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Business Associations

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I. INTRODUCTION

This Article surveys notable cases in the areas of corporate, limited liability company, partnership, agency, and joint-venture law decided between June 1, 2013 and May 31, 2014 by the Georgia Supreme Court, the Georgia Court of Appeals, the United States Court of Appeals for the Eleventh Circuit, and the United States district courts located in Georgia.[1]

II. ISSUES OF FIRST IMPRESSION

A. *Questioned Application of the Business Judgment Rule*

During this survey period, the United States District Court for the Northern District of Georgia and the United States Court of Appeals for the Eleventh Circuit each certified questions to the Georgia Supreme Court regarding whether the business judgment rule precludes ordinary negligence claims against bank officers and directors. In *FDIC v. Loudermilk*,[2] the district court acknowledged that other federal courts

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1. For an analysis of Georgia business associations law during the prior survey period, see Crystal J. Clark, *Business Associations, Annual Survey of Georgia Law*, 65 MERCER L. REV. 55 (2013).

2. 984 F. Supp. 2d 1354 (N.D. Ga. 2013).

in the district "have uniformly applied the business judgment rule to protect bank officers and directors," but it "respectfully disagree[d]."[3] The court pointed to policy reasons to explain why the business judgment rule should not be applied to bank officers and directors sued by the Federal Deposit Insurance Corporation (FDIC).[4]

The court also cited section 7-1-490 of the Official Code of Georgia Annotated (O.C.G.A.),[5] which sets forth "the ordinary negligence standard of care applicable to bank officers and directors."[6] As a result, the court denied the defendants' motion to dismiss and certified the unsettled issue of law to the Georgia Supreme Court.[7]

In *FDIC v. Skow*,[8] the Eleventh Circuit also questioned the interaction of the business judgment rule with O.C.G.A. § 7-1-490.[9] With "no clear controlling precedent from the Supreme Court of Georgia," the court certified its questions to the Georgia Supreme Court.[10] The supreme court heard oral arguments in connection with the certified questions from *Loudermilk* on April 21, 2014, and *Skow* on May 19, 2014.[11] The impact of the court's decision could be quite far reaching. In addition to impacting the potential liability of Georgia's bank officers and directors, it is likely to have implications for the liability of other officers and directors as well.

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3. *Id.* at 1358-59.

4. *Id.* at 1359. Unlike a corporation, the monetary loss for a failed bank is ultimately borne by taxpayers and "echo[es] throughout the local and national economy." *Id.*

5. O.C.G.A. § 7-1-490 (2004).

6. *Loudermilk*, 984 F. Supp. 2d at 1359; *see also* O.C.G.A. § 7-1-490 ("Directors and officers of a bank or trust company shall discharge the duties of their respective positions in good faith and with that diligence, care, and skill which ordinary prudent men would exercise under similar circumstances in like positions.").

7. *Loudermilk*, 984 F. Supp. 2d at 1362.

8. 741 F.3d 1342 (11th Cir. 2013).

9. *Id.* at 1346.

10. *Id.* at 1346-47 (certifying, "(1) Does a bank director or officer violate . . . O.C.G.A. § 7-1-490 when he acts in good faith but fails to act with 'ordinary diligence' . . .?" and "(2) . . . can the bank officer or director defendants be held individually liable if they . . . are shown to have been ordinarily negligent or to have breached a fiduciary duty, based on ordinary negligence in performing professional duties?").

11. *Computerized Docketing System and Case Types: Case Number S14Q0454*, SUPREME COURT OF GEORGIA, http://www.gasupreme.us/docket_search/results_one_record.php?caseNumber=S14Q0454 (last visited Aug. 26, 2014); *Computerized Docketing System and Case Types: Case Number S14Q0623*, SUPREME COURT OF GEORGIA, http://www.gasupreme.us/docket_search/results_one_record.php?caseNumber=S14Q0623 (last visited Aug. 26, 2014).

B. *Application of Attorney-Client Privilege*

For the first time, the supreme court addressed the parameters of attorney-client privilege in the context of communications between a law firm and its in-house counsel in a legal malpractice lawsuit.[12] In *St. Simons Waterfront, LLC v. Hunter, Maclean, Exley & Dunn, P.C.*,[13] St. Simons Waterfront, LLC (SSW) sued Hunter, Maclean, Exley & Dunn, P.C. (Hunter Maclean), alleging legal malpractice stemming from Hunter Maclean's representation of SSW in a commercial real estate venture. When Hunter Maclean learned that it might be sued by SSW, it informed its in-house general counsel about the potential lawsuit. The in-house general counsel interviewed the attorneys who had been involved in the representation of SSW. At the same time, Hunter Maclean continued to represent SSW in real estate closings.[14]

After SSW brought suit, it sought the production of communications between Hunter Maclean and its in-house general counsel. The trial court held that any privilege the communications might have had was nullified due to the conflict of interest that had developed between Hunter Maclean and SSW.[15] According to the trial court, a conflict of interest existed because Hunter Maclean had "engaged in efforts to defend itself against SSW while simultaneously continuing to represent SSW, without advising SSW of the conflict."[16] The trial court concluded that "the conflict between the involved attorneys and SSW must be imputed to [the in-house general counsel] under Rule 1.10 of the Georgia Rules of Professional Conduct; and that any privilege within the firm was negated by this conflict of interest."[17]

The Georgia Court of Appeals reviewed other jurisdictions' approaches to the issue and then developed its own framework in which to analyze the case. The Georgia Supreme Court granted certiorari.[18] In considering the issue, the court determined that the best approach is "to analyze the privilege issue . . . as we would in any other lawsuit in which the privilege is asserted."[19] Accordingly, the court stated that attorney-

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12. *See* St. Simons Waterfront, LLC v. Hunter, Maclean, Exley & Dunn, P.C., 293 Ga. 419, 422, 746 S.E.2d 98, 104 (2013).

13. 293 Ga. 419, 746 S.E.2d 98 (2013).

14. *Id.* at 420, 746 S.E.2d at 102.

15. *Id.* at 421, 746 S.E.2d at 103.

16. *Id.*

17. *Id.*; *see also* GA. RULES OF PROF'L CONDUCT R. 1.10 (2001).

18. 293 Ga. at 419, 421, 746 S.E.2d at 102, 103.

19. *Id.* at 423, 746 S.E.2d at 104. Likewise, the court determined that in the law firm in-house general counsel context, the attorney work product doctrine should also be analyzed "using the standard rules that govern the doctrine in other contexts." *Id.* at 429,

client privilege attaches in the in-house general counsel context when "(1) there is an attorney-client relationship; (2) the communications in question relate to matters on which legal advice was sought; (3) the communications have been maintained in confidence; and (4) no exceptions to privilege are applicable."[20]

For the first requirement–establishing an attorney-client relationship–the court stated that a law firm must, as a factual matter, establish that "the firm's in-house counsel was actually acting in that capacity with regard to anticipated legal action against the firm."[21] To establish an attorney-client relationship in the in-house general counsel context, law firms should consider (1) adopting billing procedures that reflect that the firm itself is a client; (2) maintaining a separate file for communications pertaining to the representation; and (3) maintaining a full-time general counsel.[22] Disagreeing with the trial court's holding that the conflict of interest impacted the attorney-client privilege determination, the court opined that "the potential existence of an imputed conflict of interest between in-house counsel and the firm client is not a persuasive basis for abrogating the attorney-client privilege between in-house counsel and the firm's attorneys."[23]

Regarding the second requirement–that the communications relate to the purpose for which legal advice was sought–discussions with in-house counsel should involve "matters within the scope of the attorneys' employment with the firm."[24] Regarding the third requirement–that the communications remain confidential–only attorneys associated with the case at issue should be involved in the communications with the in-house counsel.[25]

Finally, to establish the attorney-client privilege, there must not be an applicable exception to the privilege.[26] In this regard, the court declined to adopt a "fiduciary duty" exception in the law firm in-house counsel context.[27] The court rejected "the notion that the attorney's

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746 S.E.2d at 108.

20. *Id.* at 423, 746 S.E.2d at 104 (citations omitted).

21. *Id.*

22. *Id.* at 424, 746 S.E.2d at 105.

23. *Id.* at 425-26, 746 S.E.2d at 105-06.

24. *Id.* at 426, 746 S.E.2d at 106.

25. *Id.* at 427, 746 S.E.2d at 107.

26. *Id.*

27. *Id.* at 428-29, 746 S.E.2d at 107-08. Fiduciary duty exceptions prohibit persons acting in a fiduciary capacity from asserting the privilege to shield their "communications with counsel from the beneficiary of the fiduciary relationship." *Id.* at 427, 746 S.E.2d at 107.

duty of loyalty [to his or her client] should automatically trump the privilege."[28]

Law firms now have specific guidance with respect to preserving the attorney-client privilege in connection with communications with their own in-house general counsels.

III. NOTEWORTHY CASES

A. *Stock Transfer Restrictions*

In *Mossy Dell, Inc. v. AB&T National Bank (In re Beauchamp)*,[29] the United States District Court for the Middle District of Georgia held that the stock-transfer restrictions listed under O.C.G.A. § 14-2-627(d)[30] are exhaustive, and any transfer restrictions not consistent with this statute are impermissible.[31] In *In re Beauchamp*, a corporation's articles of incorporation prohibited the transfer of any shares for a period of ten years. Once the ten-year period had expired, the corporation's shares could only be transferred to the shareholders' lineal descendants. A creditor of one of the shareholders obtained a judgment against the shareholder, whereby his shares were confiscated and sold at a public sale to that creditor. As purchaser of the shares, the creditor demanded that the corporation issue a new stock certificate recognizing the purchaser as the owner of the shares. This lawsuit ensued.[32]

Based on a plain language interpretation of O.C.G.A. § 14-2-627(d), the district court determined that (1) "subsection (d) lists the permissible mechanisms that may be used by a transfer restriction" and (2) "all mechanisms not listed are impermissible."[33] In applying the statute to the case at hand, the court determined that the ten-year transfer restriction was unreasonable, did not fit within one of the categories set forth in O.C.G.A. § 14-2-627(d), and was unenforceable.[34]

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28. *Id.* at 429, 746 S.E.2d at 108.
29. 500 B.R. 235 (Bankr. M.D. Ga. 2013).
30. O.C.G.A. § 14-2-627(d) (2003).
31. *In re Beauchamp*, 500 B.R. at 242.
32. *Id.* at 238.
33. *Id.* at 242.
34. *Id.* Factors relevant to determining the reasonableness of a transfer restriction include: (1) "the size of the corporation," (2) "the degree of restraint upon alienation," (3) "the time the restriction is to continue in effect," (4) "the method to be used in determining the transfer price of shares," (5) "the likelihood of the restriction's contributing to the attainment of corporate objectives," (6) "the possibility that a hostile shareholder might injure the corporation," and (7) "the probability of the restriction's promoting the best interests of the corporation." *Id.* at 244.

With respect to the family-related transfer restriction, the court determined that it was an acceptable mechanism for restricting transfers because it fit within O.C.G.A. § 14-2-627(d)(4), which permits prohibiting "transfer of the restricted shares to designated persons or classes of persons."[35] The court noted that O.C.G.A. § 14-2-627(d)(4) does not require a corporation to provide "an avenue for every shareholder to realize the value of his or her shares" because such a requirement would threaten the corporation's ability to restrict transfer to certain persons or classes of persons.[36] In sum, stock transfer restrictions must fall within one of the categories listed under O.C.G.A. § 14-2-627(d).

B. Clarifications Regarding Standards of Care

In *Rollins v. Rollins*,[37] the Georgia Supreme Court reversed the holding of the court of appeals regarding the appropriate standard of care owed by directors of corporations when such corporations are held within trusts and such directors are trustees of such trusts.[38] In *Rollins*, certain family trusts held a minority interest in corporate family entities. The trustees were alleged to have engaged in mismanagement of the trusts. The court of appeals determined that a heightened, trustee-level fiduciary standard applied to the case at issue.[39]

In reversing the court of appeals, the supreme court stated, "Although that holding may be appropriate as a general rule, it is inappropriate in this case both because the cardinal rule in trust law is that the intention of the settlor is to be followed, . . . and because the trusts hold only a minority interest in the family entities."[40] With the trusts holding only a minority interest, it is preferable instead to "allow the trustees to act in the interest of *all* the shareholders."[41] Accordingly, the court applied a deferential standard, holding that a trustee's corporate duties and actions should be held to a corporate-level fiduciary standard when a trustee of a trust, which holds a minority interest in a corporate entity, is also a director of such a corporate entity.[42]

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35. *Id.* at 245 (quoting O.C.G.A. § 14-2-627(d)(4)). The family-related transfer restriction prohibits the transfer to a designated class of persons–any class of persons who are not the shareholders' lineal descendants. *Id.*

36. *Id.*

37. 294 Ga. 711, 755 S.E.2d 727 (2014). Last year's Article discussed the holding and analysis of the appellate court for this case. *See* Clark, *supra* note 1, at 55-56.

38. *Rollins*, 294 Ga. at 712, 755 S.E.2d at 729.

39. *Id.* at 711-12, 755 S.E.2d at 729.

40. *Id.* at 714, 755 S.E.2d at 730 (citations omitted).

41. *Id.* at 715, 755 S.E.2d at 731 (emphasis added).

42. *Id.* at 715-16, 755 S.E.2d at 731.

C. *Clarifying the Reach of a Non-competition Clause*

In *Primary Investments, LLC v. Wee Tender Care III, Inc.*,[43] the Georgia Court of Appeals held that the non-competition clause in an asset-purchase agreement (APA) did not apply to the members of a limited liability company when the APA had only been signed by the limited liability company, not the individual members.[44] In *Primary Investments, LLC*, the Nixons purchased substantially all of the assets of Primary Investments, LLC (Primary) from the O'Briens through an APA between Primary, the seller, and N&N Holdings, LLC, the buyer.[45] The non-competition clause in the APA stated: "Until three years after the Closing Date . . . Seller agrees that neither Seller nor *its agents* will, unless acting in accordance with Buyer's prior written consent, . . . open any child care facility within a ten-mile radius of any Business Locations being sold to the Buyer hereunder."[46] Within two years, the O'Briens opened a new childcare facility within the ten-mile radius of Primary. This suit ensued.[47]

In determining whether the non-competition clause in the APA applied to the O'Briens, the court noted that the O'Briens were not a party to the agreement and did not sign the APA in their individual capacities.[48] Primary had no authority to bind the O'Briens on an individual basis to the terms of the APA.[49] As such, the court determined that "merely including the term 'its agents' in a contract signed by a limited liability company does not bind its members or managers individually."[50] In sum, to properly bind a limited liability company's members or managers, each individual must be made a party to the agreement, and each must sign in his or her individual capacity.[51]

D. *Statute of Limitations for Partnership Claims*

In *First Benefits, Inc. v. Amalgamated Life Insurance Co.*,[52] the United States District Court for the Middle District of Georgia confirmed Georgia Supreme Court precedent, holding that the statute of limitations

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43. 323 Ga. App. 196, 746 S.E.2d 823 (2013).
44. *Id.* at 201, 746 S.E.2d at 828.
45. *Id.* at 196-97, 746 S.E.2d at 826.
46. *Id.* at 197, 746 S.E.2d at 826.
47. *Id.*
48. *Id.* at 198-99, 746 S.E.2d at 827.
49. *Id.* at 200, 746 S.E.2d at 828.
50. *Id.*
51. *Id.*
52. No. 5:13-CV-37, 2013 U.S. Dist. LEXIS 110222 (M.D. Ga. Aug. 6, 2013).

for claims by one partner against another partner does not begin to run until after dissolution of the partnership.[53] The court rejected the defendant's argument that "'contemporary' Georgia law holds that limitations periods on claims between partners run from the breach of duty."[54] Thus, the court held that the plaintiffs' claims were not barred because four years had not elapsed since the plaintiffs allegedly terminated the partnership.[55]

E. Determining Proper Parties to a Lawsuit

In *National City Mortgage Co. v. Tidwell*,[56] the Georgia Supreme Court reversed the Georgia Court of Appeals and held that a merged corporation had standing to continue an action that had been brought against one of the premerger entities.[57] In *Tidwell*, the plaintiffs originally filed suit against National City Mortgage Company (National City), which merged with PNC Bank while the lawsuit was pending. No motion was made to add or substitute PNC Bank, and National City continued as the named defendant. When PNC Bank, as successor in interest to National City, attempted to appeal an adverse trial court ruling, the court of appeals dismissed the appeal, citing PNC Bank's lack of standing.[58]

The supreme court reversed the court of appeals jurisdictional decision, holding,

> When corporations merge, state law provides that the title to each corporation's property vests in the surviving corporation without any conveyance, transfer, or assignment . . . and a proceeding pending against any corporation to the merger may continue as if the merger did not occur or the surviving corporation may be substituted in the proceeding.[59]

The court concluded that the claims originally filed by and against National City could continue because National City and PNC Bank were deemed to be the same legal entity because of the merger.[60]

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53. *Id.* at *10.
54. *Id.* at *7-8, *9.
55. *Id.* at *8-10.
56. 293 Ga. 697, 749 S.E.2d 730 (2013).
57. *Id.* at 700, 701, 749 S.E.2d at 733, 734.
58. *Id.* at 697-98, 749 S.E.2d at 731-32.
59. *Id.* at 700, 749 S.E.2d at 733.
60. *Id.* at 701, 749 S.E.2d at 733-34.

F. Contractual Interpretation

In *Herren v. Sucher*,[61] the court of appeals determined that an agreement to indemnify and hold another harmless "is not synonymous with an agreement to assume another's liabilities."[62] In *Herren*, a plaintiff who suffered a stroke sued the original seller of a dietary supplement, Barrin Innovations, LLC (Barrin). Barrin argued that it was not a proper party to the lawsuit, rather the entity that had purchased Barrin's assets was the proper party. The purchase agreement by which Barrin sold its assets included an indemnity clause, but did not include an express statement that the buyer would assume Barrin's liabilities.[63] The court opined that, as a general matter, a buyer does not assume a seller's liabilities.[64] Because the express language of the purchase agreement did not contemplate the buyer's assumption of Barrin's liabilities, although Barrin may eventually have a right to claim indemnity from the buyer, Barrin was determined to be a proper party to the lawsuit.[65]

G. Determining the Independence of Review Committees

In *Benfield v. Wells*,[66] the court of appeals determined that a corporation's review committee was independent despite the fact that a committee member had certain connections to the defendants whom the committee was investigating.[67] The plaintiff claimed that the review committee lacked independence because a committee member had connections with the defendants: one defendant had approved the committee member's compensation at a previous company, one had served on a committee with him at another company, and other defendants were members of various charitable organizations with

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61. 325 Ga. App. 219, 750 S.E.2d 430 (2013).

62. *Id.* at 225, 750 S.E.2d at 435.

63. *Id.* at 219-20, 225, 750 S.E.2d at 431-32, 435. The indemnity clause stated: "Buyer shall indemnify and hold harmless Seller from any liability arising from the actions of the business including but not limited to liabilities incurred, outstanding debts, harm caused by products and/or machinery owned or produced by the businesses." *Id.* at 225, 750 S.E.2d at 435.

64. *Id.* at 224, 750 S.E.2d at 435. Such exceptions include express agreement, merger, "fraudulent attempt to avoid liabilities," and situations where a buyer is a "mere continuation of the predecessor corporation." *Id.* (quoting First Support Servs. Inc. v. Trevino, 288 Ga. App. 850, 852, 655 S.E.2d 627, 630 (2007)).

65. *Id.* at 226, 750 S.E.2d at 435-36.

66. 324 Ga. App. 85, 749 S.E.2d 384 (2013).

67. *Id.* at 90, 749 S.E.2d at 388.

him.[68] The court characterized these connections as "business-only" connections and considered them insufficient to render the committee member "unable to 'base his decision on the merits of the issue rather than being governed by extraneous considerations or influences.'"[69] In sum, such personal relationships, where a person does not have a personal interest in the transaction, are insufficient to negate independence.

H. Piercing the Corporate Veil and Separateness of Limited Liability Companies and Corporations

In *Insituform Technologies, LLC v. Cosmic TopHat, LLC*,[70] the United States District Court for the Northern District of Georgia addressed various issues relating to piercing and reverse piercing the corporate veil of a limited liability company.[71] The court reconfirmed that Georgia law does not support a claim for reverse piercing of the corporate veil.[72]

Under Georgia law,

> The failure of a limited liability company to observe formalities relating to the exercise of its powers or the management of its business and affairs is not a ground for imposing personal liability on a member, manager, agent, or employee of the limited liability company for liabilities of the limited liability company.[73]

Likewise, undercapitalization of a limited liability company, in and of itself, is insufficient to warrant piercing the corporate veil unless it is "coupled with evidence of an intent at the time of the capitalization to improperly avoid future debts of the [LLC]."[74] This case confirms the continuation of Georgia's law regarding piercing the corporate veil, particularly with respect to limited liability companies.

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68. *Id.* at 89, 749 S.E.2d at 388.

69. *Id.* at 89-90, 749 S.E.2d at 388 (quoting the trial court). The court also noted that the corporation had met its burden of proving the independence of the committee via the following: (1) the extensive report generated by the committee, which included a description of the review process and an investigation of the committee members' backgrounds and qualifications regarding their independence; and (2) the affidavits that the committee members submitted confirming their independence. *Id.* at 86-87, 749 S.E.2d at 386-87.

70. 959 F. Supp. 2d 1335 (N.D. Ga. 2013).

71. *Id.* at 1344-45.

72. *Id.* at 1344.

73. O.C.G.A. § 14-11-314 (2003).

74. *Insituform Techs., LLC*, 959 F. Supp. 2d at 1345 (alteration in original) (quoting Milk v. Total Pay & HR Solutions, Inc., 280 Ga. App. 449, 453, 634 S.E.2d 208, 212 (2006)).

I. The Separate Legal Nature of Corporations

In *Department of Transportation v. McMeans*,[75] the supreme court reiterated the concept that corporations are separate legal entities, distinct from their shareholders, officers, directors, and employees.[76] In *McMeans*, McMeans Leasing, Inc. (MLI) was wholly owned by Brian McMeans, who also personally owned property leased by MLI. When condemnation proceedings for the property were initiated, Mr. McMeans filed certain pleadings, personally alleging both damage to the property and business loss. The trial court struck the pleading for business loss claims. The court of appeals reversed, and the supreme court granted certiorari.[77] The supreme court concluded that the trial court had not erred.[78] In its analysis, the court cited the legal separateness of corporations, which "is so even in the situation in which a corporation is owned solely by one person."[79] As such, the court determined that MLI, as lessee of the property, was required to plead the business losses resulting from the condemnation, not McMean.[80]

75. 294 Ga. 436, 754 S.E.2d 61 (2014).
76. *Id.* at 437, 754 S.E.2d at 63.
77. *Id.* at 436-37, 754 S.E.2d at 62.
78. *Id.* at 438, 754 S.E.2d at 63.
79. *Id.* at 437, 754 S.E.2d at 63.
80. *Id.* at 438, 754 S.E.2d at 63.

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