement indicated that French was assigning her unit to Sellers' wife for $15,000. It also contained language indicating that Sellers had hired an investment banker to "examine the feasibility of partnership sale, expansion, or acquisition," that the parties had agreed that the $15,000 price was not necessarily indicative of the fair market value of the unit and that the unit "may in the future become more valuable."

Approximately one year after French sold her unit to Sellers' wife, Sellers sold WKA for $27,150,000. This amounted to approximately $180,000 per limited share. French sued, claiming, *inter alia*, securities fraud violating Rule 10b-5, material misrepresentation, fraud, and breach of fiduciary duty. The Court rejected arguments that the acknowledgements in the assignment agreement rendered the information regarding the Sellers' efforts to sell the business and the offers he had received immaterial. The Court held that there were issues of material fact as to whether Sellers' nondisclosures misled French as to the value of her unit and its marketability.

15. Partnership Buy-Sell Agreements Bankruptcy: *In re Newlin*, 370 B.R. 870 (Bankr. M.D. Ga., June 29, 2007)

In In re Newlin, 370 B.R. 870 (Bankr. M.D. Ga., June 29, 2007), the Bankruptcy Court for the Middle District of Georgia held that a trustee who did not act to assume a partnership agreement within the sixty-day period set by the Bankruptcy Code had no authority to force the debtor partner to withdraw from the partnership or to force the remaining partner to purchase the debtor partner's interest, finding that the mandatory purchase right was an executory portion of the contract.

The debtor in the bankruptcy case was a dentist, Dr. Newlin, who owned a one-half interest in a professional partnership, Newlin & Winchester Partners ("N&W"), a Georgia general partnership. Dr. Newlin had created the partnership by a written agreement with Dr. Winchester in 1999, when Dr. Newlin sold Dr. Winchester a one-half interest in his dental practice for $347,500. The withdrawal provision in the partnership agreement provided that when one partner issued a notice of withdrawal, the other partner had to purchase the withdrawing partner's interest in the partnership within between 180 and 240 days. The agreement contained a formula for calculating the amount to be paid.

In 2004, Dr. Newlin filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code, which was converted into a claim under Chapter 7 in 2006. In the Spring of 2006, the trustee sent a letter to Dr. Winchester purporting to withdraw Dr. Newlin from the partnership and attempting to force Dr. Winchester to purchase Dr. Newlin's interest. Dr. Newlin strongly objected to this action and threatened the trustee with litigation. Eventually, the trustee and Dr. Newlin entered into an agreement

[13] WKA was probably converted to a limited liability limited partnership after the enactment of O.C.G.A. §§ 14-8-62, *et seq.* in 1997, authorizing LLLP elections.

that Dr. Newlin himself would purchase the interest from the bankruptcy estate for $35,000. A creditor of the estate, Columbus Bank & Trust Co. ("CB&T"), filed an objection to the trustee's motion to sell the partnership interest. The issue was whether the proposed sale was in the best interest of the estate. The Bankruptcy Court found that it was not.

A threshold question was whether the trustee had the authority to withdraw Dr. Newlin from the partnership and to require Dr. Winchester to follow the mandatory withdrawal "buy-out" as set forth in the partnership agreement. The Court first had to determine whether the partnership agreement was executory under the Bankruptcy Code. If a trustee does not assume an executory contract of the debtor within sixty days after the bankruptcy petition is filed, then the contract is deemed rejected. Here, the trustee did nothing to assume the partnership agreement within the sixty-day time frame.

A previous decision had held that partnerships should be viewed as a combination of property interests in the profits of the partnership and an executory contract with respect to the governance of the partnership. CB&T argued that the exercise of the mandatory purchase right did not relate to the management of the property, rather it was related to the sale of a property right. However, the Court held that it was subject to the executory contract limitations in the Bankruptcy Code because it was a right reserved to an acting partner in the partnership and was a managerial right. Because the mandatory withdrawal provision of the agreement was part of an executory contract, which the trustee did not assume, the trustee was not permitted to enforce that provision.

Since the trustee had no authority to either withdraw Dr. Newlin from the partnership or to compel Dr. Winchester to purchase Dr. Newlin's interest, the trustee instead had to prove that the sale to Dr. Newlin for $35,000 was in the best interest of the bankruptcy estate. Based on evidence that as late as 2004, Dr. Newlin had estimated the value of his interest in the partnership to be $500,000, the Court held that the trustee had not carried her burden of proving that the proposed sale to Dr. Newlin was in the best interests of the estate. Therefore, the Court sustained CB&T's objection to the trustee's motion to sell to Dr. Newlin.

16. Derivative Suits by Limited Partners in an ULPA Limited Partnership: *Hendry v. Wells*, 286 Ga. App. 774, 650 S.E.2d 338 (2007)

In Hendry v. Wells, 286 Ga. App. 774, 650 S.E.2d 338 (2007), the Georgia Court of Appeals held that limited partners in a limited partnership governed by the Uniform Limited Partnership Act ("ULPA"), O.C.G.A. §§ 14-9A-1, et seq. did not have standing to assert certain claims because they were derivative in nature.[14] The nature of the injury determines whether a claim by limited partners against the general partners is derivative or personal. Since the limited partners had not sought to sue derivatively, the Court did not decide whether ULPA, which does not contain a statutory derivative action provision, permits limited partners to sue derivatively.

Class B limited partners of a Georgia limited partnership sued the general partners and the partnership itself. The defendants argued that some of the claims were derivative in nature, not direct claims on which the limited partners could sue individually or as a class. The trial court concluded that the "special injury" rule that determines whether corporate shareholder claims are derivative or direct applies equally to limited partners attempting to bring a direct claim against a general partner. The Court of Appeals looked to various provisions of ULPA in deciding the issue, although the statute, unlike RULPA, does not contain provisions expressly authorizing derivative actions by limited partners.[15] The Court noted that limited partners have contract rights and that general partners owe fiduciary duties to limited partners. The Court examined the nature of injury claimed and the relief sought. It held that when the claim is one that would benefit the limited partners and not the partnership as a whole, then it is not a derivative claim and can be brought by the limited partners in their individual capacity.

The Court held that the limited partners could bring a claim against the general partners alleging that the general partners blocked the settlement of an earlier lawsuit which would have been yielded payments to the Class B limited partners. Because, as the Court viewed it, the limited partners and not the partnership suffered the resulting injury, that claim was not derivative in nature and the limited partners could bring the action directly. The Court held that the limited partners could also bring a claim

[14] Currently formed limited partnerships and older partnerships which have chosen to opt in are governed by the Revised Uniform Limited Partnership Act ("RULPA"), O.C.G.A. §§ 14-9-100, et seq.

[15] The Georgia Civil Practice Act does not contain a general provision for derivative actions similar to F.R. Civ. P. 23.1. When the Georgia Legislature revised Georgia's class action rules in 2003, it deleted former O.C.G.A. § 9-11-23(b), a derivative action provision referring to "shareholders" of incorporated and unincorporated "associations." Unlike the derivative provisions in the GBCC, the Nonprofit Corporation Code and LLC Code, both former Rule § 9-11-23(b) and currently RULPA permit commencement of a derivative action without a demand upon the managing directors, trustees or general partners if there is a basis for excusing it. Compare O.C.G.A. §§ 14-2-742, 14-3-742 and 14-11-801(2) with § 14-9-1001 and former § 9-11-23(b).

based on a 2002 consent solicitation and involving an injury to their right to receive compensation because it, too, was not an injury to the partnership itself and therefore not derivative. A third claim brought by the limited partners, based on a 2005 consent solicitation, involved the general partners' dishonoring a promise to waive outstanding management fees owed to an affiliate of the general partners, if a majority supported a partnership agreement amendment. The general partners claimed that the partnership agreement required unanimous consent of the Class A partners which prevented the arrangement from going forward. The Court held that this claim could not be brought by the limited partners directly because it involved a contractual relationship between the limited partnership and a third party, namely the management company affiliate. Therefore, any successful resolution would inure to the benefit of the entire partnership and hence the claim was derivative in nature.

However, the Court did not decide whether ULPA, which as noted lacks a statutory derivative action provision, actually permits limited partners to sue derivatively, since the limited partners did not purport to assert any claims derivatively. The Court also ruled on several statute of limitations issues of significance discussed below.[16]

17. Existence of Partnerships or Joint Ventures: *Ellison v. Hill*, ___ Ga. App. ___, 654 S.E.2d 158 (2007); *Optimum Techs., Inc. v. Henkel Consumer Adhesives, Inc.*, 496 F.3d 1231 (11th Cir. 2007)

Ellison v. Hill, ___ Ga. App. ___, 654 S.E.2d 158 (2007), ruled that it is not necessary to offer expert evidence of profitability in accordance with generally accepted accounting principles in order to establish a claim to a share of partnership profits. In that case, Darrell Ellison and Allen Hill formed a used car business, with Ellison providing the capital and Hill responsible for the day-to-day management of the business. Following Ellison's death, Hill presented a claim against his estate, claiming that the business had been a partnership and that he was entitled to one half of the profits. The estate moved for summary judgment, claiming that there were no profits to share. It filed affidavits from certified public accountants, who testified that they had examined and recast the balance sheet of the business in accordance with generally accepted accounting principles and found that the business had a negative equity.[17] Hill offered his own testimony as manager stating that internal and tax records showed the business to be operating profitably and having a positive net worth. The Georgia Court of Appeals rejected the estate's argument that Hill was required to offer expert testimony on the issue of the business's profitability or that profitability must be proved in accordance with GAAP. It held that Hill's familiarity as manager with records and accounts of the business entitled him to testify on personal knowledge, and that his testimony raised an issue of fact precluding summary judgment.

In Optimum Techs., Inc. v. Henkel Consumer Adhesives, Inc., 496 F.3d 1231 (11th Cir. 2007), the United States Court of Appeals for the Eleventh Circuit held that a duty to disclose material facts arises only when there is a confidential relationship, and because no confidential relationship existed between a manufacturer and distributor, the distributor was not liable for breach of fiduciary duty, breach of confidentiality, or fraudulent concealment. The Court rejected the plaintiff's claims that a partnership or joint venture existed between the parties.

Optimum Technologies, Inc. ("Optimum") was a closely-held family business that developed an adhesive product called "Lok-Lift" to prevent rugs from slipping on floors. In 1993, Henkel Consumer Adhesives, Inc. ("HCA") entered into an oral agreement with Optimum to market and distribute the Lok-Lift product to retailers. Under the agreement, HCA promised to purchase Lok-Lift from Optimum and was given the exclusive right to sell and distribute the product to retailers. Optimum and HCA worked together to design the packaging for the Lok-Lift product.

Several years after this agreement was made, HCA began to develop its own adhesive product similar to Lok-Lift called "Hold-It For Rugs". In 2002, HCA notified Optimum that it would be making changes to the Lok-Lift packaging and that Optimum should not order any more packaging without HCA's approval. In late 2002, HCA began shipping the Hold-It product to retailers in packaging similar to the Lok-Lift packaging and using the same UPC code, bar code and item number as the Lok-Lift product.

Optimum sued HCA for nine counts, including breach of fiduciary duty, breach of confidential relationship and fraudulent concealment. The district court held that there was no confidential relationship between HCA and Optimum, and, thus, there was no duty on HCA's part to disclose information related to its development and distribution of Hold-It. The court found

[16] The Court held that the limited partners' breach of fiduciary duty claims were governed by a 4-year statute of limitations and held that even though there is actionable fraud when a fiduciary fails to disclose material facts, the statute of limitations is not tolled by that fraud when the plaintiff has proper notice of information necessary to determine the truth. See below, Part E.

[17] The partnership business was run through a corporation, but the ownership of the corporation and the relationship between the two entities' finances are not explained.

there could be no fraudulent concealment without a confidential relationship, so it granted summary judgment to HCA on all three claims.

Optimum argued on appeal that there was a confidential relationship going beyond the manufacturer-distributor relationship, a relationship more in the nature of a joint venture or legal partnership. The Eleventh Circuit disagreed, finding that there was nothing more than an informal business agreement between the parties. There was no legal partnership because there was no profit-sharing agreement, nor did HCA have any right to control Optimum's business or vice versa. Because there was no confidential relationship, there was no fiduciary duty to disclose material information. Therefore, the district court's grant of summary judgment to HCA was proper.

18. Partnership Contract and Agency Issues. *Leevers v. Bilberry*, 2007 WL 315344 (M.D. Ga. Jan. 31, 2007); *Dalton Point, L.P. v. Regions Bank, Inc.*, 287 Ga. App. 468, 651 S.E.2d 549 (2007)

In Leevers v. Bilberry, 2007 WL 315344 (M.D. Ga. Jan. 31, 2007), the United States District Court for the Middle District of Georgia held that a company, which contracted to manage a partnership's property and which became the partnership's largest creditor, was not under agency principles bound by an arbitration clause contained in the partnership agreement and could not be compelled to participate in an arbitration proceeding between the partners.

John Leevers and Leonard Bilberry formed a partnership in 1997 called Foxchase Limited Liability Limited Partnership ("Foxchase"). The partnership agreement contained an arbitration clause for any disputes arising between the Partners. A few years earlier, the partners had personally purchased land that included a golf course constructed by Bilberry Golf, Inc. and after executing the partnership agreement, they transferred their personal interests in this property to Foxchase.

The partners contracted with Bilberry Golf to rebuild the golf course and to assume management of the property from 1996 to 2000. At the time, Leonard Bilberry was a 50% owner of Bilberry Golf, and his brother Lee owned the other half. Lee purchased his brother's interest in Bilberry Golf in 2000 and was thereafter Bilberry Golf's sole owner and President. During Bilberry Golf's management term, Foxchase was unprofitable and Bilberry Golf provided over $2 million in operating loans, causing it to become Foxchase's largest creditor. Leevers eventually sought to dissolve the Foxchase partnership and sought to submit the dispute to arbitration. Bilberry Golf was added as a party to the arbitration, but objected because it was not a party to the arbitration agreement.

Leevers argued that even though Bilberry Golf was not a party to the arbitration agreement, it could be compelled under agency principles to participate in the arbitration. The Court disagreed, holding that neither Leevers nor Bilberry were agents of Bilberry Golf, nor was there anything but a contractual relationship between Bilberry and Foxchase. The Court held that while Bilberry Golf may have been an agent of Foxchase as to management of the property, the contractual agreement between Foxchase and Bilberry did not create an agency relationship between the individual partners and Bilberry Golf such that Bilberry Golf would be bound by a partnership agreement signed by the partners only. Therefore, Bilberry Golf was not compelled to join the arbitration.

In Dalton Point, L.P. v. Regions Bank, Inc., 287 Ga. App. 468, 651 S.E.2d 549 (2007), the Georgia Court of Appeals held that a limited partnership was bound to the scope of its "corporate" bank resolution, despite arguments that the authorized transactions could involve breaches of fiduciary duty. The plaintiff, Dalton Point, sued Regions Bank for the money its bookkeeper embezzled from the limited partnership's bank account. Dalton Point's signature card for its bank account with Regions Bank was signed by a Dalton Point limited partner, Ronald Ralston and its bookkeeper, Patricia Page. Limited partner Ralston and bookkeeper Page also signed Dalton's Certificate of Resolution which was filed with the Bank authorizing the Bank to honor "all drafts, checks, or other items . . . . or transfer . . . even though drawn, endorsed or otherwise payable to [Ralston or Page]." The Resolution also provided that the Bank "need make no inquiry concerning such withdrawals." Dalton Point alleged that the Bank had notice that the bookkeeper was breaching her fiduciary duties to the limited partnership. It argued that the Bank was not entitled to rely on the Corporate Resolution because it was an unenforceable disclaimer of its responsibilities to act in good faith. The trial court granted Bank's motion summary judgment holding that the Corporate Resolution, the signatory card, and O.C.G.A. § 11-4-406 barred Dalton Point's claims. The Court of Appeals affirmed, ruling that the Bank was a holder in due course of the disputed items. The Court, also found, citing Freese v. Regions Bank, 284 Ga. App. 717, 644 S.E.2d 549 (2007) that the Resolution was not "unenforceable" because it did not "disclaim the bank's obligations of good faith; it simply provide[d] the framework within which the bank was allowed to operate." It is not clear from the opinion whether the parties raised or the Court

considered the issue of why the signatures of a limited partner and a bookkeeper to a limited partnership's Corporate Resolution were sufficient to bind the limited partnership.[18]

C. LIMITED LIABILITY COMPANIES.

Unlike in the last two years, there have not been any Georgia appellate decisions in 2007 to date addressing issues specific to limited liability companies. The following two decisions could be read to have possible implications for Georgia LLCs.

19. Fiduciary Duties of LLC Officers, Directors and Majority Members: *Megel v. Donaldson,* ___ S.E.2d ___, 2007 WL 4126886 (Ga. App., Nov. 21, 2007)

Megel v. Donaldson, ___ S.E.2d ___, 2007 WL 4126886 (Ga. App., Nov. 21, 2007) involved claims of breach of fiduciary duty and fraud by investors against the developer of a senior citizen living facility project in Senoia, Georgia, that failed because of the refusal of local authorities to rezone the property. The investors, who purchased a 30% interest in an LLC, claimed that the developer breached fiduciary duties owed as "corporate officers, directors, majority shareholders, or otherwise" by using investment funds for living expenses and to fund his investment in another venture. The Court rejected these claims because the investors were found to have executed a development contract that specifically mentioned the use of investor funds for "salaries (general or normal household living expenses)" and imposed no restrictions on the funds paid out as salary. The Court held that there was no fiduciary duty between the developer and the investors, because "[t]he transaction in this case was a business transaction in which the responsibilities of the parties were defined explicitly in the Agreement." The Court did not mention the LLC's operating agreement, discuss how the development agreement governed the developer's duties as majority member or manager of the LLC, or whether the development agreement satisfied provisions under O.C.G.A. § 14-11-305 permitting limitations of liability if set forth "in the articles of organization or a written operating agreement." The plaintiffs' claims for conversion, fraud and rescission were held to be barred by the merger clause of the development agreement and the plaintiffs' waived any right to rescind because they did not assert a claim for rescission until they filed an amended complaint.

20. LLC Direct versus Derivative Actions: *In re Wheland Foundry, LLC,* 2007 WL 2934869 (Bkrtcy. E.D. Tenn., Oct. 5, 2007)

A recent Tennessee bankruptcy court decision addressed the issue whether claims asserted by two members of a Georgia limited liability company against the third member, were direct claims that could be maintained outside of the LLC's bankruptcy proceedings or were derivative claims belonging to the debtor and hence property of the bankruptcy estate. In re Wheland Foundry, LLC, 2007 WL 2934869 (Bkrtcy. E.D. Tenn., Oct. 5, 2007). Using a special injury analysis, the Court decided that, as a matter of Georgia law, the members' claims for breach of fiduciary duty and usurpation of a corporate opportunity were derivative in nature and therefore belonged to the debtor LLC. The plaintiffs attempted to invoke the exception to derivative standing under Thomas v. Dickson, 250 Ga. 772, 301 S.E.2d 49 (1983) that permits direct actions where all interested parties are parties or their interests are adequately represented in the proceeding. The Court found that exception inapplicable because there were numerous unpaid creditors who would be benefited by a recovery by the LLC. The Court next analyzed the members' claims for misrepresentation. It held one misrepresentation claim to be derivative where the alleged injury was the loss of the plaintiffs' interest and their capital contributions in the debtor, which the Court characterized as injuries stemming from the debtor's bankruptcy affecting both members and creditors. It held that the members did allege special injury in other claims for misrepresentation and in claims for tortious interference with the members' contractual relations with the debtor.

[18] Compare McKenna v. Capital Resource Partners, IV, L.P., 286 Ga. App. 828, 650 S.E.2d 580 (2007) (addressing the authority of a controlling shareholder to reach an agreement binding on a corporation).

REPORT FROM THE CORPORATE CODE COMMITTEE

By: Bruce D. Wanamaker, Esq.
Ledbetter Johnson Wanamaker LLP

Overview

For nearly 40 years Georgia has had a modern, flexible and balanced corporate code which has compared very favorably with the General Corporation Law of Delaware ("DGCL"), the NY Business Corporation Law and the corporation laws of other leading corporate domiciles. The Business Law Section's Corporate Code Committee (the "Code Committee") has played a critical role in helping to maintain this parity. The Code Committee is charged with ongoing responsibility for keeping up with new developments in the corporate area, including:

- notable judicial decisions,
- changes to the ABA's Model Business Corporation Act ("MBCA"), the DGCL and other innovative legislation, and
- practical problems encountered by lawyers in serving their corporate clients.

The Code Committee is also responsible for drafting proposed legislation that cures particular problems, eliminates undesirable ambiguities, and enhances the flexibility, predictability and utility of our corporate laws here in Georgia. The Committee's legislative agenda is generally driven by the objectives of ensuring that our corporate laws are responsive to the changing needs of business and evolving market conditions, and that our corporate laws experience an orderly, coherent growth.

Most of the Code Committee's work is typically done at the subcommittee, working group or task force level. Currently, the Code Committee maintains the following four subcommittees:

- Updating Amendments Subcommittee, chaired by Sid Brown, which was created to address proposals for improving the Corporate Code based on case law developments and changes to the MBCA, the DGCL and other corporate statutes,
- Subcommittee on D&O Liability and Indemnification, chaired by John Latham, which was created to focus on provisions of the Corporate Code governing the standards of conduct and liability of directors and officers, as well as indemnification and advancement,
- Conforming Changes Subcommittee, chaired by Bob Bryant, which works closely with the Section's Partnership and LLC Committee and was created for purposes of considering proposals to facilitate entity conversions and to address undesirable or unintentional inconsistencies among the Corporate Code, and the LLC, LP and Partnership Acts, and
- Georgia Nonprofit Corporation Code Subcommittee, chaired by Randy Johnson, which was created to focus on curing particular problems with the Nonprofit Code and otherwise ensuring that it is up-to-date and conforms, where appropriate, to the Corporate Code.

The Code Committee has two "standing" working groups. One, led by Bill Baxley, focuses on the standards of conduct and liability applicable to directors and officers of Georgia corporations. The other, chaired by Tom Richey, focuses on indemnification, advancement and related matters. Last fall, the Code Committee also created an ad hoc "majority voting" task force led by Alan Prince. This group was charged with responsibility for considering and drafting amendments designed to facilitate the adoption of voting requirements for director elections that differ from the current default plurality standard under the Corporate Code.

Recent Legislative Accomplishments

The Code Committee assisted with the development of a legislative proposal for the 2007 session of the General Assembly which had emanated from the Partnership and LLC Committee. This legislative proposal included amendments to Sections 14-2-1109.3, 14-9-206.8, and 14-11-906 of the Corporate Code, the LP Act, and the LLC Act, respectively, all of which became effective July 1, 2006 (and authorize the conversion of Georgia corporations, LPs, and LLCs to foreign corporations, LPs, and LLCs). These provisions were enacted without any filing requirement or other procedural mechanism to alert the Georgia Secretary of State that a Georgia entity has converted to an entity formed under a foreign jurisdiction's law.

These amendments, which are technical in nature, corrected that oversight by imposing the requirement that a "Certificate of Conversion" be filed with the Georgia Secretary of State for purposes of making the conversion a matter of public record. This legislative proposal also added provisions that permit a converting entity to file a copy of its Certificate of Conversion with the clerk of the

superior court of any county in which the converting entity owns real property and authorize the Georgia Secretary of State to collect a $95 fee for the filing and administration of the Certificate of Conversion. A bill to enact these amendments (S.B. 234, 2007-2008 Gen. Assem., Reg. Sess. (2007)), which was adopted by the General Assembly and signed into law by Governor Perdue, became effective July 1, 2007.

Current Projects and Plans

"Majority Voting"/Director Selection Reform

The movement to get publicly held corporations to adopt majority voting for the election of directors has gained considerable momentum over the course of the past three proxy seasons. With this movement showing no signs of losing steam, the Code Committee opted to consider whether any changes to the provisions of the Corporate Code governing director elections were warranted and, early last fall, announced the creation of the Majority Voting Task Force to be led by Alan Prince. The task force subsequently conducted several meetings and conference calls and presented its recommendations to the full Code Committee at the end of October. A complete copy of the majority voting legislative proposal that was adopted by the full Code Committee on October 30, 2007 and submitted to the State Bar's Advisory Committee on Legislation (the "ACL") is set forth in the exhibit following the end of this report.

On November 30, 2007, the proposal was unanimously approved to be within the scope and purpose of the State Bar and on its merits by the ACL. I am pleased to report that this proposal was also approved by the State Bar's Board of Governors (the "BOG") at its mid-year meeting on January 12, 2008. We anticipate that a bill to enact this proposed legislation will be introduced in the General Assembly later this month or early in February.

I want to thank each member of the Majority Voting Task Force (Stan Blackburn, Sid Brown, Bob Bryant, George Cohen, Bryan Davis, Dan Falstad, Tom McNeill, Parth Munshi, Alan Prince, Jim Smith and David Wisniewski) for a job well done. The Section is very fortunate that these dedicated practitioners were willing to devote such an extraordinary amount of time and effort to this project. I would also like to thank the other members of the Code Committee who participated in the process, particularly those asking thoughtful questions along the way and suggesting various clarifications to the proposed language that were incorporated in our final proposal.

Other Projects and Plans

There are a number of things that Chauncey Newsome, Director of the Corporations Division, would like the Code Committee to begin looking, including:

- changing of some of our filing fees to be more in line with neighboring states (expedites and mergers, mainly),
- creating another vehicle for updating officer information (rather than the Annual Registration Form),
- the possibility of moving to annual registration based upon company formation date (versus an Annual Report Filing Season of Jan-Mar),
- the advisability of changes to our business entity statutes based on provisions of the Model Registered Agents Act, and
- various techniques for reducing fraudulent filings.

Please contact Sid Brown at Jones Day (srbrown@jonesday.com), chair of our Updating Amendments Subcommittee, if you are interested in working with representatives of the Secretary of State to help address any of these issues.

We are also planning to launch a comprehensive review project early this spring. More details will be circulated to the Committee membership in the coming weeks, but in general, the idea would be to set up a half dozen or so working groups, with each to have responsibility for reviewing a particular set or category of provisions of the Corporate Code (e.g., shares & distributions, shareholders, officers & directors, mergers and other fundamental changes, dissenters' rights, dissolutions, etc.) and recommending any changes. We are also exploring the possibility of securing the assistance of a law professor to serve as a "reporter" for this initiative. The goal would be to complete our review and recommend a package of proposed changes in time for adoption by the General Assembly in 2009, to coincide with the 20th anniversary of 1988 Corporate Code's effectiveness. Please do not hesitate to contact me via email (bwanamaker@ljwlaw.com) if you have any interest in helping out with this particular project or joining the Code Committee. Your participation is always most welcomed and encouraged.

Last but not least, I would like to thank our past chair, Tom McNeill, for his great leadership of the Code Committee, and his colleague, Lou Spelios, for all of his hard work and dedication in helping Tom and host of others shepherd the Code Committee's last four sets of legislative

proposals through the State Bar's ACL and BOG, and the General Assembly.

REPORT FROM CHAIR OF PARTNERSHIP AND LLC COMMITTEE

By: L. Andrew Immerman
Alston & Bird LLP

Technical Correction Legislation Passed

The Committee reported last year (see Business Law Section Newsletter March 2007) on proposed legislation to remedy a technical deficiency affecting conversions of Georgia entities into "foreign" (for example, Delaware) entities. The proposed legislation has since been enacted. Act 242 (SB 234). The text of the legislation does not specify an effective date, and the General Assembly has listed the effective date as May 24, 2007, the date of signing by the Governor. *See* http://www.legis.state.ga.us/legis/2007_08/sum/sb234.htm. Under O.C.G.A. § 1-3-4, however, the effective date appears to be July 1, 2007.

Act 817 (SB 469), effective July 1, 2006, had systematically addressed entity conversions under Georgia law, including conversions of Georgia entities into "foreign" entities. Under the provisions as originally enacted, however, when a Georgia entity converted to a "foreign" entity, no notification to the Georgia Secretary of State was required. Thus the Georgia Secretary of State might have had no way to trace the Georgia entity to its successor "foreign" entity. Bruce Wanamaker (Chair of the Corporate Code Committee) and Cass Brewer (then Chair of the Partnership and LLC Committee) therefore prepared technical correction legislation, which resulted in Act 242.

Act 242 requires a "Certificate of Conversion" to be filed with the Georgia Secretary of State to evidence the Georgia entity's conversion. In addition, the entity resulting from the conversion is deemed to appoint the Georgia Secretary of State as its agent for service of process in a proceeding to enforce any of its obligations arising prior to the effective time of the conversion. Also, a converting entity is permitted to file a copy of its Certificate of Conversion with the Clerk of the Superior Court of any county in which the converting entity owns real property. These changes are reflected in:

O.C.G.A. § 14-2-1109.3(i), (j), (k) (Business Corporation Code);

O.C.G.A. § 14-9-206.8(g), (h), (i) (Limited Partnership Act); and

O.C.G.A. § 14-11-906(g), (h), (i) (LLC Act).

Act 242 also authorizes the Georgia Secretary of State to collect a $95 fee on the filing of a Certificate of Conversion. *See* O.C.G.A. §§ 14-2-122(10), 14-9-1101(8), and 14-11-1101(a)(16).

Comprehensive Review of Georgia Acts

2007 was an exceptionally active year for us, and 2008 should be very busy as well. The Committee has been holding monthly meetings to undertake the first comprehensive review of the Georgia LLC Act since the Act went into effect in 1994. These meetings, and the information and materials circulated by email among the members, have been a great learning experience for many of us. We are very fortunate that members of the original drafting committee for the Georgia LLC Act (including Bob Bryant, Chuck Beaudrot, Cass Brewer, David Santi, and Mike Wasserman) are still participating actively in our Committee. It is also heartening that a group of newer members, including Vice Chair Lee Lyman and several others, have been enthusiastically contributing to the Committee's work. In attempting to update the Georgia LLC Act, we have been comparing legislative changes made in the last few years in other states, especially Delaware, and also comparing the Revised Uniform Limited Liability Act (2006). We have also been looking at a first draft of the American Bar Association's Model Limited Liability Company Act (August 2007), and the ABA drafters have asked for our comments and suggestions on the draft.

The Committee will continue to meet monthly in 2008. We will refine our proposed changes to the Limited Liability Company Act, and begin a review of the Limited Partnership Act and the General Partnership Act. Kate Martin, one of the newest members, is preparing an initial mark-up of the Limited Partnership Act, and has agreed to head up a new Limited Partnership Subcommittee.

Our goal is to submit proposed legislation to the bar's Advisory Committee on Legislation in the Fall of 2008, for introduction into the General Assembly in the legislative session beginning January 2009.

Southeast Business Tax Forum

The Section was a co-sponsor of the Southeast Business Tax Forum, held May 17 - 18, 2007, at the Twelve Hotel in Atlanta. Other co-sponsors were the American Bar Association, Section of Business Law, and the State Bar of Georgia, Taxation Law Section. The 2007 seminar featured several sessions on partnerships and LLCs, including "New Developments in Partnership Compensation," "Using Partnerships and LLCs in Business Transactions," and "Strategies for Exiting a Partnership."

The Section will co-sponsor the Southeast Business Tax Forum again this year (May 14 – May 15, 2008, at the same location). The agenda for the 2008 seminar program has not set, but will include sessions dealing with partnerships and LLCs.

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All comments and suggestions from members of the Section are encouraged. In addition, all members of the Section with an interest in partnerships and LLC are very welcome to join the Committee. Some of the most valuable contributions this year have been made by new Committee members. Feel free to contact Andy Immerman at andy.immerman@alston.com.

SHARE YOUR KNOWLEDGE -- GET PUBLISHED

We are accepting submissions for publication in this newsletter. Contact Sterling Spainhour by e-mail at (sspainhour@jonesday.com) as soon as possible to reserve space and to obtain a copy of our submission guidelines. If you have encountered an interesting legal development or issue recently, please consider sharing your knowledge with your colleagues by submitting a piece for publication in this newsletter.

THANK YOU TO OUR SUPPORTERS

On behalf of the Section, we want to express our gratitude to **ICLE in Georgia, Bowne of Atlanta, Inc.** and the **Staff of the State Bar of Georgia** for their assistance in printing and mailing this newsletter, which reaches 1,700 members throughout Georgia and in other states. We depend on the assistance of these supporters to produce this newsletter and value their continued support.