# Seventh Annual Survey: 2011 Georgia Corporation and Business Organization Case Law Developments

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

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## I. INTRODUCTION.

This paper surveys case law developments regarding corporate and business organization law issues handed down by the Georgia state and federal courts during 2011. A few decisions address matters of first impression or appear to have significant precedential value for other reasons. Others illustrate and confirm settled points of law or are instructive for the legal issues that typically arise in a corporate law practice or in business organization disputes.

To make the survey easier for the reader to navigate and locate decisions of interest, the survey is divided into two parts – first, an Overview, that catalogs all the 2011 Georgia business organization decisions covered in the survey with a brief description of their principal rulings and, second, a Discussion of Case Law Developments, which summarizes the decisions in more detail, with some discussion and analysis where warranted.

In both parts, the decisions are organized in sections, first, by entity type – decisions that focus on corporations, limited liability companies and partnerships – and, second, by business transaction and litigation issues that are generally common to all forms of business organization. Some decisions involve multiple entity types and/or both transactional and litigation issues and were thus difficult to categorize. A final section covers selected decisions handed down in 2011 by the Georgia Business Court and other state trial courts.

## II. OVERVIEW

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

In one of 2011's more significant decisions, *Patel v. Patel*, 761 F. Supp. 2d 1375 (N.D. Ga. 2011), the United States District Court for the Northern District of Georgia addressed an open issue in the development of Georgia law on negligent misrepresentation claims, holding that corporate officers and directors were not liable to investors for alleged negligent misrepresentations in the corporation's offering documents because they did not have any "direct communications" with the investors. The Georgia Court of Appeals in *Gordon Document Products, Inc. v. Service Technologies, Inc.*, 308 Ga. App. 445, 708 S.E.2d 48 (2011) affirmed summary judgment on breach of fiduciary duty claims against a former non-officer employee for alleged wrongful solicitation of employees because his employment agreement expressly provided that he did not have authority to bind the corporation and, in any event, a fiduciary duty with regard to customer relations would not support a claim for wrongful solicitation of employees. The Court in *Dempsey v. Southeastern Industrial Contracting Co.*, 309 Ga. App.

140, 709 S.E.2d 320 (2011) found no personal liability on the part of a corporate CEO for an alleged failure to train employees in proper safety procedures. The U.S. District Court for the Southern District of Georgia in *Life Alarms Systems, Inc. v. Valued Relationships, Inc., et al.*, 2011 WL 1167174 (S.D. Ga. Mar. 28, 2011) held that officers and employees acting within the scope of their duties are protected from liability for tortious interference with contract where the corporation's actions are privileged. The Georgia Court of Appeals addressed claims of personal liability in two cases involving loans. In *Elwell v. Keefe*, 312 Ga. App. 393, 718 S.E.2d 587 (2011) the Court held that corporate officers signing a note in a representative capacity were not personally liable on the debt and in *PlayNation Play Systems, Inc. v. Jackson, Inc.*, 312 Ga. App. 340, 718 S.E.2d 568 (2011) it held that, because guarantees must be strictly construed, a personal guarantee signed by an owner of a corporation was unenforceable because it failed to properly identify the corporate debtor.

## B. CORPORATE STOCK AND DEBT OWNERSHIP AND RIGHTS.

In 2011 the Georgia Court of Appeals decided three cases involving shareholders' rights to inspect corporate books and records. In a case of first impression, the Court in *Mannato v. SunTrust Banks, Inc.*, 308 Ga. App. 691, 708 S.E.2d 611 (2011), addressed the authority of a corporation under O.C.G.A. § 14-2-1602(e) to adopt bylaws limiting shareholder inspection rights for shareholders owning two percent or less of the corporation's stock, holding that the statutory limitation preempts a two-percent shareholder's common law right of access to books and records. In *Advanced Automation, Inc. v. Fitzgerald*, 312 Ga. App. 406, 718 S.E.2d 607 (2011), the Court ruled that O.C.G.A. § 14-2-940's provision for exclusive jurisdiction over an action involving shareholder oppression claims in a statutory close corporation does not affect the venue of an inspection rights proceeding filed by the same shareholder against the same corporation in a court where its registered office is located. In *Grapefields, Inc. v. Kosby*, 309 Ga. App. 588, 710 S.E.2d 816 (2011), the Court held that the award of attorney's fees in an inspection rights proceeding is subject to the "any evidence" standard of review.

A corporate director's claim for rescission of her purchase of stock in a bank holding company in *Griffin v. State Bank of Cochran*, 312 Ga. App. 87, 718 S.E.2d 35 (2011), was barred because her access to information regarding the bank's financial condition rendered reliance on the alleged misrepresentations unreasonable. In *Capital Financial Services Group, Inc. v. Hummel*, 313 Ga. App. 278, 721 S.E.2d 108 (2011) the Court held that claims for conversion of a securities account were insufficient because notification to the brokerage firm of the entry of an injunction in a divorce case did not constitute an exercise of "dominion" over the account. In *Akanthos Capital Management, LLC v. CompuCredit Holdings Corp.*, 770 F. Supp. 2d 1315 (N.D. Ga. 2011), corporate noteholders were held not to be barred by the indenture's "No Action Clause" from asserting extra-contractual fraudulent transfer claims against insiders and those claims were not deficient despite the lack of allegations of insolvency, illegality or default.[1]

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[1] The district court decision was reversed this year by the Eleventh Circuit in *Akanthos Cap. Mgt., LLC v. CompuCredit Holdings Corp.*, ___ F.3d ___, 2012 WL 1414247 (11th Cir. Apr. 25, 2012) (upholding bar of no action clause).

## C. NONPROFIT CORPORATIONS.

In two separate decisions involving the ownership of church real estate, *Presbytery of Greater Atlanta, Inc. v. Timberridge Presbyterian Church, Inc.*, 290 Ga. 272, 719 S.E.2d 446 (2011) and *Rector, Wardens and Vestrymen of Christ Church in Savannah v. Bishop of the Episcopal Diocese of Georgia Inc.*, 290 Ga. 95, 718 S.E.2d 237 (2011), the Georgia Supreme Court employed the "neutral principles" doctrine and legal rules of general application, local church articles of incorporation and national church membership agreements to find that local church property was held in trust for the benefit of the national church organizations.

The Georgia Court of Appeals in *Partnership Housing Affordable to Society Everywhere, Inc. v. Decatur County Board of Tax Assessors*, 312 Ga. App. 663, 219 S.E. 2d 556 (2011) held that a nonprofit was not entitled to the ad valorem tax exemption for charities because of its non-charitable use of funds. In a contest over control of a nonprofit corporation, *Harris v. The Southern Christian Leadership Conference, Inc.*, 313 Ga. App. 363, 721 S.E.2d 906 (2011), the Court upheld the trial court's determination of the validity of two disputing factions' claims to incumbency and the effectiveness of their meetings and actions and affirmed a ruling that former directors of the corporation had breached their fiduciary duties by pursuing a lawsuit without authorization and using corporate funds to pay the resulting litigation expenses.

## D. LIMITED LIABILITY COMPANY DEVELOPMENTS.

In *St. James Entertainment LLC v. Crofts*, --- F. Supp. 2d ---, 2011 WL 3489992 (N.D. Ga. Aug. 8, 2011), the District Court held that neither a provision in an agreement to form an LLC permitting members to pursue other opportunities nor an exculpatory clause barred claims against an LLC member for allegedly diverting a business opportunity that had been presented to the company. The Georgia Court of Appeals in *Moses v. Pennebaker*, 312 Ga. App. 623, 719 S.E.2d 521 (2011) held that the valuation of an LLC interest for purposes of conversion and breach of fiduciary duty claims was properly determined as of the date when the LLC could no longer carry on its business, not a later date on which judicial dissolution was ordered.

During 2011, the U.S. District Court for the Middle District of Georgia issued three decisions dealing with a dispute in a two-member LLC. In *Denim North America Holdings, LLC v. Swift Textiles, LLC*, 2011 WL 97238 (M.D. Ga. Jan. 12, 2011), the Court held that the LLC's participation in a lawsuit instituted by one member against the other was unauthorized under its operating agreement, thus the LLC's joinder was fraudulent and could not destroy diversity of citizenship and defeat federal court jurisdiction. In *Denim North America Holdings, LLC v. Swift Textiles, LLC*, 2011 WL 318127 (M.D. Ga. Jan. 28, 2011), the Court held that, under O.C.G.A. § 14-8-6(b), LLC members are not "partners" and partnership fiduciary duties are inapplicable to the LLC. It ruled that the fiduciary duties owed by a managing member of an LLC were applicable to a member entitled to appoint half of the members of the LLC's board of managers. It dismissed conflict of interest claims because the operating agreement contained a provision opting out of the LLC Code's conflict of interest rules as permitted under O.C.G.A. § 14-11-307(a). In *Denim North America Holdings, LLC v. Swift Textiles, LLC*, 816 F. Supp. 2d 1308 (M.D. Ga., 2011), the Court ruled on summary judgment, addressing specific allegations of fraud in the inducement concerning the plaintiff's entry into the LLC and reaffirming its ruling that an

LLC member entitled to appoint one half of the members of an LLC's board of managers may owe fiduciary duties as a managing member under O.C.G.A. § 14-11-305.

## E. PARTNERSHIP LAW DEVELOPMENTS.

The Georgia courts handed down several decisions in 2011 addressing partnership issues, in addition to the *Denim North American* decision, cited above. In *The B&F System, Inc. v. LeBlanc*, 2011 WL 4103576 (M.D. Ga. Sept. 14, 2011), the Court addressed the requirements for the formation of a general partnership, holding it to be a jury issue, discussed the imputation of knowledge among partners and from officers to a corporation, held that partners could not be "strangers" to a contract for purposes of wrongful interference claims, but ruled differently as between corporations and their shareholders and required evidence of insolvency for veil-piercing claims. The decision is noteworthy for its consideration of a seldom-asserted alternative "common enterprise" theory of joint liability. In *Day v. Nu-Day Partnership, LLLP*, 289 Ga. 357, 711 S.E.2d 689 (2011), the Georgia Supreme Court held that the *ultra vires* doctrine applies to actions of a business entity, not the actions of its owners in transferring their interests. The Georgia Court of Appeals in *Sutter Capital Management, LLC v. Wells Capital, Inc.*, 310 Ga. App. 831, 714 S.E.2d 393 (2011) held that a limited partnership's investor list was not a trade secret. In an instructive decision, the Court in *AAF-McQuay, Inc. v. Willis*, 308 Ga. App. 203, 707 S.E.2d 508 (2011) addressed the rights and conduct of partners that are creditors of the partnership, holding that they are fully entitled to take actions consistent with their rights as creditors, but can be held liable for exceeding those rights. In an action to recover for a share of lost profits from the misappropriation of business opportunity, the Court in *McMillian v. McMillian*, 310 Ga. App. 735, 713 S.E.2d 920 (2011) permitted discovery of financial records from a competitor allegedly benefiting from the opportunity. In *Moses v. Jordan*, 310 Ga. App. 637, 714 S.E.2d 262 (2011), the Court found issues of fact in a claim for wrongful dissolution of a general partnership under O.C.G.A. § 14-8-38(b) of the Georgia Uniform Partnership Act, noting that the power to dissolve a partnership must be exercised in good faith.

## F. TRANSACTIONAL CASES.

In *Yi v. Li*, 313 Ga. App. 273, 721 S.E.2d 144 (2011), the Georgia Court of Appeals considered the effect of a franchisor's refusal to approve the sale of a franchised business, holding that the failure to satisfy an express condition precedent to performance of the contract for sale of the business did not support rescission because the contract did not obligate the seller to fulfill the condition. The Court in *Thompson v. Floyd*, 310 Ga. App. 674, 713 S.E.2d 883 (2011) found issues of fact in a business broker's claim for fees for sale of a business, including whether the "CEO" was acting in a personal or agency capacity and whether the agreement was sufficiently definite to be enforceable. The Court in *West v. Diduro*, 312 Ga. App. 531, 718 S.E.2d 815 (2011) construed a contract for sale of a business to require only a conveyance of corporate assets, not the seller's stock in the corporation. The Eleventh Circuit Court of Appeals in *United States v. Fort*, 638 F.3d 1334 (11th Cir. 2011) dealt with the timing for tax purposes of the receipt of restricted shares that were deposited into an escrow account with restrictions on transfer, holding that receipt occurred on deposit when the taxpayer received dividend and voting rights and market risk, rather than later when the escrow and restrictions expired.

G. <u>LITIGATION ISSUES</u>.

1. <u>Derivative Action Procedure</u>.

Two decisions in 2011 addressed the rule in *Thomas v. Dickson*, 250 Ga. 772, 301 S.E.2d 49 (1983) that permits shareholders in a close corporation to assert claims directly to recover for injuries to the corporation if the interests of all shareholders are represented in the case and creditors would not be adversely affected. The Court in *Wood v. Golden*, 2011 WL 2516704 (N.D. Ga. June 23, 2011) found a direct action permissible to assert a closely-held corporation's claims, but in *Southland Propane, Inc. v. McWhorter*, 312 Ga. App. 812, 720 S.E.2d 270 (2011) the direct action exception was held inapplicable because the interests of creditors were not protected.

In *Anderton v. Bennett*, 2011 WL 4356505 (N.D. Ga., Sept. 16, 2011), the District Court held that because of the interest of the Federal Deposit Insurance Corporation as receiver of a failed bank ("FDIC-R") in claims for mismanagement of the bank, the FDIC-R was entitled to intervene in an action involving stock-based employment benefit plans asserting claims for alleged wrongdoing by officers and directors of the bank. The Georgia Court of Appeals in *Crittenton v. Southland Owners Association, Inc.*, 312 Ga. App. 521, 718 S.E.2d 839 (2011) ruled that claims based on irregularities in an election of directors were derivative, not direct, because the defendants' alleged conduct breached duties to the corporation and all its shareholders. The Georgia Supreme Court in *Brown v. Pounds*, 289 Ga. 338, 711 S.E.2d 646 (2011) invalidated a corporate bylaw amendment adopted by the corporation's board of directors because it conflicted with provisions of a derivative action settlement.

2. <u>Alter Ego, Piercing the Corporate Veil, and Other Forms of Secondary Liability</u>.

The District Court for the Southern District of Georgia in *Great Dane Limited Partnership v. Rockwood Service Corporation*, 2011 WL 2312533 (S.D. Ga. June 8, 2011) held that allegations of insolvency are essential to a veil-piercing claim because otherwise the plaintiff has an adequate remedy at law. In a noteworthy decision by the District Court for the Middle District of Georgia, *Tindall v. H&S Homes, LLC*, 2011 WL 5827227 (M.D. Ga. Nov. 18, 2011), the Court recognized a Georgia common law preference claim against corporate insiders for preferring their interests to those of other creditors of an insolvent corporation and held that such claims are governed by a six-year statute of limitations for breaches of trust. In *In re Palisades at West Paces Imaging Center, LLC (Watts v. Peachtree Tech. Partners, LLC)*, 2011 WL 4459778 (Bankr. N.D. Ga. Sept. 13, 2011) the U.S. Bankruptcy Court for the Northern District of Georgia held that LLC members, whose membership interests were redeemed by the LLC pursuant to a settlement when the LLC was insolvent, could be subject to fraudulent conveyance claims for recovery of the funds received in the redemption. In a rather remarkable decision, the Court in *Terrell v. OTS, Inc.*, 2011 WL 2619080 (N.D. Ga. July 1, 2011) held that a solely-owned corporation could be held liable on a theory of negligent entrustment for its shareholder's battery of an employee because the shareholder's knowledge of prior incidents and his tendency to commit battery were imputed to the corporation.

3. Jurisdictional Cases.

The Georgia Supreme Court in *Amerireach.com v. Walker*, 290 Ga. 261, 719 S.E.2d 489 (2011) expressly rejected the "fiduciary shield" doctrine, holding that long arm jurisdiction may be exercised over corporate officers based on their conduct in their official capacities. The Court in *Azalea House LLC v. National Registered Agents, Inc.*, 415 Fed. Appx. 958, 2011 WL 679413 (11th Cir. Feb. 25, 2011) held that a registered agent appointed pursuant to O.C.G.A. § 14-2-504 owes only a duty of reasonable care when receiving service of process for the LLC.

4. Evidence – Business Records Act.

Four 2011 decisions by the Georgia Court of Appeals addressed issues under the Georgia Business Records Act exception to the hearsay rule. The Court in *Saye v. Provident Life and Accident Ins. Co.*, 311 Ga. App. 74, 714 S.E.2d 614 (2011) (en banc) held that the Business Records Act does not authorize the admission of documentary evidence of telephone conversations. Documents were found admissible under the Act in *Melman v. FIA Card Services, N.A.*, 312 Ga. App. 270, 718 S.E.2d 107 (2011) (credit card records were properly admitted as business records without testimony as to their truthfulness, accuracy or completeness), *Ellington v. Gallery Condominium Association, Inc.*, 313 Ga. App. 424, 721 S.E.2d 631 (2011) (condominium association account ledger of assessments was properly admitted as business records), and *Dawson Pointe, LLC v. SunTrust Bank*, 312 Ga. App. 338, 718 S.E.2d 570 (2011) (loan history properly admitted as business records was held sufficient to prove interest owed without evidence of prime rate specified in promissory note).

5. Director and Officer Liability Insurance.

In *Empire Fire & Marine Ins. Co. v. Ison*, 2011 WL 1326057 (M.D. Ga. Apr. 6, 2011) Coverage for officers, directors, employees and shareholders provided under company liability and umbrella policies was held to have been released in a prior settlement.

6. Nondischargeability of Breach of Fiduciary Duty Claims.

Four decisions from the U.S. Bankruptcy Court for the Northern District of Georgia ruled on various aspects of the nondischargeability of claims under 11 U.S.C. § 523(a)(4) (fraud or defalcation by fiduciaries) in close corporation and LLC disputes, in the process addressing a wide range of business organization issues. In *In Re Kwang Cha Yi*, 2011 WL 1364229 (Bankr. N.D. Ga. Apr. 11, 2011), the Court held that § 523(a)(4) does not apply to pre-investment conduct because at that stage there is no fiduciary duty. It also held that shareholder claims to enforce inspection rights must be brought against the corporation, not its officers. In *In re Riddle*, 2011 WL 2461896 (Bankr. N.D. Ga. April 6, 2011), the court held that claims of fraud can constitute debts, but corporate fiduciary relationships do not suffice for purposes of 11 U.S.C. § 523(a)(4). In an extensive opinion, the Court in *In re McClelland*, 2011 WL 2461885 (Bankr. N.D. Ga. June 8, 2011) addressed LLC formation, considered direct vs. derivative claims, holding the direct action exception under *Thomas v. Dickson, supra*, to be inapplicable, and found personal liability for conversion of investor funds by an LLC manager to be nondischargeable, but not under § 523(a)(4) because LLC managers are not a fiduciaries under § 523(a)(4). The Court in *In re Richards*, 2011 WL 1522327 (Bankr. N.D. Ga. March 18, 2011) held that the LLC entity form does not shield a managing member from liability for fraud in which she participated.

7. Miscellaneous Litigation Procedure Issues.

In *Omni Builders Risk, Inc. n/k/a Best Value Insurance Services, Inc. v. Bennett*, 313 Ga. App. 358, 721 S.E.2d 563 (2011), counsel of record was held to lack apparent authority to settle where the CEO/majority shareholder had personally attended the mediation at which the settlement was allegedly reached. In *SN International, Inc. v. Smart Properties, Inc.*, 311 Ga. App. 434, 715 S.E.2d 826 (2011) the Georgia Court of Appeals remanded the trial court's decision in a sale of business case stating that the complexity of the case required findings of fact and conclusions of law. Finally, the Court in *D.C. Micro Development, Inc. v. Briley*, 310 Ga. App. 309, 714 S.E.2d 11 (2011) held that the compensation of a receiver for a corporation was a matter within the trial court's discretion.

## H. GEORGIA BUSINESS COURT AND OTHER STATE TRIAL COURT BUSINESS ORGANIZATION DECISIONS.

The Georgia Business Court and other Georgia Superior Courts rendered decisions in 2011 concerning the exclusivity of dissenters' rights under the Georgia Business Corporation Code in five cases brought by shareholders in putative class actions challenging merger transactions involving publicly-held Georgia corporations. In *In re Radiant Systems, Inc. Shareholder Litigation*, Civil Action No. 2011-CV-203228 (Fulton Sup. Ct. Aug. 10, 2011), finding dissenters' rights to be exclusive, the Business Court denied a motion to permit expedited discovery in a shareholder class action seeking to enjoin a third party tender offer and back-end merger for alleged breaches of fiduciary duty by management and the board in allegedly failing to obtain adequate value for the company's stock, engaging in a "flawed" sale process, and failing to disclose material information in the company's Form 14D-9 filed with the Securities and Exchange Commission . In *Kramer v. Immucor, Inc.*, Civil Action No. 2011-CV-203124 (Fulton Sup. Ct. August 12, 2011), the Business Court denied a motion to expedite proceedings in a similar case relying on and based on the reasons set forth in the *Radiant Systems* decision. The Business Court in *Shaev v. EMS Technologies, Inc.*, Civil Action No. 2011-CV-203036 (Fulton Sup. Ct. Aug. 25, 2011), denied a motion to expedite proceedings in a shareholder class action brought to enjoin a tender offer and second stage merger, based on the exclusivity of dissenters' rights, citing *Radiant Systems* and *Kramer v. Immucor*. Two other trial court decisions addressed similar claims and likewise denied relief on the same or similar grounds: *Schorsch v. Immucor, Inc.*, Civil Action No. 11-A-7776-1 (Gwinnett Sup. Ct. Aug. 16, 2011) (denying a motion for interlocutory injunction) and *In re Servidyne, Inc. Shareholder Litigation*, Civil Action No. 2011-CV-202977 (Fulton Sup. Ct. Aug. 17, 2011) (denying a motion for expedited discovery and expedited proceedings in a shareholder class action suit on the grounds that the appraisal remedy was both an exclusive remedy and an adequate remedy at law).

In decisions involving other corporate and business organization issues, the Business Court in *GAA Nicholson Advisors, LLC v. Cortland Partners, LLC*, Civil Action No. 2010-CV-191111 (Fulton Sup. Ct. Jan. 27, 2011) held that an LLC operating agreement requirement of unanimity for major decisions did not apply to the agreement's buy-sell provisions. In *Estate of Joy W. O'Brien v. Conza*, Civil Action No. 2010-CV-188721 (Fulton Sup. Ct. May 9, 2011), the

Court denied a motion to dismiss claims against the managing partner of a limited partnership for tortious deprivation of a business interest and against the majority shareholder of a corporation for breach of fiduciary duty. The Business Court in *Peevy v. Brown*, Case No 2010-cv-180583 (Fulton Sup. Ct. Apr. 5, 2011), approved a class action settlement in a suit contesting the fairness of a merger of a Delaware corporation over objections that the settlement provided inadequate benefits to the class. The Court in *Greenwald v. Odom*, Civil Action File No. 2008-CV-154834 (Fulton Sup. Ct. Feb 9, 2011) granted summary judgment on claims for fraud and negligent misrepresentation based on allegedly inaccurate oral statements regarding future revenues and financial condition and omissions from written offering materials,[2] and in *South Coast Life Liquidity, LLP v. Sterling Currency Group, LLC*, Civil Action File No. 2009 -CV-175697 (Fulton Sup. Ct. April 18, 2011) denied motions to dismiss and for more definite statement as to fraud counterclaims.

## III. DISCUSSION OF CASE LAW DEVELOPMENTS.

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

***Patel v. Patel*, 761 F. Supp. 2d 1375 (N.D. Ga. 2011) – Officers and Directors Held Not Liable for Negligent Misrepresentations in Corporate Offering Documents for Lack of Direct Communications with Investors.**

Investors in a holding company for a failed bank brought action against the bank's officers and directors alleging that two private placement memoranda ("PPMs") pursuant to which the defendants solicited investors concealed the bank's true financial condition and business operations in violation of state and federal securities laws. The Investors also asserted claims for negligent misrepresentation. The court granted the defendants' motion to dismiss the plaintiffs' claims of Georgia Securities Act violations, rejecting the plaintiffs' argument that there is some uncertainty as to whether scienter is required under the Georgia statute. The court agreed with the defendants that Georgia law requires a showing of scienter to state a claim for relief under O.C.G.A. § 10-5-12(a). The court also determined that while the Georgia Supreme Court and the Eleventh Circuit have not spoken on the issue, the Georgia Court of Appeals' recognition that the current version of O.C.G.A. § 10-5-12(a)(2) mirrors Rule 10b-5 and requires a showing of scienter was sufficient to determine the state of Georgia law on the issue.

The plaintiffs had also alleged negligent misrepresentation claims based on their assertion that the officer and director defendants were control persons who issued and were identified in the allegedly misleading PPMs, that they were therefore in privity with the holding company, and that the misleading statements in the PPMs should be attributed to them. The plaintiffs contended that the court should make an exception to the direct communication rule for claims of negligent misrepresentation where "a known third party's reliance was the desired result of this misrepresentation," citing *Robert & Co. Assoc. v. Rhodes-Haverty Partnership*, 250 Ga. 680, 300 S.E.2d 503, 504 (1983). The court declined to make such an exception, noting that the Georgia

[2] Affirmed in part, reversed in part, *Greenwald v. Odom*, 2012 WL 400710 (Ga. Ct. App., Feb. 9, 2012).

Supreme Court in *Holmes v. Grubman*, 286 Ga. 636, 691 S.E. 2d 196 (2010), expressly limited common law negligent misrepresentation claims in holder cases to circumstances where a plaintiff can allege and prove direct communication with a defendant and specific reliance on that defendant's communication. The court rejected the control persons/privity argument, reaffirming the principle that "Georgia courts have consistently held that 'the mere operation of a corporate business does not render a corporate officer personally liable for the corporate acts." Because the plaintiffs failed to allege any direct communication between themselves and the defendants, the court dismissed their negligent misrepresentation claims. "Allowing a claim against the defendants for negligent misrepresentation based solely on Haven Trust's PPM's would be contrary to Georgia law." This case appears to represent an extension of the limitations in *Holmes v. Grubman* to purchase cases at least as to claims against officers and directors for corporate statements.

***Gordon Document Products, Inc. v. Service Technologies, Inc.*, 308 Ga. App. 445, 708 S.E.2d 48 (2011) – Breach of Fiduciary Duty Claims Against Former Non-Officer Employee Based on Alleged Authority to Bind Corporation Held to be Insufficient.**

In this non-competition case, Gordon Document Products, Inc. ("GDP") sued former non-officer employees and Service Technologies, Inc. ("STI"), a competitor and their new employer, asserting claims, among others, for breach of written employment agreements and breach of fiduciary duty against one former employee, Jeffrey Layne, for using confidential information in order to solicit GDP customers and induce other GDP employees to leave their employment. The Court of Appeals affirmed the trial court's summary judgment for defendants on all claims.

The Court of Appeals held the employment agreements to be overbroad and unreasonable and, hence, unenforceable. GDP argued that Layne had authority to bind GDP to customer contracts, was accordingly GDP's agent and thus owed a fiduciary duty to GDP. The Court discussed and applied O.C.G.A. § 23-2-58, imposing fiduciary duties on parties in confidential relationships, including principal and agent, and O.C.G.A. §10-6-1, regarding formation of agency relationships. Layne's employment agreement expressly stated that "Employee will not, without the specific written direction of the Company have authority to bind the Company for any debt or obligation." *Id.* at 454. The Court of Appeals held that the parol evidence rule barred GDP's argument that this provision did not apply to customer agreements. It also addressed the limited nature of fiduciary duties based on contracting authority, citing *Atlanta Market Center Mgmt. Co v. McLane*, 269 Ga. 604, 607, 503 S.E.2d 278 (1998) and ruling that, in any event, a fiduciary duty with regard to customer relations would not support GDP's claim for wrongful solicitation of its employees. *Id.* at 454:

> "Thus, although Layne may have owed GDP a fiduciary duty with respect to the customer contracts he entered into on its behalf, there is no evidence he occupied a similar confidential relationship with respect to employee relationships."

***Dempsey v. Southeastern Industrial Contracting Co.*, 309 Ga. App. 140, 709 S.E.2d 320 (2011) – No Personal Liability of Officers for Corporate Torts Based on Duty to Train Employees.**

A truck driver for a parcel delivery company sued Southeastern Industrial Contracting Co. ("Southeastern"), a company that inspected the parcel delivery service's facility, and Southeastern's chief executive officer, alleging that they failed to properly inspect and maintain conveyor belt equipment, failed to notify parcel delivery service about proper location of safety equipment, and failed to warn the parcel delivery service of the risks of dangerous conditions. As to the CEO, the driver alleged that he had a duty to train the company's personnel. The trial court granted summary judgment and the Court of Appeals affirmed. As to Southeastern's CEO, the Court confirmed the general principles that corporate officers are not liable for corporate torts in which they do not participate or direct the particular act to be done. It held that the claim against the CEO failed as a matter of law because "the mere fact that an injury occurred during a period when [CEO] was responsible for employee training and dispatch is not sufficient to support an inference that the injury was caused by some actionable negligence on [CEO]'s part." *Id.* at 144, 324.

***Life Alarms Systems, Inc. v. Valued Relationships, Inc., et al.*, 2011 WL 1167174 (S.D. Ga. Mar. 28, 2011) – Officers and Employees Protected by Corporation's Privilege from Liability for Tortious Interference when Acting within the Scope of their Duties.**

In this matter, Plaintiff, Life Alarm Systems, Inc. ("LA") and Defendant Valued Relationships, Inc. ("VRI") were both in the business of providing personal emergency response services ("PERS"). VRI provided PERS units and monitoring services that LA offered to its customers. Defendant Chris Hendriksen was president of VRI. LA sued VRI and Hendriksen for tortious interference with LA's contractual relationships with its customers, and VRI counterclaimed for amounts owed under its equipment lease and monitoring contracts with LA.

When LA fell behind in payments to VRI, VRI notified LA that it was in default, and started contacting LA customers directly by phone followed up by a letter stating that VRI was not longer working with LA and offered to keep the customer's medical alert system and support center by paying VRI directly. Upon learning of VRI's contact with the LA customers, LA filed suit requesting a temporary restraining order, preliminary and permanent injunction, based on alleged tortious interference with contractual and business relations. VRI filed a motion for summary judgment contending that VRI's actions were authorized under the Monitoring Agreement and that Hendriksen's actions were performed within the scope of his duties as president of VRI. The Court noted that an "entity cannot be held liable for tortuous interference unless it is 'a stranger to both the contract at issue and the business relationship giving rise to and underpinning the contract' . . . [a]ccordingly, 'all parties to an interwoven contractual arrangement are not liable for tortuous interference with any of the contracts or business relationships.'" *Id.* at *6, citing *Atlanta Mkt. Mgmt. Co. v. Equitable Real Estate Inv. Mgmt., Inc.*, 269 Ga. 604, 609 n.2, 503 S.E.2d 278 (1998). VRI was not a "stranger" to the contracts and business relationships at issue because "one is not a stranger to the contract just because one is not a party to the contract." *Id.* Thus, the Court found VRI's actions to be "privileged" and granted VRI's motion for summary judgment on LA's claim for tortious interference. The Court also found that Hendriksen acted within his scope of employment and thus he was not personally liable for tortuous interference with contractual or business relations. The Court held that when a company is not a "stranger" its employees "cannot be held individually liable for acts that may affect the relationship if those acts were performed within the scope of their employment." Because Hendriksen's actions fit "squarely within the scope of [his] employment as president of VRI" and since VRI was not a "stranger" to the relationship with LA, the Court granted VRI's motion for summary judgment on the claim against Hendriksen. *Id.* at *7-8.

***Elwell v. Keefe*, 312 Ga. App. 393, 718 S.E.2d 587 (2011) – Corporate Officers Signing in Representative Capacity Found Not Personally Liable on Note.**

In this case, Betty and Kenneth Keefe as lenders sued DCI Logistics, Inc., Larry Elwell and Brian West for default under a promissory note that Elwell and West had each signed. Beneath their signatures were the company name, their printed names and their titles as company officers. Plaintiffs contended that Elwell and West were personally liable for the loan because the promissory note contained a mention of "guarantors" and it thus also served as their personal guarantees of the company's debt. The Court of Appeals reversed the trial court's grant of summary judgment for the plaintiffs finding that "in the face of the plain language of the [note]" Elwell and West signed the promissory note "in their representative capacity on behalf of the corporation," thus binding the corporation only to pay the debt. The Court noted that a single signature "generally denotes that the person is signing in either an individual or representative capacity, but not both," citing and quoting *Groth v. Ace Cash Express, Inc.*, 276 Ga. App. 350, 623 S.E.2d 208 (2005).

***PlayNation Play Systems, Inc. v. Jackson, Inc.*, 312 Ga. App. 340, 718 S.E.2d 568 (2011) – Guaranty Signed in Trade Name that Failed to Identify Corporate Debtor Strictly Construed and Held Unenforceable.**

In this case, creditor sought to enforce personal guaranty after the debtor defaulted under the distribution agreement between the parties. Defendants Robert Jackson and Gerald Flanagan owned The Bottom Line, "a limited liability Pennsylvania corporation," d/b/a Swingset Planet, which sold and installed children's swing sets purchased pursuant to a 2006 dealership agreement between Swingset Planet and PlayNation. Jackson executed a personal guaranty for the debts of "Swing Set Planet" a month after the parties entered into the dealership agreement, listing "Swing Set Planet" as the principal debtor. In 2008, PlayNation licensed its name and Jackson and Flanagan changed The Bottom Line's trade name to PlayNation Parties and Playgrounds, while continuing to conduct the same business. PlayNation Parties failed to make payments on outstanding invoices and sued for breach of Jackson's personal guaranty, interest and attorney's fees. The trial court granted Jackson's motion for summary judgment finding that the debtor listed on the guaranty was "Swing Set Planet," without any reference to a corporation or other legal person. Jackson was accordingly obligated to guarantee the debt of Swing Set Planet only, not that of The Bottom Line, or its later d/b/a, PlayNation Parties. The Court of Appeals noted that a guarantee must identify the debt, the principal debtor, the guarantor and the creditor, and that guarantees must be strictly construed. The Court state that "to hold otherwise would extend a guarantor's liability by implication or interpretation – an act forbidden to the court," and affirmed trial court's grant of Jackson's motion for summary judgment.

For additional decisions involving officer liability, see *The B&F System, Inc. v. LeBlanc*, 2011 WL 4103576 (N.D. Ga. Sept. 14, 2011) in section E, below; *In Re Kwang Cha Yi*, 2011 WL 1364229 (Bankr. N.D. Ga. Apr. 11, 2011 ) and *In Re Riddle*, 2011 WL 2461896 (Bankr. N.D. Ga. April 6, 2011) in section G.6., below.

## B. CORPORATE STOCK AND DEBT OWNERSHIP AND RIGHTS.

### *Mannato v. SunTrust Banks, Inc.*, 308 Ga. App. 691, 708 S.E.2d 611 (2011) – O.C.G.A. § 14-2-1602(e) Authorized Limit on Shareholder Inspection Rights Preempts Common Law Right of Access to Books and Records.

A shareholder owning less than two percent of SunTrust shares filed a complaint in equity seeking to enjoin SunTrust from denying his request for access to the corporation's books and records. The shareholder had made a derivative action demand, asking SunTrust to pursue breach of fiduciary duty claims against its officers and directors related to the collapse of the housing market, but SunTrust's board of directors rejected his request after creating a special committee and retaining independent counsel to investigate. Following the rejection of his request for suit, the shareholder demanded access to SunTrust's books and records. SunTrust denied the request because the shareholder owned less than two percent and was therefore not entitled to inspect its books and records under its bylaws, which contained a limitation on inspection rights pursuant to O.C.G.A. § 14-2-1602(e). That subsection provides:

> "The right of inspection granted by this Code section may not be abolished or limited by a corporation's articles of incorporation or bylaws. However, the right to inspection enumerated in subsection (c) of this Code section may be limited by a corporation's articles of incorporation or bylaws for shareholders owning 2 percent or less of the shares outstanding."[3]

The shareholder argued that, notwithstanding the limitation in SunTrust's bylaws, he was entitled to exercise inspection rights under Georgia common law. The trial court granted SunTrust's motion to dismiss, and the Court of Appeals affirmed, finding that O.C.G.A. § 14-2-1602(e) abrogated any common law right of inspection provided to shareholders owning two percent or less of a corporation's shares. The court reviewed the legislative history of the provision in the unofficial "Peach Sheets," which reported that the two percent ownership limitation "met with significant opposition and debate." 308 Ga. App. at 692, citing K. Barfield, "Revised Georgia Business Corporation Code," Selected 1988 Georgia Legislation, 5 Ga. St. U.L. Rev, 285, 297

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[3] O.C.G.A. § 14-2-1602(c) authorizes inspection of excerpts of minutes of board of directors' meetings, accounting records, and shareholder records, provided that the shareholder makes a good faith demand for their inspection "for a proper purpose that is reasonably relevant to his legitimate interest as a shareholder." O.C.G.A. § 14-2-1602(f). By contrast, shareholders are unconditionally entitled to inspect the corporation's articles of incorporation, bylaws, shareholder or board resolutions regarding board composition or classes of shares, minutes of shareholders' meetings, a list of directors and the most recent annual registration with the Secretary of State.

(1988) at 299.[4] The court also reasoned that "[t]o conclude otherwise would render this Code provision meaningless, a result precluded by our rules of statutory construction." The court held: "Based on the plain language of OCGA 14-2-1602(e) and the intent of the General Assembly, we conclude that this Code provision abrogates by necessary implication any common law right of inspection provided to shareholders owning two percent or less of a corporation's outstanding shares."

***Advanced Automation, Inc. v. Fitzgerald*, 312 Ga. App. 406, 718 S.E.2d 607 (2011) – Statute Providing for Court's Exclusive Jurisdiction Over Statutory Close Corporation Oppression Action does not Affect Venue of Proceeding to Enforce Inspection Rights.**

A former employee of a Georgia statutory close corporation brought suit against the CEO and corporation in the Superior Court of Fulton County pursuant to O.C.G.A. § 14-2-940, seeking damages for breach of fiduciary duty, punitive damages and attorneys' fees. She also requested that the court require the corporation to purchase her shares for their fair value. Less than one month later, the former employee filed suit in the Superior Court of Cobb County, seeking to enforce her right as a shareholder to inspect the corporation's records. The Superior Court of Cobb County ordered the corporation to produce the records and awarded attorneys' fees, and the corporation appealed.

On appeal, the corporation argued, *inter alia*, that the Cobb County Court lacked jurisdiction because O.C.G.A. § 14-2-940 conferred exclusive jurisdiction on Fulton County. O.C.G.A. § 14-2-940 provides that a shareholder of a statutory close corporation may petition the court for relief if those in control of the corporation have acted, are acting or will act in a manner that is illegal, oppressive, fraudulent or unfairly prejudicial to the petitioner. It also provides that the proceeding must be commenced in the superior court of the county where the corporation's principal office is located, and that "[t]he jurisdiction of the court in which the proceeding is commenced is plenary and exclusive." However, the statute also provides that a shareholder's right to commence a proceeding under its provisions is in addition to any other right or remedy the shareholder may have. Relying on that language, the Georgia Court of Appeals held that while the Superior Court of Fulton County had exclusive and plenary jurisdiction over the first action, it did not preclude the shareholder's availing herself of other rights and remedies she had – such as the right to inspect the corporation's records, so the Superior Court of Cobb County was not divested of jurisdiction over the second action. The general venue provision for corporations under the Georgia Business Corporation Code is O.C.G.A. § 14-2-510, which provides that, generally, corporations are deemed to reside and are subject to venue in the county where the registered office is located. That section also confers venue for contract and tort

[4] The court discussed the use of the Peach Sheets as a source of legislative history, 308 Ga. App. at 692 n.1. By contrast, in rejecting the shareholder's citation of a comment to Subsection 14-2-1602(f) to support his argument that it provided a savings clause for common law inspection rights of two percent and less shareholders, the court referred to the disclaimer accompanying the comments that they should not be considered to be a statement of legislative intention and the rejection of the comments as authoritative by the Georgia Supreme Court in *Service Corp. International v. H. M Patterson & Son*, 263 Ga. 412, 115 n.5, 434 S.E.2d 455 (1993).

actions in counties where the corporation "has an office and transacts business" if the contract was made or was to be performed or the tort cause of action "originated" there.[5] However, O.C.G.A. § 14-2-940(b) provides that a shareholder must commence a proceeding under subsection (a) of that section in the superior court of the county where the corporation's principal office (or, if none in the state, its registered office) is located. The company actually argued that its principal office was in Dekalb County, but the plaintiff filed in Fulton, where the company's CEO resided, pursuant to the joint tortfeasor venue provision of O.C.G.A. § 9-10-31(b), since the CEO was also a defendant.

As for the inspection rights part of the Code, O.C.G.A. § 14-2-1604(b) and (c) provide that a shareholder whose requests to inspect and copy have not been met may "apply to the superior court in the county where the corporation's registered office is located." In this case, the corporation's registered office was in Cobb County.[6]

**_Grapefields, Inc. v. Kosby_, 309 Ga. App. 588, 710 S.E.2d 816 (2011) – Award of Attorney's Fees in Shareholder Books and Records Inspection Action Is Subject to "Any Evidence" Standard of Review.**

In this case, a shareholder of Grapefields, Inc. sought to copy and inspect Grapefield's corporate records under O.C.G.A. § 14-2-1602. Grapefields failed to respond to the stockholder's request, and the shareholder applied to the superior court under O.C.G.A. § 14-2-1604 and obtained an order allowing inspection and copying of the records as well as attorney's fees. *Id.* Grapefields appealed the award of attorney's fees. The appellate court affirmed.

The superior court held a hearing on attorney's fees under O.C.G.A. § 14-2-1604(c) and awarded the shareholder $25,220 as reasonable attorney's fees based on an affidavit filed by the shareholder's attorney stating the fees were expended in obtaining the order.

The Court of Appeals noted that O.C.G.A. § 14-2-1604(c) provides in mandatory language that the court "'shall' award attorney fees unless the inspection was refused in good faith." As a result, "the award of attorney fees will be affirmed on appeal if there is any evidence to support it unless, as a matter of law, the corporation proved that it refused inspection in good faith." *Id.* (citing *Haggard v. Bd. of Regents of Ga.*, 257 Ga. 524, 527, n.3, 360 S.E.2d 566 (1987)). Grapefields did not argue that it had refused inspection in good faith, arguing instead that some of the fees were unreasonable and were not "incurred to obtain the order" allowing inspection. *Id.* at 818.

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[5] Under § 14-2-510(b)(4), a tort plaintiff can sue in the county where the cause of action originated even if the corporation does not maintain an office and transact business there, subject, however, to the right of the corporation to remove the action to the county where it maintains "its principal place of business,"

[6] Special proceedings for appraisal of dissenters shares, O.C.G.A. § 14-2-1330, and judicial dissolution, O.C.G.A. § 14-2-1431 also restrict venue to where the registered office is (or has been) maintained. For venue over corporations in garnishment cases, *see* O.C.G.A. § 14-2-510(b)(5) and § 14-5-9.

> Grapefields argued that the shareholder's attorney's affidavit showed that legal research was unrelated to the matter, the attorney's consultations with a third party were unrelated to the order, and that some fees were unreasonable because they involved clerical services rather than legal services. *Id.* The court noted that Grapefields waived its right to cross-examine the attorney at the hearing and instead relied solely on its written response. *Id.* Further, the affidavit did not show on its face that the fees were unreasonable or incurred for unrelated matters, so under the "any evidence standard of review," the court held "that there was some evidence to support the superior court's award of attorney's fees. *Id.*

For another decision regarding inspection rights, see *In re Kwang Cha Yi*, 2011 WL 1364229 (N.D. Ga. April 11, 2011) (inspection rights claim must be asserted against the Company, not its officers) discussed in Section G.6 below.

***Griffin v. State Bank of Cochran*, 312 Ga. App. 87, 718 S.E.2d 35 (2011) – Director's Claim for Rescission of Stock Purchase Barred by Access to Financial Information Rendered Reliance on Alleged Misrepresentations Unreasonable.**

In this case, the State Bank of Cochran d/b/a First Laurens Bank ("FLB") sought to collect on a promissory note executed by MAL Rentals, LLC and Loretta M. Griffin. Griffin counterclaimed for fraudulent inducement.

Griffin was a member of the board of directors of Community Bank of West Georgia ("CBWG") and its holding company, Community Bancshares of West Georgia, Inc. (collectively "the boards"). A consultant hired by the boards informed the board members that CBWG would be sold but that they needed additional capital to fund continuing operations before the sale. Griffin claimed that based on advice from the consultant, she purchased additional shares of stock in order to provide capital in 2007 and 2008. Griffin obtained a loan from FLB to purchase the stock and later transferred the stock to MAL Rentals, which she owned and operated. FLB refinanced the loan in 2009 and MAL Rentals was named as the debtor. On behalf of MAL Rentals, Griffin signed a promissory note and a security agreement pledging the purchased stock as collateral for the refinanced loan. Griffin also signed a personal guaranty under which she accepted liability for repayment of the loan, plus attorneys' fees and collection costs. Both the note and the guaranty contained "integration" clauses providing that the note and loan documents were "the complete and final expression of the agreement[.]"

In 2009, CBWG was closed and the FDIC was named as receiver. As a result, FLB determined that a condition of default had occurred under the terms of the promissory note because the collateral securing the debt was rendered worthless. Griffin failed to provide substitute collateral as FLB requested and FLB filed suit to collect the loan. In her counterclaim, Griffin claimed she was fraudulently induced to purchase the stock based on the consultant's "alleged misrepresentation that CBWG was going to sell, which purportedly induced [her] to obtain the loan for her purchase of additional stock used to fund CBWG's continued operations pending a potential sale."

The Court of Appeals held that this alleged misrepresentation was not actionable because it did not "relate to an existing fact or a past event" but instead related to future events. The court noted that "[r]epresentations concerning expectations and hopes are not actionable" (citing *Fuller v. Perry*, 223 Ga. App. 129, 131(1), 476 S.E.2d 793 (1996)). The consultant's statements were a prediction that CBWG would be sold, and Griffin testified in her deposition that "she was aware that no final sale of CBWG had occurred at the time of the alleged misrepresentation and when she obtained the loan." Therefore, the consultant's statements were not actionable. The court also noted that although "claims of fraud arising from a representation of a future event made with knowledge that it is false or intention not to perform may be actionable[,]" there was no evidence here that the consultant knew that CBWG would not be sold or that he intended that any sale would not be finalized (quoting *Fuller*, 223 Ga. App. at 131-132(1), 476 S.E.2d 793).

The court also rejected Griffin's claim that the consultant's recommendation that she should invest more capital into CBWG was a misrepresentation because there was no evidence that this was a false representation. The consultant did not misrepresent CBWG's financial condition, and Griffin admitted that she knew the bank needed additional capital to continue operations. Further, there was no evidence that Griffin relied on the representation, as is necessary to make the representation actionable (citing *GCA Strategic Investment Fund v. Joseph Charles & Assocs.*, 245 Ga. App. 460, 464(3), 537 S.E.2d 677 (2000)). Griffin, as a board member, had access to financial information regarding CBWG and Community Bancshares, and was thus "in at least as good a position as the [FLB] to analyze [CBWG's and Community Bancshares's] financial condition, and [her] failure to investigate the matter showed a lack of due diligence." (quoting *Baxter v. Fairfield Financial Svcs.*, 307 Ga. App. 286, 294, 704 S.E.2d 423 (2010)). Griffin also could not blame FLB for her investment decision because "no confidential relationship exists between a bank and its customers or others with whom the bank deals" (quoting *Lilliston v. Regions Bank*, 288 Ga. App. 241, 244, 653 S.E.2d 306 (2007)). For these reasons, the court affirmed the lower court's grant of summary judgment for FLB on Griffin's fraud claim. Griffin's securities fraud claim under the former version of O.C.G.A. § 10-5-12 also failed because securities fraud and common law fraud required proof of the same elements (citing *Keogler v. Krasnoff*, 268 Ga. App. 250, 254, 601 S.E.2d 788 (2004)).

***Capital Financial Services Group, Inc. v. Hummel*, 313 Ga. App. 278, 721 S.E.2d 108 (2011) – Claims for Conversion of Securities Account Fail for Lack of any Exercise of Dominion over Account.**

This case involved a husband's claims for conversion of a securities account in the context of a divorce action. The Court of Appeals held the wife and her counsel did not exercise dominion or right of ownership over the account sufficient to establish the husband's claim for conversion.

Michael Levy, the sole owner of Capital Financial Services Group, Inc. ("Capital"), filed for divorce from his wife Sirka Hummel in November 2007. Hummel was represented in the divorce by the law firm of Warner, Mayou & Bates, P.C. ("Warner, P.C."). On March 11, 2009, the trial court entered a standing order in the divorce action providing that the parties were "enjoined and restrained from selling, encumbering, trading, contracting to sell, or otherwise disposing or removing from the jurisdiction of the court, any of the property belonging to the parties except in the ordinary course of business." Warner, P.C. sent letters and copies of the order to banks and other institutions holding Levy and Capital's accounts, including TD Ameritrade.

After the parties entered into a settlement agreement and final judgment and the court entered the decree of divorce, Levy attempted to trade stock on behalf of Capital using his TD Ameritrade account. TD Ameritrade notified Levy that it had received a letter from Warner, P.C. stating that "the account had been subject to a 'civil levy' or 'third preliminary injunction' since March 11, 2009 (the date of the standing order)." TD Ameritrade stated that Warner, P.C. had said the account could only be released with a court order or confirmation from Warner, P.C. Capital then sent a letter to Warner, P.C. demanding that Warner, P.C. notify TD Ameritrade that the account should be released. Warner, P.C. responded that it had sent the order to TD Ameritrade but had not said there was a "civil levy" on the account, and that Levy should request that TD Ameritrade contact Warner, P.C. Capital then filed a complaint for conversion against both Hummel and Warner, P.C., alleging that Warner, P.C. was in control of the account and in the alternative, that Warner P.C. should be liable for conversion because it failed to contact TD Ameritrade after learning that Levy's account was frozen. The trial court granted Warner, P.C. and Hummel's motion for summary judgment without identifying the facts on which its decision was based or its analysis of the legal principles involved.

The Court of Appeals affirmed the trial court's decision, holding that Capital could not establish the elements of conversion. In order to prove conversion, there must be an "unauthorized assumption and exercise of the right of ownership over personal property belonging to another, in hostility to his rights; an act of dominion over the personal property of another inconsistent with his rights; or an unauthorized appropriation." (quoting *J. Kinson Cook, etc. v. Heery/Mitchell*, 284 Ga. App. 552, 558(c), 644 S.E.2d 440 (2007)). Capital failed to show the elements of conversion because there was no act of dominion, since Warner, P.C. did not place a hold on Capital's account and did not have the authority to do so, and because the way in which TD Ameritrade interpreted Warner, P.C.'s letter and the court's order did not constitute an unauthorized appropriation by the firm. Additionally, the court rejected Capital's argument that Warner, P.C. should be liable for conversion based on the failure to contact TD Ameritrade after finding out that it had frozen Capital's account because "Warner, P.C. cannot be held liable for conversion for the failure to release dominion or control over Capital's property when it did not exercise that control."

The Court did not mention Article 8 of the Uniform Commercial Code, O.C.G.A. §§ 11-8-101 *et seq.*, "securities entitlements," "securities accounts" as forms of property created under Article 8 and defined in § 11-8-102(a)(17) and § 11-8-501(a), respectively, or the concept of "control," as defined in O.C.G.A. § 11-8-106.

***Akanthos Capital Management, LLC v. CompuCredit Holdings Corp.*, 770 F. Supp. 2d 1315 (N.D. Ga. 2011) – Corporate Noteholders Permitted to Assert Fraudulent Transfer Claims against Insiders in Absence of Insolvency, Illegality or Default.**

Noteholders for a publicly-traded company primarily owned by insiders brought suit under Georgia's Uniform Fraudulent Transfer Act ("UFTA") alleging that the defendant company and its insiders were defrauding the noteholders by transferring the company's assets to themselves while knowing that it would make it impossible for the company to repurchase the outstanding notes held by plaintiffs when they became due. Defendants moved to dismiss, first arguing that claims under UFTA were barred because the note indentures contemplated the transfers and remedies at issue. The defendants argued that the plaintiffs' rights were contractual in nature and thus extra-contractual claims were barred under New York law. The court disagreed, finding that while the plaintiffs were ultimately seeking to enforce rights granted by the indenture, their UFTA claim depended on outside facts and circumstances, turning on the defendants' intentions behind the transfers rather than their facial validity. The defendants also argued that suit was barred by the "No Action Clause" in the indentures, which required a demand on the issuer by 25% of the noteholders and notice of default. The court found that the plaintiffs in fact represented a majority of the noteholders, that there was no default to declare under the indentures and that the issuer's conduct and the need for equitable relief made it impossible as a practical matter to comply with the No Action Clause, citing *Whitebox Convertible Arbitrage Partners, L.P. v. World Airways, Inc.*, 2006 WL 358270 (N.D. Ga. Feb. 15, 2006).

Defendants next argued that the UFTA claim was not ripe because it had not missed any payments or obligations to Plaintiffs under the notes. The court found that such a ripeness argument was precluded, and that there were no provisions within the UFTA that require a creditor's claim to be ripe. In determining whether the Defendants had an actual intent to defraud, the court noted that the UFTA does not require that the plaintiffs show that Defendants intended to make the company insolvent, but merely that they intended to hinder the plaintiffs' ability to recover the value of their notes. UFTA also does not require the transfer itself to be illegal, only that the defendants' intention in making the transfers was to defraud creditors. The defendants argued that because the company was not insolvent, their duties were owed to the shareholders and that their actions must be taken to maximize shareholder value. The court refused to dismiss on this basis, and pointed out that the defendants did not show that maximizing shareholder value and defrauding noteholders are mutually exclusive actions. Finally, the court also agreed that UFTA allows for plaintiffs to seek injunctive relief against future disposition of the asset transferred or other assets, and the plaintiffs were allowed to seek injunctive relief to prevent the company from completing a spin-off that plaintiffs' claimed would be harmful to their interests.

The district court decision was reversed this year by the Eleventh Circuit in *Akanthos Cap. Mgt., LLC v. CompuCredit Holdings Corp.*, ___ F.3d ___, 2012 WL 1414247 (11th Cir. Apr. 25, 2012) (upholding the bar of the indenture's no action clause).[7]

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7 In a companion appeal by CompuCredit the Eleventh Circuit had ruled that the noteholders' collective action in rejecting CompuCredit's tender offer for their notes at less than par and their demand for full payment did not violate the Sherman Act: however, that decision has been vacated for *en banc* consideration, *CompuCredit Holdings Corp. v. Akanthos Cap. Mgt., LLC,* 661 F.3d 1312 (11th Cir. 2011), *vacated,* (11th Cir., *en banc*, Apr. 16, 2012).

## C. NONPROFIT CORPORATIONS.

***Presbytery of Greater Atlanta, Inc. v. Timberridge Presbyterian Church, Inc.*, 290 Ga. 272, 719 S.E.2d 446 (2011) – Neutral Principles of Law, Corporate Charter, Book of Order and Course of Dealing Establish an Implied Trust in Favor of Parent Church on Local Church's Property.**

In this case, the Georgia Supreme Court applied neutral principles of law to determine whether a local church, Timberridge Presbyterian Church ("Timberridge"), or the national organization, Presbyterian Church in the United States ("PCUSA"), had the right to control local property, absent express language in deeds conveying the property from its original owners to a corporation, Timberridge Presbyterian Church, Inc. ("TPC Inc.") to the local church.

To avoid First Amendment concerns in resolving property disputes among hierarchical religious denominations, the Court applied "neutral principles of law" to determine whether the local church or the parent church organization had the right to control the local property. These "neutral principles" included provisions of the relevant deeds, state statutes, and the governing documents of the local and general churches.[8]

The dispute arose between TPC Inc. and PCUSA as to who controlled Timberridge's property. In September 2007, TPC Inc. filed an action for declaratory judgment and injunctive relief against PCUSA, seeking a declaration that TPC Inc. owned all of Timberridge's property and did not hold it in trust for the benefit of PCUSA. TPC Inc. later amended its complaint to add a quiet title action. PCUSA filed a counterclaim, contending that TPC Inc. held the church property in trust for the benefit of PCUSA and should be enjoined from transferring the property. The parties filed cross-motions for summary judgment, and the trial court entered orders applying the neutral principles of law doctrine and concluding, among other things, that Section G-8.0201 of the PCUSA's Book of Order created a trust in favor of PCUSA as to any property held by TPC Inc. TPC Inc. filed an appeal and the Georgia Court of Appeals reversed the trial court's judgments. The Court of Appeals weighed the neutral principles, the relevant deeds, state statutes, and local and national church documents together, finding that the national church documents could not be dispositive. Instead, the Court focused on whether the evidence

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[8] See *Jones v. Wolf*, 443 U.S. 595, 602-606 (1979) (discussing the "corporate charter" of the local church and the "constitution of the general church"); *Georgia Dist. Council of the Assemblies of God, Inc. v. Atlanta Faith Mem. Church, Inc.*, 267 Ga. 59, 60-61, 472 S.E.2d 66 (1996) (reviewing the bylaws of the denomination); *Crumbley v. Solomon*, 243 Ga. 343, 343-344, 254 S.E.2d 330 (1979) (reviewing the Disciplinary Rules of the parent church); *Carnes v. Smith* , 236 Ga. 30, 37, 222 S.E.2d 322 (1976) (reviewing the Book of Discipline of the parent church and noting that the corporate charter of the local church would have been relevant if the local church had one). "We review all of these materials, keeping in mind that the outcome of these church property disputes usually turns on the specific facts presented in the record, that the neutral principle factors are interrelated, and that our ultimate goal is to determine 'the intentions of the parties' at the local and national level regarding beneficial ownership of the property at issue as expressed 'before the dispute erupt[ed]' in a 'legally cognizable form.'" *Jones v. Wolf* , 443 U.S. at 603, 606.

established an express trust under O.C.G.A. § 53-12-20. See *Timberridge Presbyterian Church, Inc. v. Presbytery of Greater Atlanta, Inc.*, 307 Ga. App. 191, 705 S.E.2d 262 (2010). The Court of Appeals concluded that,

> [r]ead as a whole in light of the relevant law, the evidence is inadequate to show the existence of a trust in favor of the Presbytery. The evidence must reveal that "factors other than mere connectional relationship between a local and general church were present." In the absence of some showing of intention and assent on the part of Timberridge, neutral principles of law cannot support the unilateral imposition of a trust provision drafted by the purported beneficiary of the trust and the resulting deprivation of the opposing party's property rights.

The Georgia Supreme Court granted *certiorari*, analyzed the issues by likewise considering the deeds, statutes, church governing documents and national church documents, and reversed. First, the deeds that transferred the property from the individual owners to Timberridge between 1970 and 1987 did not show an intent by the grantors to create a trust, but they also did not expressly preclude the creation of one. Because there was no language in the deeds creating a trust in favor of the national church, the Court held the deeds to be of limited value in deciding the case.

Second, the Supreme Court looked at two statutes: O.C.G.A. § 14-5-46, entitled "Conveyances to churches or religious societies confirmed," and O.C.G.A. § 53-12-20, entitled "Express Trusts." O.C.G.A. § 14-5-46 was quickly dismissed because the Court found that the Court of Appeals erroneously concluded that local and national church documents cannot establish a trust in favor of the national church without compliance with this statute. The Court concluded that the church documents in this case could not create a trust in favor of PCUSA because they were not "sufficient to establish an express trust" since they did not "show 'with reasonable certainty' an intention on the part of Timberridge to create a trust." The Supreme Court stated that requiring compliance with O.C.G.A. § 53-12-20, however, would be inconsistent with the teaching of *Jones v. Wolf* – "that the burden on a national church and its member churches to provide which one will control local church property in the event of a dispute will be 'minimal.'" 443 U.S. at 606. The Court noted that local churches can modify their deeds, amend their charters, or draft a separate, legally recognized document to establish an express trust as set forth in O.C.G.A. § 53-12-20. But that should not be the *only way* in which the parties can ensure that local church property will be held in trust for the benefit of the national church; it may also be done through the national church's constitution, for example, by making it "recite an express trust." *Jones,* 443 U.S. at 606. In short, contrary to the Court of Appeals' decision, the Supreme Court held that even though a trust was not created under the state's generic express trust statutes does not preclude the implication of a trust on church property under the neutral principles of law doctrine.

Third, the Supreme Court looked at the local church governing documents. Again, the Court disagreed with the Court of Appeals and held that TPC Inc. had legal title to the local church's property and its founding document plainly made the local church subject to the PCUSA Book of Order, which contains a very explicit trust provision. Under the corporate charter and the Book of Order, any effort by TPC Inc. or its members to break away from the PCUSA would result in the individuals no longer being members of the corporation and the property reverting to the control of PCUSA. By adopting these Articles of Incorporation, TPC

Inc. agreed to bind itself to PCUSA and to abide by the Book of Order, which included an explicit property trust.

Fourth, the Supreme Court analyzed the national church documents. Timberridge joined the PCUSA when the reunited national church was established in 1983. There was no dispute that *at that time* (1) the PCUSA's governing constitution plainly stated that local churches hold their property in trust for the use and benefit of the general church, and (2) the governing constitution of the national church to which Timberridge had previously belonged, the Presbyterian Church in the United States, contained an identical trust provision. Moreover, the Court held, *when Timberridge affiliated with the PCUSA*, it agreed that it "was a local expression of the universal church," that it would be "governed by this Constitution," that its active members have "voluntarily submitted to the government of this church," and that it would "function under the provisions of this Constitution." Timberridge, the Court stated, then had the right to leave the PCUSA for eight years, taking its property with it, but instead it stayed. Thus, contrary to the Court of Appeals' view that the PCUSA "unilateral[ly] impos[ed]" the trust provision without any assent by the local church, the Supreme Court held that Timberridge's act of affiliating with the PCUSA in 1983 with a trust provision *already* in its governing constitution demonstrated that Timberridge assented to that relinquishment of its property rights - rights it then chose not to reassert by leaving the new national church during the next eight years.

Finally, the Court rejected an assertion that the neutral principles doctrine, and particularly its consideration of church governing documents, creates a bias for the national church. The Court stated that the neutral principles doctrine, as approved by the majority in *Jones v. Wolf*, allows hierarchical denominations to structure the property relationships between the general and local churches before disputes arise. The result is not pre-ordained; it depends on the deeds, statutes, and national and local churches' governing documents. Thus, like the trial court, the Supreme Court concluded that neutral principles of law demonstrated that an implied trust in favor of the PCUSA existed on the local church's property to which TPC Inc. held legal title.

***Rector, Wardens and Vestrymen of Christ Church in Savannah v. Bishop of the Episcopal Diocese of Georgia Inc.*, 290 Ga. 95, 718 S.E.2d 237 (2011) – Neutral Principles of Law Used to Find that Local Church Property was Held in Trust for the Benefit of the National Church.**

In this case, as in *Presbytery of Greater Atlanta, Inc. v. Timberridge Presbyterian Church, Inc.*, *supra*, the Supreme Court of Georgia applied the neutral principles of law doctrine approved by the U.S. Supreme Court in *Jones v. Wolf*, 443 U.S. 595, 602-606 (1979) to settle a property dispute between the Rector, Wardens and Vestrymen of Christ Church in Savannah (collectively "Christ Church") and the Protestant Episcopal Church in the United States of America ("Episcopal Church") and Episcopal Diocese of Georgia, Inc. ("Georgia Diocese").

On November 14, 2007, the Episcopal Church and Georgia Diocese filed suit against Christ Church seeking injunctive relief, damages, and a declaratory judgment that all the property of Christ Church was held in trust for the Episcopal Church. The trial court granted summary judgment in favor of the Episcopal Church and the Georgia Diocese. The Court of

Appeals affirmed. 305 Ga. App. 87, 699 S.E.2d 45 (2010). Both the trial court and the Court of Appeals relied in part on O.C.G.A. §§ 14-5-46 and 145-5-47 in concluding that the property of Christ Church was impressed with an implied trust in favor of the Episcopal Church. The Supreme Court of Georgia granted Christ Church's petition for *certiorari* to decide whether the trial court and the Court of Appeals erred in applying the neutral principles doctrine, particularly with respect to O.C.G.A. §§ 14-5-46 and 145-5-47. As in *Presbytery of Greater Atlanta*, the Court analyzed the deeds, state statutes, and the governing documents of the local and national churches. The Court concluded that the lower courts correctly applied neutral principles of law in finding that Christ Church's property was held in trust for the benefit of the Episcopal Church.

The first neutral principle to be examined was the legal instruments of title that were used to transfer the property at issue. The Court agreed with the trial court and the Court of Appeals that none of the title instruments in the case created a trust in favor of the Episcopal Church. However, they did not preclude the creation of one. Christ Church, like other legal titleholders in fee simple, had the authority to place its property in trust or to act in ways that would impress a trust on the property. Given that the instruments of title neither included nor prohibited a trust in favor of the Episcopal Church, they held a limited role in the neutral principles analysis in this case, and so the Court turned to consideration of other neutral principles.

Next, O.C.G.A. §§ 14-5-46 and 14-5-47 [9] were used to express Georgia's policy of looking to "the mode of church government or rules of discipline" in resolving church property disputes – a policy fully consistent with *Jones v. Wolf*'s focus on local and general church governing documents as an important neutral principle. Christ Church pointed to Georgia's generic express trust statute found in O.C.G.A. § 53-12-20 as proof that there was no trust over Christ Church's property in favor of the Episcopal Church. However, as in *Presbytery of Greater Atlanta*, the Court stated, requiring strict compliance with O.C.G.A. § 53-12-20 would be against the teaching of *Jones v. Wolf* (holding that the burden on the general church and its local churches to provide which one will control local church property in the event of a dispute will be "minimal"). The Court noted the fact that a trust was not created under Georgia's generic express trust statute does not preclude the implication of a trust on church property under the neutral principles of law doctrine.

The final neutral principle the Court analyzed was the governing documents of the local and general churches. "The neutral-principles method, at least as it has evolved in Georgia, requires a civil court to examine certain religious documents, such as a church constitution, for language of trust in favor of the general church." *Jones v. Wolf*, 443 U.S. at 604. Christ Church repeatedly pledged its unequivocal adherence to the discipline of the Episcopal Church, including when it organized the Georgia Diocese of the Episcopal Church in 1823 and in its formal corporate Articles of Amendment filed with the State of Georgia in 1918 and its Articles of Incorporation filed in 1981. The record also showed that at all times during the 180 years before this dispute began, Christ Church acted consistently with the Episcopal Church's canons regarding its property, demonstrating Christ Church's understanding that it could not consecrate, alienate, or encumber its property without the consent of the Episcopal Church. Having

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[9] §§ 14-5-46 and 14-5-47 address conveyances of property "to any church or religious society." They date back more than two centuries. 290 Ga. at 99, 818 S.E.2d 237.

reviewed the governing documents of the local church and the general church, the Court concluded, as did the trial court and the Court of Appeals, that a trust existed on Christ Church's property in favor of the Episcopal Church.

***Partnership Housing Affordable to Society Everywhere, Inc. v. Decatur County Board of Tax Assessors*, 312 Ga. App. 663, 219 S.E. 2d 556 (2011) – Nonprofit Did Not Qualify for Ad Valorem Tax Exemption for Charities Because of Non-charitable Use of Funds.**

O.C.G.A. § 48-5-41(a)(4) provides that "[a]ll institutions of purely public charity" shall be exempt from all ad valorem property taxes. In order to qualify as an institution of "purely public charity" under this Code section, "*First, the owner must be an institution devoted entirely to charitable pursuits*; second, the charitable pursuits of the owner must be for the benefit of the public; and third, the use of the property must be exclusively devoted to those charitable pursuits," quoting *York Rite Bodies, etc. v. Board of Equalization, etc.*, 261 Ga. 558, 408 S.E.2d 699 (1991) (emphasis by Court).

The Court in this case found that Partnership Housing Affordable to Society Everywhere, Inc. ("PHASE") was not entitled to an exemption under O.C.G.A. § 48-5-41(a)(4) because it was not "devoted entirely to charitable pursuits." Based upon the "any evidence" standard of review, the Court affirmed the trial court's decision that PHASE's conduct in giving $229,950 to a limited partnership in the form of a loan that was not expected to be repaid served the non-charitable purpose of increasing the limited partnership's tax credits. This unearned increase in the tax credits provided pecuniary gain to investors related to PHASE in violation of PHASE's articles of incorporation, which provided that PHASE would "receive and administer funds *exclusively* for … charitable purposes *without pecuniary gain* or profit, *incidental or otherwise*, to any individual…" (emphasis by Court). A *certiorari* petition is pending at this writing.

***Harris v. The Southern Christian Leadership Conference, Inc.*, 313 Ga. App. 363, 721 S.E.2d 906 (2011) – Directors of Nonprofit Corporation Breached Fiduciary Duties by Pursuing Lawsuit without Authorization and Using Corporate Funds to Pay Litigation Expenses.**

In this case, the Southern Christian Leadership Conference, Inc. ("SCLC"), its Board of Directors, and three individuals (collectively, "SCLC"), sued six former or current members of its Board of Directors ("the Defendants"), seeking an order enjoining them from interfering with the SCLC's corporate governance or with its use and enjoyment of the corporate headquarters. The SCLC also sought a declaratory judgment identifying its board members and officers, alleging that the Defendants had breached their fiduciary duty to the corporation, and seeking the repayment of corporate money the Defendants used to pay legal fees in a previous lawsuit. The SCLC also sued Wachovia Bank, N.A., and Citizens Trust Bank, seeking an injunction directing that the SCLC accounts be controlled by the Board of Directors.

The trial court granted a permanent injunction against the Defendants from interfering with the SCLC's governance, from interfering with the SCLC's use of its property and assets, and from holding themselves out as corporate officers unless they were re-elected, reinstated, or appointed by the Board. The court also determined and declared the identity of the members of the Board of Directors as of June 1, 2010, and held that the acts taken by that Board and its successors in accordance with the SCLC's constitution and by-laws were binding on the corporation. The trial court also found that the bank accounts at Wachovia and Citizens Trust should be managed and controlled by the Board of Directors, and ordered the banks to lift any freezes on the accounts and give access to the authorized representatives of the Board. The court then found that the Defendants breached their fiduciary duties to the SCLC by using corporate funds to pay for the previously-dismissed lawsuit, which had not been authorized by the Board of Directors. The trial court entered a judgment against all four Defendants for $12,240.

The Defendants enumerated seven errors on appeal: (1) that the trial court erred in finding that the Defendants' meetings were not valid under the SCLC constitution and by-laws, and that the actions taken at the meeting were valid; (2) that the trial court erred in finding that the meetings held by the plaintiffs' faction of the SCLC Board of Directors were legal and in conformity with the SCLC's constitution and by-laws; (3) that even if the Plaintiff's meetings were proper, the removal of any Board members during those meetings was improper; (4) that the trial court erred in finding that certain defendants breached their fiduciary duties in failing to investigate allegations of monetary misuse; (5) that the trial court erred in finding that Defendants breached their fiduciary duties by paying $12,240 from SCLC funds to the attorney in a prior lawsuit; (6) that the trial court erred in failing to consider "admissions of perjury"; and (7) that the trial court erred in "refusing to consider" their motion to disqualify the SCLC's attorney based on a non-waivable conflict of interest. After reviewing the testimony and other evidence, the Court of Appeals found no errors and affirmed the trial court's findings of fact and conclusions of law on these issues.

## D. LIMITED LIABILITY COMPANY DEVELOPMENTS.

***St. James Entertainment LLC v. Crofts*, --- F. Supp. ---, 2011 WL 3489992 (N.D. Ga. Aug. 8, 2011) – Diversion of Company Business Opportunities Not Permitted Despite Provision Allowing Pursuit of Other Opportunities and Exculpatory Clause.**

On November 30, 2001, Jimmy Seals and Defendant Dash Crofts entered into an Agreement with Jack Hale, d/b/a Hale House Productions, and Plaintiff St. James Entertainment LLC to create a company, SCHR Productions, LLC, which would produce re-recordings of Seals & Crofts songs for a new album. 2011 WL 3489992 at *1. The Agreement provided that SCHR would be run by the Board of Managers, which initially included Hale, Seals, and Crofts. Although the court does not refer to the Agreement as an LLC operating agreement, its description of the provisions indicates that it served that purpose, but also governed the rights and obligations of the parties with respect to the venture it was formed to conduct. Under the Agreement, only St. James and Hale had "authority to bind the Company with respect to any contracts or documents reasonably necessary for the promotion, manufacturing or distribution of the Album." *Id.* Seals and Crofts were to "complete production and delivery to the Company at least [45] minutes of master recordings…within [10] weeks from the date of the first recording session," but failure to perform these obligations would "not be deemed a breach of [the] Agreement unless [St. James] gives [Crofts] written notice of such failure to perform" and the failure was not corrected within 30 days after notice. *Id.*

Also, under the Agreement, all parties were "entitled to pursue other investments, business opportunities or musical pursuits…free and clear of any interest, claim or entitlement of the Company and any other Member." No member had any duty to "offer any other Member an opportunity to invest in, or otherwise participate in any such investment, business opportunity or musical pursuit." A manager of the company would not be liable to the company or its members "for any act or omission, unless such act or omission is the direct result of fraud or willful misconduct of the Manager where the Manager did not act in good faith." *Id.* However, each member did agree to do all other acts "as may be required by law or as may be required to carry out the intent and purposes of the Agreement." *Id.*

The parties completed the album with 41 minutes and 44 seconds of recordings and released it in May 2004. In 2008, John Lappen, an agent for San Juan Records, contacted John Bultman, the managing member of the Company, to inquire about using the album's version of the song "Summer Breeze." Bultman notified Crofts, who then sent an email to Lappen stating that Bultman and his company were an investment company that did not know anything about music. The email stated further that Crofts thought Seals would be reluctant to re-record "Summer Breeze," but that he would call him to discuss. Additionally, Crofts stated that Bultman's company would not be involved in the deal because his company was "only involved in the second recording of Summer Breeze and not in any other hit we recorded." However, Crofts sent the email to Bultman instead of Lappen by accident. St. James claimed that Crofts' email was intended to divert San Juan Records from doing business with the company, but Crofts claimed the email was meant to prevent Lappen from contacting St. James so that Crofts could "verify Lappen's credentials, qualification and reputation."

After Crofts sent the e-mail to Bultman, Crofts continued to communicate with Lappen but ultimately rejected Lappen's offer to re-record "Summer Breeze." St. James claimed that it declined Lappen's offer to use the album version of the song on the basis of Crofts' alleged misconduct.

In July 2009, St. James sued Crofts, seeking equitable rescission of the contract and damages for breach of contract, breach of fiduciary duty, breach of the duty of good faith and fair dealing, and unjust enrichment. St. James also sought injunctive relief and an accounting. The court dismissed the equitable rescission claim and the parties filed motions for summary judgment.

St. James claimed that Crofts breached the agreement by using the recordings for commercial gain without the company's permission. St. James claimed that Crofts had no authority under the agreement to negotiate with Lappen or San Juan, and that Crofts breached the agreement by interfering with a potential business deal for the company.

The court framed the issue as whether Crofts acted within his contractual rights to pursue other business opportunities or whether he failed to carry out the company's business by attempting to divert its opportunity for personal benefit. Without specifically so holding, the court clearly interpreted the disclaimer of business opportunities not to permit the diversion of opportunities that were first presented to the company. The court concluded that a jury could find that Crofts' communications with Lappen were intended to screen San Juan Records as Crofts claimed, and that Crofts did not breach the agreement. *Id.* at *5. Further, if the jury found that Crofts thought Lappen was only interested in re-recording the song and was not aware of Lappen's interest in the album, Crofts would be pursuing other business opportunities, which was allowed under the terms of the agreement. Alternatively, a jury could find that Crofts was trying to divert business from the company, thus breaching the provision of the agreement requiring Crofts to do all acts "as may be required to carry out the intent and purposes of [the] Agreement." *Id.* Therefore, the court denied summary judgment to either party on those claims.

On St. James' breach of fiduciary duty claim, Crofts argued that his conduct was allowed by the agreement, and even if it was not, the exculpatory clause in the Agreement required a showing of bad faith. The court stated that "corporate" officers and directors are fiduciaries and owe a duty of good faith to the company, citing O.C.G.A. § 14-11-305(1), and since there was a genuine dispute regarding whether Crofts attempted to steer business away from the company, the court could not grant either party summary judgment on this claim. *Id.* at *7.

The court next addressed St. James' claims for breach of the duty of good faith and fair dealing. The court held that there was a genuine dispute regarding whether Crofts' actions were permitted under the agreement or whether he breached the agreement, so the court could not "determine as a matter of law whether Defendant violated the duty of good faith and fair dealing." *Id.* at *8. Additionally, although Croft may not have had an obligation to "promote the Album before seeking a separate business opportunity, he does have an obligation not to divert a business opportunity away from the Company." Therefore, the court denied both parties' motions for summary judgment on the breach of fiduciary duty claim.

St. James also argued that it was entitled to the equitable remedy of accounting if it could prove that Crofts breached his fiduciary duties. In support of this argument, St. James cited *Williams v. Tritt*, 262 Ga. 173, 415 S.E.2d 285, 286 (1992). In *Williams*, the Supreme Court of Georgia held that accounting was an "appropriate remedy under the Georgia Uniform Partnership act, specifically O.C.G.A. § 14-8-33." *Id.* (citing *Williams*, 415 S.E.2d at 286). The court distinguished the *Williams* case on the facts because in *Williams* there was evidence that one partner received benefits from a business to which another partner did not consent. *Id.* (citing *Williams*, 415 S.E.2d at 286). The court noted that the Georgia Code allows for an accounting in partnerships in O.C.G.A. § 14-8-33, but there is no corresponding provision for limited liability companies. Further, St. James failed to produce "evidence that an accounting would likely result in the discovery of an amount of money to which it is entitled." *Id.* (citing *Riverview Condo. Ass'n. v. Ocwen Fed. Bank, FSB*, 285 Ga. App. 7, 645 S.E.2d 5, 7 (2007)). Therefore, the court dismissed St. James' request for accounting.

***Moses v. Pennebaker*, 312 Ga. App. 623, 719 S.E.2d 521 (2011) – Valuation of LLC Interest for Conversion and Breach of Fiduciary Duty Claims Properly Determined as of Date When LLC Could no Longer Carry on Business, not Date on Which Judicial Dissolution is Ordered.**

Ashley Pennebaker, one of two members of International Merchandise Group, LLC ("IMG") a Georgia LLC, filed a petition for judicial dissolution. The second member, Douglas Moses, filed an answer asserting a counterclaim for fraud and breach of fiduciary duty. The court entered a consent order granting a final judgment on the issue of dissolution, dissolving IMG but retaining jurisdiction to enter any ancillary or other relief to effect the winding up and termination of the LLC and to effect the other dictates of the order. Later, Pennebaker filed several amendments to the petition for dissolution, adding other claims for conversion, breach of fiduciary duty and usurpation of corporate opportunities, and for compensatory and punitive damages. The court eventually found that Moses had willfully and intentionally failed to comply with various court orders, and it struck his answer and dismissed his counterclaim with prejudice. It entered judgment and awarded damages in favor of Pennebaker on all his claims, and Moses appealed, arguing that the court erred in considering the claims asserted in the amendments to the dissolution petition because they were filed after the court entered final judgment on the petition. The Georgia Court of Appeals held that Pennebaker was authorized to amend his pleadings because at the time of the amendments, the court had not entered a pretrial order, which under O.C.G.A. § 9-11-15(a) terminates a plaintiff's ability to amend as a matter of right, nor had the court entirely disposed of all the claims asserted in the case.

Moses also argued on appeal that the court erred in calculating damages as to the dissolution of IMG because it should have based the value of the company on the date when the court entered the order dissolving it. The Court of Appeals disagreed, finding that the court was entitled to determine the company's value as of the date that Pennebaker had ceased participating in the operation of the company and it was no longer possible to carry on the company's business. *See* O.C.G.A. 14-11-603(a) ("the court may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or a written operating agreement.") As of that date, Pennebaker had notified Moses of his intent to terminate their business relationship and dissolve IMG, and a few months later filed the petition for judicial dissolution. The petition alleged that as of the date of filing, the corporation could not carry on its business, the members could not agree on material decisions necessary for its operation, and it could not be effectively managed by its members. The allegations in the petition were undisputed because the court had struck Moses' answer. On the valuation date issue, the Court of Appeals cited two decisions holding that damages based on the value of a business interest should be determined at the time that the plaintiff was deprived of the business interest or the plaintiff ceased his or her involvement with the company, *Monterrey Mexican Restaurant of Wise, etc. v. Leon*, 282 Ga. App. 439, 449-450(5)(c), 638 S.E.2d 879 (2006) and *Internal Medicine Alliance v. Budell*, 290 Ga. App. 231, 235(1), 659 S.E.2d 668 (2008), and noted that it was required to affirm the trier of fact if the award was within the range of evidence presented at trial and could reverse the findings of fact rendered in a bench trial only if clearly erroneous.

The Court of Appeals also affirmed the trial court's award of nominal damages for breach of fiduciary duty and usurpation of corporate opportunities, finding that Moses took control of IMG without authority, managed IMG unilaterally and without authority, and set up a company to compete with IMG, that he operated out of IMG' office using IMG's equipment and employees.

***Denim North America Holdings, LLC v. Swift Textiles, LLC*, 2011 WL 97238 (M.D. Ga. Jan. 12, 2011) – LLC's Participation in Lawsuit Was Unauthorized under Operating Agreement, thus its Joinder Was Fraudulent and Could Not Destroy Diversity of Citizenship.**

This is the first of three decisions handed down by the U.S. District Court for the Middle District of Georgia in a factually complicated dispute involving a joint venture conducted through an LLC.

The plaintiffs in this case sought remand of the action from federal to state court after its removal on the grounds that complete diversity of citizenship between the parties did not exist. Plaintiffs claimed that plaintiff Denim North America, LLC ("DNA") and defendant Swift Textiles, LLC ("Swift") were both citizens of the same state, Georgia. The defendants argued that DNA was fraudulently joined and its citizenship should be ignored. The court found that DNA's participation in the suit was unauthorized under its operating agreement, it was thus fraudulently joined and its citizenship did not destroy diversity.

The case arose from a dispute between plaintiffs DNA and Denim North America Holdings ("Holdings") and defendants Galey & Lord, LLC, Patriarch Partners, LLC, and Swift. *Id.* DNA was "a limited liability company with two members, each with a 50% ownership interest." Plaintiff Holdings was one of the members and defendant Swift was the other, so DNA was attempting to sue one of its owners. When DNA was established, the two owners executed a written operating agreement stating that each member would appoint four managers to manage DNA. A majority of the managers had to approve most management decisions, and they were specifically authorized to retain legal counsel. Defendants argued that DNA was fraudulently joined as a plaintiff because it was undisputed that a majority of the managers did not approve the filing of the action.

Plaintiffs filed affidavits from DNA's president, Larry Galbraith, stating that "he authorized the filing of this action on behalf of DNA." 2011 WL 97238 at *1. Plaintiffs claimed that Galbraith did not have to obtain the approval of a majority of the managers before filing suit because "he had previously retained legal counsel in other unrelated matters without the express concurrence of a majority of the managers." Further, plaintiffs claimed that the operating agreement allows "delegation of the authority to retain legal counsel to the president." The operating agreement stated that the managers can "delegate certain management functions to various officers" and provided that the president had certain management responsibilities. *Id.* at *2. Based on the operating agreement and the alleged prior course of conduct, plaintiffs argued that Galbraith could institute the action against Swift. Defendants countered that the agreement "unambiguously requires that any action by DNA against one of its owners requires, at a minimum, concurrence by a majority of its managers."

The Court noted that the disposition of the motion for remand hinged on whether defendants showed by clear and convincing evidence that DNA's president could not institute the action because "[i]t is well established under Georgia law that if an officer of a legal entity, including a limited liability company, did not have authority to institute a legal action on behalf of that entity, then that legal action must be dismissed." *Id.* (citing *Glisson Coker, Inc. v. Coker*, 260 Ga. App. 270, 272-73, 581 S.E.2d 303, 305-06 (2003)). If Galbraith did not have authority to bring suit, then DNA's pleading of jurisdictional facts would be fraudulent.

The Court held that neither the operating agreement nor past conduct authorized Galbraith to bring suit "without the express concurrence of a majority of the managers." *Id.* at *3. The fact that Galbraith had retained counsel on unrelated matters in the past was irrelevant because the issue was whether he was "authorized to institute *this particular* action against Defendants, one of whom is a member and 50% owner of DNA." Even though as president, Galbraith had authority to handle some legal issues "as part of the day-to-day affairs of the company, it would be an irrational legal stretch to conclude that this alleged delegation of authority would include authorization to sue one of its significant owners." *Id.* (citing *Glisson Coker, Inc.*, 260 Ga. App. at 830, 581 S.E.2d at 305).

Therefore, the Court held that defendants met their burden of establishing fraudulent joinder, and the motion for remand was denied because complete diversity existed. The court noted that its holding placed DNA in a difficult position because it could not "seek a direct remedy through the courts for the violation of certain rights that one of its 50% owners feels should be vindicated through the judicial process." *Id.* However, this problem was due to DNA's management structure, which the members agreed to. The Court noted that DNA's members were still free to pursue any other remedies under Georgia law to resolve the management deadlock.

***Denim North America Holdings, LLC v. Swift Textiles, LLC*, 2011 WL 318127 (M.D. Ga. Jan. 28, 2011) – Under O.C.G.A. § 14-8-6(b), LLC Members Are Not Partners and Partnership Fiduciary Duties Held Inapplicable to LLC; Fiduciary Duties of a Managing Member Apply to Member Entitled to Appoint Half of Managers; conflict of interest claims dismissed where operating agreement contained opt-out provision under O.C.G.A. § 14-11-307.**

In the second decision, the court addressed the defendants' motion to dismiss for failure to state a claim for which relief can be granted under Fed. R. Civ. Proc. 12(b)(6).

Plaintiff Denim North America Holdings, LLC ("Holdings") and Defendants Swift Textiles, LLC ("Swift"), Galey & Lord, LLC ("Galey"), and Patriarch Partners, LLC ("Patriarch") "entered into a business venture to manufacture and sell denim textile products through a limited liability company, Denim North America, LLC ("DNA")." 2011 WL 318127 at *1. Holdings and Swift jointly controlled and owned DNA, and the dispute arose when Holdings claimed that Defendants "fraudulently induced it into the venture and subsequently breached contracts and fiduciary duties relating to that business relationship." *Id.*

Before 2006, DNA was a Georgia company owned by John Pezold and George Jeter. The company was profitable but was not operating at full capacity, so in 2006, a Galey executive proposed a joint venture with DNA, Swift, Galey, and Patriarch. Galey owned Swift and Patriarch owned Galey (the subsidiaries collectively referred to as "Swift Galey").

Patriarch negotiated the joint venture on behalf of all the defendants and met with DNA representatives in New York at which, Patriarch representatives made representations about how

DNA would benefit from the joint venture. Patriarch discussed Swift Galey's sales program and sales support department, and represented that "Swift Galey's sales, marketing, development, technical service, and customer service capabilities" could combine with DNA's existing facilities to increase sales and profits. Patriarch also stated that "if DNA would exclusively manufacture premium quality denim" at its Georgia facility, "then Swift Galey would use its manufacturing facilities in China and Mexico to produce lower-grade denim." The products "could then be combined to offer a mixed product base that would be more attractive to customers." *Id.* Patriarch represented that if DNA agreed to this arrangement, "Swift Galey would hire DNA's sales force and use its exclusive efforts to sell DNA's denim." *Id.* at *2. Further, Swift Galey would produce enough orders for DNA to operate its facility at full capacity. DNA would need to purchase new equipment from Swift Galey and hire and train new employees to meet this demand.

Pezold and Jeter then formed Holdings in order "for Holdings and Swift to jointly own and manage DNA." Swift took a 50% ownership interest in DNA and Holdings remained a 50% owner and manager under a Subscription Agreement executed in September 2006. Holdings, Swift, and DNA entered into an Operating Agreement under which DNA was run by eight managers, four of whom were appointed by Holdings and four of whom were appointed by Swift. Swift, Galey, and DNA entered into a Manufacturing and Supply Agreement.

DNA then sold its existing equipment, installed new equipment from Swift Galey, hired and trained new employees, and converted its facility to full capacity in accordance with the agreements. However, Swift Galey failed to produce the promised customer orders. Also, 12 months into the joint operation, Swift Galey "terminated its sales force and abandoned its obligations to DNA." Holdings had to rehire DNA's sales staff, terminate the new employees running the facility, and finance DNA's operations on its own. Holdings also "discovered that Patriarch had concealed ten million yards of warehoused denim inventory which Swift Galey sold for its own benefit after the joint operation of DNA had begun." *Id.*

Following these developments DNA and Holdings filed suit against Swift, Galey, and Patriarch, alleging fraudulent inducement, breach of fiduciary duty, breach of contract, rescission, breach of duties owed by members of an LLC under O.C.G.A. § 14-11-307, and punitive damages. All three defendants filed motions to dismiss for failure to state a claim.

Defendants argued that Holdings' breach of fiduciary duty claim failed because there was no partnership between Defendants and Holdings, and thus no fiduciary duty. *Id.* at *6. The court agreed that there was no partnership, noting that under Georgia law, "[a] partnership is an association of two or more persons to carry on as co-owners a business for profit." *Id.* (quoting O.C.G.A. § 14-8-6(a)). However, "any association formed under any other statute of this state…is not a partnership." *Id.* (quoting O.C.G.A. § 14-8-6(b)). Therefore, an association formed under the Georgia Limited Liability Company Act, O.C.G.A. § 14-11-100 *et seq.* is not a partnership. Despite Holdings' claim that it formed a partnership with defendants, the agreements the parties executed contradicted this claim because DNA was a Georgia limited liability company with Holdings and Swift as its members. *Id.* at *7. The "relationship between Holdings and Defendants arises from its status as a member of DNA and not as a partner in a separate partnership." *Id.* (citing § 14-8-6(b)). Further, Patriarch and Galey were not members of DNA and therefore had "no relationship with Holdings that would give rise to a breach of fiduciary duty claim." Therefore, the Court dismissed Holdings' claims for breach of fiduciary duty against Patriarch and Galey.

As for Holdings' breach of fiduciary duty claims against Swift, the court noted that "managing member[s] of a limited liability company…owe a fiduciary duty to its fellow members." *Id.* (citing O.C.G.A. § 14-11-305(1)). Swift claimed it did not owe a fiduciary duty to Holdings because it was not a managing member. The Court noted that Swift was correct that a non-managing member of an LLC does not owe duties to the LLC or other members just by acting as a member. *Id.* (citing O.C.G.A. § 14-11-305(1); *accord ULO, LLC v. Meder*, 293 Ga. App. 176, 184-85, 666 S.E.2d 713, 720-21 (2008)). However, the Court found that Swift was a managing member because under DNA's Operating Agreement, Swift appointed four of the eight managers, and the managers could only take action if a majority of the managers agreed. Swift therefore owed a fiduciary duty to Holdings.

Swift also argued that it did not breach any fiduciary duty because Holdings' complaint only alleged that Swift breached duties arising from the written agreement. Swift relied on the principle that failure to perform under a contract is not a tort, and in order to sue for breach of fiduciary duty, "'the defendant must also breach an *independent* duty created by statute or common law' and 'the plaintiff must have an independent injury over and above the mere disappointment of plaintiff's hope to receive the contracted for benefit.'" *Id.* (quoting *Brock Built, LLC v. Blake*, 300 Ga. App. 816, 824, 686 S.E.2d 425, 432 (2009)). Holdings claimed Swift breached its fiduciary duties by "(1) making fraudulent misrepresentations and fraudulently concealing material facts in the operation of' DNA…(2) usurping LLC opportunities and engaging in a conflict of interest transaction when it concealed millions of yards of warehoused denim and subsequently sold that inventory for its sole benefit after the start of the Holdings-Swift joint operation of DNA,…and (3) closing its China and Mexico manufacturing facilities and terminating DNA's sales staff shortly after" the start of the joint venture. *Id.* at *8. The Court found that despite the fact that allegations nos. (2) and (3) related to obligations under the Manufacturing Agreement, Holdings could still assert the breach of fiduciary duty claim because "Swift had a duty to 'act in a manner [it] believes in good faith to be in the best interests of the limited liability company'" in addition to its contractual duties. (quoting O.C.G.A. § 14-11-305(a)). Additionally, "Holdings was not a party to the Manufacturing Agreement[,]" so Holdings could not assert its breach of fiduciary duty claims as a breach of contract claim. Therefore, Holdings' breach of fiduciary duty claim was independent of any breach of contract claim, and the Court denied defendants' motion to dismiss this claim.

Defendants next argued that Holdings was estopped from asserting fraud claims based on the merger provisions in the operating and subscription agreements. *Id.* at *12. The Court noted that typically, if there is a merger clause in a contract, a plaintiff "'cannot argue they relied [upon] misrepresentations other than those contained in the contract.'" *Id.* (quoting *Authentic Architectural Millworks v. SCM Group, USA*, 262 Ga. App. 826, 828, 586 S.E.2d 726, 729). However, the Court held that the merger provisions here did not preclude Holdings' claims "as a matter of law because Holdings is seeking to rescind those agreements based on inceptive fraud and because Holdings' fraudulent inducement claims are based in part on the Subscription Agreement itself." *Id.*

The Court then addressed Holdings' claims for rescission of the contract. The Court noted that in general, a party seeking rescission must do so before filing a lawsuit, and Holdings did not do so. However, there is an exception to this rule when it would be "impossible or unreasonable" to tender return of the consideration in exchange for rescission. *Id.* at *13 (citing *Orion Capital Partners, L.P. v. Westinghouse Elect. Corp.*, 223 Ga. App. 539, 543, 478 S.E.2d 382, 385 (1996)). Holdings alleged that "rescinding the agreements would be unreasonable or impossible and that it was made so by Defendants' wrongful conduct." Therefore, the Court held that Holdings sufficiently raised issues of fact regarding whether tender would be reasonable, and denied defendants' motion to dismiss this claim. The Court also held that the Subscription Agreement's merger provision did not preclude the sales projections fraud claim because that claim was based on statements in the subscription agreement itself.

Finally, defendants sought dismissal of Holdings' claims under O.C.G.A. § 14-11-307, the conflicting interest provisions of the Georgia LLC Code. The DNA Operating Agreement provided that that statute section shall not apply to DNA's members, and the statute section expressly provides that a limited liability company may opt out of the provisions of § 14-11-307.[10] The Court agreed, holding that "to the extent the Operating Agreement survives Holdings' fraudulent inducement claim, the Operating Agreement's disclaimer precludes Holdings' claim under O.C.G.A. § 14-11-307." *Id.* If Holdings succeeded in rescinding the Operating Agreement, the claim would be moot. Therefore, the Court granted the defendants' motion to dismiss this claim.

***Denim North America Holdings, LLC v. Swift Textiles, LLC*, 816 F. Supp. 2d 1308 (M.D. Ga., 2011) – Decision on Fraud in Inducement Claims in Organization of LLC; LLC Member Entitled to Appoint One Half of Members of Board of Managers Has *De Facto* and May Owe Fiduciary Duties as a Managing Member under O.C.G.A. § 14-11-305.**

This case involved a textile manufacturer's suit against a competitor, alleging that the competitor fraudulently induced it to enter into a business venture and breached its fiduciary duties as a managing member of the LLC through which the venture was conducted. The case arose from a dispute between plaintiff Denim North America Holdings ("Plaintiff") and defendants Galey & Lord, LLC ("Galey"), Patriarch Partners, LLC ("Patriarch"), and Swift Textiles, LLC ("Swift") (collectively, "Defendants"). Plaintiff and Defendants manufactured and sold denim products through Denim North America, LLC ("DNA"), which was owned jointly by Plaintiff and Swift.

The third decision in the case concerns the Defendants' motion for summary judgment on the Plaintiff's claims for fraudulent inducement and breach of fiduciary duty. On entering into their business venture, the parties executed a Subscription Agreement, a Manufacturing and Supply Agreement and an Operating Agreement. Under the agreements, Plaintiff and Defendant would each have a 50% ownership interest in DNA. The operating agreement provided that Swift and Plaintiff would each appoint four managers and that any action had to be approved by

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[10] 14-11-307. Conflicting interest transactions:
"(a) The provisions of this Code section shall apply to a limited liability company unless its articles of organization or a written operating agreement provides that they shall not apply. . . ."

at least a majority of the managers.  Plaintiff or Swift could replace any of their four managers without the other party's consent.

First, while the deal was being negotiated and before the documents were executed, Plaintiff requested financial information and Swift agreed to provide financial records upon request.  However, Swift failed to provide the requested financial information to Plaintiff.  Swift also developed sales projections for the venture but refused Plaintiff's requests to guarantee the sale projections.

Second, Plaintiff knew as of the closing that Swift held some existing inventory it planned to sell, but did not know the exact amount, which was in the range of 10.5 million yards, or $30 million worth of product.  After the transaction closed, Swift liquidated its inventory at prices that Plaintiffs alleged undercut DNA's prices and adversely impacted DNA's sales.

Third, at the time of the transaction, Swift was also involved in two separate joint ventures in foreign countries to supply low cost denim, one in China that involved constructing a new facility with funding from Swift and another in Mexico with an existing denim plant.  The deal terms did not require Swift's foreign joint venture facilities to stay open; however, the transition plan depended "on Swift having low cost suppliers to produce low margin product." After the transaction closed, Swift stopped managing the Chinese facility although the facility continued to operate and Swift continued to maintain its ownership interest.  The Mexican facility was not profitable and was closed.

Plaintiff claimed that Defendants had fraudulently induced it to enter into the business venture and that Defendants violated their fiduciary duties to Plaintiff.  The Court granted Defendants' motion for summary judgment on "Plaintiff's fraudulent inducement claim predicated upon concealment of Defendant's financial condition" and "Plaintiff's breach of fiduciary duty claim based on the foreign ventures."  The Court denied summary judgment on Plaintiff's fraudulent inducement claims based on Defendants' sales projections and Plaintiff's claims for breach of fiduciary duty based on "Swift's sales made in competition with DNA" and Swift's termination of its sales staff, holding that there were genuine factual disputes.

In granting summary judgment on Defendants' alleged failure to provide financial information in response to Plaintiff's requests, the Court relied on *Bogle v. Bragg*, 248 Ga. App. 632, 633-37, 548 S.E.2d 396 (2001), which affirmed summary judgment on an executive's claims that he was fraudulently induced to purchase stock based in part on statements that a financial statement would be ready and provided to him shortly.  In *Bogle*, the Court held that the executive chose to proceed with the transaction without the financial statements, and in an arm's length transaction, the company had no special duty to disclose the statements.  Similarly, in this case, Defendants did not have any special duty to disclose the Swift financial statements they had promised, and Plaintiff chose to proceed knowing that it lacked the requested information.

Plaintiff also claimed that Swift breached its fiduciary duty to Plaintiff.  Defendants argued that Swift did not owe a fiduciary duty to Plaintiffs and that even if Swift did owe a fiduciary duty, there was no evidence that it breached that duty.  Reaffirming its ruling on the defendants' motion to dismiss, the Court noted first that "[u]nder Georgia law, a managing member of a limited liability company owes a fiduciary duty to its fellow members."  O.C.G.A.

§ 14-11-305(1). However, if management of the LLC is vested in one or more managers, a person who is a member but not a manager does not have duties to the LLC or the other members based solely on his capacity as a member, (citing O.C.G.A. § 14-11-305(1); *ULQ, LLC v. Meder*, 293 Ga. App. 176, 184-85, 666 S.E.2d 713, 720-21 (2008)). Under the Operating Agreement, Swift and Plaintiff were both members of DNA, each appointed four managers, and could replace managers without the other member's approval. The Court noted that the "critical question" was "whether Swift's appointment of four of DNA's eight managers means that Swift itself was a managing member of DNA." The Court held that "Swift's ability to appoint four managers gave it *de facto* control of the DNA board of managers[,]" which created "a genuine fact dispute as to whether Swift was a managing member of DNA and therefore owned fiduciary duties to Holdings."

Next, the Court addressed whether there was a factual dispute concerning whether Swift breached its fiduciary duty to Plaintiff by selling off its inventory in competition with DNA and by closing the foreign facilities. The Court noted that although Plaintiff knew Swift planned to sell inventory, Swift failed to disclose that it had millions of yards of denim in inventory. There was evidence that those sales "adversely impacted sales of denim produced by DNA because Swift undercut DNA's price and flooded the market with its inventory." Therefore, the Court denied summary judgment on the fiduciary duty claim based on Swift's sale of inventory.

The Court awarded the Defendants summary judgment as to Plaintiff's claims that they breached fiduciary duties by closing the Mexico and China plants. The Mexican plant was losing money, and it was not a breach of fiduciary duty to decide not to spend more money to keep the plant open. The Chinese plant was still open, operating, and partly owned by Swift. Plaintiff could not establish a breach of fiduciary duty as to the Chinese facility, either.

The Court rejected Defendants' argument that Plaintiff did not produce evidence and present expert testimony on damages for its fraudulent inducement and fiduciary duty claims. Plaintiff did produce evidence of: (1) how much denim DNA sold; (2) Swift's inventory sales; (3) the pricing of the denim; and (4) the cost of installing manufacturing equipment, training the staff and other expenses related to the transaction. Plaintiff's damages could be calculated based on this evidence, and the Court could not find as a matter of law that those calculations would be too complicated for a jury or the Court to understand them without expert testimony.

For additional decisions involving LLC issues, see *In re McClelland*, 2011 WL 2461885 (Bankr. N.D. Ga. June 8, 2011) and *In re Richards*, 2011 WL 1522327 (Bankr. N.D. Ga. March 18, 2011) in section G.6., below.

## E. PARTNERSHIP LAW DEVELOPMENTS.

***The B&F System, Inc. v. LeBlanc*, 2011 WL 4103576 (M.D. Ga. Sept. 14, 2011) – Existence of a Partnership, Imputation of Knowledge, Stranger Status among Partners and Between Corporations and Shareholders for Interference with Contract Claims, Common Enterprise Theory of Joint Liability, and Insolvency Requirement for Veil-Piercing Claims.**

Plaintiff The B&F System, Inc. ("Plaintiff" or "B&F") was a wholesale distributor of imported products, many of which were imported from China. Plaintiff owned trademarks for the words “MAXAM USA” and “MAXAM.” In the 1970’s, Defendant Lloyd LeBlanc, Jr. (“Lloyd”) began operating a distribution center for Plaintiff’s products along with the other individual defendants, his wife Edna LeBlanc (“Edna”) and children Jeffrey LeBlanc (“Jeff”) and Lloyd LeBlanc, III (“Jody”). Defendants became an independent distributor when Lloyd, d/b/a MAXAM Wholesale of Georgia entered into a MAXAM Independent Distributorship Agreement (“MIDA”) with Plaintiff. Lloyd and B&F also executed a Service Mark License Agreement (“SMLA”), which gave Lloyd a license to use the “MAXAM” mark in his business. Lloyd operated the business first as a sole proprietorship and then incorporated Defendant Maxam Wholesale of Atlanta, Inc. (“MWA”) in 1991. Lloyd was the sole shareholder of MWA but the MIDA and SMLA were never assigned or transferred by Lloyd to MWA.

Lloyd, Jeff, and Jody split the businesses’ profits equally between themselves, except for a brief period during which Jody temporarily left the business to start a company that imported Mexican pastries, Defendant Productos Mexicanos Don Jose (“PMDJ”). Jeff registered the domain name and created a website at www.maxamwholesale.com for MWA and later registered a similar domain name at www.maxamwholesale.net. By 2005, MWA had grown its revenues to about $5 million per year.

In 2005, there was a change in control at B&F and B&F’s new president proposed changing B&F’s business relationship with MWA such that MWA would be a customer and not an independent distributor. MWA’s sales began to decline steadily and Jody began to research importing products directly from China, which Jeff and Jody could use to establish a competing wholesale business. Lloyd and Edna provided financial backing in the form of loans of approximately $950,000 and Jeff and Jody ordered goods from China through Defendant PMDJ d/b/a Direct Source Imports (“DSI”). Jeff and Jody stored the inventory in the MWA warehouse while they were still working for MWA and sharing in its profits. The inventory was transferred to Defendant DSI after it was incorporated in 2007. Lloyd and Edna leased space in their warehouse to DSI and allowed DSI to use the warehouse’s phones and computers.

When B&F learned that DSI was importing goods and storing them in MWA’s warehouse, B&F retrieved all of B&F’s merchandise from MWA’s warehouse, except for inventory needed to fill back orders. B&F also faxed Lloyd a letter advising him and his sons to stop competing with B&F, but B&F never terminated the MIDA. B&F notified many of MWA’s customers that MWA had ceased operations and that they should place their orders with B&F directly. There was also a dispute between the parties regarding the websites, with B&F objecting to DSI and MWA continuing to use the trademark “MAXAM Wholesale” in their domain name.

B&F subsequently filed suit against Lloyd, Edna, MWA, DSI, Jeff, and Jody. MWA and Lloyd filed counterclaims, as did Jeff, Jody, and DSI. B&F filed a motion for summary judgment on 15 of its 17 claims and on Lloyd and MWA’s counterclaims. Defendants also filed summary judgment motions.

B&F claimed in part that Lloyd, Jeff, and Jody breached the MIDA, alleging that they were in a partnership and were thus jointly liable for wrongful acts, (citing O.C.G.A. §§ 14-8-13, 14-8-15). Defendants argued that they were not in a partnership. The court noted that “[i]n Georgia, the issue of partnership ‘is generally a mixed question of law and fact, and cannot be resolved as a matter of law unless the verdict one way or the other is determined by the evidence.'" (quoting *Flatau v. Tribble's Shoes, Inc. (In re Lawrence*, 82 B.R. 157, 161 (Bankr. M.D. Ga. 1988) (and *Pope v. Triangle Chem. Co.*, 157 Ga. App. 386, 388, 277 S.E.2d 758 (1981)). The court held that it could not decide the partnership issue as a matter of law because a jury could either find that Lloyd, Jeff, and Jody were partners or not based on the evidence. There was evidence that they split the profits of the business, and "receipt by a person of a share of the profits of the business is prima-facie evidence that he is a partner in the business." (quoting O.C.G.A. § 14-8-7). However, that inference does not arise if the money was paid as "wages, salary, or other compensation to an employee." (quoting *id.*) The court found that the jury would have to decide the question of fact as to whether the profits paid were wages, salary, or other compensation and would then decide whether a partnership existed. Once the jury decided that issue, it could address the breach of contract claim.

On a related claim, Plaintiff argued that Edna, Jeff, Jody, PMDJ, and DSI tortiously interfered with Plaintiff's contractual relationship with Lloyd under the MIDA and the SMLA. The court noted that the individual defendants were not strangers to the MIDA, as required for a claim of tortious interference, citing *Atlanta Mkt. Ctr. Mgmt. Co. v. McLane*, 269 Ga. 604, 609(2), 503 S.E.2d 278 (1998). On the contrary, they had "a direct economic interest in the MIDA," and therefore could not be strangers to the contract. The court noted that this was "especially true under B&F's theory that Jeff, Jody, and Lloyd were all partners, jointly liable, and jointly on notice about the various agreements." The court rejected B&F's attempt to "have it both ways" because Jeff and Jody could clearly not be strangers to the MIDA if they were partners with Lloyd. However, the court did agree with B&F that PMDJ and DSI were strangers to the contract; noting that "[t]he fact that non-strangers are the shareholders of those corporations does not make the corporations non-strangers." The court found that based on the record evidence, the jury should decide the tortious interference claims against PMDJ and DSI. On Plaintiff's claim of tortious interference with the SMLA, the court noted that if Jeff and Jody were determined to be in a partnership with Lloyd, the knowledge of the SMLA would be imputed to them. As a result, the court denied both sides' motions for summary judgment on this claim. Regarding whether DSI and PMDJ could be liable for tortious interference with the SMLA, the court noted that "[u]nder Georgia law, 'knowledge of officers of a corporation is knowledge to that corporation and the corporation is bound thereby.'" (quoting *Stein Steel & Supply Co. v. Franco*, 148 Ga. App. 186, 188, 251 S.E.2d 74 (1978)). If Jeff and Jody had knowledge of the SMLA, "that knowledge would be imputed to the corporations" of which they were officers.

B&F argued further that as corporate officers, Lloyd, Jeff, and Jody should be personally liable for torts committed by MWA, DSI, and PMDJ. The court noted that in general, "a corporate officer cannot be held to be vicariously liable for such damages as would otherwise be recoverable from his corporate principal." (quoting *Fields Bros. Gen. Contractors v. Ruecksties*, 288 Ga. App. 674, 677, 655 S.E.2d 282 (2007)). However, if the officer "takes part in the commission of a tort by the corporation[,]" he will be personally liable (quoting *Brown v. Rentz*, 212 Ga. App. 275, 276(2), 441 S.E.2d 876 (1994)). The court held that if B&F produced sufficient evidence showing that the officers took part in the commission of any torts by the corporations, they could be held personally liable.

B&F also argued that Lloyd, Jeff, and Jody were individually liable for any trademark infringement that their companies committed. The court noted that a "corporate officer who directs, controls, ratifies, participates in, or is the moving force behind the infringing activity, is personally liable for such infringement without regard to piercing of the corporate veil," (quoting *Babbit Elecs., Inc. v. Dynascan Corp.*, 38 F.3d 1161, 1184 (11th Cir. 1994)). The court held that the jury would have to decide some of the infringement claims, and that B&F could at that time present evidence that the individual defendants were "the moving force behind the infringing activity."

Further, B&F argued that MWA, DSI, and PMDJ should be held jointly liable because they were "a single business enterprise[,]" as they "were under the same management, split profits, and appeared in this litigation collectively." The court noted that "Georgia courts recognize a common business enterprise theory of liability." However, B&F argued that the individual and corporate defendants should all be held jointly liable under a "common enterprise theory," whereas the common enterprise theory "only applies to corporate or similar business entities." B&F failed to provide any legal authority "showing that individual defendants are subject to a common enterprise claim." The court found further that B&F failed to establish its common enterprise claim because the companies had different officers, did not collectively file the lawsuit, were pursuing separate counterclaims, and any profit sharing was between the individual defendants and not the corporations.

B&F also sought to "pierce the corporate veils of MWA, LeBlanc's, PMDJ, and DSI, and hold Lloyd, Jeff, and Jody personally liable for all amounts owed by the corporations." The court held that B&F's alter ego claim failed because it failed to show or even plead insolvency and a showing of insolvency is a precondition to piercing the corporate veil (citing *Great Dane Ltd. P'ship v. Rockwood Serv. Corp.*, No. CV 410-265, 2011 WL 2312533, *4 (S.D. Ga. June 8, 2011)). If there is an adequate remedy at law in the form of the ability to pay a money judgment, then the corporate veil cannot be pierced, (citing *In re Friedman's Inc.*, 285 B.R. 381, 415 (S.D. Ga.. 2008)). Because B&F failed to plead or show insolvency of the corporate defendants, it had an adequate remedy at law and piercing the corporate veil "would not be proper."

***Day v. Nu-Day Partnership, LLLP*, 289 Ga. 357, 711 S.E.2d 689 (2011) – *Ultra Vires* Doctrine Applies to Actions of a Business Entity, Not the Actions of its Owners in Transferring their Interests.**

This case involved a partnership's action to quiet title to real property that the partnership's former owner, Lon Day, attempted to convey to his wife, Norma Day. Lon Day had three adult children from a previous marriage, Lee, Don, and Nancy. In December 2001, Lon Day formed Nu-Day Partnership, LLLP ("Nu-Day") as a family limited liability limited partnership for the "purpose of owning and managing property." Lon and his three children were Nu-Day's limited partners. 289 Ga. at 357. Lon created LLD Management to serve as Nu-Day's sole general partner.[11] Lon originally held all officer positions of LLD Management, but later appointed Don as President and Nancy as Secretary and Treasurer and then transferred his interest in LLD Management to Don and Nancy, leaving them as sole owners of LLD

[11] The court does not mention what form of business entity LLD Management was.

Management, Nu-Day's general partner. In 2003, Lon transferred real property located on Bishop Street in Atlanta (the "Bishop Street property") to Nu-Day.

Several years later, Lon claimed that the 2001 transfer of his interest in LLD Management was an *ultra vires* act and attempted to unilaterally convey the Bishop Street property from Nu-Day to himself and then from himself to his wife Norma. Nu-Day, through Lon's children, filed suit against Norma to quiet title to the property and clarify that Nu-Day was still the owner. The Superior Court of Fulton County granted Nu-Day's motion for summary judgment on the quiet title claim, and the Georgia Supreme Court affirmed.

The court held that Lon's transfer of his interest in LLD Management was not a void, *ultra vires* act. The court stated that "[i]n the instant case, an *ultra vires* act, by definition, would be '[a]n act…[that] is beyond the scope of the powers granted by law to [a] *corporation*, so that it is not in the power of the *corporation* to perform it under any circumstances.'" *Id.* at 358, (quoting *Georgia Granite R. Co. v. Miller*, 144 Ga. 665, 87 S.E. 897 (1916)). Therefore, the court held that "*ultra vires* acts have nothing to do with the actions of an individual who simply chooses to transfer his own interest in a company to other individuals, as such actions have nothing to do with the corporation itself acting beyond the scope of its legal authority." *Id.* (citing *Savannah Ice Co. v. Canal-Louisiana Bank & Trust Co.*, 12 Ga. App. 818, 825, 79 S.E. 45 (1913); O.C.G.A. § 14-2-304(b) (outlining how corporate actions can be challenged as *ultra vires*).[12] The court upheld Lon's transfer of his interest in LLD Management to Don and Nancy. As a result, Lon did not have any ownership interest in LLD Management and could not transfer the Bishop Street property owned by Nu-Day to his wife. *Id.* at 358.

***Sutter Capital Management, LLC v. Wells Capital, Inc.*, 310 Ga. App. 831, 714 S.E.2d 393 (2011) – Investor List Held not to be a Trade Secret.**

Plaintiffs Wells Capital, Inc. and Wells Partners, L.P. (collectively "Wells") sued defendants Sutter Capital Management, LLC and Sutter Opportunity Fund 3, LLC (collectively "Sutter") for misappropriation of a list of the names and addresses of Wells' investors, alleging a violation of the Georgia Trade Secrets Act. The trial court granted summary judgment to Wells and the Court of Appeals reversed, holding that a list of investors in a public limited partnership was not a trade secret.

"Wells Real Estate Funds I through XII were Georgia public limited partnerships. Wells Capital, Inc. is a general partner of Wells Real Estate Funds I, II, and III, and Wells Partners, L.P., is a general partner of Wells Real Estate Funds IV through XII. Investors in the partnerships were limited partners" and Wells kept a list of data regarding all the investors in the partnerships. The list included the investors' names and addresses.

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[12] The court also rejected Norma's argument that the transaction was void because it was not registered with the Securities and Exchange Commission because the type of transfer was specifically exempted from registration under the Securities Act of 1933 under 15 U.S.C. § 77d(2) ("'transactions by an issuer [of shares] not involving any public offering' are exempted transactions."). *Id.* at 358.

Sutter Capital Management managed "private investment funds that are invested mostly in real estate limited partnerships purchased in the secondary market" and Sutter Opportunity Fund 3 was one of the funds that Sutter Capital Management managed. Sutter's business attempted to "acquire real estate limited partnership units at discounts and then resell them for a profit."

Ira J. Gaines was an investor and limited partner in the Wells partnership. Under the terms of the Wells partnership agreement, any limited partner or its designated representative could inspect the list of limited partners. However, when Gaines became a limited partner, he executed an addendum "in which he agreed to only request a copy of the list…for purposes reasonably related to [his] interest in the Partnership." Gaines also agreed that he would not request the list for any commercial purposes, including for the purpose of selling the list or making a tender offer to the limited partners.

Gaines was also a "creditor of Sutter Capital Management and an investor/owner of Sutter Opportunity Fund 3, LLC." Sutter Capital Management's president told Gaines that Sutter wanted a copy of Wells' investor lists in order to "mail mini-tender offers to the limited partners for the purchase of Wells's partnership units." Gaines requested Wells' tax returns and attachments from the IRS, which included the names and addresses of all the partners. The IRS shipped the information to Sutter's office because at that time, it "would provide such information regarding other limited partners to an existing limited partner in a partnership." Sutter then provided the list to Business Services Network, Inc. ("BSN"), which Sutter hired to create mailing lists using the information. *Id.* at 394, 714 S.E.2d 833. BSN mailed the mini-tender offers from Sutter, and a number of Wells investors sold their partnership units to Sutter. When it became a partner, Sutter executed the same addendum that Gaines executed in which Sutter agreed not to request the list of investors in order to make tender offers.

Wells sued Sutter, claiming Sutter "misappropriated confidential lists of Wells investors, which constituted trade secrets." The trial court granted summary judgment to Wells and awarded damages. Sutter appealed, arguing that the investor lists were not trade secrets, and the Court of Appeals agreed. The court noted that in order to recover under the Georgia Trade Secrets Act, O.C.G.A. § 10-1-760 et seq., the plaintiff must show that the information was a "trade secret" under O.C.G.A. § 10-1-761(4) and that the defendant "misappropriated that trade secret." The Georgia Trade Secrets Act defines a "trade secret" in part as information that "[d]erives economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use…" *Id.* at 395, 714 S.E.2d 833 (quoting O.C.G.A. § 10-1-761(4)(A)).

The court did not address Wells' efforts to maintain the secrecy of the information, but held that "Wells has failed to demonstrate that the lists "[d]erive[ ] economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use'." (quoting O.C.G.A. § 10-1-761(4)(A)). Wells had mailed a position statement to its limited partners recommending that they reject Sutter's tender offer but also informing them that accepting the offer would "have no direct financial impact on the general partners or their affiliates." Wells' vice president and chief of staff stated the same thing in their depositions, testifying "that none of the partnership transfers to Sutter had any direct financial impact on the general partners or their affiliates related to the partnership." Therefore, the court held that the necessary conclusion was "that there is no economic value to Wells in *maintaining the secrecy*, if any, of the list as it relates to the mini-tender offers." Wells did not provide "any other basis to conclude that the secrecy of the lists has economic value." *Id.* Rather, the court held that Wells was confusing its alleged damages from sending the position statement to the investors with the "requisite economic value of the secrecy of the investor lists." *Id.* Therefore, the investor lists and addresses were not a trade secret and the court of appeals reversed the trial court's judgment in favor of Wells.

***AAF-McQuay, Inc. v. Willis*, 308 Ga. App. 203, 707 S.E.2d 508 (2011) – Partners that Are Creditors of the Partnership May Take Actions Consistent with their Rights as Creditors, but Can Be Held Liable for Exceeding those Rights.**

This case involved an individual partner's suit against the corporate partner for breach of partnership agreement and breach of fiduciary duty, and the corporate partner's counterclaims for unpaid amounts due under a promissory note.

The partnership originally had three partners: AAF-McQuay, Inc. d/b/a McQuay International ("McQuay"), T. W. Ruskin, and Larry R. Willis. Willis brought suit against McQuay, alleging breach of the partnership agreement and breach of fiduciary duties. McQuay asserted various counterclaims, including breach of a guaranty agreement. The trial court granted Willis' motion for partial summary judgment and denied McQuay's summary judgment motion. The Court of Appeals affirmed the trial court's decision in part and reversed in part. The Court of Appeals upheld the trial court's grant of summary judgment in favor of Willis on his claims for breach of the partnership agreement and breach of fiduciary duty.

McQuay is a global manufacturer, seller, and servicer of commercial heating, ventilating, and air-conditioning ("HVAC") products. Generally McQuay conducted its sales through independent representatives reporting to regional company sales managers, with the servicing business operated by company-owned entities. However, in Georgia and some other states, McQuay chose to use a partnership model by forming a joint venture with local partners.

In May of 1998, McQuay formed McQuay of Georgia, LLP (the "Partnership") by entering into a limited liability partnership agreement with Ruskin and Willis. McQuay also transferred its service and warranty work in Georgia to the partnership. *Id.* at 205, 707 S.E.2d at 512. McQuay held a 50 percent interest in the Partnership, Willis and Ruskin each held a 25 percent interest. Ruskin was appointed president and Willis as executive vice president, and they were responsible for day-to-day management. McQuay financed the operation and Willis signed a guaranty agreement for the debt. The Partnership's loan was modified due to additional advances made by McQuay, and Willis executed an amended guaranty agreement in connection with the amended promissory note.

From the beginning, the Partnership had financial problems and could not make its loan payments to McQuay. Ultimately, the partnership defaulted on the loan. McQuay then demanded full payment of the loan and threatened to repossess the collateral, but did not pursue legal action on the loans or guarantee. Willis claimed it was because McQuay wanted sole ownership of the service business and was trying to get rid of Ruskin and Willis, citing a 2002 internal strategy document that McQuay produced during discovery in which McQuay proposed taking "steps to obtain a majority interest in the Partnership" in order to establish "control of the company." *Id.* at 206, 707 S.E.2d at 513. The document stated that McQuay's "[u]ltimate objective is to divest the sales company and retain ownership of the service business." *Id.*

In May 2002, McQuay gave Ruskin a demand letter informing him that the loan was in default and McQuay would enforce payment. In June 2002, McQuay made formal restructuring proposals to Willis and Ruskin, under which McQuay would have a majority interest. In December 2002, a partnership meeting was held and "Willis was voted in to replace Ruskin as interim president" but McQuay's proposed resolutions were not adopted. *Id.*, 707 S.E.2d at 514. Two days after the meeting, McQuay delivered letters to Ruskin and Willis demanding payment of the defaulted loans. Further internal McQuay documents indicated that McQuay was attempting to intimidate ("hammer") Ruskin and Willis into agreeing to a restructuring of the Partnership.

McQuay then "abandoned its plan to acquire a controlling ownership interest in the Partnership and instead attempted to have its interest in the Partnership bought out." *Id.* at 208. Willis and an officer of the partnership offered to purchase McQuay's interest, and at the same time Ruskin and another officer also presented a proposal. At a meeting, "McQuay warned Willis that the partner whose proposal was rejected by McQuay would need to leave the Partnership or have his interest bought out." *Id.* McQuay accepted Ruskin's proposal and sent Willis a right of first refusal letter, but Willis did not respond. At a September 26, 2003 partnership meeting, Willis was terminated.

Willis threatened legal action regarding the amount he was owed in the buyout, and Ruskin suggested to McQuay that they should terminate Willis for cause before he sued, so that they would not have to pay him for his ownership interest. McQuay agreed and decided to terminate Willis before Willis initiated legal action. When McQuay's negotiations with Ruskin broke down, McQuay again brought up the Partnership's default on its loan obligations and notified the partnership of its intent to seek an alternate distributor for its products. Ruskin then filed suit against McQuay individually and on behalf of the partnership, asserting claims for breach of the partnership agreement. That case settled, and "[p]ursuant to the settlement agreement, McQuay's 50 percent interest in the Partnership was transferred to Ruskin" and another officer in December 2005. Willis did not respond to a second right of refusal letter containing the settlement agreement. As of the date of the court's decision in this case, the partnership was still operating but was not the service provider for McQuay. McQuay operated its own office in Georgia.

In his suit, Willis claimed "McQuay breached Section 7.04(a) of the Partnership Agreement by not purchasing his Partnership interest after his termination on September 26, 2003." *Id.* at 210. That section stated that upon termination of a partner without cause, the partnership must buy the partner's interest. McQuay moved for summary judgment, claiming Section 7.04(a) was not triggered because Willis was not terminated, he was just removed as president. McQuay pointed to other evidence that Willis was not terminated, including the fact that he continued to receive an IRS Schedule K-1 each year since his alleged termination. The trial court denied McQuay's motion for summary judgment, concluding that "there was conflicting evidence on the issue of whether Willis was terminated as a partner." The Court of Appeals affirmed this decision. *Id.* at 210-211.

Willis also "alleged that McQuay breached its fiduciary duty toward him by attempting to terminate him as a partner a second time 'for cause'" to avoid having to buy him out under the partnership agreement. *Id.* at 211. The Court of Appeals again held that the trial court correctly denied summary judgment to McQuay on this claim because there was some evidence that Willis had been terminated as a partner.

Willis alleged in Count 3 of his complaint that "McQuay breached its fiduciary duty toward him by using coercive and deceptive tactics in its efforts to restructure the Partnership, with the ultimate goal of obtaining the right to operate the Service Business on its own." *Id.* McQuay argued that its actions were consistent with the actions of a secured creditor, but the trial court denied McQuay's motion for summary judgment because there was conflicting evidence on this claim. The court stated that although "a partner who is also a creditor of the partnership may take actions consistent with her rights as a creditor without breaching her fiduciary duties owed to other partners…a partner nevertheless can breach those duties if her actions go beyond that of a simple secured creditor." *Id.* (citing *Westminster Properties v. Atlanta Assoc.*, 250 Ga. 841, 843(1), 301 S.E.2d 636 (1983); *Natpar Corp. v. E. T. Kassinger, Inc.*, 258 Ga. 102, 105-106(2), 365 S.E.2d 442 (1988)). Additionally, under the fiduciary duty of good faith, a partner cannot improperly oust a partner and take for himself the assets of the partnership. Here, there was evidence that McQuay took actions beyond those of a secured creditor because, among other things, it may have used default letters to coerce the partners into accepting the restructuring favorable to McQuay. Therefore, there was a genuine issue of material fact and the trial court properly denied summary judgment on this claim.

In Count 7 of his complaint, Willis claimed that McQuay breached limitations in the Partnership Agreement on the transfer of partnership interests when it transferred its 50 percent ownership interest in the Partnership to Ruskin as part of the settlement agreement. Section 7.08(b) of the Agreement stated that if a partner attempted to transfer his partnership interest, the transferor remains a partner until the non-transferring partners holding at least 66 2/3% of the partnership interests consent to make the transferee a partner. Ruskin and Willis held only 50%, so McQuay could not make the transfer. McQuay argued that Willis could not enforce that section "based on the affirmative defenses of waiver, equitable estoppel, mutual departure, and promissory estoppel." *Id.* at 217. The trial court granted Willis' motion for summary judgment on this claim.

The Court of Appeals held that the trial court erred when it concluded that there was no evidence supporting McQuay's waiver defense. A party to a contract can waive a contractual provision for his benefit, and "[a] party's protracted silence, or unreasonable delay in making protest, can raise a fact issue as to whether she has waived a contractual right." *Id.* at 217-218, 707 S.E.2d at 521. Willis never responded to McQuay's right of refusal letters concerning the sale of McQuay's interest and the settlement agreement, and Willis' silence raised a fact issue as to whether he waived his right to object to non-compliance with Section 7.08(b). Therefore the court reversed the trial court's grant of summary judgment to Willis on his claim for violation of Section 7.08(b).

The trial court also erred by concluding "there was no evidence to support McQuay's affirmative defense of equitable estoppel." *Id.* A party may be estopped from raising a defense where there is some "'intended deception in the conduct or declarations of the party to be estopped, or such gross negligence as to amount to constructive fraud, by which another has been misled to his injury.'" *Id.* at 218-219, 707 S.E.2d at 521 (quoting *Smith v. Direct Media Corp.*, 247 Ga. App. 771, 773(1), 544 S.E.2d 762 (2001)). The court found this case to be similar to the *Smith* case, where the court found that equitable estoppel arose based on the plaintiff's reliance on the defendant's conduct. Willis engaged in negotiations concerning the buyout with McQuay, went to meetings on that issue, and was sent two right of refusal letters, so a jury could conclude "that Willis's conduct was tantamount to 'such gross negligence as to amount to constructive fraud.'" *Id.*, 707 S.E.2d at 521-522 (quoting *Smith*, 247 Ga. App. at 773-774, 544 S.E.2d 762). Willis argued that equitable estoppel could not apply because McQuay's sale of its interest in a suit that excluded Willis showed McQuay's bad faith. *Id.* at 220, 707 S.E.2d at 522. The court said that because the case involved conflicting evidence regarding McQuay's bad faith, there was a genuine issue of material fact as to whether Willis was equitably estopped from invoking Section 7.08(b).

However, the court affirmed the trial court's holding that "there was no evidence to support McQuay's affirmative defenses of mutual departure and promissory estoppel." *Id.* "Mutual departure requires the receipt or payment of money or some other sufficient consideration" to depart from contractual terms, and there was no evidence of consideration. *Id.* (citing O.C.G.A. § 13-4-4; *Turem v. Sinowski & Jones*, 195 Ga. App. 829, 829-830(1), 395 S.E.2d 60 (1990); *Southwest Plaster & Drywall Co. v. R. S. Armstrong & Bros. Co.*, 166 Ga. App. 373, 374, 3-04 S.E.2d 500 (1983); *Lester v. Trust Co. of Ga.*, 144 Ga. App. 526, 527(1), 241 S.E.2d 633 (1978)). Further, there was no evidence that Willis made any promise about Section 7.08(b), as would be necessary for McQuay to establish promissory estoppel. Therefore, the Court of Appeals affirmed the trial court's summary judgment against McQuay on its promissory estoppel defense.

***McMillian v. McMillian*, 310 Ga. App. 735, 713 S.E.2d 920 (2011) – In Case to Recover Share of Lost Profits from Misappropriation of Business Opportunity, Discovery of Financial Records Permitted from Competitor Benefiting from the Opportunity.**

This case involved a partner's suit against his former partner and the former partner's business for misappropriation of business opportunities. The Court of Appeals reversed the trial court's decision denying the plaintiff's motion to compel discovery regarding the defendants' financial records.

Cousins Bruce and Robbie McMillian formed a partnership that engaged in bulk-mail services and named their business Corporate Mail Management ("Corporate Mail"). After a few years of unsuccessful operation, Robbie left the partnership and formed a new company, Mail Source & Data, Inc., that engaged in the same business. Bruce sued Robbie and Mail Source, alleging that Robbie violated his duties to the partnership and to Bruce by misappropriating the partnership's business opportunities and giving them to Mail Source. Bruce sought Mail Source's financial records as evidence of his damages but the trial court refused to compel that discovery. The Court of Appeals granted interlocutory review on that issue.

Bruce sued Robbie after Robbie started a new company, Mail Source, that directly competed with Corporate Mail. Robbie did not tell Bruce that he was forming a new and competing company. Mail Source was formed and began operations in January 2003, although between January and April of 2003, Robbie was ostensibly still managing Corporate Mail. Bruce alleged that during that time, Robbie was actually working for Mail Source and was diverting business opportunities from Corporate Mail to Mail Source. Corporate Mail shut down in April 2003, and Robbie took all of its assets and business opportunities to Mail Source. Bruce, who had funded Corporate Mail's operations and pledged his personal residence as collateral, was left with nothing but Corporate Mail's debts. *Id.* The court noted that "[i]n its first year alone, Mail Source earned more than $245,000 from customers that previously had been customers of Corporate Mail." (*Id.* at 736, 713 S.E.2d 921.)

Bruce asserted various claims against Robbie and Mail Source, including claims for breach of fiduciary duty. Bruce sought financial records from Mail Source in order to build his claim for damages, but Mail Source and Robbie did not respond to Bruce's interrogatories or requests for the production of documents. Mail Source eventually provided some financial information after Bruce moved to compel discovery, but it still refused to produce all the information requested. Bruce pursued his motion to compel and the trial court denied the motion, based on its conclusion "that the financial records of Mail Source are not relevant to the measure of damages." *Id.* The trial court reasoned that "[d]amages for the loss of a prospective business opportunity must be based…on the value that a reasonable person would have assigned to the prospective business opportunity at the time of its loss." *Id.* Therefore, the trial court held that Mail Source's actual earnings from the business opportunities were not relevant.

On appeal, Bruce argued the financial records were relevant because Mail Source could be ordered to disgorge all profits gained from misappropriated business opportunities. Bruce cited several cases that "suggest that disgorgement of ill-gotten revenues or profits may be an appropriate remedy for a breach of fiduciary duty." *Id.* at 738, 713 S.E.2d 923 (citing *Jennette v. Nat. Community Dev. Svcs.*, 239 Ga. App. 221, 520 S.E.2d 231 (1999), *Vinson v. E.W. Buschman Co.*, 172 Ga. App. 306, 323 S.E.2d 204 (1984), *Gaines v. Crompton & Knowles Corp.*, 190 Ga. App. 863, 380 S.E.2d 498 (1989)). The court noted that those cases involved "fiduciary relationships other than partnerships" and did not decide whether the disgorgement remedy would be appropriate in the case before it. The court stated, however, that it had previously held that "when a partner wrongfully appropriates a prospective business opportunity of his partnership to his own use or that of another, the remaining partners, who are deprived of an opportunity to profit from the misappropriated business opportunity, may recover their share of the profits that the partnership would have earned from the business opportunity." *Id.* at 738, 713 S.E. 2d 920 (citing *Asgharneya v. Hadavi*, 298 Ga. App. 693, 697(4), 680 S.E.2d 866 (2009), *Arford v. Blalock*, 199 Ga. App. 434, 438(7), 405 S.E.2d 698 (1991)).

The partner's share of the profits that would have been earned "'must be shown with reasonable certainty'" and cannot be "'remote, or speculative, contingent or uncertain,'" but damages cannot be disallowed simply because it is difficult to prove the amount owed. *Id.* At 739, 713 S.E.2d 923 (quoting *Ga. Ports Auth. v. Servac Intl.*, 202 Ga. App. 777, 780(3), 415 S.E.2d 516 (1992)). Further, when "the conduct of the wrongdoer [ ] prevents a more precise calculation," the fact that it is difficult to calculate the exact amount of "damages sustained will not preclude their recovery." *Id.* at 736, 713 S.E.2d 924 (citing *Bigelow v. RKO Radio Pictures*, 327 U.S. 251, 264-266, 66 S. Ct. 574, 90 L. Ed. 2d 652 (1946)).

The court stated that if damages should be measured in terms of the partner's share of the lost profits instead of disgorgement, then Mail Source's revenues and profits gained from business opportunities that Corporate Mail lost would not be dispositive of the amount but the information would be relevant. The court noted that Bruce could argue that Corporate Mail would have earned the revenues and profits that Mail Source had earned from the business opportunities, especially if he could show that the two entities had similar prices and costs. Therefore, the Court of Appeals held that the trial court erred by concluding that the revenues and profits that Mail Source earned from business opportunities lost by Corporate Mail could not possibly be probative of the damages that Bruce might be entitled to recover.

***Moses v. Jordan*, 310 Ga. App. 637, 714 S.E.2d 262 (2011) – Issues of Fact in Claim for Wrongful Dissolution of a General Partnership under O.C.G.A. § 14-8-38(b).**

In this case involving a claim for wrongful dissolution of a general partnership, the Court of Appeals reversed the grant of summary judgment to the partner who dissolved the partnership.

In 2002, Mary Helen Moses ("Moses") and Randall Jordan ("Jordan") formed a law partnership. In the spring of 2006, Jordan began thinking of ending his partnership with Moses. In August 2006, Jordan told Moses that he was thinking about dissolving the partnership based on criticisms of Moses' behavior from Jordan and other firm employees. Moses offered to work from home in an "of counsel" role and according to Moses, Jordan was receptive to the idea and they agreed to discuss it later. A few days later, however, Jordan left a letter in Moses' office dissolving the partnership. Moses sent Jordan an email saying she did not agree to the dissolution and intended to continue representing firm clients. Moses and Jordan discussed maintaining the "status quo" until they resolved the partnership matters, but Moses' attorney later received a letter declaring the firm dissolved as of September 26, 2006. Moses learned that Jordan had formed a new firm in December 2006.

In January of 2007, Jordan sought a declaratory judgment that the partnership was dissolved, that Moses was not owed any money, and that Moses be required to account for money paid to her by the firm. Moses asserted counterclaims for "breach of the partnership agreement, wrongful dissolution of the partnership, breach of fiduciary duty" and multiple other claims. The trial court granted Jordan's motion for summary judgment on the wrongful dissolution counterclaim. Moses appealed and the Court of Appeals found that Moses had "raised genuine issues of fact" regarding the wrongful dissolution claim.

The Court noted that under the Georgia Uniform Partnership Act, a partnership can be dissolved "[b]y the express will or withdrawal of any partner," (quoting O.C.G.A. § 14-8-31(a)(2)). When the partnership is dissolved, the partners "cease to be associated in the carrying on of the partnership," (quoting O.C.G.A. § 14-8-29). The partnership is not terminated on dissolution, but continues until termination occurs through winding up of partnership affairs under O.C.G.A. § 14-8-30. The partners have a shared duty to wind up the partnership affairs. *Id.* at 265, 714 S.E.2d at 640 (citing O.C.G.A. §§ 14-8-29 and 14-8-30).

The trial court found that the partnership had been lawfully dissolved, a finding contested on appeal. The Georgia Court of Appeals noted that "[t]here are few Georgia cases addressing the scope of a partner's cause of action for wrongful dissolution," but that the Georgia Court of Appeals had adopted the California Supreme Court's reasoning in the case of *Arford v. Blalock*, 199 Ga. App. 434, 437-438(6), 405 S.E.2d 698 (1991). In the *Arford* case, the court held that although a partner has the right to dissolve a partnership, if "it is proved that the partner acted in bad faith and violated his fiduciary duties by attempting to appropriate to his own use the new prosperity of the partnership without adequate compensation to his co-partner, the dissolution would be wrongful…" *Id.* (quoting *Arford*, 199 Ga. App. at 437-438(6)). The Georgia Supreme Court endorsed the *Arford* court's reasoning in *Wilensky v. Blalock*, 262 Ga. 95, 4141 S.E.2d 1 (1992). *Id.* In that case, the court held that a claim for wrongful dissolution was viable where a partner physically excluded the other partner from the partnership's place of business and kept all of the assets and income from the partnership. *Id.* (citing *Wilensky*, 262 Ga. at 98-99(3), 414 S.E.2d 1). The Georgia Court of Appeals also addressed dissolution of a partnership in *Asgharneya v. Hadavi*, 298 Ga. App. 693, 697-698, 680 S.E.2d 866 (2009). In that case, the court upheld an award of damages for wrongful dissolution where a former partner closed the business while his partner was out of town, moved to a new space near the old business, solicited customers from the former partner, appropriated profits, and failed to compensate the former partner. *Id.* (citing *Asgharneya*, 298 Ga. App. at 697-698).

Moses contended "that genuine issues of fact exist as to whether Jordan 'froze [her] out' and appropriated the business to his own use or dissolved the partnership to gain the benefits of the business for himself without compensating her…" *Id.* at 265, 713 S.E.2d 641. The court noted a "crucial element of a wrongful dissolution claim: the partner's *decision* to dissolve must be wrongful. Stated differently, the power to dissolve 'must be exercised in good faith.'" *Id.* (citing *Arford*, 199 Ga. App. at 438).

In order to show Jordan's state of mind at the time of dissolution, Moses showed that he kept "an entire $180,000 fee for himself after depositing it into the partnership account" in March of 2006. Jordan claimed that he and Moses had an agreement that he would keep the entire fee. Moses denied making this agreement and stated in her deposition that she did not know when the money came in or that Jordan had kept it. Based on this evidence and the fact that Jordan began to think about dissolving the corporation around the same time he secretly kept the money, the court held that "Moses has presented at least one genuine issue of material fact with regard to her wrongful dissolution claim." *Id.* at 266, 714 S.E.2d 642.

O.C.G.A. § 14-8-38(b) provides the remedy for wrongful dissolution of a partnership. Each partner who has not wrongfully caused dissolution of the partnership has the right, as against the partner who wrongfully dissolved the partnership, to damages and any other remedy allowed under the partnership agreement. A *certiorari* petition is pending at this writing.

## F. TRANSACTIONAL CASES.

***Yi v. Li*, 313 Ga. App. 273, 721 S.E.2d 144 (2011) – Failure of Condition Precedent to Performance of Contract for Sale of Business Does Not Support Rescission Where Contract Did Not Obligate Seller to Fulfill the Condition.**

This case involved the sale of a business and franchise that was conditioned on the franchisor's consent to the transfer of the franchise. The Buyers sued for rescission of the transaction when the franchisor declined to consent. The Court ruled against the Buyers because the contract of sale did not place any obligation on the Seller to fulfill that condition.

The Seller contracted to sell her Bruster's Ice Cream, Inc. store franchise to Buyers but the transfer was never fully consummated and Buyers sued Seller for rescission of the contract. The Court of Appeals reversed the trial court's judgment for Buyers on the rescission claim because there was no evidence that the Seller breached the contract, as required for a unilateral right of rescission under O.C.G.A. § 13-4-62 ("A party may rescind a contract without the consent of the opposite party on the ground of nonperformance by that party but only when both parties can be restored to the condition in which they were before the contract was made.")

Buyers discussed acquiring the Bruster's franchise with Seller and applied to Bruster's for the right to operate a franchise. Buyers also signed a franchise agreement and paid a transfer and training fee to Bruster's, although Bruster's never signed the franchise agreement. Seller and Buyers then entered into a Purchase Agreement under which Buyers agreed to pay Seller $300,000 for Seller's shares of Eastern Source Investment, Inc., which operated the franchise.

The Purchase Agreement stated that closing was conditioned on obtaining the franchisor's consent. The Purchase Agreement could be terminated before closing by either party if the franchisor's consent could not be obtained. The Purchase Agreement was executed on June 13, 2007 and Buyers paid the Sellers $230,000, despite knowing that Bruster's had not yet consented to the transfer. Buyers took possession of the franchise and began operating the store on June 14, 2007. However, Bruster's gave notice on August 7, 2007 that it would not consent to the transfer. On September 13, 2007, Buyers notified Seller "they were rescinding the Purchase Agreement and demanded that the Seller not only return all monies paid with respect to the Purchase Agreement but also take back possession of the ice cream store." Seller refused and Buyers brought suit to rescind the contract. The case was tried before a jury, which found in favor of the Buyers. The court entered judgment for the Buyers on the jury's verdict and denied Seller's motion for judgment notwithstanding the verdict.

The Court of Appeals reversed that judgment, noting that Buyers premised their rescission claim on failure of the contingency that was in fact a condition precedent in the Purchase Agreement. The Purchase Agreement stated that "Seller's obligations to execute, deliver, and perform under the Agreement were conditioned upon the consent and approval of Bruster's as the franchisor." The Court held that obtaining the franchisor's consent "was a condition precedent to the duty of both parties to render their promised performances," (quoting *Desmear Systems, Inc. v. Vines*, 305 Ga. App. 730, 732, 700 S.E.2d 711 (2010)). Because the condition precedent was not satisfied, the parties were excused from their obligations under the Purchase Agreement. The Court of Appeals emphasized that the Purchase Agreement did not obligate Seller to obtain Bruster's consent to the transfer. Rather, Buyers "were the ones who pursued and coordinated their efforts to obtain the required consent directly with Bruster's. Consequently, it cannot be said that the failure to satisfy the condition constituted a breach by Seller." Also, there was no evidence that Seller did anything to prevent the condition from being satisfied. Therefore, the jury's rescission verdict was not supported by the evidence and the judgment was reversed, presumably leaving the parties where the court found them. A *certiorari* petition is pending at this writing.

***Thompson v. Floyd*, 310 Ga. App. 674, 713 S.E.2d 883 (2011) – Broker's Claim for Fees for Sale of Business – Agency Capacity of Corporate Representative and Definiteness of Agreement.**

In this case Scott Thompson, a former employee of Healthlogic Systems Corporation ("Healthlogic") sued George Floyd, Healthlogic's founder and sole shareholder, for breach of contract, promissory estoppel, and fraud, claiming that he acted as a selling business broker in connection with the sale of the corporation and was entitled to compensation for his services. The trial court granted owner's summary judgment. The Court of Appeals reversed the decision of the trial court because it found that genuine issues of material fact existed as to 1) whether the owner acted individually or as an agent of the corporation when negotiating terms of the broker's commission and 2) whether the contract terms were sufficiently specific to support contract claims.

During 2005 and 2006, Floyd was in discussions with Bank of America ("BofA") regarding a potential purchase of Healthlogic. In 2006 BofA agreed to purchase the company for $40 million subject to adjustment based on due diligence findings. During this same period, Floyd and Thompson, then a vice president for corporate development at Per-Se Technologies, discussed the possibility of the plaintiff's assisting in the sale of Healthlogic and coming to work for Floyd and Healthlogic. They discussed specific terms of payment if the business were to be sold, but the parties later disagreed on whether the potential transaction with BofA was to be included in the deal. In April 2006, Floyd designated Thompson, still employed at Per-Se Technologies, as Healthlogic's main contact for the BofA negotiations and Thompson began to assist in providing information for BofA's due diligence. In late May 2006, Thompson became the CFO of Healthlogic. After further negotiations, Thompson and Floyd agreed on a salary and a formula for "Deal Participation" depending on the business's final sale price, which Floyd wrote on the back of an envelope and signed as "CEO." The parties disagreed on whether there were further discussions and whether a final deal was reached. BofA's purchase of Healthlogic closed in September 2006. Thompson demanded that he be paid $300,000 under their agreement, but Floyd refused to pay "that much money because the deal didn't take very long to close." *Id.* at 678, 713 S.E.2d at 888. Thompson sued both Healthlogic and Floyd, but eventually dismissed the company with prejudice. Floyd moved for summary judgment arguing that the parties never reached a final agreement, and even if they did, the agreement was with Healthlogic, not with him personally. The trial court agreed with Floyd that Thompson's agreement, "if any" was with Healthlogic, not Floyd. The Court of Appeals reversed, holding that genuine issues of material fact existed both as to whether there was an enforceable oral agreement as to his compensation as a "broker" and whether the defendant acted individually or in his capacity as an agent of the company. The Court reviewed principles that govern whether contracts are binding on the agents or their principals, stating that "[t]he other party has no duty to discover that the agent speaks for his principal and not himself; the duty lies with the agent to disclose that he speaks for the principal and he does not intend to be personally liable for the agreement." *Id.* at 679, 713 S.E.2d at 888. It noted that the counterparty's awareness of principal's existence does not relieve the agent of personal liability and that the capacity in which the agent is acting depends on facts and circumstances which are to be decided by the jury. It held that Floyd's adding "CEO" to his signature did not control the issue as a matter of law, given Thompson's testimony to the contrary. Citing *Turner Broadcasting System v. McDavid*, 303 Ga. App. 593, 693 S.E.2d 873 (2010) and distinguishing *BDI Laguna Holdings v. Marsh*, 301 Ga. App. 656, 689 S.E.2d 39 (2009), the Court held that Thompson's testimony was sufficiently definite with respect to compensation to raise an issue of fact as to whether the alleged contract lacked sufficient terms to be enforceable.

The Court also found issues of fact on Thompson's alternative promissory estoppel claim because indefiniteness could be obviated by performance and acceptance of performance, citing *Pine Valley Apts., L.P. v. First State Bank*, 143 Ga. App. 242, 237 S.E.2d 716 (1977). That claim was not precluded on the ground that it was based on a breached promise of employment for an indefinite term. Rather, the claims were "based on Floyd's alleged promise to pay Thompson for successfully closing the sale of Healthlogic to Bank of America. Thompson presented evidence that he relied on the promise and performed the work, and that Floyd closed the sale, and now Thompson seeks payment based on [that] promise." *Id.* at 683, 713 S.E.2d at 891. The Court also found that the evidence supported elements of fraud to survive a motion for summary judgment.

***West v. Diduro*, 312 Ga. App. 531, 718 S.E.2d 815 (2011) – Contract for Sale of Business Held to Require Conveyance of Corporation's Assets, not Seller's Stock in Corporation.**

This case involved a dispute over whether the sale of an incorporated chiropractic practice was to be a sale of assets or a sale of stock. The buyers defaulted on the promissory note and seller sued the buyers for various claims including default on the promissory note, breach of contract, and conversion. The buyers filed counterclaims for failure of consideration based on the seller's failure to convey her stock in the corporation. Reversing the trial court, the Georgia Court of Appeals held that the transaction was a sale of assets, not a sale of stock.

Shelley West ("Seller") sold her chiropractic practice, Healthsource Chiropractic of Johns Creek, P.C. ("Healthsource PC") to Matthew Diduro and Christopher Bragg ("Buyers") for $185,000. Under the Purchase Agreement, the Buyers would pay $135,000 cash and give the Seller a Promissory Note for $50,000. At the time of the sale, the Buyers only paid $125,000 in cash and orally agreed to pay the additional $10,000 at a later time. The Seller also executed a Non-Compete Agreement in favor of the Buyers. The Buyers did not request stock certificates in Healthsource PC and none were transferred when the Purchase Agreement was executed.

The Buyers took over and operated the practice but failed to make payments on the Note and failed to pay the $10,000 remaining on the purchase price. The Seller filed suit two months after the sale, alleging among other things, a claim for breach of contract based on the Buyers' default on the Note and failure to pay the $10,000 remaining on the purchase price. The Buyers counterclaimed for, among other things, breach of contract. They also asserted failure of consideration as a defense to the claim on the Note, based on the Seller's failure to convey stock when executing the Purchase Agreement. They also claimed that the Seller breached the Purchase Agreement by conveying a piece of equipment used in the practice just before the Purchase Agreement was executed.

The trial court ruled that the Purchase Agreement, Note, and Non-Compete Agreement "were executed and delivered without substantial consideration" because the Purchase Agreement contemplated both a stock sale and an asset sale, and that the buyers had not received any consideration because they had not received stock in Healthsource PC. The trial court then granted partial summary judgment to Buyers on several issues, including Seller's claim under the Note. The case proceeded to trial resulting in a jury verdict awarding the Buyers damages and attorneys' fees.

The Court of Appeals reversed, rejecting the Buyers' failure of consideration defense because when the Purchase Agreement was executed, Buyers received consideration in the form of the conveyance of the Seller's chiropractic business that they proceeded to operate. Because failure of consideration was partial and not total, "the burden devolve[d] upon the defendant to prove the dollar amount of his damages or suffer judgment against him," (quoting *Greene v. Johnson*, 170 Ga. App. 760, 761, 318 S.E.2d 205 (1984)). The Court held that Buyers failed to show any damages resulting from the failure to convey the stock and thus failed to prove a failure of consideration.

The Court also reversed the trial court's finding that the Purchase Agreement was a contract for the purchase of stock rather than an asset purchase agreement despite a recital in the Non-Compete Agreement that Buyers were receiving all of Seller's outstanding corporate stock in Healthsource PC. The Court noted that "[s]hares of stock in a corporation are, of course, not an asset of the corporation; rather, they are an asset of the person or entity that owns the stock." Therefore, Seller's promise to transfer the assets of the business "did not imply a promise to transfer her stock in the corporation." The Court found the recital in the Non-Compete Agreement to be "surplusage." The Seller did not promise to convey any shares of her stock in the Purchase Agreement or elsewhere in the Non-Compete Agreement. The Court also pointed out that the Buyers accepted whatever the Seller conveyed to them when the Purchase Agreement and Note were executed and only later claimed Seller breached the agreement by failing to convey stock. Therefore, Buyers must have been satisfied with what Seller conveyed to them when they executed the Purchase Agreement.

Further, the Court examined the Purchase Agreement and noted that it "more closely resembled an executed bill of sale for personal property than an executory contract for the sale of a business." As a result, Seller was only required to convey the assets owned by the corporation on the date the Purchase Agreement was executed and could not breach the Purchase Agreement by transferring an asset to a third party before it was executed.

***United States v. Fort*, 638 F.3d 1334 (11th Cir. 2011) – Receipt of Restricted Shares for Tax Purposes Occurs When Taxpayer Has Dividend and Voting Rights and Market Risk, Despite Deposit into Escrow Account and Restrictions on Transfer.**

The Eleventh Circuit held that a taxpayer who received restricted shares in the nature of an escrow fund in exchange for release of his partnership interest had constructively received the shares at the time of closing of the transaction, and was liable for the tax on the full value of the income during that year. The defendant taxpayer was a partner in Ernst & Young's ("E&Y") information-technology consulting business at the time that E&Y sold that business to Cap Gemini, S.A. ("Cap Gemini"). As part of the sale, the consulting partners, including Fort, signed agreements whereby they agreed to terminate their interest in E&Y and receive a distribution of Cap Gemini shares. However, the shares were not distributed outright to each partner, but were subject to restrictions and placed into accounts similar to escrow accounts. Despite the restrictions, such as the inability to sell portions of the restricted shares and the potential for forfeiture of some or all of the shares if the partner breached his employment agreement, voluntarily left employment or was terminated, the 11th Circuit upheld the trial court's entry of summary judgment in favor of the government. The government had argued that the value of the restricted shares should have been considered taxable income in the year the partner received them. The defendant argued that he did not "receive" the restricted shares in the year E&Y's consulting business was sold because of the restrictions. The court disagreed, and found that he constructively received the shares in that year because the full consideration of the shares was paid into his account on the closing date and he therefore bore the market risk of appreciation or depreciation, he had dividend and voting rights in the shares, they were held in an individual account in his name, and he had some control over whether the shares were forfeited.

## G. LITIGATION ISSUES.

### 1. Derivative Action Procedure.

***Wood v. Golden*, 2011 WL 2516704 (N.D. Ga. June 23, 2011) – Direct Action Found Permissible to Assert Closely Held Corporation's Claims.**

Plaintiff and defendant were "partners" in a corporation, and plaintiff was CEO from January 2007 to February 2010. In February 2010, the corporation held an annual shareholders meeting where the defendant allegedly elected himself President, CEO and CFO, and soon thereafter began the process of dissolving the corporation. The day after dissolution, the defendant created a new corporation which operated at the old corporation's former place of business, employed the same employees, and used the same equipment as the old corporation. Plaintiff brought alleged direct and derivative claims, asserting that defendant breached his fiduciary duties of loyalty, good faith and fair dealing and intentionally defrauded plaintiff. Defendant argued that plaintiff failed to make proper demand under O.C.G.A. § 14-2-742, and was thus unable to pursue derivative claims. While the court agreed, it found that the determination was not dispositive because a direct action was proper under the circumstances.

In *Thomas v. Dickson*, 250 Ga. 772, 301 S.E.2d 49 (1983), the Georgia Supreme Court held that a direct action may be appropriate to assert claims belonging to the corporation that would otherwise need to be asserted derivatively, if the corporation is closely held and the circumstances show that the reasons for the general rule requiring a derivative action do not apply. Here, there was no risk of multiple suits because plaintiff and defendant were the only shareholders; there was no risk that the action would prejudice any shareholder who was not a party; and there was no indication that there were any creditor concerns. Thus, the court concluded that plaintiff was entitled to assert his claims directly.

***Southland Propane, Inc. v. McWhorter*, 312 Ga. App. 812, 720 S.E.2d 270 (2011) – Exception Permitting Direct Actions for Corporate Injuries Held Inapplicable Because Interests of the Corporation's Creditors were not Protected.**

Minority shareholder in closely-held corporation with only two shareholders brought suit against majority shareholder and other defendants alleging numerous claims, including conversion of corporate interests, defamation, breach of fiduciary duty, fraud and intentional infliction of emotional distress. Following trial, in which the jury returned a favorable verdict to the plaintiff on his conversion, defamation, breach of fiduciary duty, fraud and intentional infliction of emotional distress claims, the defendants filed a motion for j.n.o.v., which the trial court denied. On appeal, the defendants argued that the trial court erred in denying their motion for j.n.o.v. because the plaintiff lacked standing to bring a direct action on the claims pertaining to his corporate interests.

The Court of Appeals noted that while the general rule is that misappropriation of corporate assets and breach of fiduciary duty can only be pursued in derivative actions, a direct action may nevertheless be proper in the context of a closely-held corporation where the circumstances show that the reasons for the general rule requiring a derivative suit do not apply, citing *Southwest Health & Wellness, LLC v. Work,* 282 Ga. App. 619, 626, 639 S.E.2d 570 (2006).[13] The reasons are: (1) to prevent multiple suits by shareholders; (2) to protect corporate creditors by ensuring the recovery goes to the corporation; (3) to protect the interests of all shareholders; and (4) to adequately compensate injured shareholders by increasing their share values. Because there were only two shareholders here, reasons 1, 3 and 4 did not apply. However, the Court found that there was evidence presented at trial that there were creditors that were potentially in need of protection. Thus, it held that the exception permitting a direct action in the context of a closely-held corporation was inapplicable, and it reversed the jury's verdict as to the plaintiff's claims for conversion, fraud and breach of fiduciary duty. A *certiorari* petition is pending at this writing.

For another decision concerning the *Thomas v. Dickson* exception to derivative actions, see *In re McClelland*, 2011 WK 2461885 (Bankr. N.D. Ga. June 8, 2011) in Section G.6, below.

***Anderton v. Bennett*, 2011 WL 4356505 (N.D. Ga., Sept. 16, 2011) – FDIC's Interest in Failed Bank Mismanagement Claims Entitles It to Intervention in Action Involving Stock-Based Employment Benefit Plans.**

In this case, the Court granted a motion to intervene filed by the Federal Deposit Insurance Corporation as Receiver ("FDIC-R") of Silverton Bank, N.A. seeking to intervene in an action against directors of the bank and its holding company. Plaintiffs, former senior vice presidents or vice presidents of the Bank, were vested participants in two Silverton employee benefit plans, the Deferred Compensation Plan and the Long Term Incentive Plan. Both plans relegated participants to the position of unsecured creditors of the holding company and the Bank. By May 2009, the bank's financial condition deteriorated and the FDIC was appointed as the Bank's Receiver. Shortly thereafter, the Bank's holding company filed for bankruptcy. The membership of the boards of directors of the Bank and holding company was the same.

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[13] *See also Thomas v. Dickson*, 250 Ga. 772, 301 S.E.2d 49 (1983).

Plaintiffs blamed the failure of the bank on the actions of the directors and blamed the loss of their interests in the Deferred Plan and Incentive Plan on the Bank's failure. Plaintiffs alleged that the directors breached their fiduciary duties under ERISA and state common law. The FDIC-R moved to intervene in the action, contending that it has "a right to intervene because the plaintiffs have asserted derivative claims of bank mismanagement by the Director Defendants in their roles as Bank officers and because these claims now belong to the FDIC-R. In addition, . . . it owns two liability insurance policies for the directors and officers." (*Id.* at *3) Both the plaintiffs and the defendants opposed FDIC-R's Motion to Intervene on the grounds that it lacked the legally protectable interest in the case. The Court granted the FDIC-R's Motion to Intervene based on F. R. Civ. P. 24(a)(2) finding that (1) although the motion to intervene was filed six-and-a-half months after the complaint was filed, the application to intervene was timely because the discovery was at the beginning stages and the Court had not yet ruled on the motion to dismiss; (2) the FDIC had an interest in the case, because "it has a valid, legally protectable interest in derivative claims against the Bank's officers for their alleged mismanagement of the Bank . . . because the FDIC-R has the right to assert derivative claims against the Director Defendants for mismanaging the Bank;" (3) if the FDIC-R were not allowed to intervene, the claims of Bank mismanagement would be decided without its participation, "thereby usurping the FDIC-R's authority to pursue these claims as it sees fit;" and (4) the FDIC-R's interest was not adequately represented by the current parties in the case because neither plaintiffs nor defendants could represent its interest. The Court distinguished an earlier decision denying FDIC intervention, *Patel v. Patel*, Civ. Action No. 1:09-CV-3684-CAP (N.D. Ga. Dec. 29, 2010), because the plaintiffs' rights and allegations were not confined to the holding company.

***Crittenton v. Southland Owners Association, Inc.*, 312 Ga. App. 521, 718 S.E.2d 839 (2011) – Claims Based on Irregularities in Election of Directors Held to be Derivative, not Direct.**

Five plaintiffs sued Southland Owners Association, Inc. ("SOA"), a homeowners' association, and several members of its board of directors in a declaratory judgment action, claiming that the defendants improperly invalidated a March 2010 election and negligently misused association funds.[14] While the suit was pending, a second election was held in August. The trial court then dismissed the plaintiffs' claims on the ground that they were moot. The plaintiffs appealed. The Georgia Court of Appeals held that with respect to the plaintiffs' petition for the trial court to declare the March election valid, the claim was properly dismissed as moot, because it asked for the validation of "a past event," and there was thus no justiciable controversy that would resolve the uncertainty of future events. The Court of Appeals disagreed that the remaining claims regarding the proper election-voting procedures under the bylaws, negligent misuse of association funds and attorneys' fees were moot, but held that they were nevertheless properly dismissed because, according to the Court, they were derivative claims. The Court reached this decision because the plaintiffs did not plead special injuries that were separate and distinct from any injury to the corporation. "[E]lection procedures properly conducted in accordance with the bylaws benefit all members; just as election irregularities harm all the members of a corporation. . . . [and] 'the general rule is that a shareholder seeking to

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[14] In its opinion, the Court of Appeals did not mention whether the homeowners' association was a nonprofit corporation, nor did it cite any provisions of the Georgia Business Corporation Code or the Georgia Nonprofit Corporation Code.

recover misappropriated corporate funds may only bring a derivative suit.'" *Id.* at 529, 718 S.E.2d 839 (citations omitted).

The claim of election irregularities centered on the allegations that the homeowners' association had mailed a newsletter to all homeowners in February 2010 informing them that only homeowners who were current in their assessments would be allowed to vote in the upcoming board of directors election. However, shortly before the election, the board decided at an informal meeting to allow all homeowners to vote regardless of the currency of their payments, but did not notify homeowners of this decision. After the ballots had been mailed to the association's management company but before they were counted, the board sent an e-mail to a small number of homeowners indicating that a quorum of voters was not required to elect the new board. After the votes were tallied, the five plaintiffs appeared to have been elected as the new board members. At the association's annual meeting in March, however, the election committee chairperson announced that the election was invalid because of the lack of a quorum and that the incumbent board would continue to serve until a new election could take place.

For its ruling regarding the derivative character of election irregularities, the Court mostly cited "special injury" cases, but in reaching its decision found that the "[p]laintiffs' declaratory-judgment claim as to whether the defendants employed the proper election-voting procedures under SOA's bylaws is essentially a claim that defendants breached their fiduciary duties owed to SOA and all of its members." The Court did not provide any explanation of how conduct that affects the voting rights of association members could be regarded as a corporate asset or any discussion of the standing of a candidate for board membership to contest the invalidation of an election.[15]

***Brown v. Pounds*, 289 Ga. 338, 711 S.E.2d 646 (2011) – Corporate Bylaw Amendment Invalidated Because Found to be Inconsistent with Derivative Action Settlement.**

The Supreme Court of Georgia affirmed in part the Court of Appeals' determination that an amendment to the Cobb Electric Membership Corporation's ("Cobb EMC") bylaws violated a settlement agreement that had previously been entered into by the parties. The settlement agreement had provided that the EMC members ("Members") who had filed a derivative action against the company and certain of its directors and officers would seek an amendment to the bylaws at the next meeting that would allow members the right to vote for directors by mail-in

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[15] The Court cited *Dunn v. Ceccarelli*, 227 Ga. App. 505, 508, 489 S.E.2d 563 (1997) (physical precedent only), in which the "gravamen of the complaint" was that defendants "breached their fiduciary duties <u>in the management of the corporation</u> by wrongfully controlling the election results" (emphasis added). The *Dunn* court stated that association members enjoy an individual right to vote and could maintain a direct action against directors who allegedly wrongfully invalidated their votes, but it noted that those individual members were not parties to the suit, and the plaintiffs (a director and a candidate for director) were not alleging that their own votes were invalidated. *Id.* at 508. It also held that the association did not owe candidates any special fiduciary duties merely because they were candidates for office, that interference with the candidacy was an indirect injury, "and indirect injuries to a member or director resulting from direct injury to the corporation do not give rise to a direct action." *Id.* at 509.

ballots. The settlement agreement was approved by the trial court. Following the trial court's approval, a meeting of Cobb EMC's board of directors was held where the board unanimously voted to amend the bylaws to allow proxy voting at member meetings when the election of directors was *not* on the agenda.

The trial court held that the board's actions in amending the bylaws was consistent with EMC's bylaws and Georgia law and would promote member inclusion in the governing process. The Court of Appeals reversed in part and remanded, holding that the amendment was contrary to the terms of the settlement agreement because the use of proxies was inconsistent with the requirement that EMC members be provided an opportunity to vote on whether mail-in ballots could be used in director elections "at" the next member meeting. The Supreme Court disagreed with the Court of Appeals' reasoning, but found that the bylaw amendment nevertheless violated the settlement agreement because it significantly changed the conditions under which the previously agreed-upon plan for proposing the option of proxy voting was implemented. When the settlement agreement was initially entered into, Cobb EMC's bylaws allowed proxy voting only in narrow circumstances. By authorizing new avenues to vote by proxy, the Supreme Court held that the proxy voting bylaw amendment fundamentally altered the circumstances pursuant to which the members conducted business. Thus, it held that the amendment violated the spirit, if not the letter of the settlement agreement because it essentially allowed the board to unilaterally change the method of voting on the issue of the method of voting for directors, which had been a core issue addressed by the settlement agreement.

In dissent, Justice Melton noted that rather than contradicting the settlement agreement, the amendment enhanced it because it increased the ability of members to actively participate at special meetings and increased the transparency of corporate proceedings. Justice Melton stated that "it is the majority's analysis, not the bylaw amendment, which undermines both the letter and spirit of the settlement agreement between these parties."

### 2. Alter Ego, Piercing the Corporate Veil, and Other Forms of Secondary Liability.

***Great Dane Limited Partnership v. Rockwood Service Corporation*, 2011 WL 2312533 (S.D. Ga. June 8, 2011) – Allegations of Insolvency Held to be Essential to Veil-Piercing Claim Because Otherwise Plaintiff Has an Adequate Remedy at Law.**

The court denied the plaintiff's motion to compel discovery responses relating to jurisdiction on corporate veil-piercing grounds when the plaintiff had failed to allege insolvency of the corporation. The plaintiff had brought a diversity action against several defendants, alleging that they engaged in corporate veil-piercing conduct by disregarding separate corporate entities. The defendants argued that the plaintiff had not pled enough to support its veil-piercing claims, which were the sole basis for obtaining jurisdiction over two of the corporate defendants. The court held that a minimum pre-requisite to a corporate veil-piercing claim, which is an equitable claim, is that there be allegations of insolvency of the corporation because "[s]olvency – having the means to pay a money judgment – means there exists an adequate remedy at law." The court relied on *In re Friedman's Inc.*, 385 B.R. 381, 415 (S.D. Ga.), *modified on other grounds*, 394 B.R. 623 (S.D. Ga. 2008) in reaching its conclusion and in rejecting the defendants' argument that there is no explicit requirement that a plaintiff plead and prove insolvency before a court may pierce the corporate veil.

See also *The B&F System, Inc. v. LeBlanc,* 2011 WL 4103576 (N.D. Ga. Sept. 14, 2011) in section E, above.

***Tindall v. H&S Homes, LLC*, 2011 WL 5827227 (M.D. Ga. Nov. 18, 2011) – Georgia Common Law Preference Claims are Governed by a Six-Year Statute of Limitations.**

In this case a creditor plaintiff sued H&S Homes, LLC and its members and managers asserting a common law preference claim and claiming that the individual defendants improperly used their position for the purpose of preferring themselves over other creditors by transferring money and other property of H&S Homes to themselves or subsidiaries when H&S Homes was insolvent. The defendants argued that Georgia law does not recognize a "preference" claim and that the claim asserted by the plaintiff was either an improper claim under federal bankruptcy law, a fraudulent transfer claim under Georgia's Uniform Fraudulent Transfers Act ("UFTA"), or a "sub silentio" wrongful distribution claim under O.C.G.A. §§ 14-2-660 and 14-2-832. The defendants also argued that the claim was barred by the applicable statute of limitations for these various claims.

The Court disagreed with the defendants' first argument, finding that Georgia law has long recognized the type of common law "preference claim" asserted by the plaintiff, because it was really a "breach of trust" claim. Citing *Ware v. Rankin*, 97 Ga. App. 837, 104 S.E.2d 555 (1958) and *McEwen v. Kelly*, 140 Ga. 720, 79 S.E. 777 (1913), the Court held that managing officers and directors of an insolvent corporation are charged with the duty of conserving and managing its assets in trust for the creditors. They have a duty to apply the assets to the payment of debts of the corporation and may not use them to pay debts that the corporation owes to themselves. This duty gives rise to a creditor's right to sue officers and directors of a corporation who breach it.

The defendants next argued that the plaintiff's claim was time-barred, asserting that if the claim were considered a fraudulent transfer claim under the Georgia UFTA, under O.C.G.A. § 18-2-75(b), it was barred by the applicable one-year statute of limitations, and if it were considered a claim under O.C.G.A. § 14-2-832, it was barred by the applicable two-year statute of limitations. While recognizing that the defendants' alleged actions may be viewed as an improper transfer of assets actionable under the UFTA, the court determined that "nothing in that statute demands that it be the sole cause of action when a transfer to an insider is made under the guise of an antecedent debt. Plaintiff's breach of trust claim is separate and distinct from any fraudulent transfer claim," and thus the one-year statute of limitations did not apply.

The Court went on to find that a claim for wrongful distribution brought pursuant to O.C.G.A. § 14-2-832 is also different from the plaintiff's claim here. The statute provides only for a cause of action against a corporate director who allows a distribution to be made to shareholders in violation of the company's articles of incorporation or the Georgia Business Corporations Code. Here, the plaintiff's claim was based upon the broader Georgia common law charging not only directors, but also managers, officers, and sole owners of corporations with the duty of conserving and managing an insolvent corporation's assets in trust for the creditors and was not limited to distributions to shareholders. Thus, the claim was not subject to the two-year statute of limitations.

The Court held that the plaintiff's claim was subject, instead, to the statute of limitations for breach of trust claims provided in O.C.G.A. § 53-12-307, which provides two limitation periods. If a trust beneficiary receives a written report putting the beneficiary on notice of a possible claim, the breach of trust claim must be brought within two years. If no such written report is received, a breach of trust claim may be brought within six years after the beneficiary discovered or reasonably should have discovered the subject of the claim. The court held that the six-year limitation period applied in this case.

***In re Palisades at West Paces Imaging Center, LLC (Watts v. Peachtree Tech. Partners, LLC)*, 2011 WL 4459778 (Bankr. N.D. Ga. Sept. 13, 2011) – LLC Members Potentially Subject to Fraudulent Conveyance Claims for Recovery of Funds Paid to Redeem Their Membership Interests by LLC When Insolvent.**

A bankruptcy trustee brought an adversary proceeding seeking to avoid alleged fraudulent transfers against former members of the Debtor, a limited liability company, who had previously entered into settlement agreements with the Debtor. Several years prior to the bankruptcy, the defendants, with the exception of RBLB Group, LLC ("RBLB"), filed suit against the Debtor, its managers and it's 30% member, seeking relief based on alleged misrepresentations and omissions related to the Debtor's solicitation of the defendants' investments and the Debtor's start-up of operations. After litigating for over one year, the defendants and the Debtor entered into a settlement, pursuant to which the Debtor agreed to make installment payments to the defendants, and the defendants agreed to transfer and assign their membership units back to the Debtor. It was unclear from the record whether the membership units were ever actually transferred back to the Debtor. The Debtor also entered into a settlement agreement with RBLB, even though RBLB had not sued the Debtor, obligating the Debtor to make installment payments to RBLB in exchange for RBLB's transfer of its membership units back to the Debtor. After the Debtor filed for bankruptcy, the Trustee sought to avoid the payments made to the defendants pursuant to the two settlement agreements.

In a motion for summary judgment, the defendants first argued that the settlement funds were subject to a constructive trust because the Debtor obtained title to the funds through its agents' fraudulent misrepresentations. Thus, they argued, the Debtor did not "transfer an interest of the Debtor in property" under 11 U.S.C. § 548(a)(1)(b). The Court found that this argument failed because the existence of fraud was not an undisputed fact. Moreover, it would not be a foregone conclusion that, even if fraud were found, a constructive trust would be implied. It denied the defendants summary judgment on their constructive trust theory.

The defendants' main argument was that the settlement agreements created a debtor-creditor relationship, making the settlement payments to the defendants on account of an antecedent debt. The defendants also argued that as a matter of law, payment of a valid, antecedent debt constitutes reasonably equivalent value. The Trustee argued that the obligations under the settlement agreements were not antecedent debt but were actually a return of equity.

Both parties based their arguments on Section 510 of the Bankruptcy Code, which the court found was irrelevant, as Section 510 deals with the priority of claims as opposed to equity interests, and does not deal with the existence of reasonably equivalent value for claims. The Court therefore proceeded to decide whether the underlying debt was an avoidable debt of the Debtor.

The Court held that the defendants failed to demonstrate entitlement to summary judgment on the issue of whether the payments under the settlement agreements were for reasonably equivalent value as payments on account of antecedent debt. First, the record was unclear in showing that the defendants were not insiders, so the court could not conclude that they were not. Second, the Court determined it must decide whether the settlement agreements themselves were made for reasonably equivalent value by looking at the totality of the circumstances. The Court analyzed the underlying litigation to see if the settlements entered into were reasonable in light of the various considerations of the parties at the time.

For this analysis, the Court looked to whether the settlement agreements were entered into at arm's length; whether the parties acted in good faith; whether a fair market value comparison could be made; and whether the settlement was reasonable in light of the allegations and defenses in the litigation. The Court concluded it did not have enough evidence to determine whether the settlement agreements were entered into at arm's length or to determine the good faith of the parties. In looking at the fair market value comparison, the Court noted that there was no evidence on the record indicating whether the membership units were transferred to the Debtor or whether they had any value at all. Since the defendants had stipulated for purposes of the motion that the Debtor was insolvent, the Court concluded that fact suggested that the Debtor received no value for the redemption of its stock. The Court also questioned whether the Debtor received any value for cessation of the litigation, as it was unclear whether the Debtor was in business at the time of settlement. Due to the numerous issues of material fact that remained in dispute, the Court denied the defendants' motion for summary judgment on these issues.

***Terrell v. OTS, Inc.*, 2011 WL 2619080 (N.D. Ga. July 1, 2011) – Solely-owned Corporation Can Be Held Liable for Negligent Entrustment to Its Shareholder.**

Defendants Charles Lester and OTS, Inc., Lester's solely-owned corporation, filed a motion for renewed judgment as a matter of law, or in the alternative, a new trial, arguing that plaintiff should not be allowed to recover individually against Lester for battery and separately against OTS for negligent retention, as this would constitute a double recovery. The court denied the motion, finding that it was not a double recovery because, even if OTS were Lester's alter ego, they were nevertheless not the same entity, and holding OTS responsible for failing to fire Lester was not the same as holding Lester liable for not firing himself. The Court also stated that it does not find that a solely-owned corporation is exempt from a negligent retention claim under Georgia law because it is owned by the tortfeasor. Because Lester had chosen to enjoy the separate corporate form when he incorporated OTS, he should not be allowed to retain the corporate benefits without also facing the corresponding legal consequences.

The defendants had also argued that the plaintiff's negligent retention claim had not been supported by a legally sufficient basis because OTS' attorney had investigated complaints regarding Lester's alleged battery of his employees and had determined that his conduct was appropriate. Thus, according to defendants, OTS was not on notice of any tendency of Lester to batter his employees. The Court found that the jury had been given sufficient evidence from which it could conclude that the attorney's investigation did not deserve any credence. The 11th Circuit has held that while an employer can accept one employee's version of facts over another's that choice must be an honest one. The Court here found that the jury was permitted to find that OTS would not have made an honest choice in believing Lester's denials over the employees' complaints because Lester was the alter ego of the corporation, and he knew what events actually occurred. Thus, the Court held that OTS had sufficient notice to predicate a negligent retention claim.

### 3. <u>Jurisdictional Cases</u>.

***Amerireach.com v. Walker*, 290 Ga. 261, 719 S.E.2d 489 (2011) – Long Arm Jurisdiction May be Exercised over Corporate Officers Based on Their Conduct in Their Official Capacities, Rejecting the "Fiduciary Shield" Doctrine.**

This case involved a suit brought by a physician, Dr. Carol Walker, who purchased nutritional supplements from Amerireach.com, LLC d/b/a AmeriSciences ("AmeriSciences") and sold them under an agreement providing in part that any disputes regarding the agreement would "be brought in the state and/or federal court of Harris, Texas." Walker terminated the agreement and demanded that AmeriSciences repurchase products from her at not less than 90% of their original cost under Georgia's Sale of Business Opportunities Act ("SBOA"), O.C.G.A. § 10-1-415(d)(1). When AmeriSciences did not repurchase the products, Walker filed suit in Gwinnett County, Georgia against AmeriSciences and three individual corporate officers for failing to comply with the disclosure and repurchase requirements of the Georgia Fair Business Practices Act ("FBPA"), O.C.G.A. § 10-1-415(d)(1). AmeriSciences then filed a declaratory judgment against Walker in Harris County, Texas, and, after Walker failed to answer, that court entered a final default judgment finding any suit was subject to the forum selection clause and that filing suit elsewhere was a breach of contract. Subsequently, the Gwinnett County court ruled in favor of AmeriSciences, finding Walker's claims were subject to the forum selection clause and barred by *res judicata*. The trial court also dismissed the claims against the individual corporate officers, holding in part that under the "fiduciary shield" doctrine they could not be individually liable under the SBOA because they were acting in their official capacities with AmeriSciences.

The Georgia Court of Appeals reversed the trial court's ruling, holding that because Walker's claims were "based on a statutory violation instead of a breach of contract, the contractual defense of a forum selection clause does not apply, and her claims are not barred by res judicata," *Walker v. Amerireach.com*, 306 Ga. App. 658, 660(1), 703 S.E.2d 100 (2010). The Court of Appeals held that "the trial court had personal jurisdiction over the individual defendants even though they were present in Georgia only in their capacities as AmeriSciences officers, as they admittedly were founding members and top officers of a 'multilevel distribution company' as defined by O.C.G.A. § 10-1-415 and generally knew Dr. Walker's cancellation rights thereunder, which apply to any agreement made in Georgia," (citing *Walker v. Amerireach.com*, 306 Ga. App. at 662-663(3)). The Court of Appeals also held that Walker's complaint stated a claim against the individual corporate officers under the FBPA based on her claim that they violated the SBOA.

On appeal, the Georgia Supreme Court reversed the Court of Appeals on AmeriSciences' claim, holding that Dr. Walker was bound by the Texas court's judgment enforcing the contract's forum selection clause. That ruling did not apply, however, to the individual defendants. They argued that the trial court correctly held that under the "fiduciary shield" doctrine "a nonresident individual cannot be subject to personal jurisdiction in Georgia courts based solely upon acts taken in his capacity as a corporate officer." The Georgia Supreme Court noted that the doctrine has been criticized and rejected by many courts, (citing 3A William Meade Fletcher, *Fletcher Cyc. Corp.* § 1296.20; S. Larsen, Annotation, *Validity, construction, and application of "fiduciary shield" doctrine-modern cases*, 79 A.L.R.5th 587 (2000); 21 CJS Courts § 67). Further, there is "a broad consensus among federal courts . . . that due process does not require the application of the fiduciary shield doctrine." (quoting *Simplex Healthcare v. Marketlinkx Direct*, 761 F. Supp. 2d 726, 732(II) (M.D. Tenn. 2011); citing *Calder v. Jones*, 465 U.S. 783, 790, 104 S. Ct. 1482, 79 L. Ed. 2d 804 (1984) and *Keeton v. Hustler Magazine*, 465 U.S. 770, 781, fn. 13, 104 S. Ct. 1473, 79 L. Ed. 2d 790 (1984)).

The Georgia Supreme Court had not previously addressed the "fiduciary shield" doctrine, although the Court of Appeals construed Georgia law consistently with the doctrine in *Southern Electronics Distributors v. Anderson*, 232 Ga. App. 648, 650(1), 502 S.E.2d 257 (1998) and *Girard v. Weiss*, 160 Ga. App. 295, 298(1), 287 S.E.2d 301 (1981). Those cases were followed in three federal cases, *Club Car v. Club Car (Quebec Import*, 362 F.3d 775, 784(4) (11th Cir. 2004); *Canty v. Fry's Electronics*, 736 F. Supp. 2d 1352, 1360 (N.D. Ga. 2010); *United States for Use and Benefit of WFI Ga. v. Gray Ins. Co.*, 701 F. Supp. 2d 1320, 1346 (N.D. Ga. 2010). However, those federal court decisions were not binding and the Court of Appeals decisions were decided before the Georgia Supreme Court decided *Innovative Clinical & Consulting Services v. First Nat. Bank of Ames, Iowa*, 279 Ga. 672, 620 S.E.2d 352 (2005). In that case, the Court addressed O.C.G.A. § 9-10-91(1), the portion of the Georgia long-arm statute authorizing jurisdiction over a nonresident who transacts business in Georgia, under which Walker claimed the Court had personal jurisdiction over the individual AmeriSciences corporate officers. In *Innovative Clinical & Consulting Services*, the Court interpreted O.C.G.A. § 9-10-91(1) literally to mean that it "grants Georgia courts the unlimited authority to exercise personal jurisdiction over any nonresident who transacts any business in this State" to the extent allowed by procedural due process. 279 Ga. at 675-676. Here, the Court held that there is nothing in the plain language of the statute suggesting "that the Legislature intended to accord any special treatment to fiduciaries acting on behalf of a corporation or to insulate them from long-arm jurisdiction for acts performed in a corporate capacity," (quoting *Kreutter v. McFadden Oil Corp.*, 71 N.Y.2d 460, 527 N.Y.S.2d 195, 522 N.E.2d 40, 46 (1988)). Therefore, the Georgia Supreme Court held that the "fiduciary shield" doctrine is inconsistent with the literal language of the Long Arm Statute, and overruled the Court of Appeals' cases holding that the "fiduciary shield" doctrine applied in Georgia.

Further, the Court noted that the "fiduciary shield" doctrine was not required for equitable concerns because those concerns are adequately protected by constitutional due process requirements, (citing *Kreutter*, 522 N.E.2d at 46). Under *Keeton v. Hustler Magazine*, 465 U.S. 770, a court does not necessarily have jurisdiction over a corporate officer just because it has jurisdiction over the corporation. Therefore, the Court could not judge the corporate officers' contacts with Georgia based on AmeriSciences' activities. However, that prohibition does not prevent the exercise of jurisdiction over the individuals if they are "primary *participants* in an alleged wrongdoing intentionally directed at a … resident [of the forum state]… (quoting *Calder*, 465 U.S. 783). Therefore, the "status of the individual defendants as employees or officers 'does not somehow insulate them from suit in their individual capacity,'" (quoting *Calder*, 465 U.S. 783).

The Court stated that although "a company's contacts with a forum that are independent of an individual employee's contacts with the same forum are not to be aggregated against the individual employee for purposes of the minimum-contacts analysis, … for purposes of specific personal jurisdiction, the conduct in which the individual employees personally and actually engage as part of their employment duties does count against them in spite of the fact that they engaged in the activities as employees of a business entity." If the employee is the "'primary participant'" in the activities that form the basis of the court's jurisdiction over the corporation, then the court has personal jurisdiction over the individual for matters relating to those activities (citing *Application to Enforce Administrative Supoenas Duces Tecum of the Securities and Exchange Commission v. Knowles*, 87 F.3d 413, 418 (10th Cir. 1996)). The "primary participant" requirement is itself a sufficient constitutional due process protection of corporate employees and officers.

Therefore, the Court held that "both the 'long-arm statute [ ] and constitutional fairness concerns adequately protect corporate employees [and officers] and … that the [fiduciary shield] doctrine unfairly prejudices plaintiffs who have valid claims against' those individuals who have acted in a corporate capacity in Georgia," (quoting Larsen, *supra*). The Court held that the "fiduciary shield" doctrine did not apply to corporate officers or to the officers here, who were members of a limited liability company. The individual defendants here relied solely on the fiduciary shield doctrine and did not present evidence controverting the complaint; thus, the Court accepted the allegations in the complaint as true. Because the "fiduciary shield" doctrine does not apply in Georgia, the Court held that "the allegations of the complaint were sufficient to withstand Appellants' attack on the trial court's jurisdiction over the individual defendants on the ground that they acted in their corporate capacities."

On January 18, 2012, the Georgia Court of Appeals vacated Division 1 of its opinion and adopted the judgment of the Georgia Supreme Court, thus reversing the trial court's grant of summary judgment in favor of the individual officers. See *Walker v. Amerireach.com*, 313 Ga. App. 584, 722 S.E.2d 201 (2012).

***Azalea House LLC v. National Registered Agents, Inc.*, 415 Fed. Appx. 958, 2011 WL 679413 (11th Cir. Feb. 25, 2011) – A registered agent appointed pursuant to O.C.G.A. § 14-2-504 owes only a duty of reasonable care when receiving service of process for the LLC.**

Defendant National Registered Agents, Inc. ("NRAI") was Azalea House LLC's ("Azalea House") registered agent for service of process. Azalea House sued NRAI for negligence after Azalea House did not receive service of process in a state court suit and suffered a default judgment. The Eleventh Circuit Court of Appeals affirmed the district court's grant of summary judgment in favor of NRAI, holding that the failure to receive service of process and the subsequent default judgment were due to Azalea House's failure to notify NRAI that it had moved its office from Atlanta to Florida.

Azalea House was a limited liability company organized in Georgia in December 2005. *Id.* at 960. Its sole asset was property in Augusta, GA that was intended to be used as a hospitality house during the Masters Golf Tournament. At the time of organization, Azalea House designated NRAI as its registered agent for service of process and provided NRAI with an Atlanta mailing address, which was the home address of the managing agent. That address was also listed as the LLC's principal place of business and mailing address with the Georgia Secretary of State. In May 2007, the managing agent moved from Atlanta to Florida but failed to notify NRAI of his change of address, despite the fact that NRAI had stressed the importance of notifying it of any change of address for Azalea House and had provided a toll-free phone number for that purpose.

In December 2007, NRAI was served with process for a suit against Azalea House in Georgia state court. NRAI attempted to call Azalea House but had a wrong number, then forwarded the service of process by FedEx overnight service to the Atlanta address on file. *Id.* at 961. The package was not returned and NRAI got delivery confirmation from FedEx. NRAI did not try to call FedEx to verify that a signature was obtained, and FedEx had not obtained a signature. Azalea House was unaware of the action and a default judgment was entered against it. After the default judgment was entered, NRAI attempted to send the default judgment to Azalea House but discovered Azalea House was not at the Atlanta address when the FedEx package was returned undeliverable. NRAI then sent the default judgment by USPS to the Atlanta address, but it was not returned or forwarded and Azalea House never received it. As a result of the default judgment, the hospitality house property was lost. After learning that the property had been transferred, Azalea House sued NRAI for negligence.

The 11th Circuit noted that the four elements of a cause of action for negligence in Georgia are duty, breach of the duty, harm or injury, and a causal connection between the breach and the injury, (citing *Dozier v. Crane & Mach. Inc. v. Gibson*, 284 Ga. App. 496, 644 S.E.2d 333, 336 (2007)). A registered agent does not owe any specific duty of care to a limited liability company under Georgia law, and the applicable statute, O.C.G.A. § 14-2-504, does not require the agent to perform any specific acts when receiving service of process. Therefore, "a registered agent simply owes a duty of 'reasonable care' in receiving service of process." *Id.* at 962.

Azalea House claimed NRAI breached that duty by failing to obtain a signature upon delivery of service of process, which then caused NRAI to fail to take other steps to determine Azalea House's correct address. NRAI's internal manual and company policies required NRAI to obtain a signature and perform other acts to find the recipient of the notice. The court held that NRAI did not breach its duty to Azalea House because the parties did not have any agreement specifying what NRAI was required to do and NRAI never told Azalea House that it was required to obtain a signature. It held that NRAI's internal policies did not create a legal duty to Azalea House (citing *Muller v. English*, 221 Ga. App. 672, 472 S.E.2d 448, 454 (1996)). Although breach of internal policies may be admissible evidence of negligence, the evidence in this case did "not create a genuine issue of fact for trial."

For an additional decision involving jurisdictional issues, see *Denim North America Holdings, LLC v. Swift Textiles, LLC*, 2011 WL 97238 (M.D. Ga. Jan. 12, 2011) (Unauthorized participation by LLC resulted in fraudulent joinder that did not destroy diversity of citizenship), discussed in Section D, above.

### 4. <u>Evidence – Business Records Act</u>.

***Saye v. Provident Life and Accident Ins. Co.*, 311 Ga. App. 74, 714 S.E.2d 614 (2011) (en banc) – Business Records Act Exception to Hearsay Rule Does Not Authorize Admission of Documentary Record of Telephone Conversation.**

Plaintiff, the insured, sued his disability insurer for breach of insurance contract, arising after Plaintiff, a laparoscopic surgeon, stopped performing surgery and sought disability benefits allegedly due to a condition known as Dupuytren's Contracture, which caused pain and loss of dexterity in his right hand. Plaintiff's disability benefits were significantly greater if his disability was attributable to an injury, rather than sickness. The jury rendered a verdict in favor of the insurer. The Court of Appeals found that the trial court erred in admitting documentary evidence of a telephone conversation between the Plaintiff and a claims representative, in which the Plaintiff reportedly stated that his condition was caused by "sickness." The Insurer did not call the claims representative to testify regarding the conversation, but relied on the documentation as a "business record," that could be admitted under the Georgia Business Records Act, O.C.G.A. § 24-3-14(b). Citing *Mitchell v. State*, 254 Ga. 353, 329 S.E.2d 481 (1985) and *Griffin v. Bankston*, 302 Ga. App. 647, 691 S.E.2d 229 (2009), the Court held that the contents of a conversation are not an "act, transaction, occurrence or event" within the meaning of the Act. The fact that the Plaintiff's statement could be admitted under the hearsay exception for prior inconsistent statements or admissions did not cure the hearsay problem because the evidence of the statement was itself inadmissible as hearsay. The majority held that the trial court's error was harmful and warranted reversal because it went directly to the ultimate issue before the jury, i.e., whether plaintiff's disability resulted from sickness or injury. The dissent argued that the evidence was merely cumulative of other evidence that the disability was due to sickness and its admission did not warrant reversal.

***Melman v. FIA Card Services, N.A.*, 312 Ga. App. 270, 718 S.E.2d 107 (2011) – Credit Card Records Admitted as Business Records without Testimony as to their Truthfulness, Accuracy or Completeness.**

The Court of Appeals affirmed the trial court's grant of summary judgment for FIA Card Services, N.A in its suit against John Melman for money owed on his credit card account, holding that the bank's evidence of the debt was properly admitted under the Georgia Business Records Act, O.C.G.A. § 24-3-14(b). In support of its motion of summary judgment, FIA filed an affidavit of an "operation analyst" who testified that she was familiar with FIA's business records, including the ones at issue in the lawsuit, and that the business records were kept under her supervision and control. She also testified, based on those records, that Melman applied for and obtained credit from FIA, and that he made purchases and received advances from FIA. The affiant attached to her affidavit a Bank of America credit card agreement and account statement and a notice explaining that Melman's Bank of America card was being "issued and administered" by FIA. In response to FIA's motion, Melman argued that FIA produced no evidence of an accepted credit card application, of a contract between him and FIA, or his debt, and that the affiant lacked personal knowledge of his business dealings. Melman further contended that FIA did not lay a proper foundation for admitting evidence in support of its motion for summary judgment, specifically alleging that the affidavit failed to identify, describe or reference the exhibits as being FIA's business records, and that the affiant did not swear that the documents were truthful, accurate or complete. The Court found that FIA did lay a proper foundation for admitting the evidence because the affiant stated under oath that she was familiar with the business records at issue, that FIA's records were made in the regular course of business, and that she relied upon those records and her personal knowledge in making her affidavit. The fact that the affidavit did not contain an express statement regarding the truthfulness, accuracy or completeness of the records, or that the affiant failed to attach the application and thus did not submit "all papers or parts thereof referenced in the affidavit" as required under O.C.G.A. § 9-11-56(e), did not render the evidence inadmissible under the Business Records Act, because the affiant did attach the pertinent records on which she relied in her testimony.

***Ellington v. Gallery Condominium Association, Inc.*, 313 Ga. App. 424, 721 S.E.2d 631 (2011) – Condominium Association Account Ledger of Assessments Properly Admitted as Business Records.**

The Court of Appeals affirmed the grant of summary judgment to Gallery Condominium Association, Inc. in its suit against Courtney Ellington to recover unpaid condominium assessments. Contrary to Ellington's argument, the Condominium Association had authority under O.C.G.A. § 44-3-80(b)(3) and the condominium declaration to charge its unit owners for utilities, which the association paid as a common expense, and absent a transcript, the trial court's judgment was presumably correct. The Court also held that the property manager's affidavit on which the association relied was admissible under the business records exception to the hearsay rule because the affiant testified that he participated in and was familiar with the association's billing of assessments, that he was familiar with the association's records and record-keeping process and that he had personal knowledge of the information contained in his affidavit, and he attached to his affidavit the account ledger for Ellington. The Court of Appeals held that this foundation was sufficient to satisfy the business records exception.

***Dawson Pointe, LLC v. SunTrust Bank*, 312 Ga. App. 338, 718 S.E.2d 570 (2011) –Loan History Admitted as Business Records Sufficient to Prove Interest Owed without Evidence of Prime Rate Specified in Promissory Note.**

In this case, the bank sued borrower for amounts owed on a promissory note. The Defendant did not dispute its default on the loan and the principal amount owed, but argued that SunTrust failed to establish the applicable variable rate of interest, which under the terms of the note was based on "the Wall Street Journal Prime Rate." Stressing the trial court's discretion and the defendant's failure to produce evidence to the contrary, the Court found that an affidavit submitted by the SunTrust employee responsible for maintaining the bank's business records setting forth the applicable variable interest rate, showing how it changed over time and attaching a "Loan History Report" for the promissory note, was properly admitted as a business record under O.C.G.A. § 24-3-14. The Court further ruled that this evidence sufficed to establish the interest owed notwithstanding the bank's failure to produce evidence establishing the Wall Street Journal Prime Rate.

## 5. <u>Director and Officer Liability Insurance Decisions</u>.

No decisions rendered during 2011 regarding director and officer liability insurance policies came to our attention. The following decision involves coverage for corporate employees directors, shareholders and agents under another type of casualty insurance in a personal injury action.

***Empire Fire & Marine Ins. Co. v. Ison*, 2011 WL 1326057 (M.D. Ga. Apr. 6, 2011) – Coverage for Officers, Directors, Employees and Shareholders under Liability and Umbrella Policies Held to be Released in Settlement.**

The Court granted summary judgment in favor of insurer in a declaratory judgment action, finding that the insurer had no duty to defend or indemnify defendants under a garage policy and an umbrella policy against claims asserted by injured party who had entered into a settlement agreement with the insurer and the insured corporation that released the insured corporation and its employees, directors or shareholders acting within the scope of their duties from all liability to the injured party. Craig Stephen Delk had brought claims for injuries he suffered while using a water slide located at the residence owned by defendants Burd Kenneth Ison II and Kathryn Jo Ison. While the record was not clear, the court assumed that the Isons could be employees, directors, shareholders, executive officers or stockholders of Travel Country RV Center, Inc. ("Travel Country"), the named insured under a Garage Policy and an Umbrella Policy issued by Empire Fire & Marine Insurance Company ("Empire") and a co-defendant. Delk alleged that employees, agents or representatives of Travel Country installed or set up the water slide on the Ison's property.

Travel Country was the named insured under the garage and umbrella policies The Garage Policy also included as insureds Travel Country's employees, directors or shareholders but only while acting within the scope of their duties. The Umbrella Policy included as insureds Travel Country's employees, directors, executive officers or stockholders while acting within the course of their duties.

Delk, Empire and Travel Country entered into a release and settlement agreement whereby Delk released Travel Country of all liability and released any of Travel Country's employees, directors or shareholders to the extent that they were acting within the scope of their duties. The release and settlement was not intended to cover the Isons' personal liability. Delk also released Empire of all liability to him under either the Garage Policy or the Umbrella Policy.

Empire filed a declaratory judgment action seeking a declaration that it did not owe the Isons a defense or immunity because the release that extinguished the liability of Travel Country also extinguished all potentially covered liability claims against the Isons. The court held that under the Garage Policy, the Isons were only considered insureds if they were employees, directors or shareholders acting within the scope of their duties, and since Delk released all claims against Travel Country's employees, directors and shareholders while acting within the scope of their duties, then there were no potentially covered claims against the Isons under the

Garage Policy. With the Umbrella Policy, which provided coverage for Travel Country's executive officers or stockholders acting within the scope of their duties, the exact same analysis did not apply. However, the court still found that any potentially covered claims against the Isons were extinguished under the Umbrella Policy because Delk had settled and agreed to release the liability of any person or entity insured and covered under either Policy.

### 6. <u>Nondischargeability of Breach of Fiduciary Duty Claims</u>.

***In Re Kwang Cha Yi*, 2011 WL 1364229 (Bankr. N.D. Ga. Apr. 11, 2011 ) – Nondischargeability of Investor Claims and Derivative Claims: § 523(a)(4) Does Not Apply to Pre-investment Conduct; Inspection Rights Claims Must Be Brought against Corporation, not its Officers.**

Plaintiff Myong Sung Schrader filed a complaint to determine dischargeability of her claims against Debtor/Defendant Kwang Cha Yi based on Schrader's $97,000 investment in a restaurant business that Yi was to incorporate and operate. In this decision, the court ruled on and denied Yi's motion for summary judgment on most of Schrader's claims under 11 U.S.C. § 523(a)(2) for false representations regarding her investment, granted the motion as to the claims under § 523(a)(4) for "fraud or defalcation while acting in a fiduciary capacity," but denied it as to claims under § 523(a)(4) for "embezzlement."

Schrader and Yi entered into an oral contract in 2007 to establish a corporation that would operate a Mexican sports bar in Tucker, Georgia. Schrader was the chief financial officer and corporate secretary and Yi was chief executive officer. The corporation's restaurant opened in December 2008, and closed in 2009. Yi filed for Chapter 7 bankruptcy in September 2009. In her complaint, Schrader alleged that Yi had represented that her funds would be used in the business as operating capital, that she would receive 50% of the stock in the corporation and that Yi would repay the investment. She alleged that Yi diverted her funds and used them for other purposes.

Yi's motion for summary judgment was granted on the following claims:

> 1) Schrader's claim under § 523(a)(2)(A) related to Yi's representation that a corporation would be established to operate a Mexican sports bar because the record showed that the business was indeed organized and operated;
>
> 2) Schrader's claim under § 523(a)(2)(B) since the Court found no allegations setting forth the basis for relief under that section;
>
> 3) Schrader's claim for nondischargeability under § 523(a)(4) based on alleged fraud or defalcation while acting in a fiduciary capacity. The Court noted that § 523(a)(4) requires that a "fiduciary relationship under [this Section] is to be construed narrowly,"(*id.* at 5) citing *In Re Quaif*, 4 F.3d 950 (11th Cir. 1993). The Court further stated that the debtor must be "acting as fiduciary in accordance with an express technical trust that existed prior to the wrongful act, committed an act of fraud or defalcation." (quoting *In Re Lemmos*, 2005 WL 6487216 (Bankr. N.D. Ga. 2005)). Hence, the Court

held that "even if Defendant Yi had a fiduciary duty to Plaintiff Schrader as a shareholder and the shareholder could bring a claim directly against Defendant Yi as opposed to derivatively" Plaintiff has no claim under this section because "her claim does not arise from fraud or defalcation while acting as a fiduciary . . . the fiduciary must predate the wrongful act . . . the debt must be directly related to the fiduciary relationship . . [and] the claim must be a result of fraud or defalcation . . . Fraud, for purposes of [this section], is intentional deceit, while defalcation is a failure to produce funds entrusted to a fiduciary." (*Id.* at 7) (See *In Re Kalif*, 308 B.R. 614, 622 (Bankr. N.D. Ga. 2004); *In Re Quaif*, 4 F.3d at 954-55. ) Since the payments were made before the corporation was established, the Court found that the fiduciary duties arose only after payments were made. Thus, any claim for fraud or defalcation as a result of the payments did not arise while Defendant was acting in his fiduciary capacity;

4) Plaintiff's "derivative claim" for failure to disclose corporate books and records in violation of Schrader's inspection rights under O.C.G.A. § 14-2-1602. These claims must be made against the corporation, not Defendant Yi directly, citing *Barnett v. Fullard*, 306 Ga. App. 148, 151 (2010). Other derivative claims were also found insufficient – e.g., a claim for allegedly closing the business without discussion with Schrader constituted a breach of fiduciary duty, but not fraud or defalcation, and Schrader did not produce evidence supporting her claim for alleged misappropriation of corporate funds; and

5) Schrader's claim under § 523(a)(4) for "embezzlement" of corporate funds that, as stated, was not supported with evidence creating an issue of fact.

Yi's motion for summary judgment was denied on Schrader's claims under § 523(a)(2)(A) regarding:

1) Schrader's ownership in the corporation because Yi denied that she had agreed to Schrader's being 50% shareholder in the corporation, but did not produce evidence to support her motion;

2) Schrader's claim that Yi falsely promised that Schrader's money would be used in the operation of the business, because the record showed that genuine issues of fact existed; and

3) Yi's representation and lack of intent to repay Schrader because Yi failed to offer evidence regarding her intention as to the repayment of the invested funds.

The Court also found issues of fact and denied summary judgment as to Schrader's claim under § 523(a)(4) for Yi's alleged embezzlement of her original contribution of funds.

***In re Riddle*, 2011 WL 2461896 (Bankr. N.D. Ga. April 6, 2011) – Nondischargeability of Claims Based on Transaction Between Plaintiff and Debtor's Company: Claims of Fraud Can Constitute Debts, but Corporate Fiduciary Relationships Do Not Suffice for Purposes of 11 U.S.C. § 523(a)(4).**

The Debtor, Green Hobson Riddle sought dismissal of the plaintiff's complaint to determine dischargeability of debt. The plaintiff, Dot Burke, did not file a response to Defendant's motion to dismiss. However, the Court reached the merits of the motion and dismissed the Complaint for failure to state a claim under 11 U.S.C. §523(a)(2), -(3), -(4), and -(6), principally because the plaintiff did not allege sufficient facts to support her conclusory allegations of fraud and conversion. In the process, the Court addressed two issues of relevance to this Survey.

The plaintiff alleged that in 2007 she bought a horse trailer from the Debtor. In connection with this purchase, she traded in a 2005 trailer that served as collateral for a debt owed to GE Money Bank. Plaintiff alleges that the Debtor agreed to pay off the existing loan to the bank, but failed to do so. Plaintiff also executed a retail installment contract and security agreement in favor of GE Bank for an additional $18,118 to finance the purchase of the 2007 trailer. As a result, the plaintiff was indebted to GE Bank for over $30,000, secured by liens on the 2007 trailer she purchased and the 2005 trailer she traded in. Thereafter, the plaintiff returned the 2007 trailer at the Debtor's request on the representation it was sold to another customer, and he promised to replace it with a 2008 trailer, but did not. The Debtor then conveyed the 2007 trailer to another customer but did not apply the proceeds to the plaintiff's debt owed to GE Bank. The plaintiff alleged that these conveyances were done with the intent to deceive and defraud her.

The Debtor argued that all the transactions were entered into between the plaintiff and the Debtor's company, not the Debtor personally. The Court found that since a "debt" is defined as "liability on a claim," 11 U.S.C. § 101(12) and since a claim is a "right to payment," 11 U.S.C. § 101(5)(A), claims of fraud constituted "debts" for purposes of § 523, and the contractual relationship between the Debtor and the company was not "solely determinative and does not serve as a basis for dismissal of the complaint." *Id.* at *2. The Court also dismissed the complaint for lack of facts supporting a claim under 11 U.S.C. § 523(a)(4). The Debtor, as an officer of the company with which the plaintiff entered into the transactions described above, was not a "fiduciary" for purposes of 11 U.S.C. § 523(a)(4). "Fiduciary" under this section refers to "technical trusts," citing *In Re Quaif*, 4 F.3d 950, 953 ($11^{th}$ Cir. 1993). "The general fiduciary duty that Georgia corporate law imposes on a corporate officer does not establish the type of technical trust that is necessary to except a debt from discharge based on fraud or defalcation in a fiduciary capacity."

***In re McClelland*, 2011 WL 2461885 (Bankr. N.D. Ga. June 8, 2011) – LLC Formation, Direct vs. Derivative Claims, and Personal Liability for Conversion by an LLC Manager for Conversion of Investor Funds in Nondischargeability Action, but § 523(a)(4) Held Inapplicable to LLC Manager.**

This decision presents the post-trial findings of fact and conclusions of law in a plaintiff's factually complicated adversary proceeding to determine the dischargeability of a debt in bankruptcy. One of the bankruptcy debtors was Karen McClelland ("McClelland") and the plaintiff was her sister, Cindy Pollitt ("Pollitt"). McClelland formed McClelland Assoc., an Oregon corporation, in 1995 which she operated as a consulting firm. In 1999, McClelland formed McClelland Enterprise, LLC, as an Oregon Corporation. Pollitt invested $25,000 in that entity and received "stock certificates for a 17.5% membership interest in the LLC" but in 2001, McClelland retuned $15,000 of Pollitt's investment. The purpose of the investment and the company was to invest in a franchise. In 2001 or 2002, McClelland moved to Georgia and registered McClelland Enterprise to do business in Georgia.

In 2005, McClelland had begun looking for a commercial building in which to operate a sports bar and believed she had found one in strip mall called King's Crossing. Pollitt agreed to invest $100,000 in McClelland's business with the understanding that it would be used in the purchase of the commercial building. McClelland agreed that $10,000 that Pollitt had invested in McClelland Enterprise and a $40,000 personal loan that Pollitt made to McClelland would be added to Pollitt's investment in the commercial building.

In order to obtain the $100,000, Pollitt needed to refinance her home, and McClelland referred her to a mortgage broker. As part of the refinancing process, McClelland gave the mortgage broker a stock certificate showing Pollitt had a $50,000 investment and a 2% share in Reinventing Profits, LLC. Pollitt received $135,000 from the refinancing and obtained a cashier's check in the amount of $100,000, payable to "Reinventing Profits." That check was deposited into Reinventing Profits, Inc., the bank account of a separate entity serving as Reinvesting Profits LLC's manager. Pollitt received a stock certificate showing an additional 4% interest in Reinventing Profits, LLC.

According to Pollitt, in August of 2006, Pollitt transferred $25,000 to McClelland's personal bank account so that McClelland could help her manage the money. McClelland testified she did not clearly recall what Pollitt's intention for that money was, but McClelland set up account for the funds in her Quicken books for Cindy Pollitt "retirement income management." The day after McClelland received the $25,000 from Pollitt, McClelland transferred $23,000 from her personal account to Reinventing Profits, Inc.'s account.

Later in 2006, McClelland gave Pollitt a "partnership agreement" that was intended to represent the terms of Pollitt's $150,000 investment in Reinventing Profits, LLC. Pollitt signed and notarized the document but later crossed out her signature, and never returned the signed agreement to McClelland. In April 2007, Pollitt's financial situation deteriorated and she began asking for money back from McClelland, who refused because the investment "was a long-term commitment of at least five years." Pollitt retained a lawyer and filed a state court action against McClelland, her husband, Reinventing Profits, Inc., Reinventing Profits, LLC, and Father's Joint Enterprises, LLC. McClelland was a defendant in a number of lawsuits because of the closure of the restaurant, and as a result of the debts and lawsuits, she and her husband filed for bankruptcy on January 26, 2009.

The bankruptcy court conducted a three-and-one-half-day trial on the issues and made various findings with respect to McClelland's business ventures. As part of its findings, the court noted that McClelland used Reinventing Profits, Inc. to conduct multiple types of business, including consulting, and back office services to McClelland Enterprises, LLC/Father's Joint

Enterprises LLC. Reinventing Profits, Inc. served as the manager of Reinventing Profits, LLC. Additionally, McClelland and her husband owned a rental cabin that they wanted to put into a corporate name to protect themselves from liability. McClelland ran expenses and income of the cabin through Reinventing Profits, Inc. but title to the property remained in the McClellands and it was listed as their property in the bankruptcy schedules.

McClelland formed Reinventing Profits, LLC to acquire the building for the sports bar business. The court noted that "[t]he only organizational documents in evidence regarding Reinventing Profits, LLC are the Secretary of State records regarding its incorporation," including articles of organization and the "partnership agreement" with Pollitt's crossed out signature. McClelland was the managing member of Reinventing Profits, LLC and Reinventing Profits, Inc. was the manager of the LLC.

Pollitt argued that McClelland was personally liable for her $100,000 investment for the commercial building on one of five theories: (1) fraud; (2) no partnership or LLC existed; (3) breach of fiduciary duty; (4) conversion; or (5) piercing the corporate veil. The court rejected Pollitt's fraud claim because McClelland's statements to Pollitt regarding the business venture were not false or made with the intent to deceive. *Id.* at *7. The court also rejected Pollitt's theory that no partnership or LLC existed because Reinventing Profits LLC was a valid Georgia LLC when the money was transferred.

Pollitt claimed that McClelland was personally liable because she breached her fiduciary duty as a manager of a limited liability company under O.C.G.A. § 14-11-305. However, "[a] member of a limited liability company is only authorized to pursue a cause of action against a manager breaching its duties either derivatively on behalf of the corporation or directly if the plaintiff shows some special injury separate and apart from all other shareholders." *Id.* at *8. The court considered and rejected the exception allowing for a direct action in a closely-held corporation under *Thomas v. Dickson*, 250 Ga. 772, 301 S.E.2d 49 (1983). Pollitt failed to show any of the bases that would allow her to bring a direct action against McClelland for breach of McClelland's duties to the LLC and therefore could not proceed directly against McClelland. *Id.*

In addressing Pollitt's conversion argument, the court noted that as the manager of Reinventing Profits, LLC, Reinventing Profits, Inc. "was responsible for spending the money of Reinventing Profits, LLC only for the business of Reinventing Profits, LLC." *Id.* at *9. McClelland, as president of Reinventing Profits, Inc., signed all checks for the business. Ordinarily, being an officer or agent of the corporation does not make the individual liable for acts of the corporation, "directors, officers and managers can be individually liable to third parties for participating in or assenting to torts committed by them or their corporation." This liability "does not rely on piercing the corporate veil" but "arises from the tortious conduct of the individual." *Id.* The court held that McClelland converted funds of Reinventing Profits, LLC to the extent that she "caused Reinventing Profits, Inc. to spend the funds of Reinventing Profits, LLC for items other than the commercial building investment." *Id.*

The court next attempted to determine the reasonable expenses that could properly be charged to Reinventing Profits, LLC. McClelland used Reinventing Profits, Inc.'s bank account to write checks for cabin expenses, checks to McClelland, and checks for McClelland's personal expenses. The court concluded that Reinventing Profits, LLC could only be charged for "actual legal fees, accounting fees, architecture fees and other third-party fees" incurred through due diligence, but not the personal expenses. *Id.* at *9-10.

Although Pollitt demanded return of the money, McClelland never returned the funds to her. The court then addressed whether Pollitt was entitled to the return of the money because there was no written agreement addressing the length of the investment. The court held that based on the terms of McClelland's letter in support of Pollitt's refinancing application, Pollitt could have received up to $30,000 a year back from McClelland and up to $60,000 by the time she demanded the return of the money, and the balance in 2008 before the bankruptcy. McClelland committed conversion by signing all of the checks for personal expenses from Reinventing Profits, Inc., so McClelland was personally liable for the conversion of Pollitt's funds in the total amount of Pollitt's investment. Because she was personally liable for her conduct, the court did not consider the piercing the corporate veil issue. The court then addressed whether the debt was dischargeable.

Pollitt argued that the balance of the $100,000 investment was non-dischargeable under 11 U.S.C. § 523(a)(2)(A), -(a)(2)(B) or -(a)(4). 11 U.S.C. § 523(a)(2)(B) provides that a debt will be non-dischargeable in bankruptcy when it is owed for money obtained by a materially false writing regarding the debtor's or insider's financial condition "on which the creditor to whom the debt is liable for such money…reasonably relied; and" the debtor made or published the statement "with the intent to deceive," *Id.* at *15. Because there was no writing at the time of Pollitt's investment, this argument failed. Pollitt relied on e-mails that were exchanged after the transfer of funds, but the court held that e-mails sent after the fact could not form the basis for nondischargeability under this section. Further, the court held that Reinventing Profits, Inc.'s website could not form the basis for nondischargeability because the writing did not concern the debtor's or insider's financial condition.

Next, the court addressed whether the debt was nondischargeable under 11 U.S.C. § 523(a)(2)(A), which states that a debt is non-dischargeable if "it is 'for money…to the extent obtained by false pretenses, a false representation, or actual fraud other than a statement respecting the debtor's or an insider's financial condition.'" The debt was not incurred due to fraud, and McClelland's statements regarding using the money for purchasing a commercial building were true when she made them. There was no intent to deceive and therefore the debt was not nondischargeable under this section.

Finally, Pollitt argued the debt was nondischargeable under 11 U.S.C. § 523(a)(4), which states that a debt is nondischargeable "if it is 'for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny.'" *Id.* at *16. The court noted that fraud or defalcation must take place in a fiduciary capacity, but that element is not necessary if there is embezzlement or larceny. The court noted that a number of Georgia bankruptcy courts "have considered whether an officer or director of a Georgia corporation or a manager of a Georgia LLC or a partner in a partnership are fiduciaries under Section 523(a)(4). The near-unanimous result is that they are not." The court agreed with the prior decisions and held that "merely being a manager of an LLC, without more, does not create a fiduciary relationship for purposes of 11 U.S.C. § 523(a)(2)(A)."

The court also held that larceny would not provide a basis for finding the debt nondischargeable under 11 U.S.C. § 523(a)(4) because McClelland did not have a "wrongful or fraudulent intent" when Pollitt invested in the partnership. *Id.* at *17. The court next turned to whether embezzlement would provide a basis for finding the debt nondischargeable. In order to prove embezzlement, "the plaintiff must show (1) property owned by another which is rightfully in possession of the debtor; (2) the debtor appropriates the property for personal use; (3) the appropriation occurred with fraudulent intent or by deceit." *Id.* The court noted that it had previously found that McClelland had lawful possession of Pollitt's $100,000 investment and that McClelland converted some of those funds by using them for other business ventures and for personal expenses. Ultimately, the court held that McClelland converted the funds for personal use and concealed her expenditures, which showed that McClelland knew her actions were inappropriate. *Id.* at *18. Therefore, the court held that McClelland converted Pollitt's funds with fraudulent intent such that the debt was determined to be non-dischargeable. *Id.* at *19.

***In re Richards*, 2011 WL 1522327 (Bankr. N.D. Ga. March 18, 2011) – LLC Entity Form Does Not Shield Managing Member from Fraud in Which She Participated.**

ARC Real Estate, LLC ("Plaintiff" or "ARC") commenced an adversary proceeding against bankruptcy debtor Donna R. Richards ("Defendant"), seeking a determination that a debt Defendant owed to ARC was non-dischargeable under 11 U.S.C. § 523(a)(2)(A) and -(a)(6). The Defendant did not file a response to the complaint or otherwise make an appearance and an entry of default was made. In opposing the Plaintiff's motion for default judgment, the Defendant argued that she should not be held liable for the debts that were incurred by a limited liability company that she managed.

Defendant was the managing member of Richards' Advantage Housing, LLC ("Advantage"), a Georgia limited liability company that sold mobile homes in Georgia. Defendant was the only person authorized to enter into contracts on the company's behalf and she also managed the company's day to day affairs. Plaintiff executed a purchase agreement with Advantage in which Plaintiff agreed to purchase mobile homes. Some of the homes were "Contract Homes," which were being financed under a contract for title. When the Purchase Contract was executed, Advantage agreed to transfer title to thirty-three Contract Homes to Plaintiff. The Purchase Contract "included Advantage's express representation and warranty that it had legal and marketable title to each Contract Home subject to the Purchase Contract." Plaintiff alleged that when the Purchase Contract was executed, "Defendant knew that Advantage did not have legal and marketable title of the Contract Homes," and this "misrepresentation was material and induced Plaintiff to enter into the Purchase Contract." Advantage failed to perform under the Purchase Contract and never returned the purchase money to Plaintiff. *Id.* at *2.

Defendant asserted in defense to the default judgment that she was not personally liable because Advantage's status as an LLC shielded her from the action. The court rejected that defense, observing that although "generally corporate law protects its officers and shareholders from corporate liability," the "corporate entity can be invaded in some instances." *Id.* at *3. The court held that piercing the corporate veil was appropriate in this case because "the admitted factual allegations make out a fraud claim, and can create personal liability for Defendant as part of the Purchase Contract, in addition to her admitted personal liability created from the

Repayment Agreement and Personal Guarantee." *Id.* at *4. The court noted that it is well settled that a "'corporate officer cannot use the corporate form to shield himself from personal liability for fraud in which he himself is involved…'" *Id.* (quoting *Sellars v. Mallard*, 1987 U.S. Dist. LEXIS 8494, 19-20 (S.D. Ga. Sept. 8, 1987)).

**7. <u>Miscellaneous Litigation Procedure Issues</u>.**

***Omni Builders Risk, Inc. n/k/a Best Value Insurance Services, Inc. v. Bennett,* 313 Ga. App. 358, 721 S.E.2d 563 (2011) – Counsel of Record Lacked Apparent Authority to Settle where CEO/Majority Shareholder Personally Attended Mediation.**

This is an appeal from the order of the trial court enforcing a mediated settlement agreement between the parties.

After the defendant's employment at Omni was terminated, she filed an EEOC complaint alleging discrimination based on pregnancy. The parties mediated the case. The mediation was attended by the president and majority shareholder of Omni, the plaintiff and their respective attorneys. The four attendees signed an agreement to mediate, and during the mediation process they preliminarily agreed to settle the claim. The mediator prepared a "settlement memorandum" which had signature lines for both parties and their respective attorneys. The plaintiff and her attorney signed the settlement agreement. The attorney for Omni also signed the agreement, but the president himself did not sign the agreement. Later, Bennett sued Omni for breach of contract and filed a motion to enforce the settlement agreement. The trial court found the Settlement Memorandum to be "an enforceable written contract on its face [and] based upon the theory of apparent authority, [Omni] is bound by the signature of authority." [At 1]. *Id.* at 360, 721 S.E.2d at 565. Reversing, the Court of Appeals took note of the attendance of the president/majority owner of Omni and found no apparent authority in this case because "'apparent authority' is only indicated when the principal's conduct leads a third party reasonably to believe the agent has authority to act for the principal . . . here, there were no manifestations of authority by the principal to a third party, apparent authority is not in issue." *Id.* at 361, 721 S.E.2d 565.

***SN International, Inc. v. Smart Properties, Inc.*, 311 Ga. App. 434, 715 S.E.2d 826, (2011) – Sale of Business Case Requires Findings of Fact and Conclusions of Law.**

In this matter, the seller of business sued purchaser for breach of promissory note and sublease, and purchaser counterclaimed for fraudulent inducement and unjust enrichment. The trial court entered judgment for seller and denied purchaser's motion for publication of findings of fact and conclusions of law. The Court of Appeals held, given the magnitude and complexity of the case, that the trial court's ruling without findings of fact and conclusions of law contained insufficient information to permit appellate review. It vacated and remanded the case.

***D.C. Micro Development, Inc. v. Briley*, 310 Ga. App. 309, 714 S.E.2d 11 (2011) – Compensation of Receiver Held to be within Trial Court's Discretion.**

On appeal, corporate defendants and their principal challenged the trial court's order setting compensation for the corporation's appointed receiver, arguing that the receiver's failure to provide invoices prior to hearings prejudiced the corporation's ability to cross-examine the receiver. The trial court noted that a receiver is neither a party nor a witness, and the Court of Appeals deferred to the trial court's broad discretion in determining whether a party is allowed to cross-examine a receiver. The Court of Appeals also held that it was within the trial court's discretion to set a receiver's fees and resolve disputes in testimony, and determined that the trial court did not abuse its discretion in awarding the receiver's fees in an amount less than that requested by the receiver but more than the amount of zero requested by the defendants.

## H. GEORGIA BUSINESS COURT AND OTHER STATE TRIAL COURT BUSINESS ORGANIZATION DECISIONS

Three unpublished Georgia Business Court decisions address issues heavily litigated in Georgia trial courts in August 2011 in lawsuits brought as class actions by shareholders of public companies to enjoin corporate acquisitions by third parties structured as tender offers followed by short form mergers. Copies of these unpublished decisions are attached, along with copies of decisions by other courts addressing similar claims.

***In re Radiant Systems, Inc. Shareholder Litigation*, Civil Action No. 2011-CV-203228 (Fulton Sup. Ct. Aug. 10, 2011) (Long, J.)** (denying a motion for leave to conduct expedited discovery in a shareholder class action lawsuit seeking to enjoin a third party tender offer and back-end merger for alleged breaches of fiduciary duty by management and the board in allegedly failing to obtain adequate value for Radiant Systems' stock, engaging in "a flawed process" sale process and failing to make disclosures in the Form 14D-9 filing.):

> "Where the Appraisal Remedy is available, the Appraisal Remedy is the sole and exclusive remedy for a shareholder entitled to dissent.
> . . . .
> "Accordingly, because the Appraisal Remedy is the exclusive Georgia remedy and Plaintiffs have an adequate remedy at law, Plaintiffs have neither shown irreparable injury nor a colorable claim or likelihood of success thereon, and thus have not shown adequate grounds to obtain expedited discovery."

Slip Op. at 3.-4. The court also noted that the plaintiffs had not shown good cause to lift the mandatory discovery stays in Georgia's class action procedures, O.C.G.A. § 9-11-23(f)(2), and where motions to dismiss have been filed, O.C.G.A. § 9-11-12(j).

***Kramer v. Immucor, Inc.*, Civil Action No. 2011-CV-203124 (Fulton Sup. Ct. August 12, 2011) (Goger, J.)** (denying a motion to expedite proceedings in a similar case relying on and based on the reasons set forth in the *Radiant Systems* decision.).

***Shaev v. EMS Technologies, Inc.*, Civil Action No. 2011-CV-203036 (Fulton Sup. Ct. Aug. 25, 2011) (Bonner, J.)** (denying a motion to expedite proceedings in a shareholder class action brought to enjoin a tender and second stage merger, based on the exclusivity of dissenters rights, citing *Radiant Systems* and *Kramer v. Immucor*[16]). The court also addressed the plaintiff's disclosure claims, stating, "Georgia law does not provide a separate and independent remedy for disclosure claims where appraisal is available and the exceptions in O.C.G.A. § 14-2-1302(b) do not apply."[17] Slip Op. at 4. The court went on to hold on the merits that the plaintiff had failed to state a claim for breach of fiduciary duty against the individual EMS Technologies defendants and that the claim against the acquiring corporation for aiding and abetting a breach of fiduciary duty was insufficient because the plaintiff failed to allege that it "maliciously engaged in wrongful conduct, without privilege, to procure an actionable breach of fiduciary duty" (footnote omitted) as required by *Insight Tech., Inc. v. FreightCheck, LLC*, 280 Ga. App. 19, 633 S.E.2d 373 (2006). Slip Op. at 4-5

Two other trial court decisions addressed similar claims and likewise denied relief on the same or similar grounds:

***Schorsch v. Immucor, Inc.*, Civil Action No. 11-A-7776-1 (Gwinnett Sup. Ct. Aug. 16, 2011) (Ray, J.)** (denying a motion for interlocutory injunction). The court addressed both the exclusivity of dissenters rights and the plaintiff's claim that the defendants were required to disclose "the exact compensation" received by Immucor's financial advisor from engagements in which it had served as advisor to the acquirer:

> "[I]t is the Court's conclusion that the Plaintiff is unlikely to succeed on the merits in this lawsuit, in that there is an adequate remedy at law in the form of exclusive appraisal rights under Georgia's Dissenter's Rights Statute (O.C.G.A. § 14-2-1302), and that there is no requirement either under Georgia or Federal law to disclose the aggregate amount of fees a financial advisor previously earned from a buyer, and that a balancing of the equities weighs heavily in favor of the Defendants"

Slip Op. at 1.

***In re Servidyne, Inc. Shareholder Litigation*, Civil Action No. 2011-CV-202977 (Fulton Sup. Ct. Aug. 17, 2011) (Shoob, J.)** (denying a motion for expedited discovery and expedited proceedings in a shareholder class action suit seeking to enjoin a cash out merger. The Court ruled that "The Appraisal Remedy is the exclusive remedy for the claims asserted by Plaintiffs and is an adequate remedy at law." Slip Op. at 2)

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16 The Court also cited two earlier decisions to the same effect, *In re Scientific-Atlanta, Inc. S'holder Litig.*, Civil Action No. 2005-cv-109014, slip op. (Fulton Sup. Ct. Jan. 25, 2006) (Schwall, J.); *Simon v. Georgia-Pacific Corp.*, Civil Action No. 2005-cv-108796, slip. op. (Fulton Sup. Ct. Dec. 5, 2005) (Baxter, J.)

17 O.C.G.A. § 14-2-1302(b)'s exceptions to exclusivity are (1) the failure to satisfy the procedural requirements of the GBCC or the corporation's articles of incorporation or bylaws, or (2) where "the vote required to obtain approval of the corporate action was obtained by fraudulent and deceptive means."

Selected Georgia Business Court decisions are available on line at a website maintained by Georgia State University at http://digitalarchive.gsu.edu/col_businesscourt/. The following five Business Court decisions posted to the website address corporate and business organization issues:

***GAA Nicholson Advisors, LLC v. Cortland Partners, LLC*, Civil Action No. 2010-CV-191111 (Fulton Sup. Ct. Jan. 27, 2011) (Long, J.)** (LLC operating agreement requirement of unanimity for major decisions held inapplicable to buy-sell provision). In this case, the court interpreted two Georgia LLC operating agreements in the context of a dispute over efforts of the two members of a single-purpose entity, formed as an LLC to own real estate, to exercise rights under the buy-sell provisions of the property owner's operating agreement and buy each other out. The property owner LLC's buy-sell provisions were triggered by a notice from one member to the other, with the recipient accorded the right to decide whether to buy or sell. One of the two members of the LLC property owner held a membership interest in both the property owner LLC as well as in the co-member, itself a Georgia LLC. The co-member LLC's operating agreement required unanimity for "Major Decisions," and if the buy-out decision constituted a Major Decision, then the other member held an effective veto right and could buy out the co-member without the risk of having to sell its own interest. The exercise of buy-sell rights as to the property owner LLC was not expressly listed as a Major Decision in the co-member LLC's operating agreement, although the listed items did include contracts, mergers and investments involving both the members of the co-member LLC and the property owner LLC. Looking at the complex ownership structure and the purpose of the procedures adopted in the buy-sell provisions of the property owner LLC , the court ruled:

> "The Court finds Plaintiff's argument that the Buy-Sell Decision is one of the actions listed under the Major Decision provision not convincing and contrary to the intent of the parties. The Buy-Sell Provision contained in Property Owner's Operating Agreement and the Major Decision provision contained in Company's Operating Agreement were negotiated at the same time by the same individuals, albeit while acting on behalf of different, related entities. Considering the totality of the circumstances, the Court finds it hard to conceive that Plaintiff, acting on behalf of Partners, could invoke the Buy-Sell Procedure under Property Owner's Operating Agreement and then turn around and prevent Manager, acting on behalf of Company, from exercising its judgment of whether to buy or sell by contending that that decision was subject to the consent of the same party which invoked the Buy-Sell Procedure initially. To be clear, the Court does not dispute that the Buy-Sell Decision is a major decision. But to give effect to the underlying purpose of the Buy-Sell Procedure, it necessarily follows that they Buy-Sell decision cannot, at the same time, qualify as a Major Decision."

Slip Op. at 4-5. In further support of its ruling the court pointed out that the parties could easily have listed the decision on exercise of the buy-sell rights as a "Major Decision" in the co-member LLC's operating agreement, if that was the parties' intent. *Id.* at 5.

***Estate of Joy W. O'Brien v. Conza*, Civil Action No. 2010-CV-188721 (Fulton Sup. Ct. May 9, 2011) (Long, J.)** (denying motion to dismiss claims against managing partner of limited partnership for tortious deprivation of a business interest and against majority shareholder for breach of fiduciary duty). This suit was brought by the executor of the estate of a deceased investor and business owner with regard to Blimpie franchises in Georgia. The decedent was sole owner of a corporation, Statewide Development, Inc. ("SWDI") that provided services to Blimpie franchises and co-invested with the defendants in various related entities, including Finna, LP and Nicko General, Inc. The executrix alleged that the defendants wrongfully converted assets of SWDI, that one of the defendants, Joseph Conza, failed to purchase the decedent's interest in Finna as required under an Equityholders' Agreement, as well as RICO and breach of fiduciary duties claims. The court ruled on the defendants' motion to dismiss, denying the motion as to Conza, but dismissing certain claims against other defendants. With respect to a claim that Conza had "unlawfully assumed ownership of the Estate's 38% interest" in Finna, the court noted that a claim does not lie under Georgia law for conversion of an intangible interest in a business, but that Georgia does recognize "tortious deprivation of a business" as a viable claim, citing *Monterey Mexican Restaurant of Wise, Inc. v. Leon*, 282 Ga. App. 439, 638 S.E. 879 (2006). Slip Op. at 3-4. The breach of fiduciary claims were held sufficient only against Conza, who was alleged to be a majority shareholder of Nicko and managing partner of Finna, in which the decedent owned minority interests.

***Peevy v. Brown*, Case No 2010-cv-180583 (Fulton Sup. Ct. Apr. 5, 2011)** (approving class action settlement in litigation contesting fairness of merger of Delaware corporation, over objections from shareholder plaintiffs in Delaware litigation that settlement provided inadequate benefits to the class).[18] This case involved claims by Lodgian, Inc. shareholders that a merger taking the company private was unfair and that the company and board failed to disclose material information. A plaintiff in a related Delaware class action challenged the proposed settlement, contending that the corrective disclosures were immaterial, the settlement was collusive and that the settlement would release other allegedly valid non-disclosure claims, and that the settlement resulted from a "reverse auction" that was against public policy. The Mississippi Attorney General joined in the objection on behalf of a state employee retirement fund. The court, applying the class action settlement approval standards of the Georgia Civil Practice Act, O.C.G.A. § 9-11-23(e), found that the proposed settlement was "the best possible outcome for the Class in light of the considerable burden the Class would face in further pursuit of its claims." *Id.* at 3. In support of its conclusion, the court cited the facts that the merger had closed, foreclosing injunctive relief and that there did not appear to be a realistic likelihood of success on the Class's breach of fiduciary duty claims for damages, given exculpatory provisions in Lodgian's charter and the stringent test under Delaware law to establish a breach of loyalty. The court declined to "second-guess" the evaluation of the case by plaintiff's counsel, particularly in light of evidence showing a lack of any conflicts of interest by Lodgian's board of directors and management. *Id.* The court found that "the settlement was a product of arms-length negotiations," noting that the Delaware plaintiffs had failed to obtain expedited discovery

[18] GSU recommended citation: "Bonner, Alice D., "Order and Final Judgment (RONALD W. PEEVY)" (2011). *Georgia Business Court Opinions.* Paper 171. http://digitalarchive.gsu.edu/col_businesscourt/171"

or a hearing on a motion for injunction and cited the Delaware court's assessment that the class's claims showed "'a relative lack of color.'" *Id.* at 4.

***Greenwald v. Odom,* Civil Action File No. 2008-CV-154834 (Fulton Sup. Ct. Feb. 9, 2011)** (granting summary judgment on claims for fraud and negligent misrepresentation based on allegedly inaccurate oral statements regarding future revenues and financial condition and omissions from written offering materials).[19] The plaintiff, a sophisticated investor and existing Verso Technologies, Inc. shareholder, purchased additional shares in the company. The court held that the alleged oral misrepresentations of future events were not actionable. The court found that Verso Technologies' annual report contained sufficient information to counteract misrepresentations regarding its debts and losses, that the plaintiff was aware of the company's financial struggles and cash shortages and that the plaintiff could not show that he was misled by alleged misrepresentations regarding its current indebtedness and past due trade payables. The Court also held that the merger clause in the subscription agreement barred claims based on oral misrepresentations. The plaintiff could not circumvent the merger clause by seeking rescission because the defendants were not parties to the transaction. In disposing of claimed deficiencies in the offering documents, the court noted that the plaintiff did not allege that they contained any misrepresentations. It pointed to the nine pages of risk disclosures and found that the plaintiff "was well apprised of the risks that form the substance of his complaint." *Id.* at 5. The court also held that there was no confidential relationship between the parties, that the transaction was an arms-length business transaction and that the defendants thus had no duty to disclose. *Id.* at 7. In so ruling, the court did not address the relationship or disclosure duty of corporate insiders in conducting transactions with outside minority shareholders.

The decision has been affirmed in part and reversed in part by the Georgia Court of Appeals. *See Greenwald v. Odom,* 2012 WL 400710 (Ga. Ct. App., Feb. 9, 2012) (Subscription agreement's reliance clause overrides effect of merger clause and permits fraud claims based on oral misrepresentations). A petition for *certiorari* is pending in the Georgia Supreme Court at this writing.

***South Coast Life Liquidity, LLP v. Sterling Currency Group, LLC,* Civil Action File No. 2009 -CV-175697 (Fulton Sup. Ct. April 18, 2011)** (denying motion to dismiss and motion for more definite statement as to fraud counterclaims).[20] The parties formed a joint venture to market life insurance through an LLC, and the plaintiffs sued to enforce defendants' obligations under the joint venture agreement to fund the LLC. The defendants counterclaimed for fraud. The court rejected the plaintiffs' argument that the fraud claims were barred by the defendants' failure to rescind the agreement, observing that in the absence of a merger clause a party may remain bound by terms of a contract and yet sue for damages and assert claims for fraud. *Id.* at 2-3. As

[19] GSU recommended citation: "Long, Elizabeth E., "Order on Defendants' Motion for Summary Judgment (E. K. GREENWALD)" (2011). *Georgia Business Court Opinions.* Paper 180.http://digitalarchive.gsu.edu/col_businesscourt/180"

[20] GSU recommended citation: Long, Elizabeth E., "Order on Plaintiffs' Partial Motion to Dismiss and Motion for More Definite Statement (SOUTH COAST LIFE LIQUIDITY, LLP)" (2011). *Georgia Business Court Opinions.* Paper 186.- http://digitalarchive.gsu.edu/col_businesscourt/186

to the defendants' claims for conversion, the court held that money that is "specific and identifiable or earmarked for a certain purpose" can be subject to conversion, *id.* at 3, and that no pre-litigation demand is required for actual conversion, i.e., when possession of the converted property was obtained by wrongful means.

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