Business Associations

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This Article surveys noteworthy cases that the Georgia Appellate Courts, the United States District Courts in Georgia, and the United States Court of Appeals decided during the survey period as they relate to Georgia corporate, partnership, securities, and banking laws. It also
highlights certain enactments by the Georgia General Assembly revising the Official Code of Georgia Annotated ("O.C.G.A.").

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 of appellate review often seem contradictory and confused; therefore, parties who are unsuccessful at the trial court level often find it is worth the expense of an appeal to test the law on the veil-piercing issue.

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

To establish a successful claim to pierce a corporate veil, the plaintiff must show that the shareholder's disregard of the corporate entity made it a mere instrumentality for the transaction of the shareholder's own affairs; that there is such unity of interest and ownership that the separate personalities of the corporation and the owner or officer no longer exist; and that to adhere to the doctrine of a separate corporate entity would promote injustice or protect fraud. 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. See cases cited supra notes 4 and 5.
7. See cases cited supra notes 4 and 5.
1. Veil-Piercing Theory Invoked to Hold Corporation Liable for Acts of an Employee of its Sister Corporation which Disregarded its Separate Corporate Identity. In *Mark Six Realty Associates, Inc. v. Drake,* the Georgia Court of Appeals drew upon the alter ego prong of veil-piercing theory and affirmed the lower court's decision to hold a limited purpose corporation equally liable for the acts of an employee of its sister corporation. Appellee, Lynn A. Drake ("Drake") won a favorable jury verdict against Mark Six Realty Associates, Inc. ("Mark Six"), formerly known as Northside Realty Associates, Inc. ("Associates, Inc."), Northside Realty, Inc. ("Northside Realty"), and five other defendants. Among other things, Drake alleged breach of contract, negligence, and breach of warranty in connection with her purchase of a new home. The case stemmed in part from the actions of a real estate agent, Matsis, who the trial court found was acting as an employee of Associates, Inc. Northside Realty, Inc., appealed the lower court's denial of its motion for judgment notwithstanding the verdict, contending that the lower court erred in denying its motion because Northside Realty was a separate and distinct corporation from its sister corporation, Associates, Inc. The appellate court disagreed and affirmed the lower court's denial.

After the events giving rise to Drake's action, Associates, Inc. changed its corporate name to Mark Six Realty Associates, Inc. Northside Realty was formed as a separate corporation, although it did share common owners, a common address, and some duplication of corporate officers and directors with its sister corporation, Associates, Inc. Testimony from the president of Associates, Inc., who was also the executive vice president of Northside Realty, indicated that Northside Realty was created "specifically to hold the active licenses of [real estate] agents who were not active as agents for the status purpose of the Georgia Real Estate Commission." Agents whose licenses were assigned to Northside Realty worked under contracts with Northside Realty that specifically prohibited them from being "active in the real estate business other than to refer customers" to Associates, Inc. The evidence indicated that Northside Realty's sole purpose was to circumvent regulations of the Georgia Real Estate Commission that required

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9. Id. at 57, 463 S.E.2d at 918-19.
10. Id.
11. Id. at 62, 463 S.E.2d at 922.
12. Id. at 59, 463 S.E.2d at 920.
13. Id. at 60, 463 S.E.2d at 920.
these agents either to sit for a relicensing exam or to pay to keep their real estate licenses active.\textsuperscript{14}

Northside Realty argued that because it neither had employees nor operated as a business, it could not take action on its own behalf to enter into a contract, to mislead, or to confuse its name and business with that of Associates, Inc.\textsuperscript{15} The tone of the appellate court's decision indicates that without more evidence that Northside Realty was merely the alter ego of Associates, Inc., piercing the corporate veil to integrate the separate identities of Associates, Inc. and Northside Realty may have been inappropriate. However, the evidence before the trial court indicated a level of disregard by Associates, Inc. of its separate corporate identity that was sufficient to justify treating the sister corporations as a common business enterprise.\textsuperscript{16} Generally, common ownership or control is not a sufficient basis to integrate independent corporate identities; however, this case had overtones drawing upon the business conduit and evasion of contractual, statutory or tort justifications for veil-piercing.\textsuperscript{17} Thus, although not neatly confined to a discrete veil-piercing theory, this case demonstrates the importance of maintaining the separate corporate identities of sister corporations under common ownership and control.

The court was bound by a highly deferential standard of review in reaching its decision on whether any evidence presented below supported the jury's verdict when construed in a light most favorable to Drake, the prevailing party.\textsuperscript{18} The appellate court explained:

\[\text{[T]here was . . . evidence that the name of Northside Realty, Inc. was confused with that of [Associates, Inc.] by such actions as the general use of an ambiguous name which could be that of either corporation, the use of printed brochures containing the Northside Realty, Inc. name, and the use of "Northside Realty, Inc." in several written agreements [used by Matsis, the agent-employee of Associates, Inc.]. We cannot say that any of these facts, standing alone, would constitute sufficient evidence to put to the jury the question of Northside Realty, Inc.'s liability either as a member of a common business enterprise, or as the alter ego or business conduit of [Associates, Inc.]. But taken as a whole, we likewise cannot say that no evidence exists to support the jury's verdict or that the evidence demands a verdict in favor of Northside Realty, Inc. on this issue.}\textsuperscript{19}

\begin{itemize}
\item \textsuperscript{14} \textit{Id.}
\item \textsuperscript{15} \textit{Id.}, 463 S.E.2d at 920-21.
\item \textsuperscript{16} \textit{Id.}
\item \textsuperscript{17} \textit{See supra text accompanying notes 4-7.}
\item \textsuperscript{18} 219 Ga. App. at 58, 463 S.E.2d at 919.
\item \textsuperscript{19} \textit{Id.} at 62, 463 S.E.2d at 922.
\end{itemize}
The foregoing statement by the court recognizes that the concept of piercing the corporate veil to hold sister corporations jointly and severally liable is not neatly confined to a single veil-piercing theory or justification. A judicial integration of veil-piercing theories to produce new and distinct justifications for piercing the corporate veil would help courts evaluate whether the veil-piercing issue was properly submitted to a jury and would lend more certainty to a party considering appeal of an unsuccessful claim.

2. Corporate Veil Pierced on Fraud or Abuse Grounds. In *J-Mart Jewelry Outlets, Inc. v. Standard Design,*20 the Georgia Court of Appeals held that in an action brought by suppliers of a corporation against the corporation and its major shareholders alleging joint and several liability for open accounts, fraud, and racketeering, as evidenced by theft and mail fraud, the question of whether or not to pierce the corporate veil to reach the assets of a corporation's shareholders constituted a jury question if evidence existed that shortly before the corporation went out of business, the corporation paid off the balance on a shareholder's personal credit card and made unauthorized payments on the shareholder's car to the personal benefit of the shareholder.21

The defendants, Diamond Jim Halter (“Halter”), individually and d/b/a Diamond Jim’s Emporium, moved for a directed verdict on the veil-piercing issue. The trial court denied this motion based on sufficient evidence of fraud and abuse of corporate form to submit the question of whether to pierce the corporate veil to the jury. The jury, in turn, pierced the corporate veil to find Halter individually liable for the corporation’s debts to certain suppliers. On appeal, Halter argued that the evidence did not demonstrate the level of impropriety required to submit the veil-piercing claim to the jury. The appellate court dismissed Halter’s contention, finding that Halter knowingly caused the corporation to pay his credit card bill eight days before the corporation ceased business.22 The corporate check used to pay the bill was marked “Payment in Full: Jim's Personal.”23 The evidence also established that the corporation, knowing that it would soon go out of business, purchased a new Cadillac for Halter’s use and then transferred title to him for insufficient consideration.24

21. Id. at 460-61, 462 S.E.2d at 407-08.
22. Id. at 461, 462 S.E.2d at 408.
23. Id.
24. Id.
In *Pope v. Professional Funding Corp.*[^25] Professional Funding Corporation ("PFC") purchased the accounts receivable of Total Care, Inc. ("TCI"). PFC brought suit against TCI and its shareholders, alleging conversion and breach of contract.[^25] TCI shareholders and its financial manager, Lonnie Pope ("Pope"), appealed from judgments entered on jury verdicts against them. The jury pierced TCI's corporate veil to hold related entities and their owners, including Pope, personally liable for over $100,000 for TCI's failure to repurchase certain uncollected accounts receivable pursuant to its contract with PFC.[^27] The Georgia Court of Appeals found that the evidence supported the jury's decision to pierce the corporate veil.[^28]

Pope helped establish TCI as part of a business providing medical and chiropractic services to patients. TCI's two major shareholders, Drs. Ron Clark ("Clark") and Jose Arroyo ("Arroyo"), jointly owned with Pope two related corporations—Total Imaging Center, Inc. and Quantum I R Imaging, Inc. Pope, Clark, and Arroyo were also partners in CAP Realty, a partnership which owned and managed the building from which all three corporations operated. Clark, the president of TCI, testified that he, Pope, and Arroyo established TCI, the other two corporations, and CAP Realty to handle various aspects of their clinical business, and that they "transferred money back and forth between [their separate businesses] as needed' without supporting documentation."[^29] Although CAP Realty owned the building, TCI paid for improvements, and when Pope, Clark, and Arroyo sold the building, they realized a profit.[^30]

The court of appeals decided that Clark's damning testimony sufficiently foreclosed Pope from complaining that the jury's determination to disregard the corporate entity was improper.[^31] The court commented that "in light of the admitted lack of documentation, the jury could infer from Clark's testimony that [TCI's shareholders] 'bled' the company to fund other business enterprises, including CAP Realty."[^32] Accordingly, "[w]ith the artificial barriers between those entities fallen,

[^26]: Id. at 552, 472 S.E.2d at 117.
[^27]: Id. at 552-53, 472 S.E.2d at 118.
[^28]: Id. at 553, 472 S.E.2d at 118.
[^29]: Id.
[^30]: Id. at 552, 472 S.E.2d at 117-18.
[^31]: Id. at 553-54, 472 S.E.2d at 118.
[^32]: Id. at 554, 472 S.E.2d at 118.
Pope's partnership—and therefore Pope personally—was held liable for [TCI's] business debts.  

3. Bankruptcy Court Finds that Bankruptcy Trustee has Standing to Bring Action Against Debtor Corporation. In Moore v. Kumer, the United States Bankruptcy Court for the Southern District of Georgia found that a trustee in bankruptcy had standing to bring an alter ego action against entities sharing common ownership with the debtor corporation to recover property of the bankruptcy estate that was allegedly fraudulently or preferentially transferred to such entities and their principals. Recognizing that state law governs causes of action that may be asserted by a bankruptcy trustee concerning property of the estate, the court examined Georgia law but found no unequivocal support for the trustee's right to assert the claim at bar. Nonetheless, upon examining the equitable nature of an alter ego claim, as well as Georgia case law in the area, the court found that the trustee had standing to pursue its alter ego claim.

When state law allows a subsidiary corporation to bring an alter ego action against its parent corporation, or when a corporation may assert the claim against its own principals, the bankruptcy trustee has the same rights as the debtor corporation, and therefore has standing to bring an alter ego action on behalf of the debtor corporation against its parent or principals. On the other hand, if state law does not permit an alter ego action by a corporation against its parent or principals, then the trustee lacks standing to bring the claim because the trustee only succeeds to the rights that the debtor corporation holds.

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34. 221 Ga. App. at 554, 472 S.E.2d at 118.
36. Id. at 254.
37. Id. at 254-55.
38. Id. at 254 (citing S.I. Acquisition, Inc. v. Eastway Delivery Serv., 817 F.2d 1142, 1152 (5th Cir. 1987) (Texas law permits a subsidiary to bring an alter ego action against its parent). See also St. Paul Fire & Marine Ins. Co. v. PepsiCo, Inc., 884 F.2d 688, 703 (2d Cir. 1989) (Ohio law allows same); Steyr-Daimler-Puch of America Corp. v. Pappas, 852 F.2d 132, 136 (4th Cir. 1988) (Virginia law allows a corporation to assert an alter ego claim against its principals); Koch Ref. v. Farmers Union Cent. Exch., Inc., 831 F.2d 1339, 1345-46 (7th Cir. 1987) (Indiana and Illinois law also allow an alter ego action by a corporation against its principals), cert. denied, 485 U.S. 906 (1988).
ruptcy court found, however, that "Georgia law lacks unequivocal statutory or binding judicial determination that a corporation may entertain an action against its own parent or principals." Despite this holding, the court commented that Georgia law concerning the alter ego doctrine is similar to the laws of states that allow a corporation to bring an action against its parent or principals.

The alter ego doctrine was defined by the Georgia Supreme Court in Farmers Waterhouse of Pelham, Inc. v. Collins as a disregard by the stockholders of the corporate entity which creates "such a unity of interest and ownership that the separate personalities of the corporation and the owners no longer exist" so that adherence to the corporate entity "would promote injustice or protect fraud." In Stamps v. Knobloch City Communications, Ltd., the United States Bankruptcy Court for the Northern District of Georgia determined that under Georgia law, an alter ego claim is property of the bankruptcy estate. Given the similarity of the Georgia courts' definition of the alter ego doctrine to the definitions of those states that have allowed a corporation to assert an alter ego claim against its parent or principals, the bankruptcy court possibly refined Georgia's alter ego doctrine and veil-piercing theory outside the bankruptcy context by allowing the bankruptcy trustee to pursue an alter ego claim against the parent and principals of the debtor corporation.

The court recognized that "[i]t may seem strange to allow a corporation to pierce its own veil, since it cannot claim to be either a creditor that was deceived or defrauded by the corporate fiction, or an involuntary creditor [i.e., a successful tort claimant]." But in some states, piercing the corporate veil and alter ego claims are allowed to stand to prevent inequitable results. Moreover, other states have defined the alter ego doctrine as the Georgia Supreme Court defined it in Farmers Warehouse of Pelham to allow corporations to sue their parents or principals.

40. 191 B.R. at 254.
41. Id. (quoting Stamps v. Knobloch City Communications, Ltd., 105 B.R. 1018, 1022 (Bankr. N.D. Ga. 1989)).
42. 220 Ga. 141, 137 S.E.2d 619 (1964).
43. Id. at 150, 137 S.E.2d at 625.
45. Id. at 254.
46. Id. at 257.
47. Id. at 254 (quoting Phar-Mor, Inc. v. Coopers & Lybrand, 22 F.3d 1228, 1240 n.20 (3d Cir. 1984)).
48. Id.
49. Id. (citing Farmers Waterhouse of Pelham, 220 Ga. at 150, 137 S.E.2d at 625).
The Georgia Supreme Court in *Farmers Waterhouse of Pelham* refined the alter ego doctrine to allow a corporation to bring an action against its parent or principals; further refinement of the alter ego doctrine is needed in the veil-piercing arena.

**B. Successor Liability: Successor Corporation Liable for Debts of Predecessor Partnership**

In *Pet Care Professional Center, Inc. v. BellSouth Advertising & Publishing Corp.*, the court of appeals reminded Georgia lawyers that complete continuity of ownership is not required for a successor corporation to be held liable for the debts and obligations of its predecessor business entity. The Georgia Court of Appeals affirmed the lower court's judgment and held that a corporation, Pet Care Professional Center, Inc. ("Pet Care"), was a successor in interest to its predecessor partnership, Pet Care Professional Center ("Center"), and was therefore liable for the debts of Center. BellSouth Advertising & Publishing Corporation ("BellSouth") brought an action for breach of contract or, in the alternative, quantum meruit to recover amounts due under a contract for yellow-page advertising services provided to Center. The trial court entered summary judgment in favor of BellSouth. Pet Care's responsive pleading asserted that Center, not Pet Care, acted as the contractual party to the BellSouth contract; therefore, Pet Care was not responsible for the contractual liabilities of Center.

Pet Care was incorporated by three of the four partners of Center about one month after Center executed the BellSouth contract. After incorporation, Pet Care refused to pay sums owed to BellSouth for advertising provided to Center. Pet Care argued on appeal that the trial court erred in granting summary judgment in favor of BellSouth on the contract claim because "complete identity of ownership [was] required [for] a corporation ... to be deemed a successor in interest to a predecessor entity." The appellate court disagreed, citing and quoting cases on the common-law continuation-theory justification for successor liability, which provides that a successor corporation may be liable for

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52. Id., 464 S.E.2d at 251.
53. Id.
54. Id. at 118, 464 S.E.2d at 250.
the debts of its predecessor if the successor is a mere continuation of the predecessor. 55

The uncontroverted evidence showed that Pet Care continued the business of Center such that the assets of the two did not change. 56 The entities' names were substantially the same. Further, Pet Care succeeded to Center's assets, as well as its utilities and other accounts. All but one of Center's partners became a Pet Care shareholder, and as the court noted, only some continued identity of ownership is required to hold a successor corporation liable for the debts of its predecessor business entity. 57

C. Corporate Dissolution

1. Judicial Dissolution of Corporation for Deadlock of De Facto Directors. Black v. Graham 58 involved an action by a shareholder to dissolve a corporation on the basis of director deadlock. Under O.C.G.A. section 14-2-1430(2)(A), a superior court may dissolve a corporation in a proceeding by a shareholder if it is established that the directors are deadlocked in the management of the corporate affairs, that the shareholders are unable to break the deadlock, and that irreparable injury to the corporation is threatened or being suffered, or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally because of the deadlock. 59

In this case, two fifty percent shareholders, Black and Graham, owned a corporation. As sole and equal shareholders of the corporation, they functioned as de facto directors. 60 Graham filed a petition in the Spalding County Superior Court to dissolve the corporation for, among other things, director deadlock under O.C.G.A. section 14-2-1430(2)(A). The superior court appointed a custodian to run the day-to-day operations of the corporation. 61 Thereafter, the court determined that Black and Graham functioned as directors of the corporation and that they were deadlocked, and therefore the corporation should be dissolved.


57. Id. at 119, 464 S.E.2d at 251. See cases cited supra note 55.

58. 266 Ga. 154, 464 S.E.2d at 251. See cases cited supra note 55.


60. 266 Ga. at 155, 464 S.E.2d at 815.

61. Id.
because of the lack of cooperation between Black and Graham and its probable irreparable harm to the corporation. The superior court ordered that within one week of receiving an appraisal of the value of the corporation, Black and Graham would each have to submit a sealed bid for the other’s stock. The court also directed the custodian to accept the high bid, with the successful bidder paying the purchase price for the stock immediately. If neither shareholder made a bona fide offer, or for any reason the stock purchase could not be completed, then the court would designate the custodian as the receiver of the corporation and dissolve the corporation in accordance with O.C.G.A. section 14-2-1432. After the shareholders failed to complete the stock sale, the superior court converted the custodianship into a receivership and directed the receiver to liquidate the corporation.

On appeal, the Georgia Supreme Court affirmed the superior court’s order and found that Black and Graham were deadlocked and that the deadlock would harm the corporation:

A deadlock occurs “[w]here stock of [a] corporation is owned in equal shares by two contending parties, which condition threatens to result in destruction of business, and it appears that [the] parties cannot agree upon management of [the] business, and under existing circumstances neither one is authorized to impose its views upon the other . . .”

Black and Graham functioned as de facto directors of the corporation who could not agree on how to manage the business. Neither had authority to impose his view on the corporation, and the “hostile and static” situation threatened irreparable injury to the corporation. The supreme court found a “classic situation of deadlock” and affirmed the superior court’s orders.


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62. Id.
63. Id.
64. Id.
65. Id.
66. Id.
67. Id. (quoting Farrar v. Pesterfield, 216 Ga. 311, 314, 116 S.E.2d 229, 231 (1960)).
68. Id.
69. Id.
70. Id., 464 S.E.2d at 815-16.
the Georgia Court of Appeals held that a corporation could not maintain a previously filed lawsuit against certain lawyers and their law firm for legal malpractice because the corporation was administratively dissolved while the lawsuit was pending. O.C.G.A. section 14-2-1421(c) contains the fundamental restriction on the activities of an administratively-dissolved corporation. That section provides that an administratively-dissolved corporation continues its corporate existence but may not carry on any business other than that business necessary to wind up and liquidate its business and affairs under O.C.G.A. section 14-2-1405. The trial court's record indicated that the plaintiff corporation had not taken any steps toward winding up and liquidating after dissolution. Further, the corporation never maintained that its legal malpractice suit was necessary to wind up its business, but instead argued that it was entitled to maintain its suit without a showing of necessity under O.C.G.A. section 14-2-1408(b). The court readily dismissed the corporation's assertion and stated that O.C.G.A. section 14-2-1408(b) applies only to a voluntarily-dissolved corporation. Consequently, without a showing by the corporation of the necessity of maintaining the suit to wind up its affairs, the trial court did not err in granting summary judgment for the defendants. The court also found that the trial court did not err in refusing to allow the corporation to substitute its shareholders as real parties in interest in the case because the lawsuit did not constitute a corporate asset to which the shareholders became entitled upon the administrative dissolution of the corporation.

D. Imputation of Employee's Knowledge and Activities to the Corporation

In United States v. Route 2, Box 472, 136 Acres More or Less, the Eleventh Circuit Court of Appeals considered whether the criminal activity of an officer and majority shareholder of a corporation should be

72. Id. at 229, 460 S.E.2d at 563 (quoting Gas Pump v. General Cinema Beverages, 263 Ga. 583, 583, 436 S.E.2d 207, 208 (1993)).
73. Id. (citing O.C.G.A. § 14-2-1421(c) (1994)).
74. 218 Ga. App. at 230, 460 S.E.2d at 563.
75. Id. O.C.G.A. section 14-2-1408(b) provides in pertinent part that: "Upon filing of articles of dissolution the corporation shall cease to exist . . . except for such actions as the shareholders, directors, and officers take to protect any remedy, right, or claim on behalf of the corporation . . . ." O.C.G.A. § 14-2-1408(b) (1994).
76. 218 Ga. App. at 230, 460 S.E.2d at 563-64.
77. Id., 460 S.E.2d at 564.
78. Id.
79. 60 F.3d 1523 (11th Cir. 1995).
imputable to the corporation to deny the corporation an “innocent owner” defense in a forfeiture action brought by the government. The defendant-real property was a tract of land (the “Land”) owned by Dyer's Trout Farms, Inc. (the “Corporation”). Government agents discovered ninety-five marijuana plants growing near the residence of William Dyer (“Dyer”), the president and majority shareholder of the Corporation. More plants were discovered next to Dyer's home, which was located on part of the Land. Dyer admitted knowing about the plants next to his house, but denied knowledge of the ninety-five plants on other parts of the Land. In 1992, Dyer was convicted of marijuana possession. The United States subsequently filed a complaint under 21 U.S.C. § 881(a)(7) for forfeiture in rem against the Land on grounds that the Land was used to facilitate drug trafficking.

Dyer's father had incorporated the Corporation in 1976 primarily for the raising and selling of fish and livestock. In 1978, Dyer's father transferred the Land to the Corporation. Dyer acquired his stock in the Corporation upon the death of his father. Dyer owned sixty-eight percent of the stock and his two brothers owned the remaining thirty-two percent. All three brothers worked full time for the Corporation.

The United States District Court for the Northern District of Georgia granted summary judgment in favor of the government in its forfeiture proceeding. The district court determined that the Corporation was engaged exclusively in the business of raising and selling fish and livestock and that it derived all of its income from that business. The district court also found that the Corporation did not receive any benefit from the cultivation of marijuana. Nonetheless, the district court rejected the Corporation's innocent owner defense to forfeiture of the Land because Dyer's ownership and control of the family-owned Corporation sufficiently allowed imputation of knowledge of Dyer's activities to the Corporation.

The Eleventh Circuit Court of Appeals rejected the district court's analysis because “other factors” decreased the relevance of Dyer's stock ownership and corporate control, and because sufficient weight was not given to the innocent owner defense language contained in 21 U.S.C.

80. Id. at 1524.
81. Id. at 1525.
82. Id.
83. Id.
84. Id.
85. Id.
86. Id.
§ 881(a)(7).87 That section provides that "no property shall be forfeited under this paragraph, to the extent of an interest by an owner, by reason of any act or omission established by that owner to have been committed without the knowledge or consent of that owner."88

For the forfeiture action to stand under 21 U.S.C. § 881(a), the government had to establish probable cause to believe that a substantial connection existed between the Land and Dyer's illicit activities.89 The Corporation conceded that probable cause existed, but argued that the district court erred in rejecting the Corporation's innocent owner defense.90 Thus, the appellate court was confronted with the issue of whether Dyer's knowledge of illicit activity as an individual shareholder of the Corporation was imputable to the Corporation.91

In finding that Dyer's knowledge could not be attributed to the Corporation, the appellate court emphasized the government's failure to establish that the Corporation had not always been run as a legitimate enterprise, that the Corporation derived benefit from the cultivation of marijuana, and that the other shareholders had knowledge of the illegal activity on the Land.92 Knowledge of an illegal activity may only be imputed to a corporation if the knowledge is obtained by an agent acting within the scope of his employment and for the benefit of the corporation.93

The court commented that acting within the scope of employment entails more than merely being on a corporation's property; it also involves an intent to benefit the corporation.94 "An individual's knowledge of his own illegal activities, albeit pursued on corporate property, will not be imputed to the corporation where the individual was acting for his own benefit, not for the benefit of the corporation, and outside the scope of his corporate employment."95

The court found that the district court placed too much weight on Dyer's majority ownership of the Corporation.96 The court explained that corporate knowledge generally is not determined by the percentage of ownership held by the shareholder with knowledge of the illegal

87. Id.
88. Id. (quoting 21 U.S.C. § 881(a)(7) (1996)).
89. Id. at 1526 (citing United States v. A Single Family Residence, 803 F.2d 625, 628 (11th Cir. 1986)).
90. Id. at 1526-27.
91. Id. at 1527.
92. Id. at 1527-28.
93. Id. at 1527 (citing Grand Union Co. v. United States, 696 F.2d 888, 891 (11th Cir. 1983)).
94. Id. at 1528.
95. Id. at 1527.
96. Id.
activity. The court's reasoning implies, however, that if it can be shown that a corporation is merely a sham designed to hide an individual shareholder's illicit activities, then corporate knowledge may actually turn on that shareholder's percentage of ownership. The court of appeals reversed the district court's grant of summary judgment in favor of the government and remanded the case for entry of summary judgment in favor of the Corporation.

E. Shareholder Inspection of Corporate Records

O.C.G.A. section 14-2-1602(c) empowers a shareholder to inspect certain corporate records, such as minutes of board of directors and shareholders' meetings, accounting records and shareholder records, upon at least five business days' written notice of demand before the planned inspection. O.C.G.A. section 14-2-1602(d) provides further:

A shareholder may inspect and copy [such] records . . . only if: (1) His demand is made in good faith and for a proper purpose that is reasonably relevant to his legitimate interest as a shareholder; (2) He describes with reasonable particularity his purpose and the records he desires to inspect; (3) The records are directly connected with his purpose; and (4) The records are to be used only for the stated purpose.

Trial courts have great discretion in determining whether a shareholder's purpose is proper and whether the documents requested are relevant to the shareholder's purpose.

GIR's president, owned the remainder. Prior to Lance's departure from GIR, Lance and Rehberg entered into a stock purchase agreement (the "Agreement") wherein they stipulated that the fair market value of GIR stock was $49.15 per share.\(^\text{106}\) "The Agreement also provided that in the absence of majority shareholder action, the stock's value would automatically be adjusted in accordance with GIR's earnings." No majority shareholder action was taken until 1994, and Lance asserted the stock's value rose to about $55 per share based on GIR's earnings. In 1994, however, Rehberg, as the majority shareholder, voted to lower the stock's price to $25 per share.\(^\text{107}\)

In September 1994, Lance gave GIR written notice of demand for records for the purported purpose of assessing the value of his stock. GIR responded by supplying only some of the requested records and by claiming that Lance sought certain other of the requested records for an improper purpose. The trial court ordered GIR to produce most of the requested records. GIR subsequently appealed, contending the court erred in some of the factual findings upon which it based its decision.\(^\text{108}\)

In affirming the trial court's order in large part, the appellate court, in accordance with \textit{Riser v. Genuine Parts Co.},\(^\text{109}\) referred repeatedly to the trial court's broad discretion in such corporate records-demand cases. GIR asserted that the trial court erred in finding that the records were requested for a proper purpose because Lance had become a competitor of GIR and had filed a number of suits against it. GIR also argued that Lance made his request to harass GIR.\(^\text{110}\) The court rejected GIR's argument and found that the trial court had discretion to determine if Lance's demand was for the proper purpose of valuing his stock.\(^\text{111}\) GIR also argued that the trial court was not bound to the terms of the Agreement in rendering its decision. Rehberg had testified that the $49.15 per share stock value set forth in the Agreement was based on the amount of life insurance proceeds that could be obtained by the shareholders of GIR, and therefore, the $49.15 per share fair market value applied only if a shareholder died. The appellate court agreed

\(^{106}\) \textit{Id.}

\(^{107}\) \textit{Id.}

\(^{108}\) \textit{Id.} at 829-30, 466 S.E.2d at 598-99.

\(^{109}\) \textit{Id.} at 830, 466 S.E.2d at 599 (citing \textit{Riser}, 150 Ga. App. at 505, 258 S.E.2d at 187).

\(^{110}\) \textit{Id.}

\(^{111}\) \textit{Id.} at 830-31, 466 S.E.2d at 599 (citing \textit{Riser}, 150 Ga. App. at 505, 258 S.E.2d at 187).
with the trial court, however, that the Agreement was an integrated contract and that outside considerations could not alter its terms.\textsuperscript{112} GIR also argued that the trial court erred when it required GIR to pay one-half of the fee Lance paid his accountant to conduct an on-site audit of certain accounting records customarily used in performing an audit.\textsuperscript{113} Commenting on the trial court’s discretion in determining what corporate records are relevant to a shareholder’s purpose, the appellate court readily affirmed the trial court’s decision to allow Lance’s accountant access to the requested records.\textsuperscript{114} GIR realized its only victory on appeal when the appellate court found that the trial court did not have authority to assess Lance’s accountant fees incurred in the inspection process against GIR.\textsuperscript{115} Under O.C.G.A. section 14-2-1604(c), if a court orders inspection and copying of the records demanded, it must also order the corporation to pay the shareholder’s costs (including reasonable attorney fees) incurred to obtain the order, unless the corporation proves that it had a reasonable basis to refuse the shareholder’s inspection of requested documents.\textsuperscript{116} This section did not apply to Lance’s accountant fees because the fees were not incurred by Lance in obtaining the inspection order.\textsuperscript{117}

F. Dissenter’s Rights

The case of \textit{Riddle-Bradley, Inc. v. Riddle}\textsuperscript{118} stemmed from the sale of the assets of Riddle-Bradley, Inc. (“Riddle-Bradley”) to Danka Industries, Inc.\textsuperscript{119} After the sale, minority shareholders commenced legal action to exercise their dissenters’ rights by demanding that the Corporation repurchase their shares.\textsuperscript{120} Riddle-Bradley and the dissenters could not agree on the value of shares, and the Corporation petitioned the court to determine fair value. The lower court entered summary judgment in favor of the dissenters and awarded them the amount they demanded from the Corporation because the Corporation failed to commence a valuation proceeding within the statutory period without a written extension of time as section 9-11-6(b) of the Civil Practice Act (“CPA”) provides.\textsuperscript{121} The court of appeals affirmed the

\begin{itemize}
\item \textsuperscript{112} \textit{Id.} (citing O.C.G.A. § 13-2-2(1) (1982)).
\item \textsuperscript{113} \textit{Id.} at 831, 466 S.E.2d at 599.
\item \textsuperscript{114} \textit{Id.}, 466 S.E.2d at 599-600 (citing \textit{Riser}, 150 Ga. App. at 505, 258 S.E.2d at 187).
\item \textsuperscript{115} \textit{Id.}, 466 S.E.2d at 600.
\item \textsuperscript{116} \textit{Id.} (citing O.C.G.A. § 14-2-1604(c) (1994)).
\item \textsuperscript{117} \textit{Id.} See O.C.G.A. § 14-2-1604(c) (1994).
\item \textsuperscript{118} 217 Ga. App. 725, 459 S.E.2d 576 (1995).
\item \textsuperscript{119} \textit{Id.} at 725, 459 S.E.2d at 577.
\item \textsuperscript{120} \textit{Id.} See O.C.G.A. §§ 14-2-1301 to -1303 (1994) (dissenters’ rights).
\item \textsuperscript{121} 217 Ga. App. at 725, 459 S.E.2d at 577. \textit{See O.C.G.A. § 9-11-6(b) (1993).}
\end{itemize}
lower court's judgment and found that provisions of the CPA allowing
extensions of time in certain circumstances do not apply to periods of
time which are definitely fixed under the dissenter's rights statute.122

To exercise dissenters' rights, dissenters must demand payment from
the corporation of the estimated fair value of their shares plus accrued
interest.123 If the corporation and the dissenters are unable to settle
on a value for the shares, the corporation has sixty days after receiving
the dissenters' demand to commence a judicial appraisal proceeding to
determine the fair value of the shares and accrued interest.124 If the
corporation fails to commence the valuation proceeding within the sixty-
day period, then it must pay the amounts set forth in the dissenters'
demand.125 The time periods to take action under the dissenter's
rights statute are not flexible.126

While the CPA applies to appraisal proceedings,127 the Georgia Court
of Appeals has held that "[g]ranting extensions of time as permitted
under certain circumstances by the Civil Practice Act does not apply to
periods of time which are definitely fixed by other statutes."128 Because the time for filing a petition for appraisal is set by statute, the
court of appeals concluded that the CPA did not allow the Corporation
an extension of time to bring the valuation proceeding, whether upon the
consent of the parties or otherwise.129

G. Drafting Merger Agreements

The court in C & S/Souran Corp. v. First Federal Savings Bank of
Brunswick130 held that the defendant-bank's termination of a merger
agreement did not relieve it from liability under the agreement. In April
1988, Citizens and Southern Corporation, Citizens and Southern Georgia
Corporation, and Citizens and Southern National Bank (collectively "C
& S"), entered into an Agreement and Plan of Reorganization ("Agreement") with First Federal Savings Bank of Brunswick ("First Federal")
to effect a stock-for-stock merger between C & S and First Federal.131

122. 217 Ga. App. at 725, 459 S.E.2d at 577 (quoting McClure v. Department of
Transp., 140 Ga. App. 564, 564(1), 231 S.E.2d 532, 533 (1976)).
123. Id. (citing O.C.G.A. § 14-2-1330(a) (1994)).
124. Id.
125. Id.
126. Id., 459 S.E.2d at 577-78.
127. Id. (citing O.C.G.A. § 14-2-1330(d) (1994)).
128. Id., 459 S.E.2d at 577 (quoting McClure, 140 Ga. App. at 564(1), 231 S.E.2d at
533).
129. Id. at 726, 459 S.E.2d at 578.
131. Id. at 104, 463 S.E.2d at 893.

At trial, the jury found that C & S/Sovran had breached the Agreement by failing to timely pursue and file a Y-2 application with the Federal Reserve Board in accordance with the terms of the Agreement. The trial court denied C & S/Sovran’s motions for judgment on the verdict and judgment notwithstanding the verdict. C & S/Sovran then moved for summary judgment on the issues of damages and specific performance. The trial court granted C & S/Sovran’s motion for summary judgment in part and found that First Federal was entitled to specific enforcement of the Agreement. The trial court ordered C & S/Sovran to file the necessary applications with regulatory officials to effect the merger and to prepare the documents necessary for the shareholders of First Federal to make an election respecting the merger. The trial court also ruled that another trial was necessary to determine the date the merger would have been accomplished if C & S/Sovran had not breached the Agreement. The court could then determine the number of shares of C & S/Sovran stock to which the shareholders of First Federal would have been entitled under the Agreement. C & S/Sovran appealed from the trial court’s denial of its motions for entry of judgment on the verdict, judgment notwithstanding the verdict, and summary judgment on First Federal’s request for specific performance.\textsuperscript{133}

On appeal, C & S/Sovran argued that a termination provision in the Agreement exculpated it from liability for breach of the Agreement. The Agreement stated in relevant part:

\begin{quote}
Notwithstanding any other provision of this Agreement . . . and notwithstanding the approval of [the] Agreement . . . by the stockholders of [First Federal], this Agreement may be terminated and the merger abandoned at any time prior to the Effective Date:
\end{quote}

\textsuperscript{132} Id. at 105, 463 S.E.2d at 893.
\textsuperscript{133} Id., 463 S.E.2d at 893-94.
By a vote of a majority of the Board of Directors of either C & S/Sovran or [First Federal] in the event that the merger shall not have been consummated by September 30, 1991 . . . . In the event of the termination and abandonment of this Agreement . . . pursuant to Section 10.1 of this Agreement, this Agreement . . . shall become void and have no effect, except that the provisions of [certain] Sections . . . of this Agreement shall survive any such termination and abandonment.\textsuperscript{134}

C & S/Sovran argued that because it was entitled to terminate under the Agreement, upon termination, the Agreement became void and no contract existed for the trial court to enforce.\textsuperscript{135} The Georgia Supreme Court rejected C & S/Sovran's contention.\textsuperscript{136}

The court recognized that termination provisions are generally enforceable, but termination provisions which serve as exculpatory clauses "must be clear and unambiguous, they must be specific in what they purport to cover, [with] any ambiguity . . . construed against the drafter of the instrument."\textsuperscript{137} The court found that the termination provision, which C & S/Sovran drafted, did not apply if a party breached the contract.\textsuperscript{138} Because C & S/Sovran failed to incorporate language in the termination provision specifically exculpating a party from liability for breach, C & S/Sovran could not invoke that provision to relieve itself from such liability and deny First Federal its remedy of specific performance.\textsuperscript{139} The court commented that the Agreement simply did not permit a party to terminate by delaying consummation of the merger to avoid the contract; "a contract [will not] be so construed as to authorize one of the parties to take advantage of his own wrong, unless it be plain and manifest that such was the intention of the parties."\textsuperscript{140}

C & S/Sovran next contended that the trial court erred in allowing First Federal a remedy of specific performance of the Agreement. C & S/Sovran argued that because First Federal's shareholders never approved the merger, there was never an agreement to merge.\textsuperscript{141} The court found, however, that the failure of First Federal's shareholders to approve the merger was excused as a matter of law because C &

\begin{itemize}
  \item \textsuperscript{134} Id. at 106, 463 S.E.2d at 894.
  \item \textsuperscript{135} Id.
  \item \textsuperscript{136} Id.
  \item \textsuperscript{137} Id. (quoting Department of Transp. v. Arapaho Constr., Inc., 257 Ga. 269, 270, 357 S.E.2d 593, 594 (1987)).
  \item \textsuperscript{138} Id., 463 S.E.2d at 895.
  \item \textsuperscript{139} Id.
  \item \textsuperscript{140} Id. at 106-07, 463 S.E.2d at 895 (quoting Finlay v. Ludden & Bates Southern Music House, 105 Ga. 264, 267-68, 31 S.E. 180, 181 (1898)).
  \item \textsuperscript{141} Id. at 107, 463 S.E.2d at 895.
\end{itemize}
BUSINESS ASSOCIATIONS

S/Sovran's breach of the Agreement effectively prevented First Federal from obtaining shareholder approval.142

H. Shareholder Derivative Suits

In Williams v. Service Corp. International,143 the Georgia Court of Appeals held that filing both direct and derivative claims did not affect a corporate shareholder's standing as an adequate representative of the corporation's interests to bring derivative claims against an accounting firm that handled the corporation's business affairs.144 Plaintiff, Service Corporation International ("SCI"), brought a direct action and a derivative action on behalf of H.M. Patterson & Son, Inc. ("Patterson") against Patterson's accountants, Williams, Benjamin, Benator & Libby and its partners ("WBBL"). After the trial court dismissed SCI's direct action, the defendants moved to dismiss SCI's derivative action for lack of standing.145 The trial court denied defendants' motion to dismiss the derivative suit, and the Georgia Court of Appeals affirmed the trial court's denial.146

SCI held a minority shareholder position in Patterson. The directors and officers of Allen, Lee Patterson Allen, and the Allen Trust ("Allens") owned the remaining shares. In October 1990, SCI filed a derivative suit against the Allens in Fulton County Superior Court. SCI alleged various wrongdoings by the Allens, including breach of fiduciary duty, misappropriation of corporate opportunities, conversion, self-dealing, negligence, fraud, and conspiracy (the "Allen Action"). Seventeen months later, SCI moved to add WBBL to the Allen Action, but the court denied SCI's motion as untimely. In September 1992, SCI responded by filing direct and derivative actions against WBBL in the DeKalb County Superior Court. SCI asserted derivative claims against WBBL for breach of fiduciary duty, breach of agency, breach of contract and malpractice, and a direct claim for breach of fiduciary duty. SCI also alleged that WBBL had aided and abetted the Allens.147

Given the Georgia Supreme Court's holding in Thomas v. Dickson,148

142. Id.
144. Id. at 12, 459 S.E.2d at 623.
145. Id. at 10, 459 S.E.2d at 621.
146. Id.
147. Id.
148. Id., 459 S.E.2d at 621-22 (citing Thomas v. Dickson, 250 Ga. 772, 301 S.E.2d 49 (1983)). In Thomas, the Georgia Supreme Court recognized the general rule that a shareholder seeking to recover misappropriated corporate funds may only bring a derivative action. Thomas, 250 Ga. at 774, 301 S.E.2d at 50. However, despite the rule, the Court in Thomas allowed a minority shareholder of a close corporation to maintain a
the trial court determined that SCI could not maintain its direct action against WBBL. After the trial court dismissed SCI's direct action on these grounds, SCI and the Allens settled the Allen Action. In connection with the settlement, a wholly-owned subsidiary of SCI purchased all of the Allen's stock in Patterson. Consequently, at the time SCI appealed the trial court's dismissal of its direct action, SCI and its wholly-owned subsidiary owned Patterson. In November 1993, WBBL unsuccessfully moved to dismiss SCI's derivative action. WBBL claimed that SCI lacked capacity to bring such a claim on Patterson's behalf because SCI did not fairly and adequately represent Patterson's interests.149

O.C.G.A. section 14-2-741 provides that a shareholder maintaining a derivative action must have been "a shareholder of the corporation at the time of the act or omission complained of" ... and [must] '[f]airly and adequately represent the interests of the corporation in enforcing the rights of the corporation."150 WBBL contended on appeal that SCI did not fairly and adequately represent Patterson's interests because SCI filed both direct and derivative actions against WBBL, and because SCI brought the derivative action and the Allen Action to gain control of Patterson.151 The appellate court rejected WBBL's argument and noted that direct and derivative actions may be brought simultaneously.152 Thus, the court rejected the argument that SCI did not fairly and adequately represent Patterson merely because it simultaneously filed direct and derivative actions against WBBL.153 The court also rejected WBBL's argument that because SCI was involved in the Allen Action, SCI was not an adequate representative of Patterson.154 In response to WBBL's assertion that SCI brought the Allen Action as a guise to gain corporate control of Patterson,155 the court commented that SCI filed the Allen Action and the subsequent derivative action as
the sole minority shareholder in a closely held corporation whose officers and directors owned the majority of the shares.\textsuperscript{156} The fact that SCI's interests might have been antagonistic to the Allens' interest did not mean as a matter of law that SCI's interests were antagonistic to the corporation itself.\textsuperscript{157} Absent a showing by WBBL that SCI's interests were antagonistic to Patterson's interests, the court refused to conclude that SCI was not an adequate representative of Patterson.\textsuperscript{158}

I. Legislative Changes

The 1996 Session of the General Assembly of Georgia yielded several amendments to the Georgia Business Corporation Code,\textsuperscript{159} the most notable of which are summarized below.\textsuperscript{160}

1. Distribution of Rights Exclusion. O.C.G.A. section 14-2-140(6) amended the definition of "distribution" to exclude the transfer by a corporation of rights to acquire the company's shares.\textsuperscript{161} Before amendment, this section excluded only the transfer of a corporation's shares.\textsuperscript{162} The amendment should eliminate directors' concerns about personal liability for unlawful distributions in connection with rights offerings if the rights have a substantial market value upon issuance.\textsuperscript{163}

2. Revisions to Indemnification Provisions.

a. Authority of the Board to Indemnify. Former law authorized a board of directors to indemnify a director if, among other things, the director acted in a manner "he believed in good faith to be in or not opposed to the best interests of the corporation."\textsuperscript{164} Under the 1996 amendments, acts taken by a director in his official capacity are now distinguished from acts not taken in an official capacity. For actions taken by a director in his official capacity, the standard for indemnification is now whether the director reasonably believed his conduct to be

\textsuperscript{156} Id.
\textsuperscript{157} Id. at 11-12, 459 S.E.2d at 622.
\textsuperscript{158} Id., 459 S.E.2d at 622-23.
\textsuperscript{159} O.C.G.A. Title 14, Chapter 2.
\textsuperscript{163} October 19, 1995 Letter from William J. Carney on behalf of the Corporate Code Revision Committee to F. Dean Copeland of the Executive Committee Regarding Proposed Revisions to the Georgia Business Corporation Code [hereinafter the "Proposed Revisions Letter"].
in the best interests of the corporation. For actions not taken in a
director's official capacity, the standard requires that the director's
conduct be at least not opposed to the best interests of the corpora-
tion. The foregoing standard also applies to indemnification for a
director's expenses in derivative actions, unless the director received an
improper personal benefit, whether in his official capacity or other-
wise.

b. Limitations on Mandatory Indemnification. Former O.C.G.A.
section 14-2-852 provided for mandatory indemnification if a director
was successful in an action. Now, the director must be "wholly
successful" to enjoy mandatory indemnification. This amendment
is to avoid a director plea bargaining down to a single count and then
attempting to obtain mandatory indemnification for a sizable portion of
his expenses.

c. Board Authority to Authorize Advances. The 1996 amendments
added new subsections to O.C.G.A. section 14-2-853 which now provide
procedural rules for advances. Under section 14-2-853(c), a majority vote
of all disinterested directors, or a majority vote of a committee comprised
of two or more disinterested directors, is required to authorize advanc-
es. If there are not at least two disinterested directors, then the
whole board may approve the advances. Alternatively, advances
may be authorized by shareholders, but shares held by interested
directors may not be voted with respect to such authorization.

d. Procedures for Authorizing Indemnification. Revisions to O.C.G.A.
section 14-2-855 added another procedure for determining whether
indemnification is proper. If there are less than two disinterested
directors, the board may select special legal counsel to determine
whether indemnification is proper. Further, if the determination is

165. Id. § 14-2-851(a)(2)(A).
166. Id. § 14-2-851(a)(2)(B).
167. Id. § 14-2-851(d).
169. Id.
172. Id. § 14-2-853(c)(1)(B).
173. Id. § 14-2-853(c)(2).
174. Id. § 14-2-855(2)(B).
to be made by the shareholders, interested directors’ shares may not be voted.  

175. *Id.* § 14-2-855(b)(3).

176. *Id.* § 14-2-859(a). A corporation may, however, limit any of the rights to indemnification or advance for expenses created by or pursuant to Part 5 of Title 14, Chapter 2. *Id.* § 14-2-859(c).

177. *Id.* § 14-2-859(b).

178. *Id.* § 14-2-843(a).


181. *Id.* § 14-2-1002(4), (5).

182. *Id.* § 14-2-1109(b), amended by O.C.G.A. § 14-2-1109(a)(1), (b) (Supp. 1996).

183. *Id.* 14-11-901(a) (limited liability companies); *Id.* § 14-9-206.1(a) (limited partnerships).
6. Preservation of Remedies of Dissolved Corporations. Effective July 1, 1996, the dissolution of a corporation in any manner, except by a decree of the superior court which supervised the liquidation of the assets or business of the corporation as provided in O.C.G.A. sections 14-2-1430 through 14-2-1433, does not impair any remedies available to the dissolved corporation, its directors, officers or shareholders, for any right or claim existing prior to the dissolution if the action is pending on the date of dissolution or is commenced within two years of the date of dissolution.\textsuperscript{184}

7. Corporate Tax Changes. Notable changes to Title 48 of the Official Code of Georgia on Revenue and Taxation provide for additional authority of the state revenue commissioner to allocate and apportion corporate net income;\textsuperscript{185} for various changes with respect to job tax credits and employee retraining tax credits, sales tax exemptions for electricity, and primary material handling equipment;\textsuperscript{186} for sales tax exemptions for the remanufacture of certain aircraft engines, parts, or components; and for materials and property used in connection with certain federal contracts.\textsuperscript{187}

8. Pharmacists May Form Professional Corporations. Revisions to O.C.G.A. section 14-7-2 permit pharmacists to form professional corporations.\textsuperscript{188}

II. PARTNERSHIPS

A. Limited Partner-Maker's Option to Put Payments on Note for Partnership Contribution to General Partner not Valid Defense to Payment of Note

In Ameritrust Co., N.A. v. White,\textsuperscript{189} the United States Court of Appeals for the Eleventh Circuit held that a forfeiture clause in a promissory note prevented the note from qualifying as a negotiable instrument under Georgia law.\textsuperscript{190} The court also held that a subscription agreement for a partnership interest, a promissory note given by the

\textsuperscript{184} Id. § 14-2-1410.
\textsuperscript{185} See id. § 48-7-31.
\textsuperscript{186} See id. § 48-8-2 to -3.
\textsuperscript{187} See id. § 48-7-40.2; Id. § 48-9-2.
\textsuperscript{188} Id. § 14-7-2(2) (Supp. 1996).
\textsuperscript{189} 73 F.3d 1653 (11th Cir. 1996).
\textsuperscript{190} Id. at 1560.
subscribing partner to pay for his partnership interest, and an amend-
ment to the partnership agreement granting the subscribing partner a
put option, should be construed together as an integrated contract.\(^1\) However, the exercise of the option to put the note to the general
partner did not relieve the subscribing limited partner from liability on
the note.\(^2\)

Plaintiff-appellant Ameritrust Company, N.A. ("Ameritrust") sued
defendant-appellee C.K. White ("White"), the maker of a promissory
note. White gave the note in partial payment of the purchase price for
a limited partner's interest in a limited partnership known as Amber-
wood Apartments of Bartow County, II, Ltd. ("Amberwood"). Amberwood
was the payee under the note. Amberwood's general partner, Cardinal
Industries, Inc. ("Cardinal"), endorsed the note on behalf of Amberwood
to an affiliate of Cardinal, Cardinal Industries of Georgia Service
Corporation ("CIGSC"). With proper endorsement, CIGSC then pledged
the note to Ameritrust as security for a loan from Ameritrust to
CIGSC.\(^3\)

The district court held that White was not liable on the note because
the note was not negotiable and that White had a valid defense to
liability in that he properly exercised an option to put the note to
Cardinal.\(^4\) The Eleventh Circuit Court of Appeals affirmed the
district court's finding that the note was not negotiable, but disagreed
that the option to put the note to Cardinal gave White a valid defense
to liability on the note. The court determined that a forfeiture clause in
the note rendered the note nonnegotiable, but that the option to put the
note to Cardinal represented an agreement between White and Cardinal,
and that Cardinal was not a party to the note transaction underlying
Ameritrust's claim.\(^5\) The court noted that even if Cardinal were a
party to the note transaction through its relationship with CIGSC, White
still could not bring or assert a claim or defense against Cardinal
because the put option agreement would be unenforceable under
O.C.G.A. section 14-9A-47.\(^6\)

In 1985, Cardinal, as general partner, formed Amberwood as a Georgia
limited partnership. Its assets consisted primarily of an apartment

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\(^1\) Id. at 1558.
\(^2\) Id. at 1560-62.
\(^3\) Id. at 1555.
\(^4\) Id.
\(^5\) Id.
\(^6\) Id.; see infra text accompanying note 235.
A Cardinal affiliate, Cardinal Industries Development Corporation ("CIDC"), served as the original limited partner. In 1986, White subscribed to all thirty-five units of limited partnership interest in Amberwood. White had received a Private Placement Memorandum ("PPM") for the offering of the partnership units. The PPM specifically provided that any notes given by investors in payment of the purchase price for units of limited partnership interest could be assigned or pledged by Amberwood to CIGSC, and CIGSC could then pledge the notes to a creditor as security for a loan. In connection with his subscription for units, White executed a subscription agreement, power of attorney, and two promissory notes totalling $769,090. Both notes contained a forfeiture clause which provided that White would lose his interest in Amberwood if he failed to make timely payments on the note, and that Amberwood would have no obligation to White for any payments made before forfeiture. As part of the closing of White's purchase of the units of limited partnership interest, Cardinal and CIDC revised the Amended Certificate and Agreement of Limited Partnership to permit White to put to Cardinal certain obligations under the notes. An amendment to the PPM also detailed the put option.

Scheduled payments under the notes were as follows: $176,120 on June 1, 1987 and $146,440 on June 1, 1988 for the first promissory note, and $150,780 on June 1, 1989, $153,580 on June 1, 1990, and $142,170 on June 1, 1991 for the second promissory note.

The amendment provided that:

(c) The Limited Partner(s) are required to make the 1986 and 1987 payments, and their interest shall vest on a pro-rata basis for said payments at the time of the 1987 payment. The Limited Partner(s) have the option to put to Cardinal Industries, Inc. their obligations for each of the years 1988, 1989, 1990 and 1991, and in the event the option to put is exercised in any of these years, Cardinal Industries, Inc. agrees to purchase for its own account (but may re-sell) that pro-rata share of the Limited Partnership interest. The option to put must be exercised in writing by Limited Partner(s) and must be delivered to Cardinal Industries, Inc. at least forty-five (45) days prior to the June 1 payment date for the year in which it is exercised.

(e) The option to the Limited Partner(s) to put any year's payment to Cardinal Industries, Inc. must be exercised separately for each of the
years of the option, under the terms and conditions set forth here-in.\textsuperscript{201}

A Certificate of Amendment to Limited Partnership Agreement of Amberwood ("Certificate") was filed with the clerks of the appropriate Georgia courts. The Certificate indicated that CIDC withdrew from the partnership, that White owned all of the limited partnership units, and that White contributed $896,980 to the partnership. The Certificate failed, however, to reference White's put option.\textsuperscript{202}

In July 1987, White made the first payment on the first note. In September 1987, Cardinal, as general partner, endorsed the two notes to CIGSC, who in turn endorsed the notes to Ameritrust as security for a loan.\textsuperscript{203} White, unaware of the transfer of the notes, paid the second installment on the first note which represented payment in full. Cardinal forwarded White's payments to Ameritrust.\textsuperscript{204}

In February 1989, Amberwood defaulted on a mortgage payment on partnership property to Crossland Bank ("Crossland"), and Crossland placed Amberwood in receivership. After White received notice of the receivership, he immediately decided to exercise his option to put payments on the second note to Cardinal. By letter dated April 7, 1989, White put his June 1, 1989 payment to Cardinal and informed Cardinal that he also intended to put his 1990 and 1991 payments. All notices were proper.\textsuperscript{205}

Cardinal filed for bankruptcy in May 1989. In January 1990, Ameritrust notified White that it held the unpaid second note and that White should make his 1990 payment to Ameritrust. White disclaimed liability under the note and asserted Cardinal's responsibility pursuant to the exercised put option. Ameritrust reviewed the subscription documents and discovered the put option as set forth in the amended PPM.\textsuperscript{206}

Ameritrust filed an action in December 1990 against White to collect on the second note. Both parties moved for summary judgment, and White filed a motion to add a counterclaim against Ameritrust. The counterclaim alleged that Ameritrust's actions constituted a conspiracy with Cardinal in the conversion of the notes for Cardinal's benefit and in a breach of fiduciary duties owed to White and Amberwood by

\textsuperscript{201} Id. at 1566-57 (emphasis in original).
\textsuperscript{202} Id. at 1557.
\textsuperscript{203} Id. The loan was made to CIGSC, but the proceeds of the loan were deposited in a Cardinal bank account. Id.
\textsuperscript{204} Id.
\textsuperscript{205} Id.
\textsuperscript{206} Id.
Cardinal under partnership law and the partnership agreement. 207 The district court denied both parties' motions for summary judgment, but allowed White's counterclaim. 208

The district court ruled that the forfeiture clauses in the notes rendered them nonnegotiable and that Article Three of the Uniform Commercial Code did not govern, but that Georgia's common law on the assignment of a contractual right to pay applied. 209 Accordingly, Ameritrust took the second note subject to any defenses, including the put option defense that White could assert against the assignors of the note, Cardinal and CIGSC. 210

The district court granted judgment for White on Ameritrust's claim on the unpaid note, and judgment for Ameritrust on White's counterclaim. 211 Ameritrust argued that the put option could not vary the terms of the unpaid note. Ameritrust also asserted that pursuant to the modification clause contained in the note, any changes had to be attached to the note to be effective. 212 The district court found, however, that all of the subscription documents and instruments, including the note, constituted one integrated contract, therefore, the put option was "attached" to the note by virtue of being part of the contract. 213 The district court stated that under the integrated contract, White had a contingent obligation to pay on the note only if he failed to properly exercise the put option, and that White was not liable on the second note because he properly exercised his option to put payments under the note to Cardinal. 214 On White's counterclaim, the district court found the evidence insufficient to establish the existence of a conspiracy. 215

The court of appeals agreed that the note was not negotiable, but did not agree that White's exercise of his put option relieved him from liability. 216 Because the forfeiture clause rendered the note nonnegotiable, "Ameritrust did not qualify as a holder in due course . . . [and] took the note subject to White's put option defense and any other defenses." 217 Ameritrust argued on appeal that the district court erred
in concluding that the subscription documents and instruments constituted a single, integrated contract.\textsuperscript{218} The appellate court determined that the subscription materials, including the PPM, the note, and the put option agreement, constituted one integrated contract and that the put option agreement did not need to be attached to the note in accordance with the note's modification clause.\textsuperscript{219} The note did not contain a merger clause providing that the note was the sole and entire agreement of the parties. A merger clause would have required any modification to have been attached to be effective.\textsuperscript{220} Nonetheless, the appellate court concluded that the district court erred in holding that White's exercise of his put option released him from liability on the note.\textsuperscript{221} The appellate court held that White's put option defense was not a valid defense against Ameritrust's claim on the note and that White, after exercising his option, had an obligation to continue to make payments to Ameritrust on the note.\textsuperscript{222} The appellate court further construed the put option agreement to give White a contractual right to collect from Cardinal, payments made by White under the note after exercise of the option.\textsuperscript{223} However, this did not abrogate White's liability to Amberwood, or its assignee, under the note because Cardinal was neither the original obligor nor an assignee.\textsuperscript{224} The court's holding was consistent with \textit{Signet Bank v. Weaver},\textsuperscript{225} a case involving Cardinal and a put option clause identical to the one at issue in Ameritrust.\textsuperscript{226} Amberwood's Certificate indicated White as the sole but limited partner and indicated that White's contributions to the partnership totalled $896,980.\textsuperscript{227} The certificate made no mention of the put option.\textsuperscript{228} Under O.C.G.A. section 14-9A-25(b), a certificate of limited partnership must be amended upon a change in the amount or character of a limited partner's contribution.\textsuperscript{229} The court noted that even if White's defense had been valid, the partnership certificate should have been amended to account for the put option because the put option

\begin{thebibliography}{9}
\bibitem{218} \textit{Id.}
\bibitem{219} \textit{Id.} at 1561.
\bibitem{220} \textit{Id.} (distinguishing \textit{Kiser v. Godwin}, 90 Ga. App. 825, 84 S.E.2d 474 (1954)).
\bibitem{221} \textit{Id.} at 1563.
\bibitem{222} \textit{Id.} at 1562-63.
\bibitem{223} \textit{Id.} at 1562.
\bibitem{224} \textit{Id.}
\bibitem{225} No. 4-90-CV-49 (N.D. Ga. May 13, 1991).
\bibitem{226} 73 F.3d at 1559-62 nn.7, 8 & 19.
\bibitem{227} \textit{Id.} at 1562.
\bibitem{228} \textit{Id.}
\bibitem{229} \textit{Id.} (quoting O.C.G.A. § 14-9A-25(b)).
\end{thebibliography}
represented a change in the amount and character of his contribution to the partnership.\textsuperscript{230}

In further support of its holding, the court followed the chain of assignment of obligations under the note.\textsuperscript{231} White made the note payable to Amberwood, which endorsed the note to CIGSC, which in turn endorsed the note to Ameritrust.\textsuperscript{232} Cardinal was outside the chain of assignment and therefore, could not be liable on the note as an assignee.\textsuperscript{233} The court added that even if Cardinal had been a party to the note transaction because of its affiliation with CIGSC, White's contractual right against Cardinal under the put option agreement contravened the Georgia Limited Partnership Act and was therefore unenforceable.\textsuperscript{234} O.C.G.A. section 14-9A-47 deals with withdrawal or reduction of a partner's contribution and provides:

\begin{itemize}
\item[(a)] A limited partner shall not receive from a general partner or out of partnership property any part of his contribution until:
\begin{itemize}
\item[(1)] All liabilities of the partnership, except liabilities to general partners and to limited partners on account of their contributions, have been paid or there remains property of the partnership sufficient to pay them; [and]
\item[(3)] The certificate required under Code Section 14-9A-20 is canceled or so amended as to set forth the withdrawal or reduction.\textsuperscript{235}
\end{itemize}
\end{itemize}

Under the put option agreement, White's contractual right against Cardinal, a general partner, amounted to a right to receive from Cardinal part of White's contribution to the partnership.\textsuperscript{236} The application of O.C.G.A. section 14-9A-47 rendered White's contractual right unenforceable without a showing that all obligations of Amberwood's third party creditors had been satisfied.\textsuperscript{237} The appellate court remanded the case to the district court to decide whether the assignment of the notes was improper.\textsuperscript{238}

\begin{itemize}
\item[230.] \textit{Id.}
\item[231.] \textit{Id. at} 1562-63.
\item[232.] \textit{Id. at} 1562.
\item[233.] \textit{Id.}
\item[234.] \textit{Id. at} 1563.
\item[235.] \textit{Id.} (quoting O.C.G.A. § 14-9A-47 (1994)).
\item[236.] \textit{Id.}
\item[237.] \textit{Id.}
\item[238.] \textit{Id. at} 1564.
\end{itemize}
B. Legislative Changes

See discussion on legislative changes with respect to merger of entities supra part I(I)(5).

III. Securities

A. Securities Arbitration

1. Absent Clear Statement of Intention in Contract to the Contrary, a Contractual Choice-of-Law Provision May Not Preclude an Arbitral Award of Punitive Damages that Otherwise Would Not Be Proper. In Mastrobuono v. Shearson Lehman Hutton, Inc.,239 the United States Supreme Court held that a contract between a securities brokerage firm and its customer permitted an arbitral award of punitive damages, despite a provision in the parties' agreement that New York law, under which arbitrators are not authorized to award punitive damages, would govern.240 In so holding, the Supreme Court reversed the judgments of the district court and the court of appeals that disallowed the arbitrators' award of punitive damages.241

Petitioners, Antonio and Diana Mastrobuono, had opened a securities trading account with the respondent, Shearson Lehman Hutton, Inc. ("Shearson") by executing Shearson's standard-form client's agreement (the "Client's Agreement"). The agreement contained an arbitration clause, and a choice-of-law clause providing for New York law to govern. In 1989, petitioners sued Shearson in the United States District Court for the Northern District of Illinois, alleging that Shearson had mishandled their account and claiming damages based on a number of state and federal law theories. Shearson moved to stay the court proceedings and to compel arbitration pursuant to the rules of the National Association of Securities Dealers.242 The district court granted the motion, and a panel of three arbitrators subsequently awarded $400,000 in punitive damages and $159,327 in compensatory damages to petitioners.243

Shearson moved to vacate the award of punitive damages because under New York law, arbitrators lack the authority to award such

240. Id. at 1217-18.
241. Id. at 1219.
242. Id. at 1214-15.
243. Id. at 1215.
damages.\textsuperscript{244} Because New York law allows courts, not arbitrators, to award punitive damages, the district court granted the motion to vacate the damages award, and the Seventh Circuit Court of Appeals affirmed.\textsuperscript{246} The United States Supreme Court granted certiorari to resolve a conflict among the Courts of Appeals as to "whether a contractual choice-of-law provision may preclude an arbitral award of punitive damages that otherwise would be proper."\textsuperscript{246}

The Supreme Court reversed the decisions of the district court and the Seventh Circuit Court of Appeals.\textsuperscript{247} The Supreme Court commented that it has repeatedly held that the Federal Arbitration Act ("FAA")\textsuperscript{248} preempts inconsistent state law.\textsuperscript{249} The real issue, in the Supreme Court's view, involved whether contractual provisions in an agreement could preempt the FAA.\textsuperscript{250} Shearson argued that in the Client's Agreement, the parties could lawfully agree to limit the issues to be arbitrated and that under such agreement, the petitioner waived any claim for punitive damages.\textsuperscript{251} In response, the Supreme Court noted that it had previously held that "the FAA's pro-arbitration policy does not operate without regard to the wishes of the contracting parties."\textsuperscript{252} Further, the Supreme Court commented that its past decisions "make it clear that if contracting parties agree to include claims for punitive damages within the issues to be arbitrated, the FAA ensures that their agreement will be enforced according to its terms even if a rule of state law would otherwise exclude such claims from arbitration."\textsuperscript{253} Thus, in the Supreme Court's view, the case hinged on interpreting the arbitration and choice-of-law provisions of the Client's Agreement to determine the arbitrability of the petitioner's claim for punitive damages.\textsuperscript{254}

The Client's Agreement included a standard choice-of-law provision that New York law governed the agreement. Additionally, this agreement stated that "any controversy" arising out of the transactions

\textsuperscript{244} Id.
\textsuperscript{245} Id. (citing Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793 (N.Y. 1976)).
\textsuperscript{246} Id.
\textsuperscript{247} Id.
\textsuperscript{250} Id. at 1216.
\textsuperscript{251} Id. at 1215.
\textsuperscript{252} Id. at 1216 (citing Volt Info. Sciences, Inc. v. Board of LeLand Stanford Junior Univ., 489 U.S. 468 (1989)).
\textsuperscript{254} Id.
between Shearson and the petitioner would be settled by arbitration in accordance with the rules of the National Association of Securities Dealers ("NASD"), or the Board of Directors of the New York Stock Exchange and/or the American Stock Exchange.\(^\text{255}\) However, the Client's Agreement did not contain any express reference to claims for punitive damages.\(^\text{256}\)

The Supreme Court stated that in the absence of contractual intent to exclude punitive damage claims from the agreement to arbitrate, the FAA would preempt any New York law which rejected an arbitrator's power to award punitive damages.\(^\text{257}\) Viewing the choice-of-law provision in isolation, the Supreme Court concluded that the clause could be read merely as a substitute for a conflict-of-laws analysis that would otherwise determine what state's laws would apply to contractual disputes among the parties.\(^\text{258}\) Moreover, the Supreme Court noted that even if a court read the choice-of-law provision as more than a substitute for ordinary conflict-of-laws analysis, the provision should not be read so broadly as to make "New York law" mean "New York decisional law, including that State's allocation of power between courts and arbitrators, notwithstanding otherwise applicable federal law."\(^\text{259}\)

The Supreme Court then examined the arbitration provisions of the Client's Agreement for a punitive damages exclusion, but could not find one.\(^\text{260}\) Instead, the relevant provision authorized arbitration in accordance with the NASD's Code of Arbitration Procedure ("NASD Code").\(^\text{261}\) The NASD Code does not expressly state that arbitrators may award punitive damages, but a manual provided to NASD arbitrators states that "[p]arties to arbitration are informed that arbitrators can consider punitive damages as a remedy."\(^\text{262}\) Thus, the relevant provisions in the Client's Agreement, taken together, did not convince the Supreme Court that the parties contracted to exclude punitive damages from arbitration.\(^\text{263}\) This analysis, coupled with basic tenets of contractual interpretation (i.e., that ambiguous language should be construed against the drafting party, and that a document should be read to give effect to all of its provisions and to render them

\(^{255}\) Id. at 1217.

\(^{256}\) Id.

\(^{257}\) Id.

\(^{258}\) Id.

\(^{259}\) Id.

\(^{260}\) Id. at 1218.

\(^{261}\) Id.

\(^{262}\) Id. (quoting Mastrobruoro v. Shearson Lehman Hutton, Inc., 20 F.3d 713, 717 (7th Cir. 1994), rev'd, 115 S. Ct. 1212 (1995)).

\(^{263}\) Id.
consistent with each other) and the federal policy favoring arbitration, convinced the Supreme Court to reverse the district court and the Seventh Circuit Court of Appeals and to hold that a New York choice-of-law provision did not exclude punitive damages from the arbitration award.264

Justice Thomas dissented by questioning the majority's interpretation of the Client's Agreement in light of the Supreme Court's decision in Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University.265 In Volt, the Supreme Court held that the FAA "simply requires courts to enforce private contracts to arbitrate as they would normal contracts—according to their terms."266 Justice Thomas noted that the holding in Volt led the Supreme Court to enforce a choice-of-law provision that incorporated a state procedural rule concerning arbitration proceedings.267 He argued that the choice-of-law provision in the Client's Agreement could not reasonably be distinguished from the choice-of-law provision in Volt.268 Moreover, Justice Thomas commented that the majority's reliance on an NASD manual instead of NASD rules, was misplaced.269

Regardless of which reasoning is more lucid, this case certainly highlights the proposition that boilerplate choice-of-law provisions in contracts containing arbitration provisions should be replaced with clauses pertaining to the parties' intention regarding the specific issues to be arbitrated.

2. Eleventh Circuit Applies Mastrobuono; Due Process Challenge to Arbitral Award of Punitives Fails. The Eleventh Circuit Court of Appeals had the opportunity to apply the holding of Mastrobuono in Davis v. Prudential Securities, Inc.270 The case reached the Eleventh Circuit on appeal from the confirmation by the United States District Court for the Southern District of Florida of an arbitrators' award of punitive damages.271

Citing Mastrobuono, the court dismissed the appellants claim that the arbitration panel lacked authority under New York law to award punitive damages to the appellee.272 The court also rejected the

264. Id. at 1219.
266. 115 S. Ct. at 1219 (Thomas, J., dissenting) (citing Volt, 489 U.S. at 478).
267. Id.
268. Id. at 1221.
269. Id. at 1221-23.
270. 59 F.3d 1186 (11th Cir. 1995).
271. Id. at 1187.
272. Id. at 1188-89.
appellant's due process challenge to the arbitral award of punitive damages because the state action element of a due process claim is absent in both the private arbitration of cases and in the confirmation of arbitration awards by a court.273

3. The Court, Not the Arbitrator, Determines Timeliness of Claim Under Section 15 of NASD Code of Arbitration Procedure. In Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen,274 the Eleventh Circuit Court of Appeals held that the court, not the arbitrator, determines whether an NASD Code of Arbitration claim is timely.275 The claimants, Simon and Judith Cohen ("Cohens"), signed a Customer Agreement with Merrill Lynch, Pierce, Fenner & Smith ("Merrill Lynch"). The agreement provided for arbitration pursuant to the NASD Code to resolve any disputes between the Cohens and Merrill Lynch.276 The Cohens filed an arbitration claim with the NASD alleging that Merrill Lynch had defrauded them into making and keeping certain investments between 1985 and 1991. Particularly, the Cohens asserted claims for common law fraud, breach of fiduciary duty, gross negligence, violation of the Florida Securities and Investor Protection Act, and intentional infliction of emotional distress.277

In response, Merrill Lynch filed suit in Florida state court seeking to enjoin arbitration on the ground that the Cohens' claims were time-barred under Section 15 of the NASD Code.278 The Cohens removed the case to federal court on grounds of diversity and moved to compel arbitration.279 The district court held that the arbitration panel, not the court, should determine the question of whether the Cohens' claims were time-barred.280 Accordingly, the court granted the motion to compel arbitration and dismissed Merrill Lynch's suit.281

On appeal, Merrill Lynch argued that "section 15 [of the NASD] Code"282 is a substantive eligibility requirement relating to the arbitra-

273. Id. at 1191-94.
274. 62 F.3d 381 (11th Cir. 1995).
275. Id. at 382.
276. Id.
277. Id.
278. Id.
279. Id.
280. Id.
281. Id.
282. Section 15 of the NASD Code provides that arbitration claims must be submitted within six years of "the occurrence" or event giving rise to the act or dispute, claim, or controversy. The section emphasizes that this limitation does not "extend . . . statutes of limitations" and will not apply "to any case which is directed to an arbitrator by a court." NASD CODE OF ARBITRATION PROCEDURE § 15, reprinted in NASD Manual (CCH) ¶ 3715
bility of claims over six years old." The Cohens countered by arguing that section 15 is not an eligibility requirement, but rather a procedural statute of limitations, and its applicability must be determined by the arbitrator.

The court noted a split among the circuits with regard to the issue of who determines whether a claim is timely under section 15. The Third, Sixth, and Seventh Circuits have held that section 15 is a jurisdictional prerequisite to arbitrability, and as such, the court must determine whether the claim is timely. The Fifth Circuit has held that section 15 is a procedural requirement to arbitration that must be determined by the arbitrator. The Eighth Circuit has also concluded that the question of timeliness is for the arbitrator, but has based its determination on section 35 of the NASD Code, which provides that "the arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code which interpretation shall be final and binding on the parties." In the Eighth Circuit's view, when parties agree to submit claims to arbitration pursuant to the NASD Code, their clear intent is to leave the question of arbitrability to the arbitrators due to section 35.

The Eleventh Circuit Court of Appeals reversed the district court and sided with the Third, Sixth, and Seventh Circuits by holding that section 15 of the NASD Code is a substantive eligibility requirement and, as such, a court must decide if claims are timely under that section. The court rejected the Eighth Circuit's section 35 analysis, but quoted Mastrobuono, in which the Supreme Court stated that "due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of

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(1994).
283. 62 F.3d at 382.
284. Id.
285. Id. at 383.
286. Id. See also PaineWebber, Inc. v. Hofmann, 984 F.2d 1372 (3d Cir. 1993); Dean Witter Reynolds, Inc. v. McCoy, 995 F.2d 649, 651 (6th Cir. 1993); Edward D. Jones & Co. v. Sorrells, 957 F.2d 509, 512 (7th Cir. 1992).
287. Id. See also Smith Barney Shearson, Inc. v. Boone, 47 F.3d 750, 754 (5th Cir. 1995).
288. 62 F.3d at 383 (citing FSC Sec. Corp. v. Freel, 14 F.3d 1310 (8th Cir. 1994)).
289. 14 F.3d at 1313. Section 35 grants arbitrators the power "to interpret and determine the applicability of all provisions" under the NASD Code. This interpretation will then "be binding upon the parties." NASD CODE OF ARBITRATION PROCEDURE § 35, reprinted in NASD Manual (CCH) ¶ 3735 (1994).
290. 62 F.3d at 383.
arbitration.' However, the court commented that the Supreme Court recently concluded in *First Options of Chicago, Inc. v. Kaplan* that "this presumption in favor of arbitration is not applicable when the question to be resolved is who decides arbitrability." The court determined that arbitrators are to resolve this question only when there is clear and unmistakable evidence that the parties agreed to arbitrate the question of arbitrability. The court then held that section 35 of the NASD Code "is not 'clear and unmistakable evidence' of the parties' intent to allow the arbitrator to determine the timeliness of the claim." 

B. Investment Advisers: Requirements for Qualification as Investment Adviser Under the Investment Advisers Act for Application of the Act's Antifraud Provision

In *United States v. Elliott,* the Eleventh Circuit Court of Appeals decided a first-impression issue concerning the requirements for qualification as an investment adviser under the Investment Advisers Act of 1940 ("Act"). The case stems from the alleged fraudulent acts of defendants-appellants, Charles Phillip Elliott ("Elliott") and William H. Melhorn ("Melhorn"), who managed a number of investment companies including Elliott Real Estate, Inc., Elliott Securities, Elliott Mortgage Company, Inc., and Elliott Group, Inc. (collectively, "Elliott Enterprises").

From 1980 to 1987, Elliott owned and served as president of Elliott Enterprises. During that time Melhorn began as special assistant to Elliott and later became chief executive officer of Elliott Enterprises. Although Elliott Securities operated as a securities broker, the rest of Elliott Enterprises marketed various investment vehicles created and managed by Elliott Enterprises. Elliott Enterprises lost millions of dollars each year from 1980 to 1987. Despite these losses, Elliott and Melhorn kept their investors and attracted new ones by making false

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294. 62 F.3d at 384 (quoting First Options of Chicago, 115 S. Ct. at 1924).
295. Id.
296. Id. at 385. See also Edward D. Jones & Co. v. Sorrells, 957 F.2d 509, 514 (7th Cir. 1992).
297. 62 F.3d 1304 (11th Cir. 1995).
299. 62 F.3d at 1306.
claims about the safety and performance of Elliott Enterprises' investments.\footnote{300}{Id.} Elliott Enterprises hid its dire financial condition from its investors by regularly sending them competitive interest payments. Despite its huge losses, Elliott Enterprises maintained these interest payments by using a "Ponzi," or pyramid scheme in which "interest payments were funded not only by returns from underlying investments, but also by the principal from newer investor funds."\footnote{301}{Id.} Further, ample evidence showed that both Elliott and Melhorn profited greatly from the illicit arrangement.\footnote{302}{Id.}

Following an investigation by the SEC in 1987, a receiver took control of Elliott Enterprises. At that time, liabilities exceeded assets by more than $20 million. New investors could no longer be attracted, the Ponzi scheme collapsed, and interest payments ceased. Investors and creditors of the failed Elliott Enterprises recovered ten-and-a-half cents on the dollar from the receiver.\footnote{303}{Id.}

Elliott and Melhorn were indicted on twenty-two counts of fraud under the Act,\footnote{304}{Id.} six counts of securities fraud under the Securities Act,\footnote{305}{15 U.S.C. § 77q(a) (1994); 18 U.S.C. § 2 (1994).} ten counts of mail fraud,\footnote{306}{Ten counts brought pursuant to 18 U.S.C. §§ 2, 1341 (1994). 62 F.3d at 1307.} and one count of conspiracy.\footnote{307}{One count brought pursuant to 18 U.S.C. § 371 (1994). 62 F.3d at 1307.} The charges in the indictment stemmed from misrepresentations allegedly made by Elliott and Melhorn to nineteen individuals.\footnote{308}{62 F.3d at 1307. The court noted that its review found only nineteen victims instead of the twenty-three stated by Melhorn's counsel at sentencing. Id. at 1307 n.2.} In March 1990, a jury returned a guilty verdict on virtually all the charges.\footnote{309}{Id. at 1307.} In July 1990, the United States District Court for the Middle District of Florida sentenced the defendants to prison terms and ordered them to make full restitution.\footnote{310}{Id.}

\begin{itemize}
\item \footnote{300}{Id.}{\ For example, Elliott and Melhorn represented to investors that: Elliott Enterprises was financially sound; Elliott Enterprises was a regulated bank; certain investments were insured and secured when, in fact, these investments were either backed by no collateral or insufficient collateral; income from certain investments was tax-free; and Elliott Enterprises had received clean audit reports from the Florida Department of Professional Regulation when, in truth, no audits were performed. Id.}
\item \footnote{301}{Id.}{Id.}
\item \footnote{302}{Id.}{Id.}
\item \footnote{303}{Id. at 1307.}{Id. at 1307.}
\item \footnote{304}{Id.}{Id.}
\item \footnote{308}{62 F.3d at 1307. The court noted that its review found only nineteen victims instead of the twenty-three stated by Melhorn's counsel at sentencing. Id. at 1307 n.2.}{62 F.3d at 1307. The court noted that its review found only nineteen victims instead of the twenty-three stated by Melhorn's counsel at sentencing. Id. at 1307 n.2.}
\item \footnote{309}{Id. at 1307.}{Id. at 1307.}
\item \footnote{310}{Id.}{Id.}
\end{itemize}
Elliott and Melhorn raised a number of issues on appeal. One of the chief issues was that the evidence was insufficient to support their convictions for investment-adviser fraud.\textsuperscript{311} Defendants argued that they were not investment advisers within the meaning of the Act; therefore, the Act could not apply to their actions.\textsuperscript{312} Elliott and Melhorn further contended that even if they served as investment advisers, there had to be an adviser-client relationship between them and their victims for the Act's antifraud provisions to apply.\textsuperscript{313}

The court first examined whether or not Elliott and Melhorn qualified as investment advisers for purposes of the Act.\textsuperscript{314} In finding that defendants were in fact investment advisers, the court looked to Section 80b-2(a)(11) of the Act and stated that an investment adviser is:

\begin{quote}
[\textit{Any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include . . . (C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor . . . ; or (F) such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order.}\textsuperscript{315}
\end{quote}

The court cited an SEC release ("SEC Release") that clarified the SEC's position on the applicability of the Act to financial planners, pension consultants, and other financial service providers.\textsuperscript{316} The release advises:

\begin{quote}
Whether a person providing financially related services of the type discussed in this release is an investment adviser within the meaning of the Advisers Act depends upon all the relevant facts and circumstances . . . . A determination as to whether a person providing financial planning, pension consulting, or other integrated advisory services is an investment adviser will depend upon whether such person: (1) Provides advice, or issues reports or analyses, regarding
\end{quote}

\begin{flushleft}
\textsuperscript{311} \textit{Id.} at 1309.
\textsuperscript{312} \textit{Id.} at 1309-11.
\textsuperscript{313} \textit{Id.} at 1309, 1311-13.
\textsuperscript{314} \textit{Id.} at 1309.
\textsuperscript{316} \textit{Id.} at 1309-10.
\end{flushleft}
The court noted that Elliott and Melhorn clearly gave investment advice to their customers "both by advising them in their choice among Elliott Enterprises investment vehicles and by controlling the investments underlying those investment vehicles." The court then turned to the questions of whether Elliott and Melhorn were "in the business of advising others" and whether they did so "for compensation."  

Again, the court noted that the SEC Release defined the "business" standard for investment advisers. The SEC Release in pertinent part provides:

The giving of advice need not constitute the principal business activity or any particular portion of the business activities of a person in order for the person to be an investment adviser under section [80b-2(a)(11)]. The giving of advice need only be done on such a basis that it constitutes a business activity occurring with some regularity. Whether a person giving advice about securities would be "in the business" of doing so, depends upon all relevant facts and circumstances. The staff considers a person to be "in the business" of providing advice if the person: (i) holds himself out as an investment adviser or as one who provides investment advice, (ii) receives any separate or additional compensation that represents a clearly definable charge for providing advice about securities, regardless of whether the compensation is separate from or included within any overall compensation, or receives transaction-based compensation if the client implements the investment advice, or (iii) on anything other than rare, isolated and non-periodic instances, provides specific investment advice.

The court properly noted that SEC releases are merely highly persuasive authority, not dispositive. Nevertheless, the evidence persuaded the court that defendants were in the business of advising others because they satisfied "all three of the disjunctive factors given by the SEC." During the relevant period, Elliott was registered with


318. 62 F.3d at 1310 (citing Abrahamson v. Fleschner, 568 F.2d 862, 871 (2d Cir. 1977)).


320. Id. (quoting SEC RELEASE, supra note 317, at 38,402) (emphasis in original).

321. Id. (citing SEC v. Continental Commodities Corp., 497 F.2d 516, 525 (5th Cir. 1974)).

322. Id.
the SEC as an investment adviser. Further, under 15 U.S.C. § 80b-3(d), Melhorn could also be charged under the Act because he acted on behalf of Elliott, an investment adviser. The court listed numerous acts of defendants which placed defendants "in the business of advising others." For example, defendants distributed letters and brochures which held them out to the public as registered investment advisers, and received transaction-based compensation for giving investment advice. Moreover, defendants regularly gave investment advice.

Defendants contended that they were not compensated for investment advice because they did not receive a distinct fee from investors as payment for investment advice. Elliott and Melhorn argued that investors came to Elliott Enterprises to invest in the company, not to receive investment advice. However, the court rejected defendants' contention and stated that "investment advice in this case constitute[d] a significant [part] of the 'product' sold." The court said that customers relied on defendants to assist them in selecting investments. After selection of investments, Elliott and Melhorn continued to advise investors by managing the underlying investments.

Additionally, under the SEC Release, it did not matter if Elliott and Melhorn did not receive a distinct fee for providing investment advice, because receiving compensation for investment advice does not hinge upon whether investors are charged a separate fee for the investment advisory portion of the total services. Thus, "[b]ecause Elliott and Melhorn [engaged] 'in the business of advising others,' they qualiflied] as investment advisers under section 80b-2(a)(11)" of the Act.

Nevertheless, defendants maintained that even if they acted as investment advisers, they did not have an adviser-client relationship with any of the investors named in the indictment; therefore, they could
not be subject to the Act's antifraud provisions. In support of their proposition that an adviser-client relationship did not exist, Elliott and Melhorn again argued that they did not receive a separate investment advisory fee and that no investment adviser contract existed between them and their customers. The court dismissed defendants' contention because subsection 4 of the Act's antifraud provision, section 80b-6, requires the government to prove only that the defendants acted as investment advisers and that the defendants "engage[d] in any act, practice, or course of business which is fraudulent, deceptive, or manipulative." Thus, subsection 4 proscribes certain conduct by investment advisers, but does not refer to clients or to an adviser-client relationship. This reading of section 80b-6, the court commented, is bolstered by the legislative history of the Act and by case law precedent.

C. "Controlling Person" Liability Under Section 20(a) of Securities Exchange Act of 1934

The issue before the Eleventh Circuit Court of Appeals in Brown v. Enstar Group, Inc. related to what must be proved to establish "controlling person" liability under section 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The case, which originated before the United States District Court for the Middle District of Alabama, involved a suit by shareholders of Kinder-Care, Inc. ("KCI") and The Enstar Group, Inc. ("Enstar") who bought stock in Kinder-Care Learning Centers, Inc. ("KCLC") pursuant to the grant to KCI shareholders of rights to purchase KCLC stock as part of corporate restructuring. The shareholders alleged material omissions and fraud in the preparation and dissemination of the prospectus ("Prospectus") for the rights offering by the founder and former president and chairman of the board of KCI and former chairman of the board of KCLC, Perry Mendel ("Mendel").

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335. Id.
337. Id. at 1311-12.
338. Id. at 1312-13.
339. 84 F.3d 393 (11th Cir.), appeal filed, 65 USLW 3416 (Nov. 25, 1996).
340. 84 F.3d at 395. Kinder-Care, Inc. changed its name to The Enstar Group, Inc., following a corporate restructuring. Id. at 394.
341. Id. at 395.
KCI's attorney prepared the Prospectus. There was no evidence that Mendel participated in its preparation. 342  
The district court found that Mendel did not commit fraud, 343 and granted summary judgment in favor of Mendel. The court also found no facts to support a conclusion that Mendel was a controlling person of KCI at the time of the issuing of the Prospectus. Thus, Mendel could not be secondarily liable under Section 20(a) of the Exchange Act as a controlling person. 344  
On appeal the appellants conceded that Mendel would be liable for violations of the Exchange Act only if he were a controlling person within the meaning of the Exchange Act. 345 Section 20(a) of the Exchange Act provides that:

Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable . . . . 346  

"Control" is defined under the regulations promulgated pursuant to the Exchange Act as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person." 347 The plaintiff has the burden of proving that a defendant is a controlling person. 348 However, the courts of appeals are split on how a plaintiff meets this burden. 349  
The Eighth Circuit's test is the most widely used test for determining controlling person liability. 350 That test includes two prongs. The first prong requires that a plaintiff prove that "the defendant . . . actually participated in (i.e., exercised control over) the operations of the corporation in general." 351 The second prong requires a showing that the defendant possessed the power to control the specific transaction or activity upon which the primary violation is predicated. 352 Although

342. Id. at 394.
343. Id. at 395.
344. Id.
345. Id.
346. Id. at 395-96 (quoting 15 U.S.C. § 78t(a) (1994)).
347. Id. at 396 (quoting 17 C.F.R. § 230.405 (1996)).
348. Id.
349. Id.
350. Id.
352. Id.
a number of other circuits had already adopted the Eighth Circuit's test, the Eleventh Circuit had neither adopted that test, nor formulated its own, prior to the case at hand.\textsuperscript{353}

In this case, the Eleventh Circuit adopted the controlling person test devised below by the United States District Court for the Middle District of Alabama.\textsuperscript{354} This test finds a defendant liable as a controlling person under section 20(a) of the Act if the defendant "had the power to control the general affairs of the entity primarily liable at the time the entity violated the securities laws . . . [and] had the requisite power to directly or indirectly control or influence the specific corporate policy which resulted in the primary liability."\textsuperscript{355}

Applying the test to the facts of the case, the appellate court found that Mendel was not a controlling person of KCI, and therefore, could not be secondarily liable for KCI's alleged securities law violations.\textsuperscript{356} The court found no evidence in the trial court record that Mendel had any power over KCI at the time of the issuance of the Prospectus.\textsuperscript{357} At the time of the issuance of the Prospectus, Mendel had no role in the management of KCI.\textsuperscript{358} However, the court noted an important distinction between the Eighth Circuit's test and the Eleventh Circuit's newly-adopted test.\textsuperscript{359} The Eighth Circuit's test requires a plaintiff to prove that a defendant actually exercised power over the entity that was primarily liable.\textsuperscript{360} In this case, the Eleventh Circuit did not have to determine whether "power to control the general affairs of the entity primarily liable" means power to control in the abstract, or the actual exercise of the power to control, because it held that Mendel neither possessed nor exercised power to control the affairs of KCI at the time of issuance of the Prospectus.\textsuperscript{361}

\begin{compactitem}
\item \textsuperscript{353} Id.
\item \textsuperscript{354} Id.
\item \textsuperscript{355} Id. (quoting Brown v. Mendel, 864 F. Supp. 1138, 1145 (M.D. Ala. 1994), aff'd sub nom. Brown v. Enstar Group, Inc., 84 F.3d 393 (11th Cir. 1996), appeal filed, 65 USLW 3416 (Nov. 25, 1996)).
\item \textsuperscript{356} Id. at 397.
\item \textsuperscript{357} Id.
\item \textsuperscript{358} Id.
\item \textsuperscript{359} Id. at 397 n.6.
\item \textsuperscript{360} Id.
\item \textsuperscript{361} Id. at 397.
\end{compactitem}
A. Garnishee-Bank Liability

This year's survey discusses two garnishment cases involving garnishee banks which legal counsel should bring to the attention of bank officers in charge of answering garnishments.

1. Avoiding Liability When Answering Garnishment: Let the Court Determine Whether Funds Purportedly Held in a Trust, Escrow or Other Special Account Are Subject to Garnishment. In Wachovia Bank of Georgia v. Unisys Financial Corp., the trial court reminded Georgia banks that when a garnishment action is filed naming a bank as garnishee and the defendant has accounts denominated as a trust, escrow, or any other type of special account, the bank should avail itself of O.C.G.A. section 18-4-82 and allow the court to determine which funds are subject to garnishment to avoid garnishee liability. O.C.G.A. section 18-4-82 sets forth the requirements for answering a garnishment.

It requires the garnishee to answer the garnishment by describing what money or other property is subject to garnishment. If the garnishee cannot answer, then it must state its inability in its answer to the garnishment, together with all the facts plainly, fully, and distinctly set forth to enable the court to determine what assets, if any, are subject to the garnishment. By leaving the determination of which assets are subject to the garnishment to the court, a garnishee can avoid liability for improperly answering a garnishment.

Wachovia Bank of Georgia, N.A. ("Wachovia") should have followed the foregoing approach when it answered a garnishment filed by Unisys Finance Corporation ("Unisys"). Unisys obtained a judgment against a collection agency, Hanover Credit Corporation ("Hanover"), and to satisfy the judgment it filed a garnishment naming Wachovia as garnishee. Hanover maintained seventeen accounts with Wachovia, but Wachovia determined that fifteen of the accounts were designated as trust accounts and therefore, were not subject to garnishment. Wachovia then answered the garnishment by stating that only funds in one of the two remaining accounts were subject to the garnishment. Unisys traversed the answer, claiming it was untrue, and the trial court later found funds

363. Id. at 473, 471 S.E.2d at 557. See also O.C.G.A. § 18-4-82 (1991).
364. Id. (citing O.C.G.A. § 18-4-82 (1991)).
365. Id. at 471, 471 S.E.2d at 556.
366. Id.
Wachovia contended that the trial court erred because the accounts represented fiduciary accounts containing Hanover's clients' funds which were exempt from garnishment and argued the sufficiency of its investigation of the accounts to satisfy its burden under Georgia's garnishment laws. The Georgia Bankers Association also argued, in an amicus curiae brief filed with the court, that Wachovia's investigation of the status of the accounts satisfied garnishment requirements. Upon review of the trial court record, the court of appeals affirmed the judgment against Wachovia.

Wachovia maintained that Hanover opened and maintained the fifteen accounts at issue for depositing money that Hanover, as a collection agency, collected for its clients. Wachovia contended that the accounts represented trust accounts and therefore could not be subject to garnishment. Although it is generally true that trust accounts are not subject to garnishment for the trustee's personal debts, the court noted that Wachovia's argument assumed the existence of a trust. The question of the establishment of a trust and the ownership of the other fifteen accounts represented a question of fact for the trial court to determine. Accordingly, the court noted that the trial judge, as the fact finder, should determine the issue of whether money in the Wachovia accounts belonged to Hanover or represented trust funds for its clients.

Evidence presented by Unisys to support its contention that the accounts represented Hanover's assets and not trust accounts included resolutions of Hanover's board of directors. The resolutions listed the accounts and designated Wachovia a depository for the "funds of Hanover." The resolutions did not designate the accounts as trust accounts. Moreover, Unisys presented evidence that, pending the

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367. Id.
368. Id.
369. Id. at 474, 471 S.E.2d at 558.
370. Id. at 471-72, 471 S.E.2d at 556.
372. 221 Ga. App. at 472, 471 S.E.2d at 556.
373. Id. at 473, 471 S.E.2d at 557 (citing Spivey v. Methodist Home of the South Georgia Conference, Inc., 226 Ga. 100, 102, 172 S.E.2d 673, 675 (1970)).
374. Id.
375. Id.
376. Id. at 472, 471 S.E.2d at 556.
377. Id.
garnishment lien, Hanover drew forty-two checks on the fifteen accounts, which named Hanover as payee.\textsuperscript{378} Wachovia presented the signature cards for the accounts which used the word “trust” in the account titles, but stipulated that Hanover had sole discretion of selecting the account titles. Wachovia also received verbal assurances that the accounts were trust accounts. However, except for the verbal assurance from Hanover, Wachovia did not perform any independent investigation to determine the status of the accounts.\textsuperscript{379} The court of appeals found that the competing evidence favored Unisys’s argument that the accounts were not trust accounts.\textsuperscript{380}

By its terms, O.C.G.A. section 18-4-82 sets forth a means for a garnishee to avoid liability stemming from an answer to a garnishment.\textsuperscript{381} Wachovia answered Unisys’s garnishment by merely stating that the sum of $6,262 was subject to garnishment, but gave no indication of other funds deposited in the name of Hanover which may or may not have been subject to garnishment.\textsuperscript{382} By answering in this manner, Wachovia risked a judgment of garnishee liability if its treatment of Hanover’s accounts was erroneous.\textsuperscript{383} Wachovia’s belief that the accounts represented trust accounts not subject to the garnishment did not relieve the bank from its failure to comply with O.C.G.A. section 18-4-82.\textsuperscript{384} The court advised that Wachovia could have explained in its answer the basis for doubting ownership of the accounts and could have thereby avoided liability by presenting the matter to the court for determination.\textsuperscript{385} The court stated that “Wachovia blindly relied on the word of its depositor at its own peril.”\textsuperscript{386}

In his special concurrence to the court’s opinion, Judge Johnson addressed certain concerns presented in the Georgia Bankers Association’s amicus curiae brief.\textsuperscript{387} The Georgia Bankers Association was concerned that the court’s holding could force Georgia banks to undertake burdensome independent investigations to determine whether

\begin{itemize}
  \item \textsuperscript{378} Id.
  \item \textsuperscript{379} Id., 471 S.E.2d at 557.
  \item \textsuperscript{380} Id. at 471, 471 S.E.2d at 556.
  \item \textsuperscript{381} See infra text accompanying notes 390-92.
  \item \textsuperscript{382} 221 Ga. App. at 475, 471 S.E.2d at 558 (Johnson, J., concurring).
  \item \textsuperscript{383} Id. at 473, 471 S.E.2d at 557.
  \item \textsuperscript{385} Id. at 473, 471 S.E.2d at 557 (citing Mobile Paint Mfg. Co., 219 Ga. App. at 301, 464 S.E.2d at 905).
  \item \textsuperscript{386} Id. at 474, 471 S.E.2d at 557-58.
  \item \textsuperscript{387} Id., 471 S.E.2d at 558 (Johnson, J., concurring).
\end{itemize}
accounts opened as a trust, escrow, or other special accounts are actually what the depositors purport them to be. Judge Johnson attempted to quell these fears by reinforcing that, upon receipt of a garnishment, banks are not required to determine whether the funds are in fact held by customers in a fiduciary capacity. Judge Johnson cautioned:

But when a garnishment action is filed naming a bank as garnishee, and the defendant has accounts denominated as a trust or any other special type of account, the bank should avail itself of the provisions of O.C.G.A. section 18-4-82 and allow the trial court to determine which funds are subject to garnishment and thereby avoid liability such as that imposed here.

Johnson also emphasized that the majority opinion does not alter the general rule that trust accounts are not subject to garnishment, nor does it require banks to undertake burdensome investigations. The judge further advised that had Wachovia answered the garnishment by informing the parties and the court of the existence of the other accounts and that it could not determine whether the funds in those accounts were subject to the garnishment, then it would have fulfilled its legal obligation to answer in accordance with section 18-4-82, and would have escaped liability altogether.

2. Garnishee-Bank Liability for Failing to Include in Answer to Garnishment Funds Held by Defendant in “Corporate” Account. In Mobile Paint Manufacturing Co. v. Johnston, the court subjected a garnishee-bank to garnishee liability for failing to locate and include in its answer funds deposited by the defendant in a “corporate” account. The court decided that the “corporation” in whose name the account was opened was not actually incorporated. Thus, the funds in the corporate account were rendered assets of the defendant. Mobile Paint Manufacturing Company, Inc. (“Mobile”) obtained a judgment against Larry A. Johnston (“Johnston”), filed a garnishment against Johnston for $15,026.23, and named NationsBank of Georgia, N.A. (“NationsBank”) as garnishee. NationsBank answered that it had only $93.10 of funds subject to Mobile’s garnishment. Mobile traversed, asserting that funds in the NationsBank account of a separate entity,
Southeastern Coating, Inc. ("Southeastern"), should also be subject to the garnishment. The court of appeals granted Mobile's application for discretionary review and reversed the trial court's order denying its traverse. The trial court record indicated that Johnston was a vice president of Southeastern, an unincorporated entity, and was signatory on Southeastern's account with NationsBank. NationsBank could not locate Southeastern's corporate resolution, which should have been provided upon opening a corporate account.

NationsBank argued to both the trial court and the appellate court that even though Southeastern's account named Johnston as a signatory, without additional information, it could not locate accounts other than accounts in Johnston's name to determine whether additional funds held by the bank were subject to the garnishment. The trial court found that although NationsBank may have diverged from its internal procedures in opening the Southeastern's corporate account, it could not say that NationsBank erred in doing so. The trial court believed that an "onerous burden" would be placed on garnishee-banks if it held otherwise. The trial court concluded that assuming the Southeastern account had been a valid corporate account, NationsBank would have lacked authority to freeze the account solely on the basis of Johnston's signatory authority.

The court of appeals disagreed and found that NationsBank treated the Southeastern account as a corporate account "at its own peril." Garnishment law required NationsBank to describe in its answer the funds subject to garnishment, and to pay those funds into court. Under O.C.G.A. section 18-4-20(b), the garnishment applied to "[a]ll debts owed by the garnishee to the defendant at the time of service of the summons of garnishment upon the garnishee and all debts accruing from the garnishee to the defendant from the date of the service to the date of the garnishee's answer." In the court's view, NationsBank should

395. Id.
396. Id.
397. Id.
398. Id.
399. Id.
400. Id., 464 S.E.2d at 905.
401. Id.
402. Id.
403. Id.
404. Id.
405. Id. (citing O.C.G.A. §§ 18-4-20, -82 (1991)).
406. Id. at 299-300, 464 S.E.2d at 905 (quoting O.C.G.A. § 18-4-20(b)) (emphasis in original).
have taken the necessary steps to comply with Georgia's garnishment laws because garnishment proceedings are "measured by the strict terms of the statute." The court cautioned that "[i]n the case of corporate accounts, banks should take whatever steps are necessary to ensure that an account being opened as a corporate account, does indeed belong to a duly formed corporation." The court further commented that NationsBank's inability to locate the account did not constitute a valid excuse under the garnishment statutes. In support of this proposition, the court cited Citizens & Southern National Bank v. Plott which held that

the fact that the garnishee bank's retrieval system for its account files failed to disclose to its officer in charge of answering garnishments the contents of the [other account] does not relieve the bank of its responsibility. Whether or not its retrieval system functions, it is on notice of the contents of its account files.

B. Interpretation and Application of the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA")

1. Agency Review and Judicial Determination of Claims Against FDIC Under FIRREA. Aguilar v. F.D.I.C. involved the interpretation and application of the agency review provisions of the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA"), and judicial determination of claims against the Federal Deposit Insurance Corporation ("FDIC"). The case involved two separate appeals that began as a single state court action brought by fourteen plaintiffs against Southeast Bank ("Southeast"). Before removal to federal court, the state court entered summary judgment in favor of Southeast against eleven of the plaintiffs. This left three plaintiffs to continue the case. On appeal, the Eleventh Circuit Court of Appeals

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407. Id. at 300, 464 S.E.2d at 905 (quoting Summer v. Allison, 127 Ga. App. 217, 227(1), 193 S.E.2d 177, 185 (1972)).
408. Id.
409. Id.
412. 63 F.3d 1059 (11th Cir. 1995).
413. Id. at 1061 (citing 12 U.S.C. § 1821(d)(6) (1994)).
414. Id.
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reversed the district court's dismissal because the district court erroneously interpreted 12 U.S.C. § 1821(d)(6).415

During the pendency of the appeal, Southeast was declared insolvent and the FDIC was appointed receiver.416 The FDIC removed the case to federal district court and the plaintiffs moved alternatively to modify or to vacate the district court's judgment. The FDIC filed alternative motions for summary judgment or for a stay because plaintiffs could not maintain their suit until they had exhausted their administrative remedies before the FDIC.417

Generally, FIRREA does not give the federal courts authority to decide claims against a financial institution in federal receivership until the claimant has exhausted its administrative remedies against the FDIC.418 If a lawsuit against an institution is still pending when the FDIC is appointed receiver, and if the FDIC timely insists on the use of its administrative processes, courts will suspend action on the lawsuit. However, the court would retain jurisdiction as the claimant exhausts the administrative remedies.419 Section 1821(d)(6)(A) of FIRREA provides that within sixty days of the date the administrative claim is denied, or within sixty days of the date on which the 180-day administrative review period expires, the claimant may “file suit on such claim (or continue an action commenced before the appointment of the receiver)” in district court.420 A claimant must file suit or continue an action that was commenced prior to the appointment of a receiver before the end of the statutory period; otherwise, the claim is disallowed, and the claimant is foreclosed further relief.421

In response to the FDIC's alternative motions for a stay or summary judgment, the district court issued a stay on the action for 180 days to allow the plaintiffs to exhaust their administrative remedies against the FDIC.422 On June 19, 1992, the FDIC rejected plaintiffs' administrative claim. The 180-day stay expired on July 15, 1992, and on May 11, 1994, the district court dismissed the claim with prejudice on the grounds that the plaintiffs did not comply with 12 U.S.C. § 1821(d)(6).423 According to the district court, the plaintiffs had to take some action within sixty days after the claim denial in order for the case to

415. Id.
416. Id.
417. Id.
418. Id. (referencing Marquis v. FDIC, 965 F.2d 1148 (1st Cir. 1992)).
419. Id.
420. Id. at 1062.
422. Id. at 1061.
423. Id.
The court of appeals disagreed, reversed the district court, and held that "where the district court entered a stay of definite duration, claimants need not take affirmative action to 'continue' a suit which was filed before the appointment of the receiver: the suit goes on when the stay expires."425

Under the court's holding, the case becomes active once the definite stay expires.426 The court commented that none of the plain language of section 1821(d)(6) requires an affirmative act in a case like the one before the court, and that its interpretation was consistent with the purpose of FIRREA—quick and efficient claims processing.427 Accordingly, if a claimant fails to exhaust available administrative remedies by the time a court-ordered stay of definite duration expires, then the FDIC should assert such failure. Otherwise the suit simply continues.428

2. Right of Receiver or Conservator of Failed Financial Institution to Repudiate Lease Under FIRREA. In Resolution Trust Corp. v. United Trust Fund, Inc.,429 the United States Court of Appeals for the Eleventh Circuit held that a conservator, as well as a subsequently-appointed receiver of a failed financial institution, has an independent right to repudiate a lease under FIRREA, and that the reasonable period for repudiation begins to run anew with the subsequent appointment. The receiver repudiated the lease at issue within four months of its appointment, and the court held that this represented a reasonable time.430

United Trust Fund, Inc. ("UTF") bought Pioneer Federal Savings Bank's ("Old Pioneer's") corporate headquarters in Florida (the "Property") for $14 million and agreed to lease the Property back to Old Pioneer for a ten-year period as part of a sale and leaseback transaction.431 On February 1, 1990, the Office of Thrift Supervision ("OTS") declared Old Pioneer insolvent and appointed the RTC as its conservator. On March 8, 1990, OTS put Old Pioneer into receivership with the RTC as receiver, formed a new entity named Pioneer Federal Savings Bank ("New Pioneer"), and placed New Pioneer into conservatorship with the RTC as the appointed conservator. Under the receivership, substantially all of the assets and liabilities of Old Pioneer in receiver-

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424. Id.
425. Id. at 1062 (emphasis in original).
426. Id.
427. Id.
428. Id.
429. 57 F.3d 1025 (11th Cir. 1995).
430. Id. at 1029.
431. Id. at 1029-30.
ship were transferred to New Pioneer and placed in the hands of the federal conservator. During this period, the RTC, as conservator, performed its obligations under the lease and decided not to repudiate the lease in September 1990. On February 28, 1991, the OTS appointed the RTC as receiver of New Pioneer. RTC then entered into an agreement with Great Western Bank ("Great Western") whereby Great Western agreed to purchase some of New Pioneer's assets and assume certain of its liabilities. The agreement gave Great Western a ninety-day option to assume the lease. After discovering that Great Western had notified the RTC that Great Western would not exercise its option to assume the lease, the receiver repudiated the lease effective July 1, 1991 and cited 12 U.S.C. § 1821(e) as authority for its repudiation. The litigation focused on this repudiation.

Under 12 U.S.C. § 1821(e)(1), the RTC, as conservator or receiver, is entitled to repudiate leases. The timing of the authorized repudiation is governed by 12 U.S.C. § 1821(e)(2), which provides that "[t]he conservator or receiver appointed for any insured depository institution in accordance with subsection (c) of this section shall determine whether or not to exercise the rights of repudiation under this subsection within a reasonable period following such appointment." If the RTC, in accordance with these statutory requirements, repudiates a lease, it is not liable for damages other than contractual rent through the date of the repudiation. Moreover, the lessor has no claim for damages under any acceleration clause or under any other penalty provision in the lease agreement.

The lower court found that the RTC, as receiver, did not have a right independent of its right as the predecessor conservator to repudiate the lease. Consequently, the lower court held that the period of time to repudiate the lease began on or about March 9, 1990, when the OTS

432. Id. at 1031.
433. Id. at 1032. 12 U.S.C. § 1821(e)(1) provides that:
   In addition to any other rights a conservator or receiver may have, the conservator or receiver for any insured depository institution may disaffirm or repudiate any contract or lease—(A) to which such institution is a party; (B) the performance of which the conservator or receiver, in the conservator's or receiver's discretion, determines to be burdensome; and (C) the disaffirmance or repudiation of which the conservator or receiver determines, in the conservator's or receiver's discretion, will promote the orderly administration of the institution's affairs.
435. 57 F.3d at 1032 (quoting 12 U.S.C. § 1821(e)(2) (1994)).
436. Id.
437. Id.
438. Id. at 1031-32.
appointed the RTC as conservator for New Pioneer, and that the fifteen and one-half month period between the appointment of the RTC as conservator on March 9, 1990 and the RTC's repudiation on June 21, 1991 did not represent a reasonable time for repudiation. Accordingly, the lower court found that the RTC had defaulted on the lease.

On appeal, the RTC argued that the lower court erred by misconstruing section 1821(e), and that both the conservator and the receiver had independent rights under the statute to repudiate the lease within a reasonable time. The RTC contended that the repudiation occurred within four months of its appointment as receiver of New Pioneer. The court of appeals agreed with the RTC and reversed the lower court.

The court adopted the reasoning and holding of the Eighth Circuit Court of Appeals in Resolution Trust Corp. v. Cedar-Minn Building Ltd. Partnership. In that case, the Eighth Circuit held that the plain language of FIRREA grants an independent right of repudiation to the RTC both in its capacity as receiver and as conservator of a failed financial institution. The Eighth Circuit also found that a conservator and receiver have independent reasonable time periods in which to repudiate. Accordingly, the court of appeals refused to find the RTC liable for breach of the lease because the RTC repudiated in accordance with the statute.

C. New State Banking Laws

During the survey period, there were important revisions and additions made to the state’s banking laws, especially in the area of branch banking. On January 26, 1996, the Georgia General Assembly repealed and replaced the old Georgia branch banking act with a new

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439. Id. at 1032.
440. Id. (citing Resolution Trust Corp. v. United Trust Fund, 775 F. Supp. 1465, 1469 (S.D. Fla. 1991), rev'd, 57 F.3d 1025 (11th Cir. 1995)).
441. Id.
442. Id.
443. Id. at 1036.
444. Id. at 1032-33; Resolution Trust Corp. v. CedarMinn Bldg. Ltd. Partnership, 956 F.2d 1446 (8th Cir.), cert. denied, 506 U.S. 830 (1992).
445. 57 F.3d at 1032 (citing CedarMinn, 956 F.2d at 1450).
446. Id. (citing CedarMinn, 956 F.2d at 1451).
447. Id. at 1032-39.
448. For a discussion of rules adopted by the Georgia Department of Banking and Finance during the survey period, see Paul A. Quirós & Gregory M. Bell, Business Associations, 47 MERCER L. REV. 41, 83-85 (1995).
branch banking act (the "Intrastate Act").

One of the most notable changes made by the Intrastate Act is that after July 1, 1996, a bank, with the prior approval of the Georgia Department of Banking and Finance ("the Department"), may establish three new or additional branch banks on a de novo basis and in the same manner currently provided for the establishment of bank offices under the Georgia Code. Such branches are not geographically restricted and may be located anywhere in Georgia. Otherwise, the restrictions on the ability of Georgia banks to form or acquire branch banks that existed prior to July 1, 1996 continue to apply until July 1, 1998.

Another major revision of the Intrastate Act allows for future branching capability. Effective July 1, 1998, the Intrastate Act provides for the establishment of new or additional branches with the prior approval of the Department by three different methods: (1) de novo in the same manner as currently provided for the establishment of bank offices pursuant to the Georgia Code; (2) by relocation of the parent bank or another branch bank; or (3) by merger, consolidation, or purchase of assets and assumption of liabilities involving another parent bank or branch bank.

The General Assembly also passed significant legislation in the area of interstate branch banking by adopting an interstate banking act in 1996 (the "Interstate Act"), codified as parts 19 and 20 of Article 2, Chapter 1, Title 7 of the O.C.G.A. The General Assembly expressly intended for the Interstate Act to place primary consideration on the protection and promotion of customer convenience, the preservation of the competitive and other advantages of the dual banking system, and the proper supervision and regulation of all depository, lending and financial service providers in the state.

Effective April 1, 1996, Part 19 of the Interstate Act includes comprehensive provisions governing the acquisition of Georgia banks by out-of-state holding companies, as well as the acquisition of out-of-state banks by Georgia holding companies. In addition, the Act sets forth application, notice, registration and other related requirements.

Part 19 contains a provision prohibiting holding companies from

450. Id. § 7-1-601(c)(1).
451. Id. See also O.C.G.A. § 7-1-602 (1989).
452. Id. § 7-1-601 (Supp. 1996).
453. Id. § 7-1-601(c)(2), (3).
455. Id. § 7-1-628(c) (Supp. 1996).
456. Id. § 7-1-620.
457. Id.
acquiring a Georgia bank unless that bank or its predecessor has been in existence and continuously operated or incorporated as a bank for a period of five years or more prior to the date of acquisition.\footnote{458} Another prohibition included in Part 19 is that no out-of-state holding company may control thirty percent or more of the amount of deposits of insured depository institutions in Georgia after consummation of the acquisition.\footnote{460} This restriction is expressly made subject to any regulations passed by the Commissioner of Banking and Finance setting forth waiver procedures whereby the foregoing thirty percent limitation may be waived upon a showing of good cause.\footnote{460} Part 19 also sets out two transactions that do not have to comply with the five year rule or the thirty percent limitation—provided that the holding company notifies the Department within thirty days following the consummation of the transaction.\footnote{461} These transactions include:

1. The acquisition of a Georgia bank, if such acquisition has been consummated with assistance from the Federal Deposit Insurance Corporation under Section 13(c) of the Federal Deposit Insurance Act as amended, 12 U.S.C. § 1823(c); \footnote{460} and
2. The acquisition of a Georgia bank, if such acquisition has been consummated in the regular course of securing or collecting a debt previously contracted in good faith, as provided in and subject to the requirements of Section 3(a) of the federal Bank Holding Company Act of 1956.\footnote{462}

The General Assembly enacted part 20 of the Interstate Act to allow interstate banking and branching by merger under Section 102 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Riegle-Neal Act"), subject to certain limitations and requirements.\footnote{463} Part 20 becomes effective on June 1, 1997—the same target date implemented under the Riegle-Neal Act—and covers mergers in which the resulting bank will have banking locations in Georgia and at least one other state.\footnote{464} Basically, the resulting bank is the surviving entity remaining after the interstate merger transaction.\footnote{465} In addition, Part 20 provides for certain approval, notice, registration, and other

\footnotesize
\begin{itemize}
  \item \footnote{458} Id. § 7-1-622(b)(1).
  \item \footnote{459} Id. § 7-1-622(b)(2)(B).
  \item \footnote{460} Id.
  \item \footnote{461} Id. § 7-1-623.
  \item \footnote{462} Id.
  \item \footnote{463} Id. § 7-1-628.
  \item \footnote{464} Id.
  \item \footnote{465} Id. § 7-1-628.1.
\end{itemize}
Part 20 also includes provisions prohibiting the acquisition of any Georgia bank unless that bank (or any predecessor bank thereof) has been in existence for at least five years, as well as a provision forbidding any out-of-state bank from controlling thirty percent or more of the total amount of deposits held by all insured depository institutions. Both new provisions are similar to provisions found in Part 19.

Part 20 prohibits de novo branching in Georgia by out-of-state banks by opting out of Section 103 of the Riegle-Neal Act. The only permitted ways for an out-of-state bank to branch into Georgia is if such bank already has legally established a branch in Georgia and follows the same procedures and restrictions as Georgia banks, or if the out-of-state bank acquires a Georgia bank. However, there are restrictions on an out-of-state bank's capability to purchase and acquire Georgia branches. This restriction states that unless otherwise expressly permitted by Georgia law or regulation, no bank may acquire a branch or any other bank in Georgia without the acquisition of the entire bank, unless the acquiring bank could lawfully establish a branch in the geographic area where the branch to be acquired is located.

A number of other provisions were amended or adopted, but the foregoing provisions received the most comments from the banking industry. In addition, during the survey period the Georgia General Assembly produced significant legislation concerning the Uniform Commercial Code with respect to Article 3 (Negotiable Instruments) and Article 4 (Bank Deposits and Collections). The revisions affect banking and other transactions, and readers are referred to Professor Sabbath's article beginning on page eighty-three of this issue of the Annual Survey of Georgia Law for a thorough discussion of these changes.

466. Id. § 7-1-628.2.
467. Id. § 7-1-628.3(b).
468. Id. § 7-628.3(a)(2).
469. Id. § 7-1-628.8.
470. Id.
471. Id. § 7-1-628.9.
472. Id. §§ 11-3-101 to -605 & 11-4-101 to -407.