Mercer Law Review

Volume 47
Number 1 *Annual Survey of Georgia Law*

Article 3

12-1995

Business Associations

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ARTICLES

Business Associations

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This Article analyzes noteworthy cases in the areas of corporate, partnership, securities and banking law decided during the survey period[1] by the Georgia Court of Appeals, the Georgia Supreme Court, the United States district courts in Georgia and the United States Court of Appeals for the Eleventh Circuit. Additionally, the Article highlights certain enactments by the Georgia General Assembly revising the Official Code of Georgia Annotated ("O.C.G.A.").

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1. The survey period is June 1, 1994 through May 31, 1995.

I. CORPORATIONS

A. *Piercing the Corporate Veil*

The concept of piercing the corporate veil to hold shareholders personally liable for the debts of the corporation has been used by the Georgia courts in an attempt to remedy fraud or injustice. The courts, however, have failed to define precise standards to apply to rather predictable factual scenarios. Consequently, the results often seem contradictory and confused.[2]

Georgia courts generally frame the issue as whether the corporation is the alter ego or business conduit of its owner.[3] The principal inquiry is not the composition of corporate ownership or control since, under Georgia law, a corporation and its shareholders or officers are distinct entities even if wholly-owned and controlled by an individual.[4]

To establish a claim to pierce a corporate veil the plaintiff must show: (1) that the shareholder's disregard of the corporate entity made it a mere instrumentality for the transaction of its own affairs; (2) that there is such unity of interest and ownership that the separate personality of the corporation and the owner or officer no longer exists; and (3) that to adhere to the doctrine of a separate corporate entity would promote injustice or protect fraud.[5] For the issue to be submitted to a jury, Georgia courts require evidence that the corporate arrangement is a sham used to defeat justice, to perpetuate fraud, or to evade statutory, contractual or tort responsibility.[6]

Every year there are a number of reported cases in which a claimant seeks to pierce the corporate veil to reach the assets of a corporation's shareholders. The inquiry is a jury question and often these claims are tried in the course of litigation, although they may not be the main claim in a case. This activity will continue and be encouraged so long as the

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2. *See* Paul A. Quirós & Donna Ruth Jones, *Business Associations*, 40 MERCER L. REV. 61, 68 (1988).

3. *See, e.g.*, J & J Materials, Inc. v. Conyers Seafood Co., 214 Ga. App. 63, 64, 446 S.E.2d 781, 782-83 (1994); Hickman v. Hyzer, 261 Ga. 38, 401 S.E.2d 738 (1991); Darbyshire v. United Builders Supplies, 194 Ga. App. 840, 392 S.E.2d 37 (1990); Amason v. Whitehead, 186 Ga. App. 320, 367 S.E.2d 107 (1988).

4. International Telecommunications Exch. Corp. v. MCI Telecommunications Corp., 892 F. Supp. 1520, 1551-52 (N.D. Ga. 1995) (citing United States v. Fidelity Capital Corp., 920 F.2d 827, 837 (11th Cir. 1991) and Byrd v. Brand, 140 Ga. App. 135, 136, 230 S.E.2d 113 (1976)).

5. *See* cases cited *supra* note 3.

6. *Id.*

legislature and the courts do not develop a more workable set of legal standards to apply to veil-piercing claims.

(i) The Judiciary Seeks to Apply the Standard. In *Mitcham v. Blalock*,[7] the court of appeals was asked to reverse a trial court which refused to pierce the corporate veil in a suit brought by an investor against the officers and directors of an investment company for losses allegedly caused by the corporation's broker's fraudulent acts and by the corporation's officers' and directors' negligent supervision, control and management.[8] Once pierced, the plaintiff sought to recover against the corporation's officers and directors under section 14(c) of the Georgia Securities Act of 1973[9] and under common law doctrines of respondeat superior and breach of fiduciary duty.[10]

The court of appeals affirmed the trial court's summary judgment in favor of the defendants and the attendant decision to insulate the corporation's officers and directors from personal liability.[11] Although the Court noted the plaintiff's claim under the Georgia Securities Act was time barred by the applicable two-year statute of limitation,[12] it did analyze the veil-piercing claim and decided the plaintiff had failed to clear the essential hurdle to litigating the veil-piercing issue—that "some persuasive reason" for doing so must be presented.[13]

The plaintiff presented affidavits from two experts in the field of securities management supporting his claims that the defendants' management of the corporation was far below industry standards, but the court found the evidence insufficient to litigate the issue, stating that "plaintiff presented no evidence that defendants disregarded separation of the corporate entity by commingling assets or abuses of corporate form."[14] Further, the court placed no weight on the fact that the plaintiff had previously secured a $60,000 arbitration award against the corporation and its broker.[15] Instead, the court grounded its decision in the level of officer and director misconduct needed to pierce the corporate veil, explaining:

7. 214 Ga. App. 29, 447 S.E.2d 83 (1994).
8. *Id.* at 34, 447 S.E.2d at 88.
9. O.C.G.A. § 10-5-14(c) (1994).
10. 214 Ga. App. at 29-30, 447 S.E.2d at 85.
11. *Id.* at 35, 447 S.E.2d at 89.
12. *See id.* at 31, 447 S.E.2d at 85-86; *see also* O.C.G.A. § 10-5-14(d) (1994).
13. 214 Ga. App. at 34, 447 S.E.2d at 88. *See supra* text accompanying note 6.
14. *Id.*, 447 S.E.2d at 88.
15. *Id.* at 35, 447 S.E.2d at 89.

> An officer of a corporation who takes part in the commission of a tort by the corporation is personally liable therefore, but an officer of a corporation who takes no part in the commission of a tort committed by the corporation is not personally liable unless he specifically directed the particular act to be done or participated or co-operated therein.[16]

The plaintiff failed to make the required showing of improper corporate purpose or tortious misconduct. In fact, the officers and directors had no personal contact with the plaintiff. Thus, the court readily declined to pierce the veil.[17]

A more difficult question of whether to pierce the corporate veil or, more particularly, whether to submit the question to a jury was presented in *J & J Materials, Inc. v. Conyers Seafood Co.*[18] Here, the Georgia Court of Appeals affirmed the trial court's grant of a directed verdict in favor of a judgment debtor and its principal on a finding of no fraud, but reversed the trial court's directed verdict in favor of the debtor's principal involving an alter ego claim on evidentiary grounds.[19]

Appellant, J & J Materials ("J & J") had filed an action on account to recover payment from appellee, Conyers Seafood Company ("CSC"), for seafood CSC had procured from J & J in 1988.[20] The trial court subsequently awarded J & J a default judgment exceeding $27,000.[21] J & J could not collect on its judgment and brought an action below against CSC, CSC's sole shareholder, L.W. Evans, and Mrs. Evans for fraud and deceit.[22] The complaint alleged the default judgment had not been satisfied, and that in his responses to post-judgment interrogatories, Mr. Evans made fraudulent misrepresentations on behalf of CSC as to the nature and extent of CSC's assets in order to deceive J & J into believing the default judgment was uncollectible.[23]

Another claim tried to hold Mr. Evans personally liable as CSC's principal for the default judgment debt by piercing CSC's corporate veil.[24] The defendants denied the allegations of the complaint and

16. *Id.*, 447 S.E.2d at 88 (quoting Lincoln Land Co. v. Palfery, 130 Ga. App. 407, 411, 203 S.E.2d 597 (1973), quoting Smith v. Hawks, 182 Ga. App. 379, 384, 385, 355 S.E.2d 669 (1987)).
17. *Id.*
18. 214 Ga. App. 63, 446 S.E.2d 781 (1994) (McMurray, P.J., dissenting).
19. *Id.* at 65, 446 S.E.2d at 783.
20. *Id.* at 63, 446 S.E.2d at 782.
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*

argued that J & J failed to recover the default judgment because it did not exercise due diligence in enforcing the judgment.[25]

The facts before the court on which to evaluate the lower court's verdict were clear. Mr. Evans established a seafood wholesale business and restaurant in Georgia in 1973.[26] The enterprise was initially a sole proprietorship and operated under the tradename "Conyers Seafood."[27] In 1981, Evans incorporated his wholly-owned business and added "Inc." to the name "Conyers Seafood Company," but the business was always known simply as "Conyers Seafood."[28] In June 1987, Evans sold the retail side of Conyers Seafood to Captain Don's Seafood, Inc., which concomitantly leased-back space to Evans.[29] The sale did not involve any transfer of goodwill, tradename, telephone numbers, and the like.[30] Evans still owned the wholesale side of Conyers Seafood, but planned to wind it down.[31] After Captain Don's defaulted on the promissory note it gave Evans to finance the purchase, Evans brought an action in October 1987 on behalf of himself and CSC against Captain Don's and its principal seeking to repossess the premises.[32]

In January 1988, J & J filed suit against CSC to recover payment for the seafood it had shipped to CSC in April 1987.[33] J & J received its default judgment in August 1988.[34] In October 1988, Evans repossessed the premises from Captain Don's but failed to recover for amounts owed Evans on the note.[35] In November 1988, Evans and his wife formed L & M Evans, Inc. d/b/a Conyers Seafood.[36] Mrs. Evans owned all of the shares of the corporation.[37] Conyers Seafood operated in its usual fashion, although corporate accounts were established to reflect the change in ownership.[38] These facts were reflected in Mr. Evans' responses to J & J's post-judgment interrogatories.[39]

On appeal J & J argued that Mr. Evans' responses to the post-judgment interrogatories stated that CSC was no longer in business and

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25. *Id.*
26. *Id.* at 66, 446 S.E.2d at 783.
27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.*, 446 S.E.2d at 783-84.
31. *Id.*, 446 S.E.2d at 784.
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.*

that CSC was not owed money by any person or entity.[40] The focus of J & J's argument was that it reasonably believed CSC was no longer in business after the $27,000 judgment was rendered.[41] But the trial court found J & J's sole shareholder had knowledge that the business was operating under the tradename "Conyers Seafood" and that Mr. Evans' response was not deceptive since CSC was no longer in existence.[42] The court of appeals therefore readily affirmed the lower court's finding of no fraud.[43] The court refused, however, to affirm the trial court's directed verdict in favor of CSC and Evans with respect to the veil-piercing claim.[44]

The court commented that J & J's contention that it should be allowed to pierce the corporate veil of CSC and pursue satisfaction of its judgment against Mr. Evans in his personal capacity as CSC's sole shareholder was a "different matter" than the fraud claim against him.[45] Couching its distinction in the "any evidence test"—the standard used to grant or deny a directed verdict—the court stated:

> In Georgia, the standard used to review the grant or denial of a directed verdict is the any evidence test. Where there is no conflict in the evidence as to any material issue, and the evidence introduced, with all reasonable deductions therefrom, shall demand a particular verdict, such verdict shall be directed.[46]

The court then framed the issue in the traditional manner as whether the corporation served as the alter ego of its sole shareholder.[47] After explaining the plaintiff's hurdle to submitting the question of whether to pierce CSC's corporate veil to the jury and the standard the jury must apply in its decision, the court listed the evidence which supported its reversal of the lower court's decision not to pierce.[48]

J & J Materials, the court found, presented sufficient evidence for a jury to conclude that CSC was a mere business conduit for its sole shareholder, Mr. Evans.[49] Additional facts which the court found warranted submission of the piercing issue to a jury included: CSC only

40. *Id.* at 67, 446 S.E.2d at 784.
41. *Id.*, 446 S.E.2d at 784-85.
42. *Id.*
43. *Id.* at 64, 446 S.E.2d at 782.
44. *Id.* at 65, 446 S.E.2d at 783.
45. *Id.* at 64, 446 S.E.2d at 782.
46. *Id.* (citing Hixson-Hopkins Autoplex v. Custom Coaches, 208 Ga. App. 820(1), 432 S.E.2d 224 (1993)).
47. *Id.*
48. *Id.* at 65, 446 S.E.2d at 783.
49. *Id.*

received a tradename from Evans when formed; CSC paid Evans for its operations furniture, but the furniture was personally owned by Evans; Evans personally sold the retail end of CSC, which was supposedly owned by CSC, not Evans; and L & M Evans, Inc. was realizing the benefits of the Conyers Seafood tradename and goodwill even though it never paid CSC for those intangibles when it succeeded CSC as operator of Conyers Seafood.[50]

While the court found evidence of fraudulent transfers important in submitting the question to a jury, it nonetheless granted a directed verdict in the Appellees' favor with respect to the claim for fraud. Presumably, the court believed the veil-piercing issue was properly a matter for jury consideration on grounds that the corporate arrangement was a sham, used to defeat injustice, or used to evade statutory, contractual or tort responsibility, but not because fraud may have been committed by the Appellees. The problem, however, lies in drawing a line of distinction between the various forms of misconduct.

Judge McMurray dissented from the court's decision to reverse the trial court's directed verdict in favor of CSC and Mr. Evans on J & J's claim to pierce the corporate veil.[51] The Judge agreed there was no fraud involved in any of the transactions surrounding the formation, operation, and transfer of ownership of CSC to L & M Evans, Inc.[52]

Judge McMurray argued that ". . . [a properly formed] corporation is prima facie a distinct legal entity with rights and liabilities which are separate from those of [its shareholders] . . . ."[53] The Judge recognized that the agreements relating to the sale to Captain Don's were between Captain Don's, Inc. and L.W. Evans in his individual capacity.[54] CSC was not a party to the agreements and, consistent with Mr. Evans' responses to post-judgment interrogatories, CSC was owed no money.[55] Moreover, the dissent explained that the facts that L & M Evans, Inc. kept the same phone number and used the same tradename that CSC had used previously did not destroy Mr. Evans' prima facie status as insulated from liability for the debts of CSC.[56]

Thus, like the majority, Judge McMurray found no basis for the claims of fraud and deceit. However, unlike the majority, he found the evidence

50. *Id.*
51. *Id.* at 65, 446 S.E.2d at 783 (McMurray, P.J., dissenting).
52. *Id.*
53. *Id.* at 67, 446 S.E.2d at 784 (quoting Midtown Properties, Inc. v. George F. Richardson, 139 Ga. App. 182, 185, 228 S.E.2d 303 (1976) and citing Jones v. Adamson's, Inc., 147 Ga. App. 282, 283-84, 248 S.E.2d 514 (1978)).
54. *Id.*
55. *Id.*, 446 S.E.2d at 784-85.
56. *Id.* at 67-68, 446 S.E.2d at 785.

did not provide a basis for submitting the question of whether to pierce the corporate veil to the jury, stating: "'[O]ne who deals with a corporation as such an entity cannot, in the absence of fraud, deny the legality of the corporate existence for the purpose of holding the owner liable.'"[57]

The dissent argued that the facts which the majority believed would authorize a jury to pierce CSC's corporate veil to hold Mr. Evans personally liable for the default judgment were not sufficiently compelling to warrant reversal of the trial court's directed verdict.[58] In Judge McMurray's opinion, there was no evidence of fraud or injustice, or an attempt to avoid statutory, contractual or tort responsibilities.[59] He warned that the majority's holding "comes perilously close to permitting the sole shareholder of a close corporation to be personally liable for the debts of his corporation simply because he is the sole shareholder."[60] Judge McMurray continued:

> "[A]lthough grossly inadequate capitalization and preferential payments may, under some circumstances, rise to a level of abuse of the corporate form, the undisputed facts of this case demonstrate no abuse of the corporate form sufficient to justify piercing the corporate veil. There is no evidence that [Evans] seized assets in order to strip the [c]orporation of assets necessary to pay existing debts. There is nothing in the record to indicate fraudulent intent."[61]

The dissent demonstrates the judicial tension in developing a workable standard for differentiating fraud from other misconduct, and misconduct from legitimate asset protection planning. Applying the often enunciated piercing standards, the majority and the dissent came to opposite conclusions on the same facts. This is always disturbing, but especially so when a clear and important policy which the Georgia law seeks to promote is the encouragement of equity investment in business without the fear of unlimited liability.

(ii) Creditor of Foreign Debtor-Corporation Precluded by the Interaction of Georgia Law, the Law of the Foreign State of Incorporation and the Bankruptcy Code from Maintaining a Veil-Piercing Claim. In *Realmark Investment Co. v. American Financial*

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57. *Id.* at 68, 446 S.E.2d at 785 (quoting Lamas v. Baldwin, 140 Ga. App. 37, 40, 230 S.E.2d 13 (1976) and citing Williams Plaza v. Sedgefield Sportswear Div. of Bell Blue, Inc., 164 Ga. App. 720, 723, 297 S.E.2d 342 (1982)) (punctuation omitted).

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.* (quoting Hickman v. Hyzer, 261 Ga. 38, 40(2), 401 S.E.2d 738 (1991)).

Corp.,[62] the United States District Court for the Northern District of Georgia had to decide how the Georgia Supreme Court would apply conflict of laws rules to determine whether a claim to pierce the corporate veil was property of the bankruptcy estate or, on the other hand, whether the claim was property of the bankrupt-debtor, thus giving creditors standing to bring a claim to pierce the corporate veil.[63]

The plaintiff, Realmark Investment Co. ("Realmark"), a Georgia corporation, purchased subordinated debentures, due October 15, 1997, issued by Circle K Corporation ("Circle K").[64] In May 1990, Circle K, a Texas corporation, and its affiliates filed petitions for reorganization under Chapter 11 of the Bankruptcy Code[65] in the United States District Court for the District of Arizona.[66] Realmark brought suit against American Financial Corporation ("AFC"), an Ohio corporation, seeking to pierce the veil between AFC and Circle K on grounds that AFC was merely the alter ego of Circle K and, as such, should answer for the debts of Circle K. AFC moved to dismiss Realmark's complaint.[67]

The district court first provided the analytical framework for its decision on whether to grant or deny AFC's motion to dismiss. The court commented that as a federal district court faced with a diversity case, its first inquiry was the conflict of law rules of the forum state, Georgia, to determine which state's law governs a claim to pierce the veil of a debtor-corporation which is brought by a creditor outside the bankruptcy court.[68] Then, if Georgia's law allowed Circle K, as debtor-corporation, to assert a claim to pierce its own corporate veil to reach its controlling shareholder prior to the filing of a bankruptcy petition, the claim was property of the estate under Bankruptcy Code section 541(a).[69] If the claim was property of the estate, then only the bankruptcy trustee or the debtor-in-possession, as the case may be, could assert the veil-piercing claim; in which case creditors, such as the plaintiff, Realmark, would have no standing to assert such a claim.[70] If the claim was property of the estate, then the automatic stay provisions of the Bankruptcy Code would stay an action seeking to pierce the corporate veil.[71]

62. 171 B.R. 692 (Bankr. N.D. Ga. 1994).
63. *Id.* at 694.
64. *Id.* at 693.
65. 11 U.S.C. §§ 1101-1174 (1994) (Chapter 11).
66. 171 B.R. at 693.
67. *Id.*
68. *Id.* at 694.
69. *Id.* at 695.
70. *Id.*
71. *Id.*; *see also* 11 U.S.C. § 362 (the Bankruptcy Code's automatic stay provision).

The court recognized that Georgia courts have not directly addressed the issue of which state's laws apply in veil-piercing claims in diversity cases.[72] Consequently, this conflict of laws issue had to be resolved by the federal district court as it believed the Georgia Supreme Court would have decided it.[73]

The defendant, AFC, maintained the Georgia Supreme Court would apply the Restatement (Second) of Conflict of Laws' view, which calls for application of the law of the state of incorporation to determine a shareholder's liability to the corporation or to a corporation's creditors for corporate debts.[74] AFC argued that, because Circle K is incorporated in Texas, Texas law applied to questions of piercing the corporate veil.[75]

AFC's argument was simple and effective. It proffered that since the Georgia Supreme Court had followed the Restatement (Second) of Conflict of Laws in the corporations context before, the Court would again follow the Restatement approach in the case at bar.[76]

The district court cited *Diedrich v. Miller & Meier & Associates, Architects & Planners, Inc.*,[77] a case in which the court held that a suit against the officers and directors of a foreign corporation for misappropriation of a corporate opportunity was an internal affair properly regulated by the law of the foreign corporation's state of incorporation and not by Georgia law.[78] The court based its decision on Georgia Business Corporation Code section 14-2-310, which provides that "nothing contained in the [Business Corporations chapter] shall be construed to authorize [Georgia] to regulate the internal affairs of a [foreign] corporation."[79] Further, the *Diedrich* court's decision was a recognition of the internal affairs doctrine as pronounced by the Restatement (Second) Conflicts of Laws—that the doctrine applies "whenever the issue concerns the relations inter se of the corporation, its shareholders, directors, officers or agents . . . ."[80]

In holding that Texas law applied to issues of piercing the corporate veil, the district court mentioned the plaintiff offered no cases to dispute the extension of the internal affairs doctrine as pronounced by the

72. 171 B.R. at 694.
73. *Id.*
74. *Id.* (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 307 (1971)).
75. *Id.* at 694.
76. *Id.*
77. 254 Ga. 734, 334 S.E.2d 308 (1985).
78. *Id.* at 735, 334 S.E.2d at 310.
79. *Id.*
80. *Id.* (citing RESTATEMENT (SECOND) CONFLICT OF LAWS §§ 309 and 313 cmt. a (1971)).

Restatement to alter ego claims.[81] Consequently, until the Georgia Supreme Court directly addresses the issue, the internal affairs doctrine as described in the Restatement applies to claims in which the plaintiff seeks to pierce the veil of a foreign corporation, at least in the context of claims based on alter ego grounds.

The Restatement's pronouncement of the internal affairs doctrine was also applied by the court in determining whether Georgia law would have allowed Circle K, as debtor-corporation, to assert a claim to pierce its own corporate veil to reach its controlling shareholder prior to the filing of a bankruptcy petition.[82] If so, then the claim would have been property of the estate under Bankruptcy Code section 541(a) and the creditor-plaintiff, Realmark, would not have had standing to assert its claim for relief. Under the doctrine, the law of the state of incorporation applied.[83] Texas law permits a corporation to pierce its own veil.[84] Accordingly, since the debtor, Circle K, could have brought its own alter ego claim, the claim to pierce the corporate veil was property of the bankruptcy estate.[85] Therefore, only the bankruptcy trustee (or debtor in possession) had standing to assert the alter ego claim to recover property of the bankruptcy estate.[86] The creditor-plaintiff, Realmark, had no standing to assert its veil-piercing claim because of the Bankruptcy Code's automatic stay provision.[87]

(iii) Reverse Use of Alter Ego Doctrine Rejected. In a couple of cases, plaintiffs unsuccessfully attempted to reverse the use of the alter ego doctrine to hold a corporation liable for the debts of an individual. In *Gwinnett Property, N.V. v. G + H Montage GmbH,*[88] a West German construction company, G + H, contracted to build a storage facility in Iran for an Iranian corporation.[89] Rahim Irvani personally guaranteed payment under the contract to G + H.[90] The Iranian corporation defaulted on the contract and G + H later obtained a judgment in England against Irvani on his guarantee.[91] G + H subsequently filed an action in a Georgia superior court asking the court to recognize the

81. 171 B.R. at 695.
82. *Id.*
83. *Id.*
84. *Id.*
85. *Id.*
86. *Id.* at 695-96.
87. *Id.* at 696.
88. 215 Ga. App. 889, 453 S.E.2d 52 (1994).
89. *Id.* at 899, 453 S.E.2d at 53.
90. *Id.*, 453 S.E.2d at 53-54.
91. *Id.*, 453 S.E.2d at 54.

judgment against Irvani and alleging fraudulent conversion of assets by Irvani to several corporations.[92] The trial court entered judgment for G + H, but the Georgia Supreme Court reversed.[93]

At the second trial, G + H tried to have the foreign judgment recognized and claimed that eight corporations were liable for Irvani's personal debts not only on alter ego grounds, but also for receiving the fraudulently conveyed assets from Irvani.[94] With respect to the fraudulent conveyance claim, the jury returned a verdict for over $8 million in favor of G + H and against Irvani and seven of the corporations.[95] The jury also found one of the companies, Granite Industrial Development & Services Corporation ("GIDS"), liable as Irvani's alter ego.[96] Judgment was entered on the jury verdict and the seven corporate defendants appealed the judgment and the court's denial of their motion for judgment n.o.v.[97] Irvani appealed separately.[98]

On appeal, the court reversed the trial court with respect to the alter ego claim.[99] The first reason for reversal was that Irvani was not a GIDS shareholder.[100] The court found the alter ego doctrine inapplicable where a shareholder is not involved, stating:

> "To establish the alter ego doctrine it must be shown that the *stockholders'* disregard of the corporate entity made it a mere instrumentality for the transaction of their own affairs; that there is such unity of *interest* and *ownership* that the separate personalities of the corporation and the *owners* no longer exist; and to adhere to the doctrine of corporate entity would promote injustice or protect fraud."[101]

Further, the court found that G + H improperly reversed the use of the alter ego and corporate veil-piercing doctrines. The court noted the alter ego doctrine is generally used to pierce the corporate veil to hold an individual shareholder personally liable for the debts of the corpora-

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92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.* at 895, 453 S.E.2d at 57.
100. *Id.* at 894, 453 S.E.2d at 57.
101. *Id.* at 892, 453 S.E.2d at 56 (quoting Farmers Warehouse of Pelham v. Collins, 220 Ga. 141, 150(2)(d), 137 S.E.2d 619 (1964) and Marett v. Professional Ins. Careers, 201 Ga. App. 178, 180(1)(b), 410 S.E.2d 373 (1991)).

tion.[102] In the court's view, the evidence supporting G + H's assertion of its veil-piercing claim was inseparable from that supporting its fraudulent conveyance claim.[103] However, the court of appeals reversed the lower court's judgment as to G + H's fraudulent conveyance claim.[104] Consequently, the court found that G + H's reliance on the same evidence revealed that it had not asserted a proper alter ego claim, but rather had improperly asserted a fraudulent conveyance claim under the guise of a veil-piercing claim.[105]

Similarly, in *International Telecommunications Exchange Corp. v. MCI Telecommunications Corp.*,[106] the United States District Court for the Northern District of Georgia refused to reverse the use of the veil-piercing doctrine to reach a corporation to recover on the personal guarantee of its guarantor.[107] The court found a claim for fraud on the part of the guarantor could not be imputed to the corporation and, therefore, the claim to pierce the corporate veil was improper.[108]

(iv) Court Rejects Plaintiffs Use of Alter Ego Doctrine to Secure Personal Jurisdiction. Another example of the improper use of the alter ego doctrine can be found in *Taeger Enterprises, Inc. v. Herdlein Technologies, Inc.*,[109] a case in which the plaintiff made an unsuccessful alter ego claim in an effort to secure personal jurisdiction over a defendant. In *Taeger Enterprises* a subcontractor brought an action for fraudulent inducement and conversion against two nonresidents—a corporate contractor's president, Oehler, and a separate corporate consultant, Herdlein Technologies, Inc. ("HTI").[110] Neither defendant had significant ties to Georgia such that they would be subject to the court's personal jurisdiction.[111]

Nonetheless, the plaintiff attempted to impute the activities of the corporate contractor to HTI such that the aggregate contacts of both the corporate contractor and HTI taken together would be sufficient for the court to exercise personal jurisdiction over the defendants.[112] The

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102. *Id.* at 893, 453 S.E.2d at 57 (citing Southern Envtl. Group v. Rosebud Landscape Gardeners, 196 Ga. App. 392, 394(1), 395 S.E.2d 913 (1990)).
103. *Id.*
104. *Id.*
105. *Id.*
106. 892 F. Supp. 1520 (N.D. Ga. 1995)
107. *Id.* at 1552.
108. *Id.* at 1551-52.
109. 213 Ga. App. 740, 445 S.E.2d 848 (1994).
110. *Id.* at 740, 445 S.E.2d at 850-51.
111. *Id.* at 747, 445 S.E.2d at 855.
112. *Id.*

basis of the plaintiff's argument was that it did not know the corporate contractor and HTI were separate entities, as they worked closely together and shared office space, secretarial services, and telephone numbers.[113] The court found the subcontractor's ignorance of the fact that the HTI had an existence separate from the corporate contractor was not competent evidence that HTI was an alter ego of the corporate contractor such that the actions of the contractor in Georgia could be attributed to HTI to secure personal jurisdiction over HTI.[114]

B. Liability for Preincorporation Transactions—Statute Supplants Common Law "Promoter Liability"

In *Weir v. Kirby Construction Co.*,[115] the Georgia Court of Appeals clearly explained there is no common law theory of "promoter liability." Instead, Georgia Business Corporation Code section 14-2-204 is the exclusive statement of the law on liability for preincorporation transactions. Under section 14-2-204, all persons purporting to act as or on behalf of a corporation with actual knowledge there was no incorporation are jointly and severally liable for all liabilities created while so acting.[116]

In *Weir*, the defendant, Paul Weir, contracted as president of a corporation with the plaintiff, Kirby Construction Company ("Kirby"), for renovations work.[117] After the work was completed, Kirby billed Weir's corporation for $431,000.[118] Weir's corporation only paid $394,191.[119] Kirby sued Weir for the difference after discovering that when Weir entered the contract as president of the corporation, its certificate of incorporation had not been issued.[120] There was no evidence, however, that Weir actually knew the certificate of incorporation had not yet been issued when he executed the contract on behalf of the corporation.[121]

Kirby sued Weir in the trial court under a theory of common law "promoter liability" as presented in *Wells v. Fay & Egan Co.*[122] Weir

113. *Id.* at 746, 445 S.E.2d at 854.

114. *Id.* at 746-47, 445 S.E.2d at 854-55.

115. 213 Ga. App. 832, 446 S.E.2d 186 (1994). This case was decided one month before the beginning of the survey period, but was reconsidered during the survey period.

116. O.C.G.A. § 14-2-204 (1994).

117. 213 Ga. App. at 832, 446 S.E.2d at 186.

118. *Id.*

119. *Id.*

120. *Id.* at 833, 446 S.E.2d at 186.

121. *Id.*

122. *Id.* (citing 143 Ga. 732, 85 S.E. 873 (1915) which states the common law theory of "promoter liability" as:

moved for summary judgment on grounds that Georgia Business Corporation Code section 14-2-204 effectively supplanted the common law theory of "promoter liability" and former Business Corporation Code section 14-2-23.[123] Weir's motion for summary judgment was denied and the court charged the jury: "'If Paul J. Weir, at the time of the signing of the contract . . . knew *or should have known* that [his corporation] was not incorporated then he is personally liable to [Kirby] for any sums remaining due on the contract.'"[124] The jury returned a verdict against Weir for $36,493.06 and awarded $22,330.60 in attorney's fees, while the court assessed interest in the amount of $11,841.74.[125] Weir appealed.

The court of appeals reversed the trial court upon finding that its judgment was in direct contravention of the established statutory precedent of Georgia Business Corporation Code section 14-2-204.[126] The court held that to be liable for preincorporation transactions, the statute requires persons purporting to act on behalf of a corporation not yet formed possess actual culpable knowledge that the corporation's charter had not yet been issued at the time of the act.[127] Common law promoter liability assigns liability to a promoter-agent if there is no principal, regardless of knowledge. There was no evidence that Weir "purported" to act on behalf of the corporation "knowing" it was not in existence.[128]

C. *Shareholder Direct Action*

(i) "Special Injury" Rule Adopted for Determining Whether Direct Claim for Misappropriation of Corporate Funds by Fiduciary of Widely-Held Corporation is Allowed. In the 1983 case of *Thomas v. Dickson*,[129] the Georgia Supreme Court recognized

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> [I]f one contracts as agent, when in fact he has no principal, he will be personally liable. A promoter, though he may assume to act on behalf of the projected corporation and not for himself, cannot be treated as an agent of the corporation, for it is not yet in existence; and he will be personally liable on his contract, unless the other party agreed to look to some other person or fund for payment.).

123. 213 Ga. App. at 833, 446 S.E.2d at 186. *See* O.C.G.A. § 14-2-23 (codified the common law theory of "promoter liability," but replaced by O.C.G.A. § 14-2-204, which added a knowledge requirement).

124. 213 Ga. App. at 833, 446 S.E.2d at 186-87.

125. *Id.*, 446 S.E.2d at 187.

126. *Id.* at 835, 446 S.E.2d at 188.

127. *Id.*

128. *Id.*

129. 250 Ga. 772, 301 S.E.2d 49 (1983).

the general rule that "a shareholder seeking to recover misappropriated corporate funds may only bring a derivative suit."[130] Despite the rule, the court in *Thomas* allowed a minority shareholder of a close corporation to maintain a direct action against the majority shareholders for misappropriation of corporate funds since the plaintiff was the sole injured shareholder and concerns related to multiplicity of suits, prejudice to other shareholders and protection of creditors were not implicated.[131] In reaching its decision, however, the court assumed, without deciding, that misappropriation of corporate funds was primarily derivative in nature and not a direct injury.[132] Consequently, the question of whether a direct action would be available to a shareholder who suffers a direct injury remained unanswered.

The Georgia Supreme Court supplied an answer in the October 1994 case of *Grace Brothers, Ltd. v. Farley Industries, Inc.*[133] The case stemmed from a board-approved tender offer made by William Farley for all of the outstanding stock of West Point Pepperell ("WPP"), resulting in Farley's[134] successful acquisition of 95% of the stock of WPP for $58 per share.[135] During the tender offer negotiations, WPP and West Point Acquisition Corporation executed a merger agreement in which the parties agreed to use their best efforts to merge WPP with West Point Tender Corporation and then pay the remaining shareholders in WPP $58 per share upon consummation of the merger.[136]

Two years later the parties formally terminated the merger agreement after Farley announced the merger could not be completed because of financial problems.[137] The minority shareholders subsequently filed suit asserting multiple claims, directly (*e.g.* individually) and derivatively, against Farley, WPP, and WPP's officers and directors.[138] The plaintiffs requested specific performance or, in the alternative, damages

130. *Id.* at 774, 301 S.E.2d at 50.

131. *Id.* at 775, 301 S.E.2d at 51. *See* O.C.G.A. §§ 14-2-940(a)(1) and 14-2-941(a). Today, these statutory provisions authorize a shareholder in a statutory close corporation to petition the superior court for relief, including damages, if the directors "have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner, whether in his capacity as shareholder, director, or officer of the corporation." O.C.G.A. § 14-2-940(a)(1).

132. 250 Ga. at 774 n.1, 301 S.E.2d at 51 n.1.

133. 264 Ga. 817, 450 S.E.2d 814 (1994).

134. Farley used several companies to purchase WPP, including Farley Industries, Inc., West Point Tender Corporation and West Point Acquisition Corporation. 264 Ga. at 817 n.1, 450 S.E.2d at 815 n.1. Hereinafter, "Farley" means these acquisition companies.

135. 264 Ga. at 817, 450 S.E.2d at 815.

136. *Id.*

137. *Id.*

138. *Id.* at 817-18, 450 S.E.2d at 815.

for breach of the merger agreement. They also demanded damages for interference with the merger agreement, breach of fiduciary duty, unjust enrichment, corporate waste and violations of the Fair Price Requirements Act.[139]

After suit was filed, Farley announced plans to complete the merger and force the cash-out of the minority shareholders at $46 per share.[140] The plaintiffs tried to enjoin the merger, but were unsuccessful.[141] The defendants filed a motion to dismiss, asserting that the plaintiffs lacked standing to sue.[142] The defendants also moved for summary judgment.[143] The court granted both motions and entered judgment in favor of the defendants.[144]

The plaintiffs appealed, but the merger was completed in December 1993 and WPP became West Point Stevens.[145] Two of the minority shareholders accepted the $46 per share merger price and tendered their shares.[146] A third minority shareholder, Lanier,[147] dissented and pursued his statutory appraisal remedy.[148] Nonetheless, the appeal was still pursued.

The Georgia Supreme Court easily rejected the plaintiffs' derivative claims since those claims were contrary to well settled law which holds that "a former shareholder in a merged corporation has no standing to maintain a shareholder's derivative action."[149] Georgia Business Corporation Code section 14-2-741 requires the continuation of shareholder status throughout the derivative action.

Determining whether the plaintiffs had standing to assert their direct claims was a more difficult question for the court since it had failed to address the issue in *Thomas* of whether a direct action would be available to a shareholder who suffers a direct injury. Recognizing that a rule was needed, the court looked to Delaware law.[150]

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139. *Id.* at 818, 450 S.E.2d at 815.
140. *Id.*
141. *Id.*
142. *Id.*
143. *Id.*
144. *Id.*
145. *Id.*
146. *Id.*
147. Lanier was the President and CEO of WPP at the time of Farley's initial tender offer, but he did not tender any of his 22,000 shares. *Id.* at 818 n.2, 450 S.E.2d at 815 n.2.
148. *Id.*, 450 S.E.2d at 815. *See* O.C.G.A. § 14-2-1301 (statutory appraisal process).
149. 264 Ga. at 818, 450 S.E.2d at 816 (citing Scattergood v. Perelman, 945 F.2d 618 (3d Cir. 1991); Portnoy v. Kawecki Berylco Indus., Inc., 607 F.2d 765, 767 (7th Cir. 1979)).
150. *Id.* at 819, 450 S.E.2d at 816 (citing *In re* Tri-Star Pictures, Inc., Litigation, 634 A.2d 319 (Del. 1993)). *See* Holland v. Holland Heating & Air Conditioning, Inc., 208 Ga. App. 794, 432 S.E.2d 238 (1993) (the Georgia Court of Appeals applying the Delaware

Under Delaware law, a shareholder may maintain a direct action upon allegations of a "special injury," which is (1) an injury that is separate and distinct from that shared by other shareholders or (2) a wrong involving a contractual right of a shareholder which exists independently of any right of the corporation.[151] The court fully adopted the Delaware test and held that "*outside the context of a close corporation*, a shareholder must be injured in a way which is different from the other shareholders or independently of the corporation to have standing to assert a direct action."[152]

The court found that except for the claim for breach of fiduciary duty, all of the plaintiffs' claims were derivative in nature. On the other hand, the plaintiffs' claim for breach of fiduciary duty to minority shareholders based on failure to seek consummation of the original merger agreement met the newly adopted test for establishing standing to assert a direct claim.[153] The injury asserted was a "special injury" because only the minority shareholders would have received $58 per share after the originally planned merger.[154] The court stated: "Where, as here, it is sufficiently alleged that the effect of the controlling stockholders' self-serving manipulation of the corporate affairs causes a singular economic injury to minority interests alone, the minority have stated a cause of action for 'special' injury . . . ."[155]

While the plaintiffs normally would have had standing to assert their direct claim for breach of fiduciary duty, the court found they could not maintain the claim since "the statutory appraisal remedy is exclusive where the shareholder's objection is essentially a complaint about price."[156] The plaintiffs argued that since their direct claim for breach

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standard).

151. 264 Ga. at 819, 450 S.E.2d at 816.

152. *Id.* (quoting *In re* Tri-Star Pictures, 634 A.2d at 332) (emphasis added).

153. *Id.* The court noted that the director's behavior here was simply violative of their duty to treat the minority shareholders fairly. *See id.* at 820 n.7, 450 S.E.2d at 816 n.7.

154. *Id.* at 819, 450 S.E.2d at 816.

155. *Id.* at 820, 450 S.E.2d at 816 (quoting *In re* Tri-Star Pictures, Inc., Litigation, 634 A.2d 319, 332 (Del. 1993)).

156. *Id.* at 820 n.8, 450 S.E.2d at 816 n.8. The court recognized that there are exceptions to the appraisal remedy which may be invoked when there is a failure to comply with procedural requirements, or when the articles of incorporation or bylaws of the corporation or the vote required to obtain approval of the corporate action was obtained by fraudulent and deceptive means. *Id.* at 820, 450 S.E.2d at 817 (citing O.C.G.A. § 14-2-1302(b); Comment Note to 1989 Amendment)). The court also observed that with respect to the "fraud" exception to the appraisal remedy's exclusivity, "only 'actual fraud,' involving traditional notions of deception, permits collateral attack on the corporate action. Thus, a claim that 'a fiduciary has acted unfairly' cannot be used to litigate valuation issues that are appropriately disposed of in appraisal proceedings.'" *Id.* at 821 n.11, 450 S.E.2d at 817 n.11 (citing and quoting Comment Note to 1989 Amendment).

of fiduciary duty could not be raised in a statutory appraisal proceeding, they should be permitted to pursue this claim independently.[157] To that end, the minority shareholders asserted their claim was unrelated to the "fair value" of their shares.[158] This argument did not withstand scrutiny. The court found the focus of the direct claim for breach of fiduciary duty was that the plaintiffs would have received a higher price per share if the defendants had not breached their fiduciary duty to seek consummation of the merger agreement.[159] As such, a remedy beyond appraisal was unavailable.[160]

Further, despite being foreclosed from asserting a direct action for recovery on grounds of breach of fiduciary duty, in an appraisal the minority shareholder who objected to the merger and dissented would recover the "fair value" of his shares prior to the effectuation of the merger.[161] The court noted that "any facts which shed light on the value of the dissenting shareholders' interests are to be considered in arriving at 'fair value.'"[162]

(ii) *Thomas v. Dickson* Analysis Continues to Apply to Direct Actions for Misappropriation in the Context of Closely-Held Corporations. The *Thomas v. Dickson*[163] rationale still applies in the context of close corporations. In *Dunaway v. Parker*,[164] minority shareholders of a corporation brought alternative direct and derivative claims against the corporation's president, who was also the majority shareholder, for breach of fiduciary duty. The plaintiffs claimed the president had misappropriated corporate funds.[165] Although the defendant did not raise the propriety of bringing a direct claim for misappropriation of funds in the trial court, the court of appeals opted to address the issue on appeal since "interests other than those of [the] defendant [were] at stake, *i.e.*, the rights of corporate creditors and possibly shareholders not parties to this action."[166]

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157. *Id.* at 821, 450 S.E.2d at 817.
158. *Id.*
159. *Id.*
160. *Id.* (citing IRA v. Brenner Cos., 419 S.E.2d 354 (1992)).
161. *Id.*, 450 S.E.2d at 818 (citing O.C.G.A. § 14-2-1301(5)).
162. *Id.* (citing Atlantic States Constr., Inc. v. Beavers, 169 Ga. App. 584, 586, 314 S.E.2d 245 (1984)).
163. 250 Ga. 772, 301 S.E.2d 49 (1983).
164. 215 Ga. App. 841, 453 S.E.2d 43 (1994). *See* discussion *infra* Part I.E.(i) (discussing the breach of fiduciary duty aspect of the case).
165. 215 Ga. App. at 841, 453 S.E.2d at 45-46.
166. *Id.* at 845, 453 S.E.2d at 48.

The Georgia Court of Appeals first set forth the general rule that a shareholder seeking to recover misappropriated corporate funds may only bring a derivative suit.[167] It then quoted *Thomas* to explain the reasons for the rule, namely:

> 1) it prevents a multiplicity of lawsuits by shareholders; 2) it protects corporate creditors by putting the proceeds of the recovery back in the corporation; 3) it protects the interests of all shareholders by increasing the value of their shares, instead of allowing a recovery by one shareholder to prejudice the rights of others not party to the suit; and 4) it adequately compensates the injured shareholder by increasing the value of his shares.[168]

Thus, if a direct recovery would prejudice other parties (*e.g.*, creditors or other shareholders), then a direct recovery should not be allowed.[169] On the other hand, "a direct action is permissible when such prejudice is unlikely and the 'realistic objectives' of avoiding unfair access or distribution of corporate assets (committed or derived as a result of litigation) to one side over the other are more effectively accomplished via a direct action."[170]

The court of appeals found the trial jury below was properly allowed to consider the plaintiffs' alternative claim for direct relief.[171] It reached this conclusion after deciding that creditors of the corporation would not be prejudiced by the plaintiffs' direct recovery, that a multiplicity of lawsuits was unlikely, and that the jury was properly charged as to the alternative claims and apportionment of damages.[172]

D. *Shareholder Derivative Suits*

(i) Shareholder's Right to Pursue Derivative Action Not Terminated When Corporation Sues Group Other Than Directors Accused. In *McKoon v. Jones*,[173] McKoon, a shareholder of The Citizens Bank and of its holding company, Northwest Georgia Financial Corporation, brought a derivative suit against several officers and board members of both corporations, claiming they had wasted corporate assets through negligence and violations of the Georgia Racketeer Influenced

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167. *Id.*
168. *Id.* (quoting Thomas v. Dickson, 250 Ga. 772, 301 S.E.2d 49 (1983)).
169. *Id.*
170. *Id.* at 845-46, 453 S.E.2d at 48 (quoting Thomas v. Dickson, 250 Ga. 772, 301 S.E.2d 49 (1983)).
171. *Id.* at 846, 453 S.E.2d at 49.
172. *Id.*
173. 214 Ga. App. 40, 447 S.E.2d 50 (1994), *cert. granted* December 5, 1994.

and Corrupt Organizations Act ("RICO Act").[174] Several of the defendant-directors moved to dismiss the derivative action on various grounds, one of which was that the shareholders' right to pursue a derivative action terminated when Citizens Bank filed suit against its surety to recover on a fidelity bond after McKoon demanded that action be taken against the defendants.[175] The board members maintained below that the derivative action should be dismissed because the board demonstrated an appropriate reaction to the shareholders' complaint by pursuing any wrongdoing and suing the surety on the fidelity bond.[176] The trial court granted the defendant's motion solely on that ground.[177]

The court's decision was based on Comment 4 to Georgia Business Corporation Code section 14-2-742, which reads:

> There is no obligation on the part of the corporation to respond to the demand. However, if the corporation, after receiving the demand, decides to institute litigation or, after a derivative proceeding has commenced, decides to assume control of the litigation, the shareholder's right to commence or control the proceeding ends unless it can be shown that the corporation will not adequately pursue the matter.[178]

McKoon contended on appeal that the trial court erred in deciding the Comment precluded her from maintaining the derivative suit.[179] The court of appeals agreed and reversed the trial court.[180] The court restated the rule that the comments to the Georgia Business Corporation Code were not "'a statement of legislative intention by the General Assembly of Georgia nor do they have the force of statutory law.'"[181] But, as the court recognized, the comments may serve as persuasive authority.[182]

The court further determined that even if Comment 4 did apply, the directors' action against a surety for losses resulting from dishonest or fraudulent acts committed by the bank's employees was not the same as a response against the officers and directors for violation of duties they

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174. *Id.* at 40, 447 S.E.2d at 50-51. Georgia's RICO Act is codified at O.C.G.A. § 16-14-1 (1992).
175. 214 Ga. App. at 40, 447 S.E.2d at 51.
176. *Id.*
177. *Id.*
178. O.C.G.A. § 14-2-742 cmt. 4 (1994).
179. 214 Ga. App. at 40, 447 S.E.2d at 51.
180. *Id.*
181. *Id.* at 41, 447 S.E.2d at 51 (quoting O.C.G.A., Title 14, Chapter 2 (1989), p. 11, and also referencing O.C.G.A., Title 14, Chapter 2 (Supp. 1993, p. 1)). *See* Service Corp. Int'l v. H.M. Patterson & Sons, Inc. 263 Ga. 412, 415, 434 S.E.2d 455, 458 (1993).
182. 214 Ga. App. at 41, 447 S.E.2d at 51.

owed the corporation and whether these officers and directors were liable for damages for the losses of the corporation.[183] Finally, the court stated that its interpretation of Comment 4 does not prohibit the commencement of a shareholder's derivative action once the corporation files suit, without regard to the type of suit filed or the defendants named by the corporation.[184] The court did not believe it was the legislature's intention to allow officers and directors who commit fraud or negligently perform their duties to avoid a derivative suit by filing an action against the corporation's surety.[185]

(ii) Implied Actual Authority Vested in CEO of Close Corporation through Acquiescence of Minority Shareholders. In *Morris v. Williams*,[186] minority shareholders brought a derivative action against a closely-held corporation's chief executive officer ("CEO"), who was also the majority shareholder, asserting the CEO abused and commingled corporate funds.[187] The trial court entered judgment on a jury verdict in favor of the CEO.[188] The minority shareholders appealed, arguing the trial court erred in charging the jury that "'those powers inherent in the office of president [of the corporation include] . . . the apparent powers which the corporation permits him to exercise without objection.'"[189] The court of appeals essentially held that the minority shareholders were estopped from raising a breach of fiduciary duty claim against the majority shareholder-CEO because of their acquiescence to such acts in the past through failure to object to them.

On appeal, the CEO contended the jury charge was a proper statement of the law as promulgated by the Georgia Supreme Court in *Garmany v. Lawton*.[190] The court said *Garmany* stood for the proposition that:

> [W]hen there is no board of directors or the directors are inactive and the executive officer discharges its duties, and the shareholders by direct act or acquiescence invest the executive officer with the powers and functions of the board of directors as a continuous and permanent arrangement, his acts are valid as "against the corporation, or a creditor," even though they may not have been authorized by formal vote.[191]

183. *Id.*
184. *Id.* at 42, 447 S.E.2d at 52.
185. *Id.*
186. 214 Ga. App. 526, 448 S.E.2d 267 (1994).
187. *Id.* at 526, 448 S.E.2d at 268.
188. *Id.*
189. *Id.* at 527, 448 S.E.2d at 268.
190. 124 Ga. 876(1), 53 S.E. 669 (1906).
191. 214 Ga. App. at 527, 448 S.E.2d at 268-69.

Importantly, *Garmany* did not state the concept of "apparent authority" because such authority arises only when a principal leads a third party to reasonably believe the agent has authority, even though the agent does not.[192] Consequently, the trial court's charge to the jury which referred to "apparent powers" was imprecise, since, as between the agent-CEO and the principal-corporation, the CEO could not have had apparent authority.[193] Instead, the CEO had only "such actual, implied, or inherent powers as the law [gave] him or may have arisen out of special circumstances arising out of the conduct of the [principal-corporation]."[194] The court of appeals found, however, that the incorrect reference to apparent powers was "harmless inadvertence" because the trial court had otherwise stated the law correctly during the case.[195]

The court then found the trial court did not err in charging the jury that the CEO could have had authority by the acquiescence of the minority shareholders.[196] Evidence had been presented that the minority shareholders failed to object to the CEO's alleged abuse and commingling of corporate funds.[197] Moreover, the court noted: (1) the corporation leased and maintained vehicles for the minority shareholders as well as the CEO; (2) the parties regularly met to discuss corporate business; (3) the minority shareholders were aware of expenditures and had access to the corporate checkbook; and (4) the minority shareholders had received loans from the corporation and had received benefits similar to those the CEO gave himself.[198] Hence, the trial court's judgment was affirmed.

E. Breach of Fiduciary Duty

(i) CEO Breaches Fiduciary Duty in Asset Sale Transaction and Loses Statutory Immunity from Liability by Failing to Disclose Conflict of Interest. In *Dunaway v. Parker*,[199] minority shareholders of a close corporation sued the corporation's president, who was also

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192. *Id.*, 448 S.E.2d at 269.
193. *Id.*
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.*
198. *Id.* at 527-28, 448 S.E.2d at 269.
199. 215 Ga. App. 841, 453 S.E.2d 43 (1994). This case was also discussed in Part I.C.(ii)., *supra*, insofar as it addresses the propriety of direct actions for misappropriation of corporate funds in the context of closely-held corporations.

the majority shareholder, for breach of fiduciary duty in connection with the asset sale of the corporation to a competitor.[200] The Georgia Court of Appeals affirmed the trial court's judgment entered on a jury verdict in favor of the plaintiffs.[201]

The appeal stemmed from a long-standing dispute between the plaintiffs, minority shareholders of Dunaway Drug Stores, Inc. ("Dunaway Drugs"), and the corporation's CEO, William B. Dunaway.[202] The plaintiffs alleged that the defendant-chief executive officer breached his fiduciary duties by furthering his own interests, at the expense of the corporation, while negotiating and closing the asset sale of Dunaway Drugs to Jack Eckerd Corporation ("Eckerd Drugs").[203] The specific allegations were that the defendant: (1) improperly allocated $300,000 and a company car to himself in exchange for a covenant not to compete with Eckerd Drugs for three years; (2) improperly amended two corporate leases (wherein the defendant was the landlord) prior to negotiating the asset sale thereby devaluing Dunaway Drugs' leasehold interests; and (3) engaged in numerous instances of self-dealing, usurped corporate opportunities and misappropriated corporate funds.[204]

The defendant flatly denied the allegations, maintaining the sale was fair to Dunaway Drugs and its shareholders.[205] He further argued that the sale was unanimously approved by Dunaway Drugs' shareholders and by its board of directors, which included two of the plaintiffs and three members who had no financial stake in the transaction.[206] The defendant-chief executive officer claimed that such approval, coupled with the fact that two of the plaintiffs abstained from the vote, estopped the plaintiffs from asserting their claim.[207]

At trial below, the court found the defendant had acted covertly on a number of occasions to benefit himself at the expense of Dunaway Drugs' bottom line and had breached his fiduciary duties to the corporation and its shareholders.[208] The court also found the defendant did not disclose to the minority shareholders or other corporate directors his conflicts of interest in the transaction. Thus, under Georgia Business Corporation Code sections 14-2-860(4), 14-2-861(b)(1) and 14-2-862(a), the defendant, as an officer of the corporation, was not entitled to statutory immunity

200. 215 Ga. App. at 841, 453 S.E.2d at 45.
201. *Id.* at 850, 453 S.E.2d at 52.
202. *Id.* at 841, 453 S.E.2d at 45.
203. *Id.*
204. *Id.*, 453 S.E.2d at 45-46.
205. *Id.*, 453 S.E.2d at 46.
206. *Id.*
207. *Id.*
208. *Id.* at 841-50, 453 S.E.2d at 46-52.

from liability because he failed to make the required conflicts disclosure.[209]

The court also concluded that those plaintiffs who abstained from the Board vote on the transaction were not estopped from pursuing their claim.[210] Acquiescence in or ratification of an act must be voluntary.[211] Here, the defendant failed to fully disclose material facts about the transaction. Therefore, the plaintiffs were not estopped from maintaining their claim on grounds that the plaintiffs assented to the transactions.[212]

(ii) No Fiduciary Duty Owed to Purchaser of Business. The case, *Mail & Media, Inc. v. Rotenberry*,[213] had its beginnings in the 1990 sale by Mr. Rotenberry of his wholly-owned corporation, Mail & Media, Inc. to Sullivan Graphics, Inc.[214] In connection with the sale, Mr. and Mrs. Rotenberry entered into a noncompetition agreement with Mail & Media which provided for the payment of $3 million.[215] Mr. Rotenberry also entered into an employment agreement with Mail & Media which provided for an initial three-year term at an annual salary of $300,000.[216] In May 1992, Mr. Rotenberry died.[217] Mail & Media subsequently refused to make any payments to Mrs. Rotenberry, asserting that its obligations under the noncompete and employment agreements had ceased.[218] Mrs. Rotenberry filed suit against Mail & Media for breach of the agreements.[219] Mail & Media counterclaimed, alleging breach of fiduciary duty by the Rotenberrys while they were officers of Mail & Media.[220] The trial court entered judgment for Mrs. Rotenberry, and Mail & Media appealed.[221]

Mail & Media argued the lower court erred by finding in favor of Mrs. Rotenberry with respect to the noncompete agreement because the agreement was a personal service contract and, therefore, all of its

209. *Id.* at 847, 453 S.E.2d at 49-50.
210. *Id.* at 848, 453 S.E.2d at 50.
211. *Id.*
212. *Id.*
213. 213 Ga. App. 826, 446 S.E.2d 517 (1994).
214. The company still operated under the name of Mail & Media after the sale to Sullivan Graphics.
215. *Id.* at 826, 446 S.E.2d at 518.
216. *Id.*
217. *Id.*
218. *Id.*
219. *Id.*
220. *Id.*
221. *Id.*

obligations under the agreement ended after Mr. Rotenberry died.[222] After noting the question presented was one of first impression, the court adopted the rule that a noncompetition agreement standing alone, with no affirmative promises, is not a personal services contract, and, therefore, does not terminate upon the death of the promisor.[223] The noncompete agreement contained no affirmative promises in this case.[224] Consequently, Mail & Media's obligation did not end upon Mr. Rotenberry's death.[225]

Mail & Media then argued the trial court erred in concluding that Mrs. Rotenberry was entitled to payment under the employment agreement as executrix of Mr. Rotenberry's estate as provided in the agreement.[226] Mail & Media contended that it was relieved of its obligation because the Rotenberrys breached their fiduciary duties to the company.[227] The principal allegation was that before Mr. Rotenberry sold his company to Mail & Media, he jeopardized the continued relationship of the company with its largest customer, Bi-Lo, Inc., by setting up a reserve account for Bi-Lo.[228] Mail & Media argued that certain payments were made from that account for "unusual" expenses, including the personal expenses of Bi-Lo's advertising director, which led to the loss of the Bi-Lo account.[229] Mail & Media further contended that the Rotenberrys breached their fiduciary duties to Mail & Media by making unauthorized payments through the reserve account and by failing to disclose the existence of the account both prior to the sale of the company and afterwards while Mr. Rotenberry was acting President.[230]

The court held that Mr. Rotenberry did not owe a fiduciary duty to the buyer of his company during the time the parties were negotiating the sale of the company because, under O.C.G.A. section 23-2-58, a fiduciary or confidential relationship did not exist between the parties.[231] That section provides that a fiduciary or confidential relationship arises where "one party is so situated as to exercise a controlling influence over the

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222. *Id.*
223. *Id.* at 827, 446 S.E.2d at 519. The court adopted the rule of Sanfillippo v. Oehler, 869 S.W.2d 159 (Mo. App. 1993) and TPS Freight Distrib. v. Texas Commerce Bank—Dallas, 788 S.W.2d 456 (Tex. App. 1990). *Id.*
224. 213 Ga. App. at 826, 446 S.E.2d at 519.
225. *Id.* at 827, 446 S.E.2d at 519.
226. *Id.* at 828, 446 S.E.2d at 519.
227. *Id.*
228. *Id.*
229. *Id.*
230. *Id.*, 446 S.E.2d at 519-20.
231. *Id.*, 446 S.E.2d at 520.

will, conduct and interest of another or where, from a similar relationship of mutual confidence, the law requires the utmost good faith, such as the relationship between partners, principal and agent, etc."[232] The court also noted that, given the right set of facts, a confidential relationship may exist between businessmen.[233] But the mere fact that one party to a deal trusts and confides in another does not establish a fiduciary or confidential relationship.[234] The court observed that the employees of the purchaser were informed of the reserve account, but the purchaser did not exercise due diligence in conducting further inquiry.[235]

F. Dissenter's Rights & Exclusivity of Appraisal Remedy

See supra text accompanying notes 133-162.

G. Stand Alone Noncompetition Agreement Ancillary to the Sale of a Business is Not Personal Services Contract

See supra text accompanying notes 213-225.

H. Authority of the Comments to the Georgia Business Corporation Code.

See supra text accompanying notes 173-182.

I. Legislative Changes

During the 1995 session, the legislature made several amendments to the Georgia Business Corporation Code.[236]

(i) Voting Entitlement of Shares. Former law provided that with certain exceptions each outstanding share is entitled to one vote at a shareholders' meeting.[237] A 1995 amendment excepted shares of preferred stock issued before July 1, 1989, from the above rule.[238] The amendment also provided that an amendment or restatement to the articles of incorporation made on or after July 1, 1989 will not be deemed to have granted voting rights to preferred shares unless the amendment gave the holders of preferred stock voting rights, the

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232. O.C.G.A. § 23-2-58 (1982).
233. 213 Ga. App. at 828, 446 S.E.2d at 520.
234. *Id.* at 828-29, 446 S.E.2d at 520.
235. *Id.* at 829, 446 S.E.2d at 520.
236. O.C.G.A. §§ 14-2-101 (1994 & Supp. 1995).
237. *Id.* § 14-2-721 (1994).
238. *Id.* § 14-2-721(a) (Supp. 1995).

shareholders were given appropriate notice of the amendment, and a shareholder vote approved the restatement or amendment.[239]

(ii) Resignation and Removal of Officers. The 1995 amendment to O.C.G.A. section 14-2-843 provides that unless otherwise stated in the bylaws, any officer appointed by an authorized officer[240] may be removed at any time with or without cause by any officer having authority to appoint such officer.[241]

(iii) Reinstatement Following Administrative Dissolution. Under the 1995 amendments to Article 14, an administratively dissolved corporation now has five years from the effective date of dissolution to apply to the Secretary of State for reinstatement.[242] Prior law only allowed such corporations to apply for reinstatement within two years from the date of dissolution.[243] There were additional ministerial changes to section 14-2-1422.

(iv) Corporate Name. A minor addition to the "corporate name" provision was enacted, which requires a corporate name to be distinguishable from the name of a limited liability company formed or authorized to transact business in Georgia.[244]

(v) Authority of Foreign Corporation to Transact Business. Some changes were made with respect to activities considered "transacting business" within Georgia. If a foreign corporation is "transacting business" within the state, then it must qualify by procuring a certificate of authority from the Secretary of State before doing business.[245] Under the 1995 amendments, the fact that a foreign corporation owns or controls another entity in Georgia does not, without more, constitute "transacting business" and, therefore, qualification is not necessary.[246] A provision related to acting as a general partner of a limited partnership was deleted.[247]

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239. *Id.*

240. *See* O.C.G.A. § 14-2-840(b) (1994) ("A duly appointed officer may appoint one or more officers or assistant officers if authorized by the bylaws or the board of directors.").

241. O.C.G.A. § 14-2-843 (Supp. 1995).

242. *Id.* § 14-2-1422(a).

243. *Id.*

244. *Id.* §§ 14-2-401(b)(6) (Supp. 1995), 14-2-403 (1994).

245. *Id.* § 14-2-1501(a) (1994).

246. *Id.* § 14-2-1501(b)(13) (Supp. 1995).

247. *Id.* § 14-2-1501(b)(14).

II. LIMITED LIABILITY COMPANIES

During the survey period, the Georgia Limited Liability Company Act ("LLC Act") was amended in several respects.[248] Most of the amendments were simple textual changes and need not be addressed further. Several changes do, however, deserve attention.

A. *Duties*

Prior to its amendment, the "Duties" provision of the LLC Act[249] imposed no duties on non-manager members toward the LLC or its other members solely by reason of being a member.[250] Under the amended provision, the articles of organization or a written operating agreement may impose duties on its non-manager members *qua* members.[251] Thus, the prior law's provision is merely a default provision.

B. *Dissolution*

The dissolution provision contained in Article 6 of the LLC Act was changed to exclude the removal of a member, the assignment by a member of his entire LLC interest, and the voluntary disassociation of a member from events of disassociation for purposes of determining when an LLC is dissolved.[252]

C. *Foreign LLC—Transacting Business*

The amendments added an additional activity which, if taken alone, would not rise to the level of "transacting business," namely, "[o]wning, without more, real or personal property."[253] Further, prior law's exclusion for the activity of owning or controlling another entity organized under Georgia law or transacting business in Georgia was solidified by inserting the phrase "directly or indirectly" after "owning."[254]

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248. *Id.* §§ 14-11-100 to 1109 (1994 & Supp. 1995). For a thorough discussion of limited liability companies in Georgia see ROBERT P. BRYANT, PATRICK G. JONES & CHARLES R. BEAUDROT, JR., GEORGIA LLC/LLP HANDBOOK (1995) [hereinafter GEORGIA LLC/LLP HANDBOOK].

249. O.C.G.A. § 14-11-305 (1994).

250. *Id.* § 14-11-305(1).

251. *Id.* § 14-11-305(1) (Supp. 1995).

252. *Id.* § 14-11-602(4). *See* O.C.G.A. §§ 14-11-601(a), 14-11-502(6) (1994).

253. O.C.G.A. § 14-11-702(b)(9) (Supp. 1995).

254. *Id.* § 14-11-702(13).

D. Mergers

Article 9 on mergers was also amended in several respects. LLCs may now merge with any business entity, including corporations, as long as the statute governing the other entity does not prohibit the merger.[255] The remainder of the Article was amended to reflect this change. Conforming changes were made to the limited partnership provisions of the Georgia Limited Liability Company Act to expressly allow mergers between LLCs and limited partnerships.[256]

LLCs may merge with Georgia corporations if the corporation is the surviving entity since the definition of "joint-stock association"[257] should be read to include LLCs.[258] Another option for accomplishing the same merger (i.e., corporation surviving) is to merge the LLC into a foreign corporation, then merge the foreign corporation into the Georgia corporation.[259] On the other hand, if the objective is to have the Georgia LLC be the surviving entity, then a Georgia corporation could merge into a foreign corporation, then the foreign corporation could merge into the Georgia LLC.[260]

Lastly, an additional paragraph was added to the provision on the effects of merger to provide that if a foreign business entity which is authorized to do business in Georgia merges with an LLC and is the disappearing entity, then such LLC does not need to obtain a certificate of withdrawal from the Secretary of State.[261]

III. PARTNERSHIPS

A. Court Authorized to Order that a Limited Partner's Charged Interest be Foreclosed by Judicial Sale and May Be Purchased by Judgment Creditor

In *Nigri v. Lotz*,[262] a judgment creditor, Nigri, filed a Uniform Limited Partnership Act section 14-9A-52 petition with the trial court asking the court (1) to charge the judgment debtor, Lotz's, partnership interest in two limited partnerships with payment of the unsatisfied

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255. *See* O.C.G.A. § 14-11-901(a) (Supp. 1995); *see also* GEORGIA LLC/LLP HANDBOOK, *supra* note 248, at 33.

256. GEORGIA LLC/LLP HANDBOOK, *supra* note 248, at 33.

257. O.C.G.A. § 14-2-1109(a)(1) (1994) (defining "joint-stock association").

258. GEORGIA LLC/LLP HANDBOOK, *supra* note 248, at 33.

259. *Id.*

260. *Id.*

261. O.C.G.A. § 14-11-901(d) (Supp. 1995).

262. 216 Ga. App. 204, 453 S.E.2d 780 (1995).

amount of the judgment and (2) to order Lotz to transfer his partnership interests to Nigri in partial satisfaction of the judgment debt.[263] The trial court entered a charging order against Lotz's partnership interests, but rejected Nigri's request to transfer Lotz's partnership interests directly to him.[264] In Nigri's appeal, he asserted that the trial court erred by not granting an order to transfer the partnership interests.[265] The court of appeals found the trial court did not err in refusing to order the transfer.[266]

The court explained that in aid of a charging order courts are authorized to "appoint a receiver and make all other orders, directions, and inquiries which the circumstances of the case require."[267] The court went on to hold that in connection with a charging order, a court "is authorized to order that a *limited partner's* charged interest be foreclosed by judicial sale at which the partnership interest may be purchased by the judgment creditor or a third party."[268] But such action is at the discretion of the court issuing the charging order.[269]

Nonetheless, Nigri did not seek a foreclosure sale. Instead, he had asked the trial court to affix a value to the charged partnership interests and then to transfer the interests to him in partial satisfaction of the judgment debt.[270] The court of appeals noted further that the trial court was right, but for the wrong reasons. The trial court had erroneously concluded that such a transfer would effectively substitute Nigri as a limited partner.[271]

The court of appeals is certainly correct in this ruling. To have concluded otherwise would have given a judgment creditor the power of limited partner substitution, which should always be reserved for the general partner of a limited partnership.

B. Execution of Written Instrument in Furtherance of Business May Not Bind Partner

In *Willard v. Stewart Title Guaranty Co.*,[272] the Georgia Supreme Court had to decide whether two individuals who formed a corporation to build homes were partners and, if so, whether a note executed by one

263. *Id.* at 204, 453 S.E.2d at 781.
264. *Id.*
265. *Id.*
266. *Id.* at 207, 453 S.E.2d at 784.
267. *Id.* at 205, 453 S.E.2d at 782 (quoting O.C.G.A. § 14-9A-52(a)).
268. *Id.* (emphasis added).
269. *Id.* at 206, 453 S.E.2d at 783.
270. *Id.* at 207, 453 S.E.2d at 783-84.
271. *Id.*, 453 S.E.2d at 784.
272. 264 Ga. 555, 448 S.E.2d 696 (1994).

of them, Coburn, in his individual capacity would bind the other partner, Willard, given the execution of the note furthered the goals of the partnership, but there was no evidence the maker of the note was ever authorized to bind his partner.[273] The Court reversed the court of appeals and held that Coburn's execution of the note did not bind Willard even though it furthered their business.[274]

The facts indicate that Coburn and Willard formed a corporation, OBU Construction & Development, Inc. ("OBU Construction"), to operate a home construction business.[275] The corporation obtained a construction loan, which both Coburn and Willard guaranteed, and used the funds to build a house.[276] The house had not yet been sold by the time the loan became due.[277] So Coburn borrowed money from a bank, executed a note naming the bank as payee, and bought the house.[278] Although the loan was executed in Coburn's name, Willard actually arranged for the loan.[279] Further, Willard completed the loan application, paid for an appraisal of the property, reviewed the closing documents, and attended the closing.[280] OBU Construction also reimbursed Coburn for the down payment and made a couple of payments on the note.[281] When Coburn later sold the house, Willard shared in the sale proceeds.[282]

Coburn later became liable on the note, which should have been paid off by another financial institution.[283] The plaintiff alleged that Coburn and Willard were jointly and severally liable on the note as partners, even though the note was executed individually by Coburn.[284]

The Georgia Supreme Court reversed the court of appeals and held that Willard was not liable on the note.[285] The court stated that even assuming Coburn and Willard were partners rather than just shareholders in OBU Construction, the record on appeal did not support finding Willard liable on the note.[286] The court commented that Willard's

273. *Id.* at 555, 448 S.E.2d at 696.
274. *Id.*
275. Stewart Title Guar. Co. v. Coburn, 211 Ga. App. 357, 439 S.E.2d 69 (1993).
276. *Id.* at 359, 439 S.E.2d at 71.
277. *Id.*
278. *Id.*
279. *Id.*
280. *Id.*
281. *Id.*
282. *Id.*
283. *Id.* at 359-60, 439 S.E.2d at 71-72.
284. 264 Ga. at 555, 448 S.E.2d at 697.
285. *Id.* at 556, 448 S.E.2d at 697.
286. *Id.*

name did not appear on any of the loan documents.[287] The court rejected the court of appeals' contention that Willard would be liable on the note even though he did not sign it because "'the note was executed in furtherance of the goals of a partnership between Coburn and Willard . . . .'"[288] The Georgia Supreme Court found that *in the context of a written instrument* such an assertion reads the Uniform Partnership Act too broadly.[289]

Even if they were partners, said the Court, liability could not attach to Willard under the above section because the note was not executed in the partnership's name, nor did Willard give authorization to be bound.[290] Thus, the general rule of O.C.G.A. section 11-3-401(1) applied.[291] That section provides that "'[n]o person is liable on an instrument unless his signature appears thereon.'"[292]

C. Duties of a Limited Partnership and its Limited Partners When They Wrongfully Receive Money or Property

In *Adler v. Hertling*,[293] Hertling, a limited partner in Sahara Club/Desert Village Associates Limited Partnership ("Sahara Club"), brought suit individually and on behalf of Sahara Club against Stone Harbor Limited Partnership ("Stone Harbor") and its individual limited partners for statutory conversion of partnership funds.[294]

Sahara Club was formed to own and operate Regency Park apartments in Atlanta.[295] Stone Harbor was formed to own and operate certain Stone Harbor townhouses in Atlanta.[296] Stone Harbor and Sahara Club had a common general partner, Jules Aaronson.[297] Regency Park apartments and Stone Harbor townhouses were managed by Jason Property Management Company ("Jason").[298] Aaronson also had a financial interest in Jason.[299]

In 1987, Sahara Club refinanced its Regency Park property and deposited the $2.8 million proceeds it received from the refinancing into

287. *Id.*
288. *Id.* at 555, 448 S.E.2d at 697.
289. *Id. See* O.C.G.A. § 14-8-9(1)-(2) (1994).
290. 264 Ga. at 555, 448 S.E.2d at 697.
291. *Id.* at 556, 448 S.E.2d at 697.
292. *Id.*
293. 215 Ga. App. 769, 451 S.E.2d 91 (1994).
294. *Id.* at 769, 451 S.E.2d at 93.
295. *Id.*
296. *Id.*
297. *Id.*, 451 S.E.2d at 94.
298. *Id.*
299. *Id.*

Sahara Club's operating account.[300] Several days later over $1.8 million of the proceeds were transferred from the Sahara Club account to the "Jason Property Management Trust Account" ("Jason Account").[301] Jason used this account to aggregate the funds of the entities it managed, make overnight investments with those funds, and return the funds to the entities the next day with interest.[302]

Jason and a number of the entities it managed, including Sahara Club, entered into an "Investo-Matic Agreement" with a bank, which provided: "'Company and Owners agree that all funds in the various accounts of the Communities *are to be held by Company in escrow for the benefit only of the Community from which the funds were derived* . . . .'"[303] This agreement was signed by Jason's president, by a representative of the bank, and by Aaronson, as a general partner of various entities, including Sahara Club.[304]

On the day the funds were transferred from Sahara Club's operating account to the Jason Account, Aaronson, as general partner of Sahara Club, effectuated the distribution of approximately $2 million from the Jason Account to Stone Harbor's limited partners.[305] These distributions were made to the limited partners on account of their contributions to Stone Harbor.[306] The trial court found that at least $1.3 million of the $2 million transferred to Stone Harbor and its limited partners belonged to Sahara Club.[307] This prompted the suit by Hertling on behalf of Sahara Club against Stone Harbor and its limited partners. The trial court entered judgment in favor of Hertling and an appeal followed.[308]

The court of appeals found that Hertling's statutory conversion claim against Stone Harbor under Uniform Partnership Act contained in O.C.G.A. section 14-8-14 had merit.[309] That section reads:

> The partnership is bound to make good the loss:
> (1) Where one partner acting within the scope of his apparent authority receives money or property of a third person and misapplies it;
> and

300. *Id.* at 769-70, 451 S.E.2d at 94.
301. *Id.* at 770, 451 S.E.2d at 94.
302. *Id.*
303. *Id.*
304. *Id.*
305. *Id.*
306. *Id.*
307. *Id.*
308. *Id.* at 770-71, 451 S.E.2d at 94.
309. *Id.* at 775, 451 S.E.2d at 98.

(2) Where the partnership in the course of its business receives money or property of a third person and the money or property so received is misapplied by any partner while it is in the custody of the partnership.[310]

Aaronson gave testimony that while acting as general partner of Stone Harbor, he caused Sahara Club funds to be transferred to the limited partners of Stone Harbor because of their contributions to that partnership.[311] This, the court noted, violated the terms of the Investo-Matic Agreement and Sahara Club's partnership agreement and, therefore, was a misapplication of funds, making Stone Harbor liable to Sahara Club for conversion under the statute.[312] The court also found Stone Harbor's limited partners severally liable to Sahara Club for conversion due to the operation of the Uniform Limited Partnership Act section 14-9A-48, which states that "[a] limited partner holds as trustee for the partnership: . . . [m]oney or other property wrongfully paid or conveyed to him on account of his contribution."[313]

D. *Implied Duty of Good Faith in Partnership Agreement*

Howard v. Hammond,[314] concerned a dispute over the dissolution of an insurance agency partnership in which the plaintiff, Hammond, alleged counts of breach of contract and wrongful dissolution.[315] The lower court entered judgment on a jury verdict for the plaintiff and the defendant, Howard, appealed.[316]

The evidence in the case demonstrated that despite an at-will termination provision in the partnership agreement, Howard wrongfully kept for herself all the assets and business opportunities of the partnership and physically excluded Hammond from the partnership's place of business during the course of dissolving the partnership.[317] Uniform Limited Partnership Act section 23-2-58 holds that "partners owe a duty to act in 'utmost good faith' with regard to each other."[318] This statutory mandate was in existence when the parties entered into the partnership agreement.[319] Consequently, the partnership agree-

310. O.C.G.A. § 14-8-14 (1994).
311. 215 Ga. App. at 775, 451 S.E.2d at 98.
312. *Id.*
313. O.C.G.A. § 14-9A-48(b)(2) (1994).
314. 216 Ga. App. 703, 455 S.E.2d 390 (1995).
315. *Id.* at 703, 455 S.E.2d at 390-91.
316. *Id.* at 705, 455 S.E.2d at 393.
317. *Id.*
318. *Id.* at 706-07, 455 S.E.2d at 393.
319. *Id.* at 706, 455 S.E.2d at 393.

ment contained an implied duty of good faith, which Howard breached.[320] Importantly, the court of appeals found it was not error to permit recovery for both the breach of contract claim and the wrongful dissolution claim.[321]

E. Legislative Changes

(i) The LLP Amendments. In 1995, the legislature amended Georgia's general partnership statute[322] to authorize Georgia general partnerships to elect limited liability partnership ("LLP") status.[323] The LLP Amendments became effective on July 1, 1995.

The main characteristic of a Georgia LLP is that a partner does not assume personal liability for either partnership debts or the debts of other partners.[324] As a result, with respect to the limited liability issues applied to partnerships, an LLP may be preferred over a general partnership and also over a limited partnership, since a limited partnership requires at least one general partner to assume personal liability.

In any event, since only about half of the states have adopted LLP legislation, a Georgia LLP that does business out-of-state should first see if the foreign jurisdiction has an LLP statute.[325] If there is no LLP statue enacted in that foreign jurisdiction, then there is some risk the foreign jurisdiction will not recognize the added protection that LLP status affords partners in Georgia.[326]

It is not difficult under the Georgia statutes for a general partnership to elect to be an LLP. A general partnership must record a "limited liability partnership election" in the office of the clerk of the superior court of any county in which the partnership has an office. LLP status is then conferred on the general partnership.[327] The clerk may collect a fee in the amount of the fee then allowed for the filing of statements of partnership.[328] The election must state: (1) the name of the partnership; (2) the nature of its business; (3) that the partnership elects LLP

320. *Id.* at 707, 455 S.E.2d at 393.

321. *Id.*

322. O.C.G.A. Title 14, Chapter 8 (1982).

323. *See* GEORGIA LLC/LLP HANDBOOK, *supra* note 248, at Part 2, Chapter 1 (discussing Georgia limited liability partnerships).

324. O.C.G.A. § 14-8-15(b) (Supp. 1995).

325. GEORGIA LLC/LLP HANDBOOK, *supra* note 248, at 42.

326. *Id.*

327. O.C.G.A. § 14-8-62(a) (Supp. 1995).

328. *Id.*

status; and (4) that the election has been duly authorized.[329] The name of the LLP must include the words "limited liability partnership," or the abbreviation "L.L.P.," or the designation "LLP."[330] Moreover, the word "limited" may be abbreviated as "ltd."[331]

Conforming changes were made throughout Chapter 8 of the O.C.G.A. to conform with the addition of the LLP entity. Further, the 1995 amendments deleted the requirement that foreign limited liability partnerships have capital accounts or carry liability insurance.[332]

(ii) Foreign Limited Partnerships—Activities not Constituting Transacting Business. Two additional activities were added by the 1995 amendments which, if taken alone, would not rise to the level of "transacting business." These are: (1) owning, without more, real or personal property in Georgia; and (2) directly or indirectly owning or controlling another entity organized under the laws of Georgia or transacting business in Georgia.[333]

(iii) Limited Partnerships—Indemnification of Partners or Other Persons; Expansion, Restriction, or Elimination of Partners' Duties and Liabilities in Partnership Agreement. The Georgia Revised Uniform Limited Partnership Act was amended to include a provision which allows partners in a limited partnership to expand, restrict or eliminate the partners' liabilities and duties, including fiduciary duties, in the partnership agreement.[334] A partner's liability to the partnership and other partners cannot, however, be limited in the case of intentional misconduct or a knowing violation of the law or in any transaction for which the partner received a personal benefit in violation of any provision of the partnership agreement.[335] The amendments also state that a partner in a limited partnership shall have no liability to the partnership or other partners if he relied in good faith on a provision of the partnership agreement.[336]

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329. *Id.* § 14-8-62(a)(1)-(4) (Supp. 1994).
330. *Id.* § 14-8-63 (Supp. 1995).
331. *Id.*
332. *Id.* § 14-8-44(a).
333. *Id.* § 14-9-902(b)(9), (13).
334. *Id.* § 14-9-108(b)(1).
335. *Id.*
336. *Id.* § 14-9-108(b)(2).

IV. SECURITIES

A. Stock in Closely-Held Corporation is "Security" for Purposes of UCC's Statute of Frauds for Investment Securities; Oral Agreement By Employer to Transfer Corporate Stock to Employee Deemed not a "Sale" for Statute of Frauds Provision

In *Thompson v. Kohl*,[337] the Georgia Court of Appeals held that the stock of a closely-held corporation was a "security" within the meaning of the Uniform Commercial Code, Article 8 on Investment Securities.[338] Thus, the "sale" of closely-held stock is subject to Article 8's statute of frauds provision.[339] The court also held, however, that an employer's oral agreement to transfer corporate stock to an employee for non-monetary consideration was not a "sale" for purposes of Article 8's statute of frauds and, therefore, the agreement did not need to meet the provision's requirements to be enforceable.[340]

The case stemmed from allegations by a fired employee that his employer had verbally promised to transfer ten percent of the stock of the employer's closely-held company as compensation due under the terms of an otherwise written employment agreement.[341] If the statute of frauds provision applied, then the oral agreement would have been unenforceable absent an exclusion. The court maintained that prior Georgia cases had failed to consider the question of whether shares of stock in a closely-held corporation were "securities" under Article 8.[342]

337. 216 Ga. App. 148, 453 S.E.2d 485 (1994).

338. *Id.* at 149, 453 S.E.2d at 487. Georgia's Uniform Commercial Code—Investment Securities is codified at O.C.G.A. § 11-8-101 (1994).

339. The statute of frauds provision for Georgia's Uniform Commercial Code—Investment Securities provides that a contract for the *sale* of securities is not enforceable unless: (1) there is some signed writing signed by the party (or his authorized agent or broker) against whom enforcement is sought sufficient to indicate that a contract has been made for the sale of a stated quantity of described securities at a stated price; (2) delivery of a certificated security or transfer instruction has been accepted, or transfer of an uncertificated security has been registered and the transferee has failed to timely object, or payment has been made; (3) within a reasonable time a writing in confirmation of the sale or purchase has been received by the party against whom enforcement is sought and the recipient does not object within 10 days after its receipt; or (4) the party against whom enforcement is sought admits in his testimony, pleadings, or otherwise in court that a contract was made for a stated quantity of described securities at a defined or stated price. O.C.G.A. § 11-08-319 (1994). This provision only applies to "securities." *Id.*

340. 216 Ga. App. at 151, 453 S.E.2d at 488.

341. *Id.* at 148, 453 S.E.2d at 486.

342. *Id.* at 150, 453 S.E.2d at 487; *but see* Cohen v. William Goldberg & Co., *infra* note 351.

Citing the official comment to the UCC's definitional section in Article 8, the court easily decided that such stock was a "security."[343] In fact, the official comment states that shares of closely-held stock are intended to be included within the definition.[344] Thus, without more, the statute of frauds would have applied to the oral agreement and the offer of the securities would have been required to be in writing in order to be enforceable.

The employee argued that Article 8's statute of frauds did not apply to an oral contract under which an employer had agreed to transfer corporate stock to an employee in consideration for services rendered since the transaction was not a "sale" of securities.[345] Because Article 8 does not define "sale," the court looked to Article 2 of the UCC, Webster's Dictionary, and cases from other jurisdictions in holding that the transfer was not a "sale."[346] The court's decision turned on the fact that the employee did not have to pay for the stock in currency.[347] Given that, in the court's view, the stock had no "price," and where there was no "price" there could be no "sale" for purposes of the statute of frauds. The court held that the necessary element to a finding of no "sale" is "non-monetary consideration."[348]

The court recognized that the issue was debatable, but stated that[349] in any case, if it had found a "sale," the oral agreement would have been removed from the statute of frauds because the employee had already rendered the services that constituted the consideration for the transfer, thus entitling the employee to seek enforcement under the terms of the statute of frauds.[350]

The court's reasoning has tortured the established Georgia law in this area and has overlooked and failed to cite *Cohen v. William Goldberg & Co.*[351] That case, decided by the Georgia Supreme Court in 1992, determined that stock in a closely-held corporation is a "security." As a security such stock is subject to, among other things, the restrictions of Article 8 of the Georgia Uniform Commercial Code. There are excellent

343. 216 Ga. App. at 149, 453 S.E.2d at 487. *See* O.C.G.A. § 11-8-102(C) (1994) (definitions).

344. 216 Ga. App. at 150, 453 S.E.2d at 487.

345. *Id.*

346. *Id.*, 453 S.E.2d at 487-88.

347. *Id.* at 151, 453 S.E.2d at 488.

348. *Id.*

349. *Id.*

350. *Id. See* O.C.G.A. § 11-8-319(b) (applicable statute of frauds exclusion).

351. 262 Ga. 606, 423 S.E.2d 231 (1992) (the seminal Georgia case in the area, which stands for proposition that if it is stock, even in a closely-held corporation, it is stock under Federal securities laws and Georgia law).

long-standing and compelling policy reasons for the "in writing" requirements of the statute of frauds. These should not be abused simply to reach a "fair" result, and the need for certainty as to whether stock in a closely-held corporation is a "security" is likewise extremely important to establish.[352]

B. Eleventh Circuit Accepts and Applies "Bespeaks Caution" Doctrine

In *Saltzberg v. TM Sterling/Austin Associates, Ltd.*,[353] limited partners brought a securities fraud action against their limited partnership under section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The limited partners alleged they were lured into the partnership by offering materials which contained misstatements or omissions of material fact.[354] The United States District Court for the Northern District of Georgia had previously entered summary judgment in favor of the limited partnership, and the partners subsequently appealed to the Eleventh Circuit.

The Eleventh Circuit affirmed the lower court's judgment.[355] In so doing, the court accepted and applied the "bespeaks caution" doctrine.[356] The doctrine generally holds:

> When an offering document's forecasts, opinions or projections are accompanied by meaningful cautionary statements, the forward-looking statements will not form the basis for a securities fraud claim if those statements did not affect the "total mix" of information the document provided investors. In other words, cautionary language, if sufficient, renders the alleged omissions or misrepresentations immaterial as a matter of law.[357]

In the case at bar, the court found the limited partnership's private placement memorandum contained sufficient cautionary language to insulate the partnership from the fraud claim.[358] The court commented that the caution was not "boilerplate and was not buried among too many other things, but was explicit, repetitive and linked to the projections about which plaintiffs complain[ed]."[359]

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352. *See* Paul A. Quirós & Lynn Scott Magruder, *Business Associations*, 44 MERCER L. REV. 67, 95 (1992).
353. 45 F.3d 399 (11th Cir. 1995).
354. *Id.* at 399-400.
355. *Id.* at 400.
356. *Id.*
357. *In re* Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 371 (3d Cir. 1993).
358. 45 F.3d at 400.
359. *Id.*

V. BANKS AND BANKING

A. *Attorneys Need Express Actual Authority To Endorse and Deposit Drafts Made Payable To Clients*

In *Tifton Bank & Trust Co. v. Knight's Furniture Co.,*[360] the Georgia Court of Appeals held that where an attorney does not have the express actual authority to endorse and deposit into his account a draft made payable to a client, but does so anyway, the attorney has committed a forgery and the accepting bank is liable for conversion.[361] In reaching its decision, the court placed particular emphasis on the fact that the attorney's client had expressly forbidden him to endorse any draft on its behalf.

To be sure, *Tifton Bank* overrules the court's earlier decision in *Titus v. Commercial Bank, Douglasville,*[362] which held that an attorney had the implied authority to endorse and deposit a check made payable to his client, despite the fact the client had expressly denied the attorney the authority to do so.[363] Further, the court rejected the bank's reliance on the 1939 case of *John Bean Mfg. Co. v. Citizens Bank of Gainesville,*[364] which held that an attorney employed to collect an account had implied authority to endorse his client's name to a draft to convert it to cash where the parties had not discussed the attorney's authority.[365] The court also noted that *John Bean Mfg.* could no longer be relied on as authority for the proposition that a bank can escape liability when it pays a check on an attorney's unauthorized endorsement of his client's name.[366]

The court said that such a proposition is inconsistent with and superseded by applicable Uniform Commercial Code provisions. Under O.C.G.A. sections 11-3-419(1)(c) and 16-9-2(a), banks are generally liable for accepting deposit drafts endorsed without the authority of the payee.[367] The court commented that "[t]he legislature could have but did not carve out an exception for attorneys."[368] The court also pointed out that *John Bean Mfg.* is inconsistent with state rules on professional

360. 215 Ga. App. 471, 452 S.E.2d 219 (1994).
361. *Id.* at 471, 452 S.E.2d at 221.
362. 214 Ga. App. 657, 448 S.E.2d 753 (1994).
363. 215 Ga. App. at 472, 452 S.E.2d at 221.
364. 60 Ga. App. 615, 4 S.E.2d 924 (1939).
365. 215 Ga. App. at 471, 452 S.E.2d at 221.
366. *Id.*
367. *Id.* at 472, 452 S.E.2d at 221.
368. *Id.*

conduct.[369] In *the Matter of Antinoro*[370] and in *the Matter of Frederick M. Scherma*[371] the Georgia Supreme Court stated that it was a violation of State Bar Rule 4-102, Standard 4, for an attorney to endorse a draft on a client's behalf without permission.[372]

Presiding Judge Beasley concurred specially and Judges Pope and Blackburn joined.[373] Judge Beasley expressed concern that the court's holding would necessarily make attorneys special agents of their clients.[374] This, the Judge noted, wrongfully places severe limits on the doctrine of implied authority, thus requiring banks to make sure an attorney is authorized to endorse a client's name, perhaps by requiring production of a power of attorney, which expressly provides for such authority, in order to protect themselves from liability.[375]

Judge Beasley explained:

> No longer does [the implied authority of an attorney to endorse the name of his client on a draft] arise out of the statutory provision that "[t]he agent's authority shall be construed to include all necessary and usual means for effectually executing it . . . . Private instructions or limitations not known to persons dealing with a general agent shall not affect them. In special agencies for a particular purpose, persons dealing with the agent should examine his authority . . . ." In this case there *is* a limitation, placed by the client . . . . Thus, what was once *not* a forgery because the law implied authority where there was no express authorization and no refusal to authorize, now is regarded as a forgery if it is undertaken without express authority.[376]

B. Silent Confirmation is Not Article Five Confirmation

The Eleventh Circuit Court of Appeals concluded in *Dibrell Brothers International S.A. v. Banca Nazionale Del Lavoro*,[377] that a silent confirmation of a letter of credit is not a UCC Article 5 confirmation, but if the evidence of the existence of a contract is sufficient, recovery may be had on a claim for common law breach of contract to silently confirm.[378]

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369. *Id.* at 473, 452 S.E.2d at 222.
370. 253 Ga. 296, 319 S.E.2d 460 (1984).
371. 255 Ga. 206, 336 S.E.2d 570 (1985).
372. 215 Ga. App. at 473, 452 S.E.2d at 222.
373. *Id.* at 476, 452 S.E.2d at 224.
374. *Id.*
375. *Id.* at 476-77, 452 S.E.2d at 224.
376. *Id.* (quoting O.C.G.A. § 10-6-50 (1993)).
377. 38 F.3d 1571 (11th Cir. 1994).
378. *Id.* at 1581. This case provides an excellent overview on letters of credit transactions, which is beyond the scope of this Article.

The court explained that when a silent confirmation is part of a letter of credit transaction, "the seller acts as both the 'customer,' requesting the confirmation, and the beneficiary, receiving the assurance of confirmation."[379] But here, the court noted, the "customer" does not ask for confirmation of its engagement like an issuing bank would do in an Article 5 confirmation, but rather the "customer" is asking for the engagement of another.[380] Due to the reconfiguration of relationships between an issuing bank and a confirming bank in a silent confirmation, the confirming bank is not afforded the rights and duties provided by Article 5.[381] Thus, "[a] silent confirmer may owe a contractual duty to the beneficiary who sought the engagement, but no statutory duty is owed to the issuing bank under O.C.G.A sections 11-5-107 and 11-5-109. Also, the silent confirmer has no statutory right of reimbursement from the issuer."[382]

C. *New State Banking Rules Adopted*

Although slightly outside the survey period, there were important revisions to the state's banking laws that relate to matters during the survey period. On September 25, 1995, just four days before the first part of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal")[383] became effective, Georgia's Department of Banking and Finance (the "Department") adopted new state banking rules. As of September 29, 1995, Riegle-Neal permits bank holding companies to acquire Georgia banks subject to Georgia's five-year age requirement.[384] The second part of Riegle-Neal becomes effective June 1, 1997.[385] It allows interstate bank mergers, unless the state "opts out."[386] The Department has announced that it intends to propose an "opt-in" bill, which would allow Georgia banks to begin participating in interstate mergers early.[387] The proposal would not permit *de novo* branching. Instead, Georgia would opt-in by acquisition only.[388]

On July 14, 1995, the Department proposed new unaffiliated agency provisions which would have allowed banks to establish certain agency

379. *Id.* at 1580.
380. *Id.*
381. *Id.*
382. *Id.* at 1580-81.
383. Pub. L. No. 103-328, 108 Stat. 2338 (1994).
384. *Id.*
385. *Id.*
386. *Id.*
387. September 28, 1995 letter to all interested persons from E.D. Dunn, Georgia Banking Commissioner, regarding the status of regulations issued July 14, 1995.
388. *Id.*

relationships or alliances with other banks to provide services. Due to a large number of negative comments on one section of the new rule—the provision for Georgia banks to act as principal or agent with unaffiliated Georgia banks—the rule was not adopted, but was amended and restated and is awaiting comment before adoption.[389]

The Department noted that opportunities for unaffiliated banks to form alliances to serve a more mobile customer base would benefit smaller community banks.[390] Upon consideration of the comments received from the first proposal, the Department revised its proposed regulations on the rule to eliminate the mention of unaffiliated banks for direct bank services, and kept them only for the realm of "shared" ATMs, which require agency contracts.[391] The Department advised banks wishing to establish agency relationships before the reissued rules are adopted to contact the Department for guidance.[392]

The Department adopted new Rule 80-6-1-.14, under which the Commissioner has the authority to exempt a transaction by a Georgia bank holding company which constitutes an internal corporate restructuring from treatment as an acquisition of control within the meaning of Georgia Code section 7-1-608.[393] The Department believed that given a dynamic banking environment, banks should be able to internally reorganize through their holding companies without violating the law prohibiting bank holding companies from acquiring control of other banks.[394] Nonetheless, in order to assure that a bank holding company does not indirectly obtain banking locations in a new county, the General Statement of Policy accompanying the Rule provides that a corporate restructure may not create separate subsidiaries within a single county, as that would enable a bank to relocate one subsidiary in a new county and leave behind the other in the old county.[395]

Rule 80-6-1-.15 was adopted by the Department to further clarify Georgia's intrastate branching restrictions. Under O.C.G.A. section 7-1-608 a bank or its predecessor must have been continuously conducting a banking business for five years prior to its being acquired by a bank holding company. Rule 80-6-1-.15 permits the revival of prior unit-bank

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389. *Id. See* Proposed Banking Rule 80-1-2-.01.

390. FINAL BANKING REGULATIONS, SYNOPSIS AND PURPOSE: REISSUANCE, Chapter 80-1-2, *Agency Relationships of Financial Institutions* (Sept. 27, 1995).

391. *Id.*

392. *Id.* at section entitled "Interim Policy."

393. GA. COMP. R. REGS. r. 80-6-1-.14 (1995).

394. FINAL BANKING REGULATIONS, Department Response to Comments for Rule 80-6-1-.14 (Sept. 27, 1995).

395. FINAL BANKING REGULATIONS, General Statement of Policy for 80-6-1-.14 (Sept. 27, 1995).

charters of bank holding companies which were previously merged into another bank subsidiary. Under the rule, a revived charter is deemed to meet the five-year history requirement, effectively regaining its separate pre-merger identity and age. Thus, multi-county bank holding companies can "unscramble the egg" of a prior merger by splitting-off an acquired unit-bank charter and its associated assets. The separate charter could then be sold to another bank holding company without violating the five-year age requirement, provided that all of the banking assets associated with the charter are sold.

Rule 80-1-15-.01 was also amended to require that when a group of banks is "sharing" an ATM, only a bank or banks qualified to do a banking business in that location may actually establish, own or rent that ATM.[396] The other banks can share the ATM, but cannot be a participant in these primary functions with respect to it. The Department's policy statement for this regulation makes it clear that transaction fees are not considered rent for these purposes.[397] A bank establishing an ATM must also give prior notice by letter to the Department in accordance with Rule 80-1-1-.06.[398] Moreover, agency considerations must be addressed where a bank "shares" an ATM.[399]

Amendments to Rule 80-1-15-.03 on courier services were adopted as well. Third-party courier services must be independent of the bank and must satisfy the conditions contained in Rule 80-1-15-.03.[400] Additionally, the courier service should be generally available to the public.[401] The regulations note that it is not a violation of the rule for a bank to advertise to its customers that a third-party courier service is available to them for their bank transactions.[402] The name of the courier service must, however, be clearly distinguishable from the name of the bank.[403]

A number of other provisions were amended or adopted, but the aforementioned provisions received the most comments from the banking industry.

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396. FINAL BANKING REGULATIONS, General Statement of Policy for 80-1-15-.01 (Sept. 27, 1995).
397. *Id.*
398. *Id.*
399. *Id.*
400. FINAL BANKING REGULATIONS, General Statement of Policy for 80-1-15-.03 (1995).
401. *Id.*
402. *Id.*
403. *Id.*