Business Associations

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This Article surveys recent developments in Georgia law in the areas of corporate, partnership, securities, and banking law. It covers noteworthy cases decided during the survey period by Georgia state and appellate courts, United States district courts located in Georgia, and the Eleventh Circuit Court of Appeals. Also included are legislative
enactments by the Georgia General Assembly revising the Official Code of Georgia Annotated ("O.C.G.A.").

I. CORPORATIONS

A. Piercing the Corporate Veil

Georgia courts will often pierce the corporate veil, thereby disregarding the corporate entity, to hold its shareholders personally liable. Veil piercing is commonly relied upon to prevent use of the corporate form to perpetrate fraud or other injustice. In determining whether to disregard the corporate entity, Georgia courts often apply the alter ego doctrine. The inquiry is whether the corporation acted as the alter ego or business conduit of its owner. Decisions addressing the issue are unpredictable, often yielding inconsistent results.

1. Georgia Supreme Court Emphasizes that the Alter Ego Theory is Distinct from Agency and Joint Venturer Theories of Liability. The Georgia Supreme Court recognized the confusion apparent in cases applying the alter ego doctrine in *Kissun v. Humana, Inc.*, a medical malpractice and wrongful death action against parent corporation Humana, Inc., its wholly-owned subsidiary Humana Hospital-Newnan, and an individual physician. The court of appeals had concluded that because there was no evidence justifying piercing the corporate veil between parent and subsidiary, there could be no claim against the parent under agency or joint venturer theories. The Georgia Supreme Court granted certiorari to consider whether a parent corporation can be held liable for the acts or omissions of a wholly-owned subsidiary corporation under theories of apparent or ostensible agency or joint venturer although evidence is insufficient to pierce the corporate veil.

The supreme court held that insufficient evidence to pierce the corporate veil does not automatically preclude parent corporation liability under agency or joint venturer theories. The court noted that confusion often arises because alter ego, agency, and joint venturer theories are closely intertwined. "In discussing the alter ego doctrine, the courts frequently invoke the term 'agency' in the context of the subsidiary corporation having been so organized and controlled and its

3. *Id.* at 419, 479 S.E.2d at 752.
4. *Id.*
5. *Id.*, 479 S.E.2d at 751.
6. *Id.*
business conducted in such a manner as to make it merely an agency, instrumentality, adjunct, or alter ego of another corporation. While there are situations in which evidence that supports veil piercing also establishes an agency relationship between the parties, the theories are distinct. The court remanded the case for consideration of whether evidence existed that the subsidiary hospital acted as an agent or was a joint venturer with parent Humana, Inc. to allow a finding of liability in the absence of veil-piercing factors.

2. Requisites for Piercing Corporate Veil Not Met. In NEC Technologies, Inc. v. Nelson, the supreme court again reversed the court of appeals finding that NEC Technologies, Inc. ("Technologies"), an importer of electronic components, was not the alter ego of NEC Ltd., manufacturer of the components. Plaintiffs sued Technologies, but not manufacturer NEC Ltd., for injuries arising from a fire allegedly caused by defective electrical components in a Curtis Mathes television set. Because the supreme court’s review of the record revealed that Technologies and NEC Ltd. had not commingled funds nor shared officers and employees, the evidence did not suggest that Technologies acted as the alter ego of NEC Ltd. by importing the components. Plaintiffs’ assertion that NEC Ltd. performed its business in the United States through Technologies and a Curtis Mathes agent’s inability to distinguish between the entities did not create a question of fact on the issue.

Although neither of these cases clarified the Georgia courts’ application of veil-piercing doctrines, these cases are noteworthy as indicators of the extension of allegations of veil piercing by plaintiffs in nonconstruction related cases.

B. Successor Liability: Under “De Facto Merger” or “Mere Continuation” Theories, Second Insurer Succeeded to Liabilities of First Insurer as Result of Reorganization

In Dickerson v. Central United Life Insurance Co., a fraud action against Life of America Insurance Co., the court applied de facto merger

7. Id. at 420, 479 S.E.2d at 752-53 (citations omitted).
8. Id. at 422, 479 S.E.2d at 754.
10. Id. at 397, 478 S.E.2d at 775.
11. Id. at 390, 478 S.E.2d at 770.
12. Id. at 397, 478 S.E.2d at 775.
13. Id.
and mere continuation theories to justify its amendment of a pretrial order to name Central United as the defendant in the fraud action.\textsuperscript{15} The court found that even though the parties had structured their consolidation transaction as a purchase of assets, Central United had succeeded to the liabilities of Life of America under either de facto merger or mere continuation theories as a result of Life of America's acquisition of Central United, consolidation of the companies into a single entity operating under the Central United name, and bulk reinsurance by Central United of all of Life of America's policies.\textsuperscript{16}

The court noted the general rule that a purchasing corporation does not assume liabilities of seller unless: (1) there is agreement to do so; (2) the transaction is a merger; (3) the transaction is a fraudulent attempt to avoid liabilities; or (4) the purchaser is a mere continuation of the predecessor corporation.\textsuperscript{17} The court found that the relationship between Life of America and Central United supported the finding that Central United succeeded to the liabilities of Life of America.\textsuperscript{18}

First, the court found that the bulk reinsurance and consolidation transaction met the requisites of a de facto merger because “there was and remains a continuity of management, assets, business, physical location, and shareholders between the now defunct entity Life of America and the new entity known as Central United.”\textsuperscript{19} Second, the court concluded that the newly consolidated entity, Central United, was a “mere continuation” of Life of America.\textsuperscript{20} The test for whether one corporation is a mere continuation of another is “whether there is a continuation of the corporate entity of the seller” with the key element being “a continuity of officers, directors, and shareholders.”\textsuperscript{21} Noting that Georgia law recognizes common law continuation when there is some identity of ownership, the court found complete identity of ownership and virtual identity in management between Central United and the former Life of America.\textsuperscript{22} Thus, amendment of the fraud action to add Central United as a party was proper.\textsuperscript{23} This case illustrates that courts may look through the structure of a transaction agreed upon by the parties if the elements of a de facto merger are present in order to find continued liability.

\begin{thebibliography}{9}
\bibitem{15} Id. at 1475.
\bibitem{16} Id.
\bibitem{17} Id.
\bibitem{18} Id.
\bibitem{19} Id.
\bibitem{20} Id.
\bibitem{21} Id.
\bibitem{22} Id.
\bibitem{23} Id.
\end{thebibliography}
C. Imputation of Employee Acts and Omissions to Corporation

1. Attorney-Shareholders in Professional Corporation Not Personally Liable for Professional Misconduct of Majority Shareholder Attorney. The Georgia Supreme Court considered whether shareholder-members of a law firm organized as a professional corporation can be held jointly and severally liable to a client for the professional misconduct of another shareholder in the firm in *Henderson v. HSI Financial Services, Inc.* 24 HSI sued a law firm and its three shareholders individually to recover for the majority shareholder's failure to pay HSI money due under a note representing money collected by the firm on HSI's behalf. 25 HSI prevailed in the lower court against the two uninvolved shareholders who appealed this decision to the supreme court. 26

Before *Henderson*, a member of a firm organized as a professional corporation was personally liable for the professional misconduct of other lawyers in the firm. 27 In *Henderson* the Georgia Supreme Court overruled its earlier holding in *First Bank & Trust Co. v. Zagoria* 28 and rejected this rule of strict liability as inconsistent with the Georgia Professional Corporations Act. 29 The court stated that although it has the regulatory authority to define the group structure in which lawyers practice, such as a partnership or professional corporation, relevant statutes govern whether a particular structural form excepts its members from personal liability. 30 The court held that lawyers practicing as shareholders in a professional corporation have the same rights and responsibilities as shareholders in other professional corporations. 31

The Georgia Professional Corporations Act provides that such a corporation and its shareholders enjoy the same rights, privileges, and immunities as shareholders of business corporations. 32 The Georgia

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25. *Id.* at 844, 471 S.E.2d at 886.
26. *Id.*, 471 S.E.2d at 885.
27. *Id.* (citing First Bank & Trust, 250 Ga. 844, 302 S.E.2d 674).
29. 266 Ga. at 845, 471 S.E.2d at 886. The Georgia Professional Corporations Act is codified at O.C.G.A. sections 14-7-1 to -7.
30. 266 Ga. at 845, 471 S.E.2d at 886.
31. *Id.*
32. *Id.* at 846, 471 S.E.2d at 887 (citing O.C.G.A. § 14-7-3 (1994)).
Business Corporation Act, in turn, provides that “a shareholder of a corporation is not personally liable for the acts or debt of the corporation except that he may become personally liable by reason of his own acts or conduct.” The court concluded that the two shareholders were not jointly and severally liable for the professional misconduct of the majority shareholder. The court noted that its holding did not undermine protection of the client because a lawyer practicing in a professional corporation remains personally liable to clients for his own acts of professional negligence and the professional corporation itself is liable to the extent of its corporate assets for the malpractice of its members.

2. Criminal Conviction of Corporation for Theft of Timber Upheld. In *Davis v. State*, defendant Ronald Davis Logging Company, Inc. (“Davis Logging”) unsuccessfully challenged its conviction on two counts of theft of timber. This case illustrates the principle that a corporation may be prosecuted for an act or omission constituting a crime if an agent of the corporation performs the act that is an element of the crime while acting within the scope of his office or employment and on behalf of the corporation.

Owners of Davis Logging purported to own and later convey timber rights to a particular tract of land to Keadle Lumber Enterprises when, in fact, Davis Logging never owned the rights. The owners of Davis Logging knowingly cut timber from Keadle Lumber’s land and sold it back to Keadle Lumber with the representation that it was from another tract. The court held that the evidence was sufficient to support conviction of Davis Logging based upon the conduct of its principals while acting on behalf of the corporation.

D. Shareholder Inspection of Corporate Records

In *Westbury Square Townhouses Ass'n v. Bryan*, a case of first impression, the Georgia Court of Appeals considered what notice is required to a nonprofit corporation prior to entry of an order allowing its

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34. Id.
35. 266 Ga. at 845, 471 S.E.2d at 886.
36. Id.
38. Id. at 565, 484 S.E.2d at 287-88.
39. Id. at 566, 484 S.E.2d at 287.
40. Id.
members access to corporate records under O.C.G.A. section 14-3-1604. On application by a member, the trial court ordered Westbury Square to allow inspection of its corporate records and awarded costs and attorney fees to the member. Westbury appealed on due process grounds because it first received notice of the application for inspection only after the court had entered its order.

O.C.G.A. section 14-3-1604 provides that a court may summarily issue an order for access to records of a nonprofit corporation and order payment of a member's costs and attorney fees. However, section 14-3-1604 does not specify the form, content, or timing of notice required to the corporation before it can be ordered to permit access to its records or to pay costs and attorney fees. Although there is a strong public policy favoring a shareholder's right to inspect and copy corporate records, the court emphasized that the right must be exercised in a manner that comports with due process. The court of appeals held that the trial court violated Westbury Square's due process rights because Westbury Square did not have a reasonable opportunity to challenge the member's demand for access to records prior to being ordered to pay costs and attorney fees.

O.C.G.A. section 14-3-1604 does not define procedures for notice, and therefore, the court proposed its own guidelines:

(1) A corporate member aggrieved by a corporation's refusal of, or failure to respond to, a demand for inspection and copying of records may file an application with the superior court for an order requiring access and awarding costs and attorney fees; (2) the application shall be served on the corporation pursuant to O.C.G.A. [section] 9-11-4; and (3) the court shall expedite a hearing on the matter, as the statute requires, and the hearing may be set by rule nisi.

The case was remanded for further proceedings consistent with this procedure.

42. O.C.G.A. § 14-3-1604 (1994).
43. 223 Ga. App. at 886-87, 479 S.E.2d at 190-91.
44. Id. at 887, 479 S.E.2d at 191 (citing O.C.G.A. § 14-3-1604).
45. Id., 475 S.E.2d at 192.
46. Id., 475 S.E.2d at 191-92.
47. Id.
48. Id. at 889, 475 S.E.2d at 193.
49. Id.
E. Breach of Fiduciary Duties

1. Sale of Corporation via Leveraged Buyout to Third Party

Not Breach of Fiduciary Duty by Officers & Directors. In In re Munford, Inc., the Eleventh Circuit Court of Appeals considered whether officers and directors of Munford, Inc. ("Munford") fulfilled their fiduciary obligation to evaluate a proposed leveraged buyout merger agreement ("LBO") ultimately entered into by the corporation. Munford, Inc. alleged that its officers and directors violated the business judgment rule by approving the LBO without considering the economic effect of the transaction. That rule requires officers and directors of companies to discharge their duties in good faith and with the care of an ordinary prudent person. Specifically, Munford, Inc. on behalf of itself and unsecured creditors in Munford, Inc.'s bankruptcy proceeding, contended that the officers and directors disregarded a written report prepared by Shearson Lehman Brothers that disfavored an LBO based on its opinion that Munford would need all of its internally generated cash flow to fund growth. Munford also argued that its articles of incorporation ("Article 9") imposed a higher duty of care on officers and directors than required under state law and created a private right of action independent from O.C.G.A. section 14-2-152.1(a)(1). Article 9 "requires the directors and officers to give due consideration to 'the extent to which the assets of the corporation will be used' for financing and 'the social, legal, and economic effects of the transaction on the employees, customers, and other constituents of the corporation.'"

The court rejected Munford's arguments and determined that the directors and officers satisfied their duties under the business judgment rule. The court found that the record clearly established that Munford's officers and directors consulted legal and financial experts throughout the search for a buyer for Munford, Inc. Further, the court found that Munford's failure to support its contention of a higher duty of care by presenting any binding legal authority that Munford's

50. 98 F.3d 604 (11th Cir. 1996).
51. Id. at 611.
52. See O.C.G.A. §§ 14-2-830(a) & 14-2-842(a) (1994).
53. 98 F.3d at 611 & n.6.
55. Id.
56. Id.
57. Id.
articles created a separate cause of action imposing a greater duty than the business judgment rule required rejection of that claim. 68

2. Predicting Georgia Law, Eleventh Circuit Refuses to Recognize Financial Adviser Liability for Aiding & Abetting Breach of Fiduciary Duty. In the same case, Munford urged the court to recognize a cause of action for aiding and abetting a breach of fiduciary duty against Shearson Lehman Brothers, 59 Munford's financial advisor. Munford argued that Shearson aided and abetted the directors' and officers' breach of fiduciary duty when it provided a fairness opinion concerning the buying party's offering price despite its earlier report that an LBO was not financially prudent for Munford. 60 Such a theory would require a showing that the primary wrongdoer had a fiduciary duty and breached that duty and that the aider and abettor knew of the breach and substantially assisted in the wrongdoing. 61

The court noted that Georgia courts acknowledge aiding and abetting causes of action in limited contexts, none of which relate to breach of fiduciary duty. 62 Predicting Georgia law, the Eleventh Circuit declined to extend aider and abettor liability to breaches of fiduciary duty because to do so "would enlarge the fiduciary obligations beyond the scope of a confidential or special relationship." 63

F. General

During the survey period, the court of appeals decided six cases addressing general principles of corporate law. In Korey v. BellSouth Telecommunications, Inc., 64 the court held that an individual who arranged for telephone services with BellSouth on behalf of an unincorporated business was personally liable for both pre- and post-incorporation charges because, upon incorporation of the business, the individual never advised BellSouth that it was dealing with a newly formed corporation. 65 In Kim v. Tex Financial Corp., 66 the court held that a maker of a note was estopped to deny the corporate existence of lender Tex Financial Corporation because the maker had signed the note that

58. Id.
59. Id. at 612.
60. Id. at 613.
61. Id.
62. Id.
63. Id.
65. Id. at 859, 485 S.E.2d at 500.
explicitly listed Tex Financial Corporation as payee. The court of appeals also held in Cohen v. Capco Sportswear, Inc. that a shareholder’s handwritten, signed note to a supplier stating that the shareholder “would be happy to personally guarantee our account” did in fact constitute a guaranty binding the shareholder personally.

In Crisp Pecan Co. v. Wiggins Produce Co., the court of appeals held that an Alabama corporation could maintain a suit in Georgia, although the corporation had not obtained authority to operate in Georgia, because O.C.G.A. section 14-2-1501(b) provides an exception for corporations “transacting business” in Georgia. In Altama Delta Corp. v. Howell, the court of appeals held that ambiguities in a contract for sale and purchase of a corporation’s stock and assets required reversal of summary judgment and remand of the case to the trial court for a determination of the agreement’s meaning. Lastly, in Harish v. Raj, an action by sellers of shares of stock against buyers alleging that buyers conspired to obtain shares for less than their market value, the court of appeals held that buyers did not owe a fiduciary duty to sellers because all parties were directors of the same corporation.

G. Legislative Changes

The 1997 session of the Georgia General Assembly yielded several amendments to the Georgia Business Corporation Code, (“Corporate Code”), the most notable of which are summarized below.

1. Facsimile Transmission. O.C.G.A. section 14-2-141(b) was amended to provide that a notice sent by facsimile transmission shall be deemed to be notice in writing for purposes of corporate law. The amendment clarifies that the court of appeals holding in Georgia Department of Transportation v. Norris, that a fax is not a writing,
is not generally applicable under the Corporate Code. Amendments to O.C.G.A. section 14-2-722(b), (c), (d), and (h) and to section 14-2-724(d) and (e) added references to facsimile transmission of proxies in order to conform this language more closely to recent changes in the Model Business Corporation Act.

2. Treasury Shares. O.C.G.A. section 14-2-623 was amended to include new subsection (d), which provides that when a corporation having treasury shares declares a share dividend, the dividend shall not be deemed to include a dividend on treasury shares unless the resolution declaring the dividend expressly so provides. The amendment enables a listed company to preserve the relative value of its treasury shares by providing a default rule for the treatment of share dividends, which are sometimes treated as stock splits. New subsection (e), which authorizes a corporation to create security interests in treasury shares, was added to O.C.G.A. section 14-2-631. Subsection (e) is intended to allow a corporation to pledge its own treasury shares as collateral for corporate obligations. O.C.G.A. section 14-2-721(b) was amended to preclude a corporation from voting its own shares. A corporation's subsidiaries are already covered by this prohibition.

3. Shareholders' Meetings. Subsection (a) to O.C.G.A. section 14-2-702 was revised to eliminate the requirement that a shareholder demand be delivered only to the corporate secretary thus permitting delivery to the corporation generally. New subsection (e) to O.C.G.A. section 14-2-702 states that, unless otherwise provided in a corporation's articles of incorporation, a shareholder may revoke by a writing a written demand for a special meeting if the writing is received by the corporation prior to the call of the special meeting. New subsection (f) to O.C.G.A. section 14-2-702 provides that a bylaw provision governing the percentage of shares required to call special meetings is not a quorum or voting requirement.

80. Id. §§ 14-2-722(b), (c), (d), (h) & 14-2-724(d), (e); Id. § 14-2-722 note.
81. Id. § 14-2-623(d).
82. Id. note.
83. Id. § 14-2-631(e).
84. Id. note.
85. Id. § 14-2-721(b) & note.
86. Id. § 14-2-702(a) & note.
87. Id. § 14-2-702(e).
88. Id. § 14-2-702(f).
4. Shareholder Action by Written Consents. O.C.G.A. section 14-2-704(d) was amended to provide that when shareholders act by written consent, the consents must be dated and must be obtained within sixty days of each other. Subsection (d) states:

No written consent shall be effective to take the corporate action referred to therein unless, within 60 days of the earliest date appearing on a consent delivered to the corporation in the manner required by this Code section, evidence of written consents signed by shareholders sufficient to act by written consent are received by the corporation. The amendment was intended to minimize the possibility that shareholder action by written consent will be authorized by persons who may no longer be shareholders at the time the action is taken. Subsection (d) also permits revocation of such consents prior to filing the consents with the corporation. O.C.G.A. section 14-2-704(e) provides that these consents are not effective until filed with the corporation.

5. Required Appointment of Inspectors for Publicly Traded Corporations. Newly enacted O.C.G.A. section 14-2-729.1 requires corporations listed on a securities exchange or Nasdaq to appoint inspectors of elections and to specify their duties with respect to supervising elections.

6. Voting Rules on Merger and Asset Sales. Several technical changes were made in voting rules on mergers and asset sales. O.C.G.A. section 14-2-1103(h), which excuses a corporation from having a shareholder vote on a merger if its articles of incorporation remain unchanged, if share ownership of existing shareholders remains unchanged, and if the shares outstanding after the merger were authorized prior to the merger, was amended to include references to share exchanges. O.C.G.A. section 14-2-1202 provides for shareholder voting on certain asset sales. Subsection (e) specifies the required majority vote unless the articles of incorporation or the board specifies

89. Id. § 14-2-704(d).
90. Id.
91. Id. note.
92. Id.
93. Id. § 14-2-704(e).
94. Id. § 14-2-729.1.
95. Id. § 14-2-1103(h).
96. Id. § 14-2-1202 (1994).
a supermajority vote. Reference to voting rules contained in bylaws was inadvertently omitted and is added by this amendment.

7. Reinstatement Following Administrative Dissolution. Former law permitted an administratively dissolved corporation to be reinstated within five years of the effective date of the dissolution. O.C.G.A. section 14-2-1422(a) was amended to delete the five-year limitation. The five-year restriction was also removed by amendment to O.C.G.A. section 14-3-1422(a), dealing with administrative dissolution of nonprofit corporations.

II. PARTNERSHIPS

A. Formation

1. Franchise Contract Does Not Create Partnership Relationship. In Anderson v. Turton Development, Inc., the court of appeals concluded that a franchise contract under which one operates a business on a royalty basis does not create a partnership or agency relationship. Plaintiff alleged under partnership and agency theories that franchisor Choice Hotels International, Inc. ("Choice") was liable for injuries plaintiff sustained from a fall on an allegedly defective handicap ramp on the premises of a Comfort Inn operated by franchisee Turton Development. The court flatly rejected plaintiff's contention that the franchise agreement between the parties created a partnership relationship under which Choice could be held vicariously liable for the actions of its franchisee, Turton Development. The court stated that imposition of liability on a franchisor for the obligations of the franchisee requires a showing that: "(a) the franchisor has by some act or conduct obligated itself to pay the debts of the franchisee; or (b) the franchisee is not a franchisee in fact but a mere agent or 'alter ego' of the franchisor."

97. Id. § 14-2-1202(e) (Supp. 1997).
98. Id.
100. O.C.G.A. § 14-2-1422(a) (Supp. 1997).
101. Id. § 14-3-1422(a).
103. Id. at 273, 483 S.E.2d at 600.
104. Id.
105. Id. at 274, 483 S.E.2d at 601.
Concluding that the franchise agreement did not create an actual agency between Choice and Turton, the court stated that its operational requirements did not permit Choice to control the time, manner, and method of daily operations of the franchisee but were merely a means of protecting Choice's national identity and reputation. Although the franchise agreement required construction of handicap ramps, the ramps were designed, constructed, and maintained by Turton; therefore, Choice was not directly liable for alleged defects.

2. Alleged Statement by Individual Regarding Ownership Interest in Property Did Not Support Liability Under Ostensible Partnership Theory. An individual may be held accountable for partnership liabilities as an ostensible partner if he "by words spoken or written or by conduct, represents himself, or consents to another representing him to any one, as a partner in an existing partnership." The court of appeals examined the limits of the ostensible partnership doctrine in Lane v. Spragg, a fraud action in which the purchaser of a horse claimed that the father of a farm owner was the owner's ostensible partner and, therefore, liable for the owner's misrepresentations in connection with the sale.

Although the son represented that his father was his partner, and his father had cosigned a loan for the purchase of the farm, the court found that this evidence would not support a finding of ostensible partnership in light of the father's lack of knowledge of or consent to his son's statement. First, the court noted that O.C.G.A. section 14-8-16 provides for liability only when the ostensible partner consents to being held out as a partner. No evidence of consent existed in this case. Second, the court found that the father's cosignature on the loan, while creating a debtor-creditor relationship, did not support a finding of ostensible partnership.

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107. Id.
108. Id.
111. Id. at 606, 481 S.E.2d at 593.
112. Id., 481 S.E.2d at 594.
113. Id. at 607, 481 S.E.2d at 594.
114. Id.
115. Id. at 608, 481 S.E.2d at 594-95.
B. Substituted Service on Secretary of State Authorized

In McClendon v. 1152 Spring Street Associates-Georgia, Ltd. III, the court of appeals addressed whether a plaintiff attempting to serve process on a limited partnership in a renewal of a personal injury action made a reasonably diligent effort to serve the limited partnership's registered agent at its registered office. O.C.G.A. section 14-9-104(h) authorizes service on the Secretary of State whenever a registered agent of a limited partnership “cannot with reasonable diligence be found at the registered office.” In this case, plaintiff’s process server personally went to the limited partnership's registered office on four occasions within a nine-day period attempting to locate the registered agent. On his fifth attempt, he obtained the registered agent's phone number and left a message at the number for the agent. The court held that the plaintiff exercised reasonable diligence in his attempts to locate the limited partnership's registered agent and was authorized to serve process on the Secretary of State.

C. Rights and Liabilities of Partners

1. Partner Not Entitled to Reimbursement for Alleged Partnership Expenses Absent Required Contractual Approval. In Ledbetter v. Ledbetter, the court of appeals was called upon to resolve disputes between two partners engaged in a real estate investment partnership whose holdings included a shopping center, a mall, and a residential development. A corporation formed by the partners, Ledbetter Brothers, Inc. (“LBI”), managed the partnership's properties. Under the partnership agreement, each partner was required to submit partnership expenses to a named third party for approval and payment. However, on numerous occasions, plaintiff failed to do so. Amendments to the partnership agreement, made to facilitate termination of the partnership, granted the defendant partner’s real estate company a limited-time exclusive listing for sale of each of the partnership's properties. During the liquidation of partnership property, defendant's wife negotiated with a shopping center tenant to buy the executory portion of the tenant's lease.
Plaintiff claimed that defendant breached his fiduciary duties and engaged in impermissible self-dealing by willfully interfering in the sale of partnership property. Plaintiff pointed to defendant's wife's negotiations to buy a leasehold interest in partnership property. On cross-motions for summary judgment, the trial court held that this claim presented a jury question. The court of appeals affirmed, stating that a fact issue existed as to whether defendant was acting in a manner detrimental to the best interests of the partnership by permitting his wife to acquire an interest in the shopping center lease. The court stated that "the law forbids an agent employed to sell [realty] to place himself in an attitude of antagonism to the interest of his principal, by associating himself with another in the purchase of the land." Defendant, as the exclusive broker, owed the utmost duty of good faith to the partnership.

Defendant asserted that plaintiff willfully breached the expense approval requirement in the agreement by failing to submit several expenses for approval. Agreeing with the trial court, the court of appeals held as a matter of law that plaintiff violated the expense approval requirement in the agreement because he acknowledged his failure to submit expenses and admitted to improper use of partnership funds. A jury question remained on the issue of punitive damages arising out of plaintiff's breach because defendant alleged that plaintiff's conduct was fraudulent.

2. Auditor's Allocation of Responsibility Between Two Partners in Manner Inconsistent with Partnership Agreement Held Invalid. In McCaughey v. Murphy, the court of appeals held that an auditor allocating responsibility between two partners lacked authority to disregard the partnership agreement and award damages based on a percentage of ownership not provided by the partnership agreement. In late 1983, McCaughey and Murphy formed Boxwood Associates, a Georgia limited partnership, for the purpose of renovating a historical building. At Boxwood's inception, McCaughey was the sole general partner, owning slightly greater than a fifty percent interest;
Murphy, as a limited partner, owned the balance. When the project encountered financial difficulties in mid-1986, Murphy infused the project with large amounts of capital that went unmatched by McCaughey. Although McCaughey advised Murphy that he wanted out of the partnership and would not be responsible for any future funding of the project, McCaughey did not comply with the partnership agreement, which required the partners' mutual agreement on terms of withdrawal or reduction in partnership interest. In fact, McCaughey became a general partner in October 1987.\textsuperscript{131}

When the venture failed, Murphy sued McCaughey for recovery of funds Murphy expended to meet partnership obligations and for contribution against McCaughey as coguarantor on advances related to the project's completion. McCaughey counterclaimed. A court-appointed auditor arbitrarily concluded that McCaughey owed Murphy twenty percent of the capital contributed by Murphy. The trial court adopted the auditor's award but did not recognize Murphy's right of contribution against McCaughey.\textsuperscript{132}

The court of appeals found that the auditor erroneously concluded that McCaughey's partnership interest and corresponding share of liability was twenty percent rather than slightly over fifty percent.\textsuperscript{133} In allocating liabilities between the partners, the auditor was bound by the partnership agreement, which did not permit unilateral withdrawal.\textsuperscript{134} Because McCaughey had not withdrawn nor reduced his interest in accordance with the partnership agreement, his ownership interest remained at just over fifty percent.\textsuperscript{135} The court also reversed the trial court on the issue of contribution, rejecting McCaughey's contention that his consent was necessary for him to be obligated.\textsuperscript{136} As a general partner, McCaughey had personal liability for partnership obligations to other entities, and as his coguarantor, Murphy had a right to compel contribution against McCaughey.\textsuperscript{137}

D. Termination

In \textit{Carnes v. McNeal},\textsuperscript{138} the court of appeals held that incorporation of a partnership business and operation of the business in the corporate

\textsuperscript{131} \textit{Id.} at 874-75, 485 S.E.2d at 512-13.
\textsuperscript{132} \textit{Id.} at 874-75, 485 S.E.2d at 512-13.
\textsuperscript{133} \textit{Id.} at 875, 485 S.E.2d at 514.
\textsuperscript{134} \textit{Id.} at 877, 485 S.E.2d at 514.
\textsuperscript{135} \textit{Id.}
\textsuperscript{136} \textit{Id.} at 878, 485 S.E.2d at 515.
\textsuperscript{137} \textit{Id.}
form terminated the partnership and led the court to reject a former partner's claim for money deposited in a corporate bank account.\textsuperscript{139} The court stated that the partner turned shareholder could not rely on the partnership agreement to recover money that he had paid into the corporate account.\textsuperscript{140}

\section*{E. Legislative Changes}

Several amendments were made to the Georgia Limited Liability Company Act,\textsuperscript{141} Georgia Revised Uniform Limited Partnership Act\textsuperscript{142} and Uniform Partnership Act.\textsuperscript{143}

1. \textbf{Organization as Limited Liability Limited Partnership.} O.C.G.A. section 14-8-62(g) was amended to specifically provide that an entity may organize initially as a limited liability limited partnership rather than go through the two-step process under the pre-amendment law of forming as a limited partnership and then making the limited liability partnership election.\textsuperscript{144}

2. \textbf{Election of Limited Liability Company Status.} A Georgia corporation, limited partnership, or general partnership may elect to become a limited liability company ("LLC") pursuant to the procedure in O.C.G.A. section 14-11-212.\textsuperscript{145} New O.C.G.A. section 14-9-206.2 was enacted to permit entities to convert into limited partnerships by following the same procedure for converting to LLC status.\textsuperscript{146}

3. \textbf{Single Member Limited Liability Company.} The definition of an LLC contained in O.C.G.A. section 14-11-101(12) was amended to explicitly state that an LLC may be formed by one member.\textsuperscript{147} An amendment to O.C.G.A. section 14-11-101(18) clarified that a writing adopted by the sole member of a single member LLC constitutes an operating agreement for all purposes of the statute.\textsuperscript{148}

\begin{footnotesize}
\begin{enumerate}
\item Id. at 89, 479 S.E.2d at 476.
\item Id.
\item Id. §§ 14-9-108 to -1204.
\item Id. §§ 14-8-1 to -64.
\item Id. § 14-8-62(g) (Supp. 1997).
\item Id. § 14-11-212 (1994).
\item Id. § 14-9-206.2 (Supp. 1997).
\item Id. § 14-11-101(12).
\item Id. § 14-11-101(18).
\end{enumerate}
\end{footnotesize}
4. Real Estate Records May Reflect Conversion of Entity into LLC. New subsection (d) in O.C.G.A. section 14-11-212 explicitly permits recordation and notice of the conversion of an existing entity into an LLC in the real estate records by filing a certified copy of an LLC election with the clerk of the superior court where any real property owned by an LLC is located.149

5. Waiver of Limited Liability. Although a member of an LLC is not personally liable for the debts or obligations of the company, subsection (b) of O.C.G.A. section 14-11-303 was amended to explicitly permit a member of an LLC to agree under a written agreement to become personally obligated for debts of the company.150

III. SECURITIES

In another case involving Munford, Inc.,151 the Eleventh Circuit concluded that Georgia's stock distribution and repurchase statutes applied to a leveraged buyout acquisition of Munford, Inc.152 In the bankruptcy court, Chapter 11 debtor-corporation Munford, Inc. asserted that its directors violated Georgia's stock distribution and repurchase statutes by approving a leveraged buyout merger ("LBO") in which a third party purchased Munford, Inc.'s outstanding stock, rendering Munford, Inc. insolvent. The district court adopted the bankruptcy court's denial of the directors' motion for summary judgment, and the directors appealed.153

Georgia's capital surplus distribution statute provided that the board of directors may make distributions to shareholders out of capital surplus of the corporation in cash or property, but "[n]o such distribution shall be made at a time when the corporation is insolvent or when such distribution would render the corporation insolvent."154 Georgia's stock repurchase statute also prohibited corporate directors from repurchasing shares when the purchase would render the corporation insolvent.155 Directors who vote for or assent to a corporate distribution or stock repurchase that violates these provisions are subject to joint and several

149. Id. § 14-11-212(d).
150. Id. § 14-11-303(b).
151. In re Munford, 97 F.3d 456 (11th Cir. 1997).
153. Id. at 458.
liability for the amount distributed or paid to the extent the payments violate the restrictions. 156

On appeal the directors argued that the distribution and share repurchase statutes only applied when control of the company did not change hands and thus did not apply to this transaction because it represented an arm's-length sale of Munford, Inc. to a third party through an LBO. Alternatively, the directors argued that they were not personally liable for the alleged statutory violations because they approved the LBO in good faith and with the advice of counsel. 157

Adopting the reasoning of the bankruptcy court and affirming the district court, the Eleventh Circuit held that Georgia's restrictions on distribution and stock repurchase applied to the LBO:

To hold that Georgia's distribution and repurchase statutes did not apply to LBO mergers such as this, while nothing in these statutes precludes such a result, would frustrate the restrictions imposed upon directors who authorize a corporation to distribute its assets or to repurchase shares from stockholders when such transactions would render the corporation insolvent. 158

The court also held that liability could be imposed even if directors approved of the LBO in good faith and with advice of counsel because there is no affirmative defense for good faith and advice of counsel under Georgia's distribution and repurchase statutes. 159

IV. BANKING

A. Bank's Reversal of Customer's Deposit Three Months after Acceptance of Draft due to Missing Endorsement Raised Question of Commercial Reasonableness of Bank's Actions

In Peavy v. Bank South, 160 the court of appeals emphasized that a bank must act with commercially reasonable due diligence and good faith when exercising its contractual rights. 161 Certain Bank South customers sued the bank for conversion, tortious conversion, breach of warranty, and wrongful set-off after the bank debited their account for the amount of an improperly endorsed check that the bank allowed their

156. Id. (citing O.C.G.A. § 14-2-154(a)(1)-(2) (1982), superseded by O.C.G.A. § 14-2-832 (1994)).
157. Id.
158. Id. at 460.
159. Id.
161. Id. at 506, 474 S.E.2d at 694.
son to deposit into their account. The draft, drawn by CNL Insurance America on its account with Bank South, was jointly payable to the plaintiffs' son and Trust Company Bank even though it was endorsed only by the son. Three months later, upon discovering that the draft had been knowingly deposited without the copayee's signature, Bank South reversed the transaction, debiting plaintiffs' account and crediting CNL's account. At Bank South's request, plaintiffs voluntarily deposited $5,323.60, the amount of the draft, into their account to make up for the amount of the draft the bank had removed from plaintiffs' account.162

The trial court granted summary judgment to Bank South on all counts, and plaintiffs appealed.163 Reversing only with respect to plaintiffs' wrongful set-off claim, the court of appeals found that fact issues remained as to whether Bank South acted in a commercially reasonable manner in discovering its erroneous acceptance of the improperly endorsed draft and acted fairly as between its two customers in correcting the error.164 Given the general rule that a payor bank has until midnight of the banking day of receipt of a demand item to accept and pay or return it, the commercial reasonableness of Bank South's actions in this case, as depositary and payor bank, was clearly a question for the jury.165

B. Payment Defense to Action on Note

In Resiventure, Inc. v. National Loan Investors,166 an action by a successor-in-interest to a receiver of a failed bank against a borrower to collect on a promissory note, the court of appeals held that defendant-borrowers had the right to amend their answers to include a payment defense without leave of the court approximately seventeen months into litigation.167 The court also held that the borrowers' payment defense, which was independent of any side agreement, was not barred by 12 U.S.C. § 1823(e),168 which governs agreements against the interests of the Federal Deposit Insurance Corporation.169 First, the court of appeals reversed the trial court's ruling that the borrowers waived the payment defense.170 Under O.C.G.A. section 9-11-8(c), payment is an

162. Id. at 501, 474 S.E.2d at 691-92.
163. Id. at 503, 474 S.E.2d at 692.
164. Id. at 505-06, 474 S.E.2d at 694.
165. Id.
167. Id. at 222, 480 S.E.2d at 215.
170. Id.
affirmative defense that may be raised by amendment without leave of the court at any time before the entry of a pretrial order.\textsuperscript{171} In this case the borrowers had amended their answer to include a payment defense prior to the entry of a pretrial order; thus, leave of the court was not required.\textsuperscript{172} Second, the court of appeals reversed the trial court’s conclusion that the payment defense was barred by 12 U.S.C. § 1823(e), which precludes the maker of a note from asserting a defense based on any agreement that does not clearly appear in the bank's records.\textsuperscript{173} The court found that the borrowers’ claim of payment was not based on any unrecorded or undisclosed side agreement and was, therefore, not barred by 12 U.S.C. § 1823(e).\textsuperscript{174}

C. General

Finally, during the survey period, the court of appeals decided several cases touching on minor principles of banking law. On the issue of a bank’s fiduciary duties, the court of appeals decided \textit{Wright v. Swint},\textsuperscript{175} an action by real estate purchasers against a bank for its failure to uncover and correct a defective title.\textsuperscript{176} Although noting that the bank’s efforts in loaning money to the purchasers did not create a fiduciary relationship, the court of appeals held that the trial court erred in dismissing the bank and its agent for any wrongful acts committed on and after the defect was discovered.\textsuperscript{177} If the defendant bank and its agent assumed the duty to cure the cloud on title by promises made to the purchasers, but failed to do so, the bank may have breached a contractual duty for which an action for damages might lie.\textsuperscript{178}

In \textit{Moore v. Bank of Fitzgerald},\textsuperscript{179} a second case concerning an alleged fiduciary relationship between a bank and its customer, the court of appeals held that no such relationship existed between a mortgagor and mortgagee-bank, as creditor and debtor with clearly opposite interests.\textsuperscript{180} A letter from the bank requiring borrower to meet monthly with a bank official to monitor the progress of borrower's business did not indicate that lender and borrower had a confidential

\begin{footnotesize}
\begin{enumerate}
\item Id. at 221, 480 S.E.2d at 214 (citing O.C.G.A. § 9-11-8(c) (1993)).
\item Id. at 222, 480 S.E.2d at 214.
\item Id., 480 S.E.2d at 215.
\item Id. at 223, 480 S.E.2d at 215.
\item Id. at 224 Ga. App. 417, 480 S.E.2d 878 (1997).
\item Id. at 417-18, 480 S.E.2d at 879.
\item Id. at 419, 480 S.E.2d at 880.
\item Id.
\item Id. at 126, 483 S.E.2d at 139.
\end{enumerate}
\end{footnotesize}
The court of appeals also decided *Vass v. Gainesville Bank & Trust* and held that a bank was not required to honor a payment demand under a letter of credit when the demand failed to comply with the terms of the letter of credit. In *Hammock v. Bank South*, the court of appeals held that borrowers' voluntary reassumption of a prior debt by signing new promissory notes cured any defects in borrowers' prior contractual obligations to the bank under an unsecured letter of credit.

181. *Id.*
183. *Id.* at 261, 480 S.E.2d at 296.
185. *Id.* at 227, 483 S.E.2d at 670.