Business Associations

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This Article surveys noteworthy cases that Georgia appellate courts, the United States District Courts in Georgia, and the Eleventh Circuit Court of Appeals decided during the survey period as they relate to Georgia corporate, partnership, securities, and banking law. It also reviews important acts of the Georgia General Assembly concerning the areas of corporations, partnerships, securities, and banking law.

I. CORPORATIONS

A. Piercing the Corporate Veil

During the survey period, many of the cases decided by the Georgia Supreme Court and the Georgia Court of Appeals relating to corporations reviewed the allegations of appellants concerning the familiar corporate law doctrine of piercing the corporate veil. The courts have failed to define precise standards for these cases and this failure has resulted in rather unpredictable holdings. A tremendous amount of uncertainty exists in legal and business communities concerning the outcome in any particular fact situation. Predictably, a fair number of parties unsuccessful at the trial level appeal in order to try their luck in the appellate courts. The authors believe that much of the problem is due to the appellate courts' failure to provide the bench, bar, and business communities with a seminal case that defines clearly the piercing theory and standards.
in a way that could be useful in later cases to predict the outcome of fact patterns that suggest a piercing remedy.

In 1990 the court of appeals gave us Hyzer v. Hickman, a piercing of the corporate veil case that shocked many reviewers because it held that undercapitalization of a corporation plus any other factor that suggested abuse of the corporate form would yield a potential claim for piercing the corporate veil in Georgia. The Supreme Court of Georgia granted certiorari in Hyzer and overturned the court of appeals 1990 decision. In reviewing the court of appeals decision, the supreme court had an opportunity to enunciate a more definitive standard for piercing the corporate veil. Unfortunately, this enunciation was not forthcoming, and the supreme court overruled the court of appeals in a two-page decision.

The supreme court reviewed the facts and concluded that it could find no evidence that the shareholders at the time of the formation of the corporation intended to undercapitalize the corporation to avoid future debts. The court additionally discussed how small or "close" corporations are often capitalized with a combination of small equity and large shareholder loans in order to get tax advantages for the investors and that, in and of itself, this arrangement is not illegal. Finally, the court reviewed the discussion of "preferential distributions" alleged by plaintiffs at the trial level and concluded that it could find no evidence of such preferential distribution or fraudulent intent on the part of Hickman. The court found only a case involving a failed business and not wrongdoing, fraud, or bad faith.

The court of appeals decision in Hickman v. Hyzer concerned many Georgia attorneys because it signaled an expansion of a plaintiff's ability to prevail in a piercing case with a rather benign fact situation. Although the Supreme Court of Georgia came to the proper conclusion by applying the traditional legal standards in this area, it is disappointing that the supreme court failed to give a detailed explanation of the standards of piercing or provide helpful dicta to prevent other Hickman type cases from being tried in the future.

It can not be overstated how important it is for the commerce of the State of Georgia to insure its corporate investors that their limited liabil-

2. 195 Ga. App. at 217, 393 S.E.2d at 82.
4. Id. at 38, 401 S.E.2d at 738.
5. Id. at 40, 401 S.E.2d at 740.
6. Id.
7. Id.
8. Id. at 41, 401 S.E.2d at 740.
ity status as shareholders is secure. Piercing the corporate veil is a helpful, equitable theory necessary to right certain wrongs, but it must be used only in appropriate and carefully defined situations. As the remaining survey cases reveal, the lack of predictability in this area encourages plaintiffs and their counsel to plead a piercing theory even when the facts would not warrant such protection by the courts.

The court of appeals rendered an interesting opinion in *Southern Environmental Group, Inc. v. Rosebud Landscape Gardeners, Inc.* In an affirmance of the trial court's opinion, the court of appeals held that evidence of the maintenance of the corporate fiction could be found when one corporation purchased assets and assumed debts of another corporation that then ceased doing business, and the two corporations did not become one and the same for purposes of a garnishment debt owed by the first corporation. Rosebud Landscape Gardeners, Inc. was formed in 1985, but due to business reversals the company sold the majority of its assets to T.W. Flowers, Inc. in late 1988. The two companies had one shareholder and director in common, operated out of the same location, used the same equipment, and operated under the same trade name “Rosebud Landscape Gardeners.”

Southern Environmental Group, Inc. sued the Adamses in a garnishment action and named as a defendant in the garnishment action “Rosebud Landscape Gardeners, Inc., a/k/a and d/b/a T.W. Flowers, Inc.” The Adamses had a large contract with T.W. Flowers, Inc. (“Flowers”) and the garnishment sought to reach a payment pursuant to the contract made by the Adamses to the Flowers. Rosebud Landscape Gardeners, Inc. (“Rosebud”) responded to the garnishment by filing a traverse. Rosebud alleged that the garnishment affidavit was untrue because it ceased doing business as a corporation in December, 1988. Flowers responded by filing a claim to the money based on its 1989 contract with the Adamses.

The court determined that the only issue for decision was “whether the evidence demanded a finding that Flowers, Inc. was the alter ego of Rosebud, Inc. [such] that the corporate structures of the two companies should be disregarded.” The court believed that the case was unique because it concerned two corporations sought to be held alter egos of each other so that the latter corporation would be held responsible for a judg-

11. Id. at 395, 395 S.E.2d at 915.
12. Id. at 392, 395 S.E.2d at 914.
13. Id. at 393, 395 S.E.2d at 914.
15. Id. at 394, 395 S.E.2d at 915.
ment against the former. Normally, piercing or alter ego contests try to show that a shareholder is the alter ego of a corporation.

The court of appeals concluded that the trial court had not been persuaded that a preponderance of the evidence showed the two separate corporations to be "melded." Because evidence showed the maintenance of the corporate fiction and because the court could not properly reweigh such evidence on appeal, it upheld the trial court's decision.

The result in this case may have been different if plaintiff had pled and argued its case under theories of successor liability of a corporation or de facto merger instead of an "alter ego," piercing theory. Under the 1985 Georgia Supreme Court case of Bullington v. Union Tool Corp. and other relevant Georgia cases, there may have been an opportunity for the plaintiff to demonstrate that Flowers was a successor and had liability for obligations created by Rosebud.

To the extent that the principles concerning piercing the corporate veil can be gleaned from Georgia appellate cases, the courts generally require a showing of disregard for the corporate entity and a conclusion that not piercing would allow an entity to perpetrate a fraud, defeat justice, or evade contractual or tort responsibility. In Commonwealth Financial Corp. v. Sherrill, the court of appeals was asked to overrule the trial court when an assignee of an accounts receivable from a corporation sought to pierce the corporate veil and reach the assets of the shareholder of the corporation in order to satisfy the corporation's accounts receivable obligation. The shareholder had made no personal guarantee or other legal obligation to pay the assignor of the accounts receivable in the event the corporation failed to pay. The court of appeals found this fact fatal to the assignee's ability to pursue the shareholder of the corporation. The court held that the assignee had no greater rights against the shareholder than did the assignor of the accounts receivable.

The assignee, Commonwealth Financial, Inc. ("Commonwealth"), pled piercing of the corporate veil in order to reach the assets of Sherrill, the shareholder of the corporation that owed the money to the assignee. Commonwealth presented evidence demonstrating that Sherrill's operation of

16. Id.
17. Id.
18. Id.
20. See Paul A. Quiros & Lynn Scott Magruder, Business Associations, 42 MERGER L. REV. 71, 80-83 (1990) for a discussion of Bullington and other recent Georgia appellate cases related to successor liability and de facto merger.
22. Id. at 403, 398 S.E.2d at 438.
23. Id. at 404, 398 S.E.2d at 439.
24. Id.
the corporation amounted to, in the court's view, "far less than a model of proper corporate procedures and in many instances did not comply with legal requirements for operating in a corporate capacity." However, the court would not consider the piercing argument, in large part because it did not believe that an injustice needed to be corrected. Without detailed explanation, the court indicated that disregarding the corporate form and failing to maintain corporate procedures are not enough to pierce the corporate veil unless there is an injustice, fraud, or evasion of contractual or tort responsibility that must be addressed. The court decided that failure of a corporation to pay a financial obligation, without evidence of fraud, injustice, or evasion of contractual and tort responsibilities, would not allow a plaintiff to invoke the protection of the court by piercing the corporate veil.

In *Heyde v. Xtraman, Inc.*, the court of appeals upheld the trial court in a complex factual situation, which dealt with products liability, other tort matters, and included an appeal from a directed verdict in favor of a defendant-shareholder on a piercing of the corporate veil theory. At trial, the jury found defendant-corporation liable for over one million dollars in compensatory damages, but also returned a verdict against the shareholder, Eckes. The trial court overruled the verdict against Eckes because it had reserved its right to rule on defendant's motion for directed verdict prior to submitting this portion of the case to the jury.

The court of appeals found that plaintiffs had not presented sufficient evidence to allow the jury to pierce the corporate veil and hold Eckes personally liable for the liabilities of the corporation he had owned. The court also found no evidence of disregard of the corporate entity or of fraud, injustice, or evasion of contractual or tort responsibility. The court concluded that it would not deny the legality of the corporate existence for the purpose of holding the shareholder liable in the absence of such fraud, injustice, or evasion of responsibility.

In *Hester Enterprises, Inc. v. Narvais*, the court of appeals reversed the trial court's holding that Hester, the president of Hester Enterprises, was liable for negligent construction of a house that his company built for:

25. *Id.*
26. *Id.*
27. *Id.*
29. *Id.* at 305-07, 404 S.E.2d at 610-11.
30. *Id.* at 304, 404 S.E.2d at 609.
31. *Id.* at 306, 404 S.E.2d at 610.
32. *Id.* at 306-07, 404 S.E.2d at 610-11.
33. *Id.* at 307, at 404 S.E.2d at 611.
plaintiff. The evidence at trial showed that at the closing Hester guaranteed performance of a new agreement pursuant to which Hester Enterprises would install a central air conditioning system in plaintiff's home. The court of appeals felt that such an assurance by Hester did not imply a personal guarantee, but merely affirmed a guarantee of the corporation for its performance under this new agreement.

The court considered whether or not any evidence in the record indicated that Hester also conducted his private and corporate business on an interchangeable or joint basis, such that the corporation as a separate entity should be disregarded and Hester held liable for the obligations of the corporation. The court of appeals reviewed the facts and found no evidence that Hester commingled funds or confused the corporation's records, assets, or finances with his own, or of improper payments or undercapitalization. The court concluded that the judgment against Hester should be reversed and that the trial court erred in denying his motion for directed verdict.

In Jones v. Shafer, the court of appeals upheld the trial court's finding that Bobby L. Jones, the principal officer and stockholder of corporate-defendant, Cherokee Homes, Inc. ("Cherokee"), was personally liable to Mr. and Mrs. Shafer for the waterproofing bill arising from repair of a defective basement in a house built by Cherokee for the Shafers. Cherokee entered into a contract to build the Shafers' home, and Jones was not a party to the sales contract. The trial court found that Jones assured the Shafers that they would have a dry basement. The court of appeals upheld the trial court's ruling, which characterized Jones' statement as a personal guarantee of a dry basement, made not as the assurance of a corporate officer. The characterization of Jones' statements as a personal guarantee allowed the court of appeals to avoid considering the issues of limited liability and piercing.

35. Id. at 582, 402 S.E.2d at 336.
36. Id. at 581, 402 S.E.2d at 335.
37. Id.
38. Id., 402 S.E.2d at 334. The characterization of the issue will become relevant when we contrast this case to Jones v. Shafer, 196 Ga. App. 254, 395 S.E.2d 662 (1990), following a discussion of Hester.
40. Id. at 582, 402 S.E.2d at 335. It is apparent that the court of appeals is trying to qualify its reasoning and review of the facts with analogies to the issues it thought were relevant in order to be consistent with its finding in Hyzer v. Hickman, 195 Ga. App. 213, 393 S.E.2d 79 (1990), which was later reversed. See supra text accompanying notes 3-7.
41. 198 Ga. App. at 582, 402 S.E.2d at 336.
43. Id. at 254, 395 S.E.2d at 663.
44. Id.
45. Id.
The facts in Jones and in Hester are startlingly similar. In Hester the court focused on the piercing issue, but in Jones they focused on the fact that an officer who "personally guarantees" an obligation may be personally liable for the performance of that particular obligation. Hester was decided seven months after Jones, but the court in Hester fails to cite Jones in its decision. However, the court in Hester indicated an appreciation of the Jones rationale when it stated that "[m]oreover, a corporate officer who does personally guarantee an obligation may be personally liable for the performance of that particular obligation, but such a personal guarantee does not render him personally liable on any and all corporate obligations."46

This language suggests an interesting option to plaintiff's attorneys in piercing cases. In an appropriate factual setting, in addition to including a classic piercing pleading, the attorney should also include in the complaint pleading that an officer, director, or shareholder of a corporation made a "personal guarantee of an obligation," which should be considered separately from the piercing analysis. When an officer, director, or shareholder of a corporation makes oral statements about the subject of the corporation's business, does he speak as a representative of the corporation or in his separate capacity as an individual? The result could be a Jones analysis finding that an officer making a statement which he or she intended to be on behalf of the corporation could be construed by the trier of fact to be a personal obligation of the officer. By alleging that a separate contract arose orally between an officer, director, or shareholder of a corporation and a party with which the corporation has contracted, even about matters that were part of the corporation's contract, a piercing analysis would be avoided. This may be a Pandora's box.

The Eleventh Circuit Court of Appeals in United States v. Fidelity Capital Corp.47 reviewed the Georgia law concerning piercing the corporate veil and vacated and remanded the decision of the United States District Court for the Northern District of Georgia that allowed piercing.48 This case name may seem familiar because this article reviewed its predecessor last year.49 In the prior case the Eleventh Circuit remanded the case to the district court for determination of whether Fidelity Capital Corp. could be considered the alter ego of Skiba, its President, and the sole shareholder of its parent company, and to certify its holdings to the Eleventh Circuit.50

47. 920 F.2d 827 (11th Cir. 1991).
48. Id. at 840.
49. See Quiros & Magruder, supra note 20, at 71; see also infra text accompanying notes 50-60.
The facts in this case are a little convoluted, but simplified, Skiba owned two companies, Fidelity Capital Corp. ("Fidelity") and Peachtree/Cantrell, Inc. ("Peachtree"). Peachtree owned a tract of land and a townhouse development subject to several mortgages, which included a mortgage to Fidelity. Peachtree received a first mortgage loan from Commonwealth Mortgage Corp. ("Commonwealth") for $3,600,000 in order to develop the townhouse properties, but the attorney handling the closing failed to obtain a satisfaction of Fidelity's prior mortgage on the Peachtree property. As a result, Commonwealth had a second mortgage and needed to satisfy Fidelity in order to foreclose on the mortgage when Peachtree defaulted on the loan. Because Skiba owned Peachtree and Fidelity, plaintiff argued that both of these corporations were alter egos of Skiba and, therefore, allowing Skiba to retain Fidelity's first mortgage position in addition to the benefit of the Commonwealth loan would be inequitable.

In its November 1987 order, the district court found that Skiba was the alter ego of Fidelity. On appeal, the Eleventh Circuit decided that the district court could not conclude from Skiba's mere ownership and control of Fidelity that Fidelity became his alter ego without more evidence that Skiba abused the corporate form in some way. Accordingly, the court remanded and directed the district court to make findings of fact on the abuse of the corporate form issue.

The thrust of the Eleventh Circuit's rationale was that although it may be inequitable for Fidelity to retain its first priority mortgage lien against the Peachtree property the court cannot pierce the corporate veil unless it not only shows inequity but also shows some sort of abuse of the corporate form. Without misfeasance or malfeasance in maintaining the corporate form inequity alone is not a sufficient enough ground for a court to pierce the corporate veil.

On remand, the district court made five specific findings of fact and concluded that Skiba was Fidelity's alter ego. It found that Skiba served as the sole director and president and controlled the business decisions of Fidelity; that Skiba caused Fidelity to serve as an "informal" lender; that Skiba ran all the members of his "incestuous" group of corporations for the benefit of Fidelity; that Skiba caused payments to be made from one corporation he controlled to another corporation; and that Skiba caused Fidelity to be thinly capitalized. The district court held these findings of

51. Id. at 1345-47.
52. Id. at 1348.
53. Id.
54. Id.
55. 920 F.2d 827, 835 (11th Cir. 1991).
56. Id.
fact sufficient under Georgia law to support the conclusion that Fidelity was Skiba’s alter ego and found that Skiba’s representations to Commonwealth bound Fidelity to admit that Commonwealth would have a first mortgage interest.67

The Eleventh Circuit held the district court’s findings of facts insufficient under Georgia law to permit the conclusion that Fidelity was Skiba’s alter ego.68 The court examined each of the district court’s five findings of fact and demonstrated that under Georgia law there could be no piercing of the corporate veil.69

After reviewing the Georgia law concerning piercing, the Eleventh Circuit set up a two-prong piercing analysis.66 One prong of the analysis requires evidence of the use of the corporate form to defeat justice, perpetrate fraud, promote crime, evade contractual or tort responsibility, or any other reason that in equity or good conscience would justify the disregard of the corporate entity.61 In addition to this equitable prong, the court required another prong to show that the shareholders disregarded the corporate entity and made it a “mere instrumentality” of the transaction of their own affairs, with evidence of abuse of the corporate entity.69 This additional prong is often called “mere instrumentality,” “a unity of interest,” or “lack of separate identity that would result in injustice or promotion of fraud.” The court emphasized, however, that satisfaction of this second prong requires evidence of abuse of the corporate form.68 Evidence would include commingling of corporate assets, failure to maintain corporate records separately, and conduct of private and corporate business on an interchangeable or joint basis.64

The Eleventh Circuit, as a reviewer of Georgia law, has articulated that the “mere instrumentality” finding requires a true showing of abuse of the corporate form before a court will be permitted to order a piercing of the corporate veil. No Georgia court in recent years has been as articulate about the Georgia piercing standards as the Eleventh Circuit in Fidelity. The great value of the holding in Fidelity is its clear message that inequity alone will not justify piercing unless the “mere instrumentality” second prong is met, which will require evidence of abuse of the corporate form. Too often, piercing is given as a remedy in cases of inequity when no abuse is shown.

57. Id. at 835-36.
58. Id. at 836.
59. Id. at 836-39.
60. Id. at 836-37.
61. Id.
62. Id. at 837.
63. Id.
64. Id.
The Eleventh Circuit, when exploring the inequitable prong of the piercing analysis, added new language that has not been used by recent Georgia courts and may signal a slight expansion of what Georgia courts view as inequity. The standard formulation of the inequitable prong is that there must be evidence of use of the corporate form to defeat justice, perpetrate fraud, or evade contractual or tort responsibility. The Eleventh Circuit held that the inequitable prong is satisfied when it is shown that the corporate form was used "to defeat justice, perpetuate fraud, promote crime, evade contractual or tort responsibility, or for any other reason which in equity or good conscience would justify the disregard of the corporate entity."65

B. Pre-Incorporation Acts

In Kelley v. RS&H of North Carolina, Inc.,66 the court of appeals reviewed a case that dealt with acts by a corporation's president and financial investor made on behalf of the corporation before the proper formation of the corporation in Georgia or, if formed in another state, not registered to do business in Georgia. RS&H of North Carolina ("RS&H"), a North Carolina corporation, entered into a contract with Southern Properties of Georgia, ("Southern") to provide engineering services for a proposed real estate development project in Gwinnett County. Kelley signed as president of Southern.67

Before execution of the contract with RS&H, Kelley, as President of Southern Properties, a North Carolina corporation, applied to the Secretary of State of Georgia for a certificate of authority to do business in Georgia under the name of Southern. The Secretary of State denied the certification several weeks after execution of the contract due to a name conflict, and Kelley submitted a new application for certificate of authority using the name Southern Properties of N.C., Inc., which was granted. RS&H did not discover that there was no corporation named Southern until after it sued Kelley and MacConochie, a financial advisor, for $61,681.68, for monies owed to RS&H. Kelley and MacConochie held themselves out to be officers and employees of Southern, which did not exist as a corporation at the time the parties entered into the contract and no corporation was ever formed using that name. Kelley and MacConochie contended that there was no legal basis for personal liability on their part.68

65. Id. at 836-37 (emphasis added).
67. Id. at 236, 398 S.E.2d at 214.
68. Id. at 237, 398 S.E.2d at 215.
The court phrased the issue as whether Kelley and MacConochie acted as officers of an existing North Carolina corporation or on behalf of a fictitious, nonexistent Georgia corporation. The court reviewed former section 14-2-23 of the Official Code of Georgia Annotated ("O.C.G.A.") and concluded that persons who act on behalf of a corporation before the corporation has been registered by the Secretary of State are individually liable for the obligations undertaken as an agent for the to-be-formed corporation. The court held that if Kelley and MacConochie acted for an unregistered Georgia corporation they were liable for any of the debts incurred.

Kelley and MacConochie contended that they acted for Southern Properties, Inc., an existing North Carolina corporation and, that in the contract with RS&H, they improperly used the incorrect corporate name of Southern Properties of Georgia, Inc. The court held that the key to resolving this issue concerned the intention of the parties as to which corporation was to be the contracting party. The facts presented to the trial court indicated that Kelley and MacConochie repeatedly told RS&H agents that they were contracting with a Georgia corporation. Additionally, Kelley claimed that although he served as president of Southern Properties, Inc. he had never drawn a pay check, never appeared for work in North Carolina, did not know if the North Carolina corporation still did business, and had no evidence of his election as president of that corporation or that he had ever been issued any of its stock.

The court of appeals determined from the evidence that in judging the intent of the parties, RS&H could not have intended to contract with Southern Properties, Inc., a North Carolina corporation, because it had never heard of that corporation and did not know it existed. Because the trier of fact found in favor of RS&H, the court affirmed the verdict of the jury.

In Jones v. Burlington Industries, Inc., the Georgia Court of Appeals affirmed the action of the trial court in a suit by a seller on an unpaid
account against an unincorporated defendant. Burlington Industries established a line of credit with an unincorporated entity named RBJ Textiles in mid-1986. On September 12, 1986, an agent of Burlington Industries noted that RBJ's Textiles name had been changed to "Ronnie B. Jones, Inc. d/b/a RBJ Textiles." The unpaid account related to goods purchased from Burlington Industries by appellate between April and June 1987.

The trial court found no evidence of the formation of a corporation using the name Ronnie B. Jones or RBJ Textiles, but in March 1987 a corporation was formed called "RonJon, Inc." that Jones admitted he never mentioned to Burlington Industries. The court concluded that the trial court had acted properly in holding Jones personally liable for the debt.

C. Derivative Actions

In Phoenix Airline Services, Inc. v. Metro Airlines, Inc., the Georgia Supreme Court reversed the trial court and court of appeals in a derivative action alleging wrongful appropriation of corporate business opportunities. Officers and key employees of Metro Express, Inc. ("Metro Express"), whose sole shareholder is Metro Airlines, Inc. ("Metro Airlines"), left Metro Express and immediately began Airlines I, Inc. ("Airlines I"), which is owned by Phoenix Airlines Services, Inc ("Phoenix"). Metro Express and Metro Airlines filed an action against the employees of Airlines I and Phoenix, alleging that the employees usurped a corporate opportunity and breached fiduciary duties and that Airlines I and Phoenix directly resulted from the usurped corporate opportunity. Airlines I and Phoenix responded by moving to dismiss Metro Airlines on the grounds that it was a shareholder and as such any action by Metro Airlines should have been a derivative action. A motion for directed verdict on this same issue was later made and the court denied both the motion to dismiss and the motion for directed verdict.

Pursuant to the grant of writ of certiorari, the one question that the supreme court had to decide was "[d]id the court of appeals misconstrue the law by creating a new, non-derivative right of action in a stockholder against an officer, director or key employee of a corporation?" Put an-
other way the question is whether or not the stockholder, Metro Airlines could bring a direct claim against the defendants Airlines I and Phoenix, as opposed to a derivative claim, since Metro Airlines was a shareholder of Metro Express, the entity that allegedly suffered the injury through the corporate opportunity usurpation. The supreme court stated that the main issue in the complaint concerned whether the employees breached their fiduciary duties and usurped corporate opportunities.\textsuperscript{88} Quoting a federal district court applying Delaware law,\textsuperscript{89} the Georgia Supreme Court held that the general rule is that actions for breach of fiduciary duty are to be brought in derivative suits, even when the individual is a sole stockholder, because actions seeking to recover for usurped corporate opportunities belong to the corporation.\textsuperscript{90}

The court also found that there are exceptions to the general rule if the shareholder alleges a "special injury" that would allow a personal cause of action.\textsuperscript{91} Metro Airlines alleged that it argued in a particular paragraph of its complaint that such a "special injury" claim existed.\textsuperscript{92} The Georgia Supreme Court, quoting a Delaware state court case,\textsuperscript{93} stated that the distinction between derivative and individual actions rests upon the party being directly injured by the alleged wrongdoing.\textsuperscript{94} If the wrongdoing is against the corporation then the stockholders' only alternative is to sue derivatively. If the injuries are done to the stockholders in their individual capacities by corporate fiduciaries, then they may sue by bringing direct actions either as individuals or as a class. The court also explained the requirements of a derivative action under Georgia law and then set forth its conclusion that to have standing to sue individually, rather than derivatively on behalf of the corporation, the plaintiff must allege more than an injury resulting from a wrong to the corporation.\textsuperscript{95} The court noted that to sue as an individual in a direct action and not a derivative action, the wrong must involve something unique to the stockholder, separate and distinct from injuries suffered by other shareholders.\textsuperscript{96}

Considering these standards, the Georgia Supreme Court held that the paragraph in the complaint specified by the plaintiffs did not allege an injury to the stockholder in its individual capacity by the corporate fidu-

\textsuperscript{88} Id. at 585, 397 S.E.2d at 701.
\textsuperscript{90} 260 Ga. at 585, 397 S.E.2d at 701.
\textsuperscript{91} Id.
\textsuperscript{92} Id.
\textsuperscript{93} Kramer v. Western Pac. Indus., 546 A.2d 348 (Del. 1988).
\textsuperscript{94} 260 Ga. at 585-86, 397 S.E.2d at 701.
\textsuperscript{95} Id. at 586, 397 S.E.2d at 702.
\textsuperscript{96} Id.
ciaries and, therefore, the stockholder suffered no separate or distinct injuries and could not sue individually. The court held that the trial court, therefore, erred in failing to grant the defendant's motion to dismiss or motion for directed verdict as to Metro Airlines. The authors believe this case especially well reasoned by the Supreme Court of Georgia and should prove to be a helpful building block and guide in going beyond the Georgia Business Corporation Code in understanding derivative actions.

The Georgia Supreme Court decided another derivative action case in Hacienda Corp. v. White. A majority shareholder, sole director, and president of a corporation, White Valley Farms, Inc., failed to give proper statutory notice of a meeting to the minority shareholder. In the challenged meeting, the shareholders decided to transfer the assets of the corporation to Hacienda Corporation. An executor of the estate of a minority shareholder brought a derivation action against White Valley Farms, Inc. to set aside the deed by which it had transferred the assets to Hacienda Corporation. In addition to alleging a failure to give proper notice, the executor alleged that the deed was invalid because a second corporate officer did not attest the deed and it did not contain the corporate seal of the corporation. The trial court upheld the executor's right to bring the shareholder derivative action and set the deed aside.

The Supreme Court of Georgia held that the failure to comply with the notice provisions of a shareholder meeting did not give rise to a shareholder's derivative action. In so holding, the court stated that the purpose of the derivative action is to protect the corporation and its assets, and a violation of the notice provisions may not be asserted by the corporation itself to invalidate its own transaction. The court also stated that a cause of action for a violation of the notice provisions belongs to the shareholder and not the corporation, and that there are sufficient alternative remedies to the minority shareholders for the alleged breach of such provisions.

The court also held that the lack of corporate seal and attestation is not conclusive evidence that the corporate officer executing a deed lacks corporate authority to do so. O.C.G.A. section 14-5-7 provides that

97. Id.
98. Id. at 587, 397 S.E.2d at 702.
101. The allegation was that the corporation had failed to give notice under former O.C.G.A. § 14-2-231(2) (1988).
102. 260 Ga. at 879, 400 S.E.2d at 324.
103. Id. at 879-80, 400 S.E.2d at 324-25.
104. Id. at 880, 400 S.E.2d at 325.
105. Id.
106. Id.
the presence of a corporate seal and attestation by another corporate officer is "conclusive evidence that said officers signing are duly authorized to execute and deliver the same" but that a lack of the corporate seal and attestation does not mean that an officer does not have the authority.\textsuperscript{106} Therefore, the court reversed on both issues and remanded the case to the trial court for additional proceedings.\textsuperscript{109}

During the survey period, in \textit{Peller v. Southern Co.},\textsuperscript{110} the Eleventh Circuit reviewed a federal district court decision, in which ultimately it was determined that Delaware law governed to excuse a plaintiff in a derivative action from making a demand on the corporation prior to bringing suit.\textsuperscript{111} The Eleventh Circuit determined that it did not need to apply Georgia law to reach its holding in this case and focused on a discussion of the Delaware case \textit{Zapata Corp. v. Maldonado}.\textsuperscript{112} The district court's review of \textit{Peller} has been discussed previously in the \textit{Mercer Law Review}\textsuperscript{113} and has some relevance in that the district court assumed Georgia courts would follow \textit{Zapata} in considering the situation of a special committee of a board of director's investigation and decision related to a derivative action brought by shareholders. Although not adopted by any Georgia appellate court, \textit{Peller} may be of guidance and should be reviewed by counsel to Georgia corporations that form special committees to review derivation action demands of shareholders.\textsuperscript{114}

\section*{D. No Disparagement Clause}

In \textit{City Group, Inc. v. Ehlers},\textsuperscript{118} the Georgia Court of Appeals affirmed the trial court's opinion concerning statements made by a former President of City Group, Inc. after his signing of a severance agreement that included a "no disparagement" clause.\textsuperscript{116} Ehlers brought an action to collect a balance allegedly due on a promissory note executed by City Group, Inc., and guaranteed by another defendant. Defendants' counterclaim alleged damages due to a breach of a severance agreement executed contemporaneously with the promissory note. A severance agreement clause provided that the parties would "refrain from any disparagement of the

\begin{thebibliography}{114}
\bibitem{108} Id.
\bibitem{109} 260 Ga. at 881, 400 S.E.2d at 326.
\bibitem{110} 911 F.2d 1532 (11th Cir. 1990).
\bibitem{111} Id. at 1537-38.
\bibitem{112} 430 A.2d 779 (Del. 1981).
\bibitem{116} Id. at 709, 402 S.E.2d at 787-88.
\end{thebibliography}
character, personal, professional or business conduct, and personal, professional or business activities of each other.” The *Atlanta Business Chronicle* contacted Ehlers and asked him about his resignation. Ehlers stated that he left due to “philosophical differences,” and he proceeded to give the *Business Chronicle* a short paragraph on his disagreement with the other partners, including the fact that it was hard to “define the direction of the company.”

For guidance, the court looked to Webster’s Third New International Dictionary to discover the common meaning of the term “disparagement” and stated that it agreed with the trial court that no reasonable interpretation of Ehlers’ comments would be considered disparaging. The court therefore held that the trial court properly granted summary judgment to Ehlers.

Separation of executive officers is a fact of corporate life in Georgia and so is freedom of the press. It is predictable that statements made after a senior executive departs from a company may be interpreted differently. Ehlers reminds all Georgia practitioners that in drafting separation agreements or consulting and employment agreements that contemplate future separation, it is helpful to work out phraseology acceptable to both parties that will address third party inquiries. The language worked out between the parties should provide for exceptions such as litigation and public company disclosure issues but can routinely be worked out in such a way as to avoid appellate court litigation.

E. Legislative Changes

During the 1991 session, the legislature enacted the new “Georgia Nonprofit Corporation Code.” These provisions closely parallel the Revised Model Nonprofit Corporation Act in most respects. Additionally, the legislature changed the time of payment for corporate income taxes. The new dates are March 15, following the close of the calendar year, or the fifteenth day of the third month following the close of the corporation’s fiscal year.

Another bill dealt with situations when bids for public work contracts are made by two or more affiliated corporations and the lower bid is later rescinded. In this situation, the security posted by bid bond or other-

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117. *Id.*, 402 S.E.2d at 788.
118. *Id.* at 710, 402 S.E.2d at 788.
119. *Id.*
120. *Id.*
122. HB 338.
123. HB 463.
wise is forfeited for each corporation. The legislature also clarified that both domestic and foreign corporations have insurable interests in their key employees and that trusts created for the benefit of such corporations hold the same interest. This act also provides that charitable institutions have an insurable interest in the life of a donor. Certain other bills dealt with the powers of business development corporations, the Georgia Residential Finance Authority provisions relating to multi-family residential rental properties, the revenue bond law, the creation of a new Georgia Housing & Finance Authority, and the investment of proceeds from issued bonds.

II. PARTNERSHIPS

Partnership cases during the survey period addressed issues concerning liability of partners to third parties, the existence of a partnership relationship, and the duties of copartners.

A. Liability for Debts

In Shea v. State Farm Fire & Casualty Co., the court of appeals considered the liability of partners in a general partnership for workers compensation insurance premiums even though the partnership subsequently incorporated. The general partners neglected to inform State Farm that the partnership had incorporated, and State Farm sued to recover premiums due on insurance policies in effect prior to the date on which State Farm became aware of the incorporation of the partnership.

The former partners argued that the trial court should have ruled that the incorporation dissolved the general partnership and barred the individual partners from liability. The court of appeals decided, however, that the trial court's ruling did not involve principles of dissolution and continued liability and refused to analyze those principles on appeal. The court of appeals emphasized that the former partners failed to advise

124. Id.
125. SB 154.
126. SB 34.
127. SB 35.
128. SB 42.
129. SB 95.
130. SB 175.
132. Id. at 790, 403 S.E.2d at 82.
133. Id.
134. Id.
135. Id.
State Farm of the partnership's change of status and that State Farm continued to look to the partners and the partnership for payment of premiums. The court held that the partners contracted with the insurer as a partnership and therefore had a duty to advise the insurer of their change in status when they incorporated so that the insurer would look to the corporation for payment.  

Often, clients who ask attorneys to incorporate their businesses have been operating as sole proprietorships or partnerships prior to incorporation. As such they often enter into contracts and otherwise bind themselves individually. Clients who have recently incorporated should notify vendors and other contractual parties in writing of the change in formation status and should seek to make the new corporations liable, through assumption or direct contract, in order to benefit from limited individual liability status as soon as possible.

B. Partnership Relationship

In Ambase International Corp. v. BankSouth, N.A., plaintiff argued that defendant bank's involvement in debt restructuring rose to the level of transforming the relationship between the parties from that of borrower-lender into a partnership or joint venture. Plaintiff executed a commercial installment note in favor of defendant in the principal amount of $300,000 and executed a security agreement giving defendant a security interest in the equipment, inventory, and accounts receivable of plaintiff. Plaintiff's parent corporation and its chairman of the board guaranteed the loan and owed amounts to the bank under other notes. After plaintiff and its parent corporation failed to make installment payments on their notes, bank representatives met with the parties to propose alternatives for retiring the debts of plaintiff and its parent corporation. Defendant allowed plaintiff and its parent corporation to establish collateral accounts for the purpose of depositing all accounts receivable and, at defendant's direction, transferring funds into the operating accounts of the two companies. For the next seven months, neither party made payments of principal due under the notes, and the parent corporation engaged in negotiations for the proposed sale of its customer list. This transaction required approval of defendant bank, which withheld such approval. A few months later, defendant declared the notes in default and applied the funds in the collateral accounts to the collective indebtedness. The parent corporation's note was paid in full, but plaintiff's note still had an out-

136. Id.
137. Id.
standing principal balance even after the sale of assets of plaintiff and its parent corporation.  

Plaintiff first argued that defendant did not conduct the sale of assets in a commercially reasonable manner. However, the trial court found that written contracts proved that plaintiff and its parent corporation, rather than defendant, were the sellers. Plaintiff maintained that a relationship other than that of borrower-lender arose between the parties, and argued that a bank representative referred to plaintiff's and bank's relationship as a partnership, that defendant took over the day-to-day operations of the two companies, and that forbearance from collecting the indebtedness transformed the relationship into a partnership or joint venture.

The court determined that the record contained evidence of defendant's efforts to work with plaintiff on a regular basis toward defendant's goal of retiring the loans and found that all of defendant's actions affirmatively showed that the relationship continued as one of borrower-lender rather than as a joint venture. Additionally, the court stated that "'even if a joint venture was shown to exist, the [plaintiff has] not demonstrated how this would preclude the bank from enforcing the clear and unambiguous terms of the [notes they signed].' "

In the environmental context, lenders who have become involved in the management of a debtor, even in the role of protecting their secured position, have been held liable as operators under environmental recovery provisions. The court of appeals refused in this case to consider the relationship between these parties as other than that of borrower-lender. The court could not determine how characterizing of the relationship as a partnership or a joint venture would benefit plaintiff, nor did the court find that a public policy consideration existed to recharacterize the parties' relationship.

139. Id. at 336-37, 395 S.E.2d at 906.
140. Id. at 337, 395 S.E.2d at 907.
141. Id.
142. Id. at 339, 395 S.E.2d at 908 (citing Dolanson Co. v. C&S Nat'l Bank, 242 Ga. 681, 251 S.E.2d 274 (1978)).
143. Id. (quoting Dolanson, 242 Ga. at 684, 251 S.E.2d at 274).
144. United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990) (a secured creditor may incur liability without participating in the day to day operations of the business if such creditor participates in the financial management to a degree indicating capacity to influence the owner's treatment of hazardous waste).
146. Id.
C. No Duty to Inquire

In *Lehman v. Zuckerman*,\(^{147}\) the court of appeals examined the confidential relationship between two partners as it related to a duty to inquire and reasonable reliance.\(^{148}\) Lehman, an experienced builder, and Zuckerman, a real estate investor, formed a construction company in which Lehman served as manager and Zuckerman obtained financing for projects. Zuckerman contributed his own funds when required to complete projects and the parties executed a memorandum of understanding in which Lehman agreed to repay Zuckerman for previous advances. Lehman refused to pay, and Zuckerman sued to recover the principal balance and interest due under the memorandum of understanding. Lehman asserted a counterclaim for fraud and breach of a stock transfer agreement. The trial court awarded judgment to Zuckerman.\(^{149}\)

Lehman argued in his counterclaim that Zuckerman fraudulently procured his acceptance of the memorandum of understanding and attempted to collect sums to which Zuckerman had no entitlement. The court of appeals found evidence to support a charge to the jury on fraud with respect to expenditures for which Zuckerman sought reimbursement.\(^{150}\) The court ruled against the trial court's charge concerning a party's claim of fraud, which stated that one could not be defrauded concerning a matter in which no confidential relationship existed between the parties and both parties had access to information.\(^{151}\) The trial court also charged that a party must exercise ordinary diligence in making an independent verification of a contractual term, but noted that if a confidential relationship existed between partners, each owed a duty of utmost good faith to the other and each partner could rely on the representations made by the other partner.\(^{152}\) The court of appeals determined that in this case there was sufficient evidence of a confidential relationship between Zuckerman and Lehman, who served as equal partners in the construction company, and, therefore, Lehman could reasonably rely on representations made by Zuckerman with respect to advances, without making an independent examination of the advances before signing the memorandum of understanding.\(^{153}\)

148. *Id.* at 205-06, 400 S.E.2d at 708.
149. *Id.* at 203, 400 S.E.2d at 706.
150. *Id.* at 205, 400 S.E.2d at 708.
151. *Id.* at 205-06, 400 S.E.2d at 708.
152. *Id.* at 206, 400 S.E.2d at 708 (citing Allen v. Sanders, 176 Ga. App. 647, 337 S.E.2d 428 (1985)).
BUSINESS ASSOCIATIONS

D. Legislative Changes

During the 1991 session, the legislature amended the Georgia Revised
Uniform Limited Partnership Act\textsuperscript{154} to allow a limited partnership to in-
demnify and hold harmless any partner or other person, subject to ex-
press limitations found in the agreement of limited partnership.\textsuperscript{155} This
indemnification power is subject to qualification for intentional miscon-
duct or actions resulting in a breach of a partnership agreement.\textsuperscript{156}

III. BANKING

A. Acquisition of Branch Banks

In \textit{First National Bank v. Community Bankers Association},\textsuperscript{157} the Su-
preme Court of Georgia considered an important issue regarding the abil-
ity of depository institutions in Georgia to expand their operations.\textsuperscript{158}
The court of appeals determined that the Commissioner of the Georgia
Department of Banking & Finance (“Commissioner”) should not have ap-
proved a bank holding company’s application for the proposed acquisition
by its subsidiary of certain “branch banks” of other banking institutions.
The Community Bankers Association of Georgia (“Community”), a trade
association comprised of 291 state and national banks in Georgia, op-
posed the acquisition, and the court of appeals decided in favor of Com-
munity.\textsuperscript{159} The supreme court granted certiorari to consider whether
under the provisions of O.C.G.A. section 7-1-600(1)\textsuperscript{160} a “branch bank” is

\begin{verbatim}
155. HB 739.
156. Id.
158. Id. at 371, 394 S.E.2d at 95 (affirming Community Bankers Ass’n v. First Nat'l
71.
159. 260 Ga. at 371, 394 S.E.2d at 96.
160. Id. at 371-73, 394 S.E.2d at 96. “Bank shall include ‘bank office,’ ‘bank facility,’
‘parent bank,’ and ‘branch bank’ unless the context indicates that it does not.” O.C.G.A. §
7-1-600(1) (1989). “‘Branch bank’ means any additional principal place of business of any
parent bank located in a county other than the county which is specified in the articles
of the parent bank and wherein the parent bank is situated.” O.C.G.A. § 7-1-600(5) (1989).

In the event of merger or consolidation of two or more banks . . . where all of the
constituent banks shall have either a parent bank or a branch bank located in the
same county, then the surviving or resulting bank . . . may retain and continue to
operate any or all places of business of each constituent bank as either a branch
bank, a bank office, or a bank facility, as is consistent with and may be authorized
by this part. In the event of the purchase of substantially all of the assets of a
bank, . . . where both the selling and the purchasing banks shall have either a
parent bank or branch bank in the same county, then the purchasing bank shall
\end{verbatim}
similar enough to a "bank" so that the acquisition of a "branch bank" of one bank by another bank holding company's banking subsidiary will allow the subsidiary to operate the acquired branch bank as its own branch bank within the acquired branch bank's county.  

The court examined legislative intent to determine if the General Assembly intended that a bank, by acquiring a branch bank from a second bank, could extend the first bank's activities into another county by operating the acquired branch bank as its own branch.  

The court discovered a legislative directive that "[i]t is the intent of this act to prevent the extension of statewide banking by any institution and to encourage the normal growth of banking units in the local communities . . . and to keep banking units from expanding into territories beyond their municipal corporate limits." The court held, therefore, that a branch bank could not be considered the same as a bank under O.C.G.A. section 7-1-600(1) for the purposes of the merger and consolidation provisions found in O.C.G.A. section 7-1-602(e), which allow surviving or resulting banks to retain or continue to operate in all places of business where constituent banks were located before the merger or consolidation.  

In an appendix to this decision the court examined the entire statutory scheme dealing with the interrelationships between parent banks, branch banks, and banking operations. The court refused to allow defendant bank to circumvent the intent of the legislature to require the purchase of an entire banking operation rather than the purchase of branch banks in any locality in which a bank desired to operate a facility as its own branch.  

In dissent, Justice Fletcher decided the question the court should consider was whether the Commissioner could approve a bank holding com-

be the parent bank and may retain and continue to operate any or all places of business of the selling bank as either a branch bank, a bank office, or a bank facility, as is consistent with and may be authorized by this part.


[A] bank holding company which lawfully controls a bank or has received the requisite approvals under this Code section to acquire control of a bank may, with the approval of the commissioner . . . merge or consolidate such bank with another of such bank holding company's banking subsidiaries or have another of such bank holding company's banking subsidiaries acquire all or substantially all of the assets of such bank and consequently operate as a branch of such other banking subsidiary.


161. 260 Ga. at 371, 394 S.E.2d at 96.  
162. Id. at 373, 394 S.E.2d at 97.  
163. Id. at 373-74, 394 S.E.2d at 97 (citing 1960 Ga. Laws 68).  
164. Id. at 374, 394 S.E.2d at 97 (citing O.C.G.A. § 7-1-602(e) (1989)).  
165. Id. at 374-76, 394 S.E.2d at 97-99.  
166. Id. at 374, 394 S.E.2d at 97.
pany’s acquisition of less than all of the branches of a seller bank instead of acquiring the entire banking operations. Justice Fletcher felt that the court should be guided by the latest expression of legislative intent and amendments to the banking laws after the 1960 Act, which allowed exceptions to the general prohibition against the establishment of additional banks by large financial interests that would destroy independent banks and result in a concentration of control of the banking industry. Fletcher felt that recent banking legislation illustrated a movement toward a philosophy that larger financial institutions might offer a variety of services that would better provide for the needs of customers.

With the recent acquisitions of banking operations in Georgia by large out-of-state bank holding companies, the dissent seems to be more in touch with the economic reality of the banking business at this time. One can make the argument, however, that the majority decision may protect the continued existence of true independent community banking operations.

B. Commercial Unreasonableness

In Apcoa, Inc. v. Fidelity National Bank, an action arising from an embezzlement scheme by employees of a parking lot owner, the Eleventh Circuit affirmed an order by the district court granting summary judgment against defendant bank. The district court held that the bank breached a contractual arrangement with plaintiff and could not assert defenses in connection with the opening of two unauthorized accounts. The company deposited the parking lot revenues into authorized depository accounts, and corporate officers withdrew the funds and placed them in the main corporate account located out of state. The Atlanta office of the company did not maintain any corporate accounts to pay expenses. The company opened two depository accounts at defendant bank pursuant to corporate authorization sent from the Cleveland main office. Parking lot revenues received in Atlanta were to be deposited in these accounts and checks and drafts could be made or drawn against these funds when signed by two of four designated individuals. The forms provided to the bank listed only officers from the Cleveland office and did not include as designated signatories any employees located in Atlanta.

167. Id. at 376-77, 394 S.E.2d at 99 (Fletcher, J., dissenting).
168. Id. at 378, 394 S.E.2d at 100 (citing 1960 Ga. Laws 68) (Fletcher, J., dissenting).
169. Id. (citing Independent Bankers Ass’n v. Dunn, 230 Ga. 345, 360, 197 S.E.2d 129, 138 (1973)) (Fletcher, J., dissenting).
170. Id. at 379, 197 S.E.2d at 101 (Fletcher, J., dissenting).
171. 906 F.2d 610 (11th Cir. 1990).
172. Id. at 615.
173. Id. at 611-12.
Certain employees in the Atlanta office opened other accounts at defendant bank without corporate resolutions, authorization, or certificates executed by officers or authorized officials, and listed local employees as the authorized signatories. The bank sent the statements for these accounts to the Atlanta office, and the bank presented no evidence that the main office had any knowledge of these accounts. The local employees deposited receipts from the parking lot into these accounts and wrote checks against these accounts as part of the embezzlement scheme.174

When the parking lot owners sued the bank, the bank raised the defense of commercial reasonableness. The court of appeals stated that the rule in Georgia is "whether a reasonable man in accordance with reasonable commercial standards will be put on notice of some impropriety appearing either from the form of the instrument and its endorsements or from knowledge of the facts outside the instrument itself."175 The court also refused to accept defenses based on allegations of the parking lot owner's negligence176 or apparent authority.177 The court found that the bank's conduct had not been reasonable and that the bank should have been on notice because of the impropriety in the form of the instruments and from its knowledge of facts outside the face of the instruments.178 A finding of commercial unreasonableness negated the negligence defense and the court found no evidence that any apparent authority existed with respect to the local employees.179

C. Misapplication of Funds

In Labanz v. BankSouth, Macon,180 the court of appeals decided that punitive damages and attorney fees could not be awarded against defendant bank under circumstances in which the bank officials were unaware that plaintiff's mother misapplied the funds received from insurance checks subject to guardianship when she negotiated the checks.181 The court failed to accept plaintiff's argument that the endorsements required by the checks constituted restrictive endorsements under the Uniform

174. Id. at 613.
175. Id. (citing Trust Co. of Georgia Bank v. Port Terminal & Warehousing Co., 153 Ga. App. 735, 266 S.E.2d 254 (1980)). See O.C.G.A. § 11-3-419(3) (1982), which requires that a defendant act in good faith and in accordance with reasonable commercial standards in order to raise an affirmative defense to a conversion claim.
176. 906 F.2d at 614 (citing O.C.G.A. § 11-3-406 (1982)).
177. Id. (citing Stewart v. Midani, 525 F. Supp. 843 (N.D. Ga. 1981)).
178. Id.
179. Id.
181. Id. at 82, 400 S.E.2d at 359.
Commercial Code as adopted in Georgia\textsuperscript{182} and that the bank failed to apply the proceeds in accordance with such endorsements.\textsuperscript{183} The court concluded that the signature requirements constituted endorsements in blank\textsuperscript{184} and refused to consider as a restrictive endorsement the designation of the payee as a fiduciary.\textsuperscript{185}

Plaintiff's mother used proceeds from two life insurance policies, payable to her as guardian for plaintiff, to purchase property and to secure other loans from the bank. Eventually the bank foreclosed upon the real property and all other assets of plaintiff's mother held by the bank.\textsuperscript{186} The court accepted the bank's contention that its liability remained separate from that of the guardian and had to be predicated upon its own participation, rather than merely by the negotiation of the checks. The bank argued that it had no notice of the conversion of the funds.\textsuperscript{187} Because the court found no factual basis for liability, it did not impose attorney fees or punitive damages.\textsuperscript{188}

The court decided that the only issue concerning liability was whether the bank knew of the guardianship and still allowed the distribution of the funds.\textsuperscript{189} The court refused to rule that the bank should have known of the guardianship status, although it seems clear that the bank had notice from the face of the check that some type of guardianship was involved because the check stated that it was payable to Ms. LaBanz as guardian for the property of her son, a minor.

\section*{D. Restructuring of Loan}

In \textit{Bangs v. Farm Credit Bank},\textsuperscript{190} the court of appeals refused to require a bank to approve an application for restructuring of a loan, when defendant borrowers refused to pledge additional capital after the bank, in good faith, determined that the restructuring would exceed the foreclosure costs.\textsuperscript{191} Defendants argued that the Farm Credit Act of 1971\textsuperscript{192} required consideration of certain factors in a bank's determination of

\begin{footnotes}
\item [184] 198 Ga. App. at 83, 400 S.E.2d at 360 (citing O.C.G.A. § 11-3-204(2) (1982)).
\item [185] \textit{Id.} (citing O.C.G.A. § 11-3-117(b)(1982)).
\item [186] \textit{Id.} at 81, 400 S.E.2d at 358.
\item [187] \textit{Id.} at 81-82, 400 S.E.2d at 359.
\item [189] \textit{Id.}
\item [191] \textit{Id.} at 210, 396 S.E.2d at 8.
\end{footnotes}
whether or not to approve a restructuring application. The court refused to consider whether defendant borrowers had a private right of action or a right to assert defenses under the Farm Credit Act. The court based its decision on uncontroverted evidence that the bank considered each of the factors described in the Farm Credit Act, including whether the cost of restructuring exceeded the cost of foreclosure, and whether the borrower was applying all available income toward the payment of its primary obligations.

E. Legislative Changes

During its 1991 session, the legislature enacted laws to (1) amend the Retail Installment and Home Solicitation Sales Act and contract statutes relating to damages for writing bad checks, (2) provide that a revolving account could charge for delinquencies on installments not paid within ten days of due date, (3) amend provisions relating to licensed check cashers, and (4) prohibit merchants from requiring telephone numbers on credit card transactions and from imprinting credit cards or recording credit card numbers as a condition to accepting checks from purchasers. Additionally, the legislature enacted a measure that provides a limited good faith immunity from civil liability for directors and officers of financial institutions required by the Department of Banking and Finance, the Federal Deposit Insurance Corporation, or other agencies to provide information regarding the appearance or suspicion of criminal activity involving directors, officers, agents, employees, or customers of the financial institutions.

IV. Securities

During the survey period, the courts decided such issues as whether lots in a beach club development were securities under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), whether a defendant acted as a dealer for the purposes of the Georgia Securities Act, whether exemptions from securities regulations applied in certain

193. 196 Ga. App. at 210, 396 S.E.2d at 8.
194. Id.
195. Id.
196. HB 47.
197. HB 293.
198. HB 383.
199. SB 39.
200. SB 162.
cases, and whether misrepresentations in a prospectus violated the Securities Act of 1933, as amended (the "Securities Act").

A. Definition of a Security

In Rice v. Branigar Organization, Inc., the Eleventh Circuit Court of Appeals decided that lots in a beach club development and equity membership contracts in a country club were not securities for purposes of the Exchange Act. Defendants constructed a residentially planned unit development on a barrier island off the coast of Georgia and as a part of the development built a large country club. The purchase price of a house or lot did not include initiation fees and dues but all residents could join the country club as nonequity members by paying such fees. Defendants later created a nonprofit corporation to own the club and its facilities. The nonequity members of the club lost their usage rights and only members owning an equity interest were allowed to continue using the club.

The court applied an investment contract analysis to determine whether the Exchange Act applied and found that the purchase of an asset for use or consumption precludes the application of federal securities laws. The court did not believe that beach lots are purchased with the intent to derive profits from the entrepreneurial efforts of the developers of the lots. Plaintiffs did not offer evidence that they purchased the lots and houses for investment, and the promotional materials used to sell the lots did not emphasize purchase for investment.

Additionally, the court examined the economic reality of the club membership contracts and found that persons purchased such memberships in order to make use of the club facilities, rather than as investments. The court examined promotional materials and found that they emphasized use of the club's facilities rather than investment potential.

The court failed to consider that some people buy beach lots or homes for investment purposes and that club memberships are an important part of the marketing effort to rent beach property. The court's ap-

205. 922 F.2d 788 (11th Cir. 1991).
206. Id. at 790.
207. Id. at 789.
209. 922 F.2d at 790 (citing United Hous. Found., Inc. v. Forman, 421 U.S. 387 (1975)).
210. Id. at 791 (citing Forman, 421 U.S. at 853).
211. Id.
212. Id. Additionally, the court dismissed claims of fraud brought pursuant to the Interstate Land Sales Full Disclosure Act (15 U.S.C. §§ 1701 to -20 (1988)) relating to the nonequity memberships. 922 F.2d at 791-92.
application of the investment contract analysis, however, was probably cor-
rect because the owners in this situation did not rely solely upon the
entrepreneurial efforts of others.

B. Sales of Unregistered Securities

In Greenhill v. State,\textsuperscript{213} the court of appeals upheld a criminal convic-
tion of an unregistered salesperson for selling unregistered securities in a
fraudulent manner.\textsuperscript{214} Defendant represented himself as a publisher of
Bibles and received loans from Harvey Starr ("Starr") and other inves-
tors. Starr later found that the publishing business was not an active bus-
iness and had never published Bibles as defendant had alleged. Defend-
ant stated he obtained monies from Starr as personal loans to use for any
purpose.\textsuperscript{215}

Defendant argued that the 1986 repeal and reenactment of O.C.G.A.
section 10-5-12,\textsuperscript{216} without a saving clause, should have abated the prose-
cution against him. The court decided that a savings clause is not the
only way to validate a prosecution after the law in effect at the time of
the commission of the prohibited conduct has been repealed.\textsuperscript{217} The court
decided that legislative intent could override the lack of a savings clause
if the conduct remained a crime despite the redefinition of the statute.\textsuperscript{218}

The court also stated that a defendant has the burden of proving that a
transaction is exempt from registration under the state securities laws
and that defendant did not meet his burden.\textsuperscript{219} The court found that de-
fendant acted as a salesman pursuant to Georgia securities laws and will-
fully violated such laws by selling unregistered securities and employing a
fraudulent device.\textsuperscript{220}

Additionally, the court applied a four year statute of limitations and
found that the statutory period begins to run upon the state's knowledge
of a violation including knowledge imputed to the state by interested or
injured parties.\textsuperscript{221} Although this case dealt with violations of the Georgia
securities laws rather than federal securities laws, federal courts have

\begin{footnotes}
\item[214] Id. at 218-21, 404 S.E.2d at 580-81.
\item[215] Id. at 218, 404 S.E.2d at 579.
\item[216] O.C.G.A. § 10-5-12 (1991). Section 12(a)(1) contains the Georgia equivalent of sec-
tion 10(b) of the Exchange Act.
\item[217] 199 Ga. App. at 219, 404 S.E.2d at 580 (citing Barrett v. State, 183 Ga. App. 729,
360 S.E.2d 400 (1987)).
\item[218] Id. (citing State v. Benzaquen, 184 Ga. App. 392, 361 S.E.2d 503 (1987)).
\item[219] Id. at 220, 404 S.E.2d at 580 (citing Flynn v. State, 88 Ga. App. 52, 57, 76 S.E.2d 38
(1955)).
\item[220] Id., 404 S.E.2d at 581.
\item[221] Id. at 221, 404 S.E.2d at 581 (citing O.C.G.A. § 17-3-2(2) (1990); Duncan v. State,
193 Ga. App. 793, 389 S.E.2d 365 (1989)).
\end{footnotes}
been applying the most analogous state limitations period in determining the limitations period for violations of the federal securities laws. Recently in *Lamph, Pleva, Liphind, Prupis & Petigrow v. Gilbertson*, the United States Supreme Court decided that federal securities law claims would have the statutory limitations period provided in Section 9 of the Exchange Act.

C. Rescission and Controlling Person Liability

In *Binder v. Gordian Securities, Inc.*, the District Court for the Northern District of Georgia decided that, in a transaction exempt from registration under the Georgia Securities Act, defendants' offers of rescission did not bar plaintiffs' suit. The court found that the rescission offers made by defendants did not meet the requirements of O.C.G.A. section 10-5-14(d)(1).

The court determined that although defendants complied with Regulation D of the Securities Act, they did not have to comply with the uniform limited offering exemption of the Georgia Securities Act. Instead defendants could comply with any exemption found in such act.

An individual defendant argued that he was not a controlling person for the purposes of controlling person liability under the federal or state securities laws. If a plaintiff meets his burden of establishing that a defendant is a controlling person under the securities laws, the defendant

225. Id. at 666-67. See O.C.G.A. 10-5-9 (1991). Defendants stated in their Private Placement Memorandum that they relied on § 3(b) and § 4(2) of the Securities Act for exemptions from registration and complied with Regulation D. Defendants did not rely on Georgia's Uniform Limited Offering Exemption but relied on the exemption of § 10-5-9(13) of the Georgia Act. 742 F. Supp. at 665-66.
226. 742 F. Supp. at 666 (citing O.C.G.A. § 10-5-14(d) (1991)).
227. Id. O.C.G.A. § 10-5-14(d) (1991) requires a rescission offer to (1) offer repayment of investors' consideration; (2) within thirty days of acceptance of the offer; and (3) to pay interest accrued thereon.
229. 742 F. Supp. at 668. O.C.G.A. § 10-5-9(13) (1991) allows an exemption for offerings with less than 15 purchasers in the state and that did not involve any general solicitation or advertisement. Purchasers executed agreements concerning their investment intent. Additionally, the certificates representing the limited partnership interest contained the required legend referring to this exemption. 742 F. Supp. at 666.
must then assert a good faith affirmative defense to such allegations. Defendant must allege "that he had 'no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability of the controlled person is said to exist,'" and that he "'acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.'" The court found that the individual defendant ("Thompson") correctly alleged that his status as an officer did not automatically make him a controlling person, but that the standard required consideration of whether Thompson "'had the requisite power to directly or indirectly control or influence corporate policy.'" The court determined that Thompson was a controlling person and although he might have lacked actual knowledge of illegalities and did not induce such illegalities, he might have had reason to know of such illegalities and therefore would have acted recklessly by not attempting to prevent them. The court found that Thompson knew about the transaction and understood the basic capitalization needs and the type of investment involved in the transaction and, in his capacity as Vice President, could have reviewed documents relating to the offering. These factors raised questions of material fact concerning Thompson's good faith defense.

D. Fraud

In Leonard v. Stuart-James Co., the District Court for the Northern District of Georgia examined several issues under the federal securities laws. Plaintiff opened an investment account with Stuart-James and signed an agreement that contained a provision providing for arbitration of all claims between the parties, but did not prevent judicial review of federal securities laws claims. At the time of the execution of this agreement, a rule promulgated by the Securities and Exchange Commission required the inclusion of such language in the agreement. The court decided that the plain language of the agreement excepted federal securities laws claims from arbitration and did not provide for potential

231. 742 F. Supp. at 667-68 (citing G.A. Thompson & Co. v. Partridge, 636 F.2d 945, 958 (5th Cir. 1981)).
232. Id. at 668 (quoting 15 U.S.C. § 77 (1988)).
233. Id. (quoting 15 U.S.C. § 78t(a) (1988)).
234. Id. (quoting G.A. Thompson & Co. v. Partridge, 636 F.2d at 958).
235. Id. at 669.
236. Id.
237. Id.
240. 742 F. Supp. at 655.
changes in such laws.\textsuperscript{241} The court refused to allow the rescission of the rule to negate express terms in a contract and refused to stay the federal claims pending arbitration of the other claims between the parties.\textsuperscript{243}

Beginning in June 1987, plaintiff invested in certain “penny stocks” recommended by Stuart-James but decided to sell the securities in October of 1987 because plaintiff felt that a Stuart-James salesman acted too aggressively in dealing with his account. This salesman refused to sell the securities, and the market value decreased. Stuart-James refused to refund the value of the securities as of the date plaintiff requested their sale. Plaintiff alleged that the salesman’s failure to sell and Stuart-James’ misrepresentations and omissions caused his losses. Plaintiff alleged that Stuart-James acted as part of a conspiracy to manipulate the market and the price of the securities.\textsuperscript{244} Plaintiff’s allegations required the court to determine an issue not addressed by any federal appellate court, whether section 12(2) of the Securities Act\textsuperscript{244} applies to securities traded on the secondary market. Certain district courts examining the issue decided that the purpose of the Securities Act was to regulate initial distributions.\textsuperscript{244} Plaintiff contended that Stuart-James’ position as a market maker allowed it to offer the securities in batches and that section 12(2) covers batch offerings. The court refused to find that plaintiff stated a claim allowable under section 12(2).\textsuperscript{246}

The court next examined plaintiff’s claim under section 10(b) of the Exchange Act.\textsuperscript{247} Although plaintiff alleged that Stuart-James was guilty of misrepresentation, plaintiff did not describe with specificity any misrepresentation. The court set forth the elements of an action under section 10(b) and rule 10(b)(5): (1) a false statement or omission of material fact (2) made with \textit{scienter} (3) justifiably relied upon by the plaintiff (4) that proximately caused plaintiff’s injury.\textsuperscript{248} The court went on to state that one can prove \textit{scienter} by showing either knowing misconduct or se-

\begin{enumerate}
\item 742 F. Supp. at 657.
\item \textit{Id.} at 657.
\item \textit{Id.} at 657-58.
\item 742 F. Supp. at 658.
\item \textit{Id.} at 659.
\item \textit{Id.} (citing Bruschi v. Brown, 876 F.2d 1526 (11th Cir. 1989)).
\end{enumerate}
vere recklessness, and that reliance can be satisfied by an allegation of fraud on the market. The court also discussed the two elements of causation: (1) transaction causation, in which the misrepresentation is the cause of the purchase of the securities; and (2) loss causation, in which the misrepresentation is the proximate cause of the loss. The court found that plaintiff alleged facts that were subject to a claim under section 10(b) or rule 10b-5(a) or (c). The court found sufficient facts present to support allegations of reliance, reckless disregard (rather than scienter), and transaction causation, and allowed plaintiff to amend in order to cure the deficiency of failing to allege facts showing loss causation. Additionally, the court decided that plaintiff could allege controlling person liability if he were able to assert a section 10(b) claim.

The court applied a two-year limitations period taken from the most analogous state statute but determined that federal law governs the tolling of the statute of limitations. The decision in Lampf should alleviate the confusion over different statutory periods applied by various federal courts.

E. Legislative Changes

During its 1991 session, the legislature authorized public entities to issue bonds to invest the proceeds in insured deposits, securities, investment trusts, management-type investment companies, common trust funds maintained by a bank or trust company or other interests in registered investment funds.

V. Conclusion

During the survey period, the Georgia courts considered cases dealing with piercing of the corporate veil, preincorporation acts, derivative actions, partnership liability for debts, the partnership relationship, partners' duty to inquire, the acquisition of branch banks, commercial unreasonableness, misapplication of funds, restructuring of loans, the definition of a security, the sale of unregistered securities, rescission and controlling personal liability, and securities fraud. The courts did not break new

249. Id. (citing McDonald v. Alan Bush Brokerage Co., 863 F.2d 809 (11th Cir. 1989)).
250. Id. (citing Basic, Inc. v. Levinson, 485 U.S. 224 (1988)).
251. Id. at 660.
252. Id. at 780 (11th Cir. 1988)).
253. See supra note 74 and accompanying text.
254. SB 175.
ground in the surveyed areas, and for the most part failed to give new
direction to practitioners and potential litigants.