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Business Associations

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I. INTRODUCTION

This Article surveys some noteworthy cases involving corporations and limited liability companies decided by the Georgia Court of Appeals between June 1, 2020, and May 31, 2021.[1]

II. NOTEWORTHY CASES

A. A&M Hospitalities, LLC v. Alimchandani

A trial court abuses its discretion by permitting a "special master/auditor" to serve simultaneously as an investigator, a fact witness, and an adjudicator of factual and legal disputes—roles that are "fundamentally incompatible" with one another.[2]

In *A&M Hospitalities, LLC v. Alimchandani*, the Georgia Court of Appeals held that the Lowndes Superior Court abused its discretion when it appointed someone to serve as an auditor/special master and then permitted him to serve simultaneously as a fact witness in the case; an investigator of the facts underlying the parties' claims; and an adjudicator of all questions of law and fact.[3]

A different iteration of this case was previously before the court of appeals and was discussed in the Author's 2019 Business Associations article for the Mercer Law Review.[4] The trial court originally appointed

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1. For the summary of business associations in the prior Survey period, *see* Stuart E. Walker, *Business Associations, Annual Survey of Georgia Law*, 72 MERCER L. REV. 21 (2020).

2. A&M Hospitalities, LLC v. Alimchandani, 359 Ga. App. 271, 276, 856 S.E.2d 704, 708 (2021).

3. *Id.* at 276, 856 S.E.2d at 708.

4. *See* Stuart E. Walker, *Business Associations, Annual Survey of Georgia Law*, 71 MERCER L. REV. 15 (2019).

a lawyer named Christopher A. Cohilas to serve as a "limited receiver" in a dispute among business partners.[5] When the order appointing Cohilas was challenged on appeal, as having been entered without the requisite showing of need, the court of appeals affirmed Cohilas's appointment on the ground that the trial court's order did not vest Cohilas with the kind of powers traditionally associated with receivers; so the appointment was not required to be supported by the showing of necessity that applies to the appointment of receivers generally.[6]

After that appeal was decided and the case returned to the trial court, the superior court entered a second order appointing Cohilas to serve as a special master/auditor.[7] The second appointment order had the effect of significantly expanding Cohilas's authority. For example, under the second appointment order—which was drafted by Cohilas—Cohilas, among other things, was empowered to: conduct an accounting of the defendant limited liability company; hear motions, allow amendments, and pass upon all questions of law and fact; address all pretrial and discovery matters; monitor implementation of and compliance with all orders of the court; impose upon a party any non-contempt sanction provided by Title 9, Chapter 11, Sections 37 and 45 of the Official Code of Georgia Annotated; conduct all trial proceedings and make and recommend findings of fact on all issues to be decided by the court without a jury; and engage in *ex parte* communications with the parties, counsel, and the trial court for certain purposes.[8]

In discharging his duties as an auditor/special master, Cohilas engaged in numerous *ex parte* communications with the plaintiff's counsel concerning litigation strategy. He provided fact testimony used by the plaintiff to support allegations in the plaintiff's amended complaint and was identified as a fact witness in the plaintiff's written discovery responses. The defendants challenged Cohilas's renewed appointment on appeal.[9]

The court of appeals reversed the trial court's appointment order, concluding that the trial court abused its discretion in entering it.[10] Based on the capacious powers conferred on him by the appointment order, and on the manner in which Cohilas discharged his duties during the course of the litigation, the court of appeals determined that Cohilas was serving simultaneously in three fundamentally incompatible roles:

5. *A&M Hospitalities, LLC*, 359 Ga. App. at 271, 856 S.E.2d at 705.
6. *Id.* at 272, 856 S.E.2d at 706.
7. *Id.*
8. *Id.* at 274–75, 856 S.E.2d at 708.
9. *Id.* at 272–73, 856 S.E.2d at 706–07.
10. *Id.* at 276, 856 S.E.2d at 708.

as an investigator, a witness, and the adjudicator of factual and legal disputes. The court of appeals concluded that these facts disqualified Cohilas from serving as a special master in this case.[11]

B. Ironwood Capital Partners, LLC v. Jones

In *Ironwood Capital Partners, LLC v. Jones*,[12] the Georgia Court of Appeals held that a limited liability company that withheld a distribution to one of its members for an unreasonably long period of time without legal justification—while making *pro rata* distributions to its other members—was liable for breach of contract to the member whose distribution was unpaid.[13]

Timbervest, LLC (Timbervest), together with its officers and managers (Joel Shapiro, Walter Boden III, Donald Zell Jr., and Gordon Jones II), was sued by AT&T for alleged Employee Retirement Income Security Act of 1974 (ERISA) violations.[14] The alleged violations concerned the mismanagement by Timbervest of pension plan property that AT&T had entrusted to Timbervest as an investment fiduciary. Timbervest was owned by a single member: a limited liability company called Ironwood Capital Partners, LLC (IPC).[15] IPC, in turn, was owned by three members—Shapiro (50%), Boden (25%), and Zell (25%).[16] Jones formerly owned 25% of IPC but later sold his interest to Shapiro.[17] Eventually, the AT&T suit settled for $6 million, but the settlement agreement failed to specify how much of the total settlement each party would pay.[18]

Jones was also a member of TEP Investors, LLC (TEPI), an affiliate of Timbervest.[19] In the suit that gave rise to this appeal, Jones sued TEPI for breach of contract, on the basis that TEPI breached its operating agreement when it failed to pay Jones a distribution in April 2016—but paid *pro rata* distributions to TEPI's other members. TEPI had purposefully refused to pay the distribution to Jones on the ground that Jones owed money to Timbervest from the AT&T settlement. Ironwood, Shapiro, Boden, and Zell—all of whom were defendants in Jones's suit against TEPI—counterclaimed against Jones for breach of contract. They

11. *Id.*
12. 355 Ga. App. 371, 844 S.E.2d 245 (2020).
13. *Id.* at 376, 844 S.E.2d at 250.
14. *Id.* at 372–73, 844 S.E.2d at 248.
15. *Id.* at 372, 844 S.E.2d at 248.
16. *Id.* at 372–73, 844 S.E.2d at 248.
17. *Id.* at 373, 844 S.E.2d at 248 n.1.
18. *Id.* at 380–81, 844 S.E.2d at 253.
19. *Id.* at 372–73, 844 S.E.2d at 248.

argued that Jones breached an agreement under which he (Jones) had agreed to be responsible for paying $1.5 million of the $6 million settlement amount from the AT&T suit. The trial court granted summary judgment in favor of Jones (1) on his breach of contract claim to recover the unpaid distribution; and (2) on the defendants' breach of contract claim to recover Jones's unpaid settlement contribution. The defendants appealed these adverse rulings, and the court of appeals affirmed them.[20]

The court of appeals first concluded that Jones was entitled to summary judgment on his contract claim for the distribution payable to him by TEPI, because TEPI withheld that distribution for an unreasonably long period of time without any legal justification.[21] It separately concluded that Jones was not liable for breach of contract to Ironwood, Shapiro, Boden, or Zell.[22] There was no evidence that Jones accepted the defendants' demand that he (Jones) undertake responsibility to pay $1.5 million of the total settlement. As a result, Jones was also entitled to summary judgment on their contract counterclaim against him.[23]

The court of appeals further determined that the remainder of the claims were subject to the Bankruptcy Code's automatic stay provisions, because those claims prayed for relief against Shapiro, who filed a Chapter 7 bankruptcy petition during the pendency of the appeal.[24]

C. Optum Construction Group, LLC v. City Electric Supply Company

In *Optum Construction Group, LLC v. City Electric Supply Company*,[25] the Georgia Court of Appeals held that a fact dispute concerning the identity of two business entities precluded summary judgment in favor of a lien claimant—under Georgia's materialman's lien statute—because it remained unclear whether the lien claimant's debtor was in privity of contract with the general contractor on the construction project at issue.[26]

Optum Construction Group, LLC (Optum), a general contractor, entered into a subcontract with Palmetto Power Services Palmetto Power Unlimited, Inc. (Palmetto Unlimited), to perform electrical work on a hotel property.[27] Thereafter, Palmetto Power Services, LLC (Palmetto

20. *Id.* at 373–74, 844 S.E.2d at 249.
21. *Id.* at 376, 844 S.E.2d at 250.
22. *Id.* at 379, 844 S.E.2d at 252.
23. *Id.* at 378–79, 844 S.E.2d at 252.
24. *Id.* at 374–75, 844 S.E.2d at 249.
25. 356 Ga. App. 797, 849 S.E.2d 238 (2020).
26. *Id.* at 799, 849 S.E.2d at 239–40.
27. *Id.* at 797–98, 849 S.E.2d at 239.

Services), purchased materials necessary to perform the electrical work on the hotel property from a vendor, City Electric Supply Company (City Electric). City Electric notified Optum that it had furnished materials for use on the property at the request of Palmetto Power.[28]

After Palmetto Unlimited abandoned work on the project and failed to pay City Electric charges exceeding $100,000, City Electric filed a materialman's lien against the hotel property, where the work was being performed, in the amount of $123,716.[29] Optum discharged the lien by engaging its insurer to issue a lien-release bond in the amount of $247,432. City Electric sued Palmetto Services and eventually settled its claims and secured a confession of judgment from Palmetto Services for the unpaid charges. City Electric then sued Optum and its insurer to recover $109,379 under the lien-release bond issued by Optum's insurer.[30] City Electric and Optum filed competing motions for summary judgment on the bond claim. The Gwinnett County State Court granted summary judgment in favor of City Electric, thus denying summary judgment to Optum. Both parties appealed.[31]

On appeal, Optum argued that there was a genuine issue of material fact concerning whether City Electric was a proper lien claimant because there was no "chain of contracts" linking Palmetto Services, City Electric's debtor, to Optum.[32] Under Georgia law, in order for a lien claimant to have a validly attached materialman's lien, the claimant must prove "a contractual relationship, either directly or through a chain of contracts, between the owner of the property and the person to whom the materials are furnished."[33] Optum's contract was with Palmetto Unlimited, which represented itself to be a corporation; however, Optum acknowledged that Palmetto Unlimited was organized as a limited liability company—which, in the view of the court of appeals, could support an inference "that the named subcontractor never existed."[34]

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28. *Id.* at 798, 849 S.E.2d at 239.

29. *Id.*

30. *Id.* at 799, 849 S.E.2d at 240 n.1.

31. *Id.* at 798, 849 S.E.2d at 239.

32. *Id.* at 799, 849 S.E.2d at 240. Optum, recall, had entered a subcontract with Palmetto Unlimited, not Palmetto Services. *Id.*

33. *Id.* at 799, 849 S.E.2d at 240 (quoting Benning Constr. Co. v. Dykes Paving & Constr. Co., 263 Ga. 16, 18–19, 426 S.E.2d 564, 566 (1993)). The opinion does not make clear whether Optum was the owner of the property where the construction was taking place—as seems to be required by the language quoted from *Benning Constr. Co.*—or whether Optum simply had a contract with the property owner. The latter seems more probable, but the opinion leaves the reader wondering.

34. *Optum Constr. Group, LLC*, 356 Ga. App. at 800, 849 S.E.2d at 240.

Considering the discrepancy between the name of the company that entered into the subcontract with Optum and the name of the company that purchased the materials from City Electric, the court of appeals reversed the grant of summary judgment in favor of City Electric.[35] It concluded that "the record contains conflicting evidence regarding whether City Electric was in a contractual relationship with Optum."[36] As a result, a genuine issue of material fact existed about whether there was a chain of contracts linking the lien claimant's debtor to the general contractor.[37]

D. Ridgewalk Holdings, LLC v. Atlanta Apartment Investment Corporation

To demand inspection of a limited liability company's books and records under O.C.G.A. § 14-11-313(3),[38] the demanding party must be a "member" of the limited liability company at the time the demand is filed.[39]

In *Ridgewalk Holdings, LLC v. Atlanta Apartment Investment Corporation*, the Georgia Court of Appeals held that a fact dispute precluded summary judgment to a party claiming to be a member of a limited liability company.[40] The alleged member filed a demand to inspect the company's books and records under O.C.G.A. § 14-11-313 although, before the demand was made, the demanding party had pledged its membership interest to secure the repayment of a loan and may have assigned away any interest in the limited liability company.[41] The court determined that if, for these reasons, the demanding party was not a member of the limited liability company at the time that the demand for inspection was filed, the party could not invoke the statutory inspection process.[42]

Advocate Investments, LLC (Advocate), was a member of Ridgewalk Property Investments, LLC (RPI).[43] In 2009, Advocate pledged its

35. *Id.*

36. *Id.*

37. *Id.*

38. O.C.G.A. § 14-11-313(3) (2021).

39. *See* Ridgewalk Holdings, LLC v. Atlanta Apartment Inv. Corp., 358 Ga. App. 717, 721, 856 S.E.2d 75, 79 (2021).

40. *Id.* at 722, 856 S.E.2d at 79.

41. *Id.* at 721–22, 856 S.E.2d at 79.

42. *Id.* at 722, 856 S.E.2d at 79. The appeal involved a dispute over a party's entitlement to a real estate commission, but the statutory-inspection-process aspect of the case is the only one that merits discussion here.

43. *Id.* at 717, 856 S.E.2d at 76.

membership interest in RPI to secure the repayment of a loan. RPI alleged that Advocate, later in 2014, "assigned away" any interest that it once owned in RPI. Advocate later sued RPI over an unpaid real estate broker's commission that RPI allegedly owed Advocate. In connection with the pursuit of its claim in that suit, Advocate made a demand on RPI under O.C.G.A. § 14-11-313(3) for inspection of RPI's records.[44]

RPI refused to allow Advocate to inspect the records on the ground that Advocate was no longer a member of RPI because Advocate had assigned away its membership interest.[45] Advocate moved for summary judgment on its inspection claim. The Cobb County Superior Court denied the motion, finding that a genuine issue of material fact existed concerning whether Advocate remained a member of RPI at the time the request for inspection was made.[46]

The court of appeals affirmed the denial of summary judgment, concluding that a genuine issue of material fact existed: whether Advocate remained a member in RPI at the time it filed its inspection demand.[47] Given that dispute, summary judgment was improper.[48]

E. G&E Construction, LLC v. Rubicon Construction, Inc.

In *G&E Construction, LLC v. Rubicon Construction, Inc.*,[49] the Georgia Court of Appeals held that, for purposes of applying O.C.G.A. § 14-2-204,[50] the issuance of a certificate of incorporation by the Secretary of State is conclusive evidence of a corporation's existence.[51] The court further held that a corporation's veil of legal separateness cannot be pierced—and the shareholders' assets reached—based on allegations that the corporation's shareholder, without more, failed to respect corporate formalities in operating the corporation.[52]

In 2002, Jason Insogna formed Rubicon Construction, Inc. (Rubicon), and became its sole shareholder.[53] Rubicon was a general contractor that built and renovated houses. Insogna hired Rubicon to renovate his and his wife's own house. Rubicon, thereafter, hired G&E Construction, LLC (G&E), to work on the Insognas' house. Rubicon was dissolved in 2017.

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44. *Id.* at 721, 856 S.E.2d at 79.
45. *Id.*
46. *Id.* at 721, 856 S.E.2d at 77.
47. *Id.* at 722, 856 S.E.2d at 80.
48. *Id.* at 719, 849 S.E.2d at 78.
49. 357 Ga. App. 55, 849 S.E.2d 785 (2020).
50. O.C.G.A. § 14-2-204 (2021).
51. *G&E Constr., LLC*, 357 Ga. App. at 57–58, 849 S.E.2d at 788.
52. *Id.* at 59–60, 849 S.E.2d at 789.
53. *Id.* at 55–56, 58, 849 S.E.2d at 787, 788–89.

G&E later sued Rubicon and Insogna, to recover for unpaid work on the Insognas' house, all of which was performed by G&E before Rubicon's 2017 dissolution.[54]

G&E sought to hold Insogna personally liable for Rubicon's unpaid debt under two separate theories: (1) that Insogna acted on behalf of a non-existent corporation and was thus personally liable for its debts under O.C.G.A. § 14-2-204;[55] and (2) that Rubicon's corporate veil should be pierced—and thus Insogna's personal assets reached—because Insogna did not observe corporate formalities with respect to the management and operation of Rubicon.[56] G&E did not allege that Insogna had engaged in wrongdoing or fraud or acted in bad faith in connection with his operation of Rubicon.[57] The Dekalb County State Court granted Insogna's motion for summary judgment on G&E's claims. G&E appealed.[58]

The court of appeals rejected both of G&E's arguments for holding Insogna personally liable for Rubicon's debt.[59] First, the court held that the issuance of a certificate of incorporation by the Secretary of State, which Rubicon had been issued upon its incorporation in 2002, is conclusive evidence of a corporation's existence.[60] This defeats any claim for personal liability under O.C.G.A. § 14-2-204, so long as the actions taken by a shareholder—in this case, Insogna—on the corporation's behalf occurred during the time when the certificate of incorporation was in existence. The actions of Insogna were all taken before Rubicon's certificate of incorporation was terminated.[61] Second, the court held—reiterating a previously settled point of law—that a shareholder's mere failure to respect corporate formality, standing alone, will not, absent evidence of "wrongdoing, fraud, or bad faith," support the piercing of a corporation's veil so as to render the shareholder personally liable for the corporation's debts.[62]

54. *Id.* at 56, 849 S.E.2d at 787.

55. "'[I]mposes personal liability on one who, with culpable knowledge, incurs liabilities on behalf of a non-existent corporation.'" *G&E Constr., LLC*, 357 Ga. App. at 57, 849 S.E.2d at 787 (quoting Zuberi v. Gimbert, 230 Ga. App. 471, 472, 496 S.E.2d 741, 742 (1998)).

56. *G&E Constr., LLC*, 357 Ga. App. at 55–56, 849 S.E.2d at 787.

57. *Id.* at 59–60, 849 S.E.2d at 789.

58. *Id.* at 55, 849 S.E.2d at 787.

59. *Id.* at 56, 849 S.E.2d at 787.

60. *Id.* at 57, 849 S.E.2d at 788.

61. *Id.* at 56, 849 S.E.2d at 787.

62. *Id.* at 59–60, 849 S.E.2d at 789.

F. Wimpy v. Martin

In *Wimpy v. Martin*,[63] the Georgia Court of Appeals reiterated a settled principle of law and held that the same conduct can give rise to a claim for both breach of contract and a claim sounding in tort—such as, a breach of fiduciary duty.[64]

Floyd Wimpy, Jimmie Martin, and Anne Vail entered into a written partnership agreement to perform construction work on a house in Ellijay, Georgia.[65] They later entered into an oral partnership agreement to perform construction work on a house in Fitzgerald, Georgia. The three agreed to share equally in the profits and losses from the partnership's construction work on both houses. Under their agreements, Vail was responsible for the bidding process and for overall project management; Martin was responsible for furnishing labor for the jobs and managing the construction work; and Wimpy was responsible for maintaining the partnerships' finances. After excluding Martin's construction crew from carrying out Martin's duties and instead using his own construction crew on the two projects, Wimpy refused to pay Martin his share of the profits from the projects. Martin thereafter sued Wimpy for the amounts owed, on theories of breach of contract and tort—breach of fiduciary duties.[66]

A jury rejected Martin's contract claim but awarded damages in favor of Martin, compensatory and punitive, on his tort claim against Wimpy.[67] Wimpy appealed the jury verdict against him, arguing that Martin's tort claim could not be asserted independently of his contract claim and that, because the jury rejected the contract claim, the jury also should have rejected the tort claim. In addition, Wimpy argued that the economic loss doctrine barred Martin's recovery in tort.[68]

The court of appeals affirmed the jury's award of tort damages, rejecting as without merit Wimpy's argument that Martin's breach of fiduciary duty tort claim, as a matter of law, could not be asserted independently of the contract claim.[69] In so holding, the court reiterated the settled principle that the same conduct can give rise to both a claim for breach of contract and a claim for the breach of any separate duty

63. 356 Ga. App. 55, 846 S.E.2d 230 (2020).

64. *Id.* at 56, 846 S.E.2d at 233.

65. *Id.* at 55, 846 S.E.2d at 233.

66. *Id.*

67. *Id.* at 56, 846 S.E.2d at 233.

68. *Id.* "The economic loss doctrine generally provides that a contracting party who suffers purely economic losses must seek his remedy in contract and not in tort." *Id.* at 58, 846 S.E.2d at 235 n.3 (internal citations and quotations omitted).

69. *Id.* at 56, 846 S.E.2d at 233.

imposed by law—so long as the party's conduct in fact constitutes a breach of the non-contractual duty.[70]

G. North Walhalla Properties, LLC v. Kennestone Gates Condominium Association, Inc.

In *North Walhalla Properties, LLC v. Kennestone Gates Condominium Association, Inc.*,[71] the Georgia Court of Appeals held that a member of a condominium association lacked standing to sue such association and its director for breaches of contract and breaches of fiduciary duties.[72] The association member failed to allege any harms suffered by it individually and instead asserted only harms suffered by all association members.[73]

Kennestone Gates Condominium Association, Inc. (Kennestone) is a non-profit corporation incorporated under Georgia law. North Walhalla Properties, LLC (NWP), was a member of Kennestone and also owned properties in the condominium development, for whose benefit Kennestone was incorporated. Dissatisfied with the way that Kennestone and its officers were conducting the business of the homeowners' association, NWP sued Kennestone and one of its directors for breaches of contract and breaches of fiduciary duties.[74]

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70. *Id.* at 56, 846 S.E.2d at 233–34. The court separately rejected Wimpy's argument that the evidence presented to the jury was insufficient to support the jury finding that Wimpy, by failing to pay Martin his share of the profits from the construction projects, had breached the fiduciary duties he owed to Martin. The court also held that Martin had waived any argument based on the economic loss doctrine by failing to raise it in the trial court. *Id.* at 57–58, 846 S.E.2d at 234–35.

71. 358 Ga. App. 272, 855 S.E.2d 35 (2021).

72. *Id.* at 275, 855 S.E.2d at 39.

73. *Id.* at 275, 855 S.E.2d at 38–39.

74. *Id.* at 272–73, 855 S.E.2d at 37. In particular, in support of its fiduciary duty claims, NWP alleged that the defendants:

> [E]ngaged in "*ultra vires* actions by the Board and officers not authorized under the Declaration, Bylaws, or law"; failed to make various disclosures to membership prior to called meetings; failed to call and have meetings in violation of its Declaration and Bylaws; failed to provide a budget and profit and loss statements 30 days in advance of meetings; failed to disclose identities of vendors or provide copies of contracts between third parties or evidence of payment; maintained and managed escrow accounts without authority; charged for services not rendered or made available to [NWP]; failed to properly maintain common areas; assessed "attorney[ ] fees and expenses not related to the collection of fees, rather for advice received by them in their continuing efforts to disguise and to deny breaches of contract or fiduciary duty"; assessed [NWP's] units for work and improvements to limited common areas and individual units owned by others; assessed excessive fees and ignored a right of set-off for previous assessments paid, but not owed; and failed to provide to members minutes of annual and special meetings.

Id. at 273, 855 S.E.2d at 37–38. In addition, NWP alleged that Kennestone's director and corporate officer breached fiduciary duties owed to NWP "'and other similarly situated

Kennestone moved for summary judgment on all of NWP's claims, arguing that NWP lacked standing to bring them.[75] The Cobb County Superior Court granted Kennestone's motion, and NWP appealed.[76]

The court of appeals first summarized the relevant principles concerning direct versus derivative shareholder suits:

> [T]o have standing to sue individually, rather than derivatively on behalf of the corporation, the plaintiff must allege more than an injury resulting from a wrong to the corporation. To set out an individual action, the plaintiff must allege either an injury which is separate and distinct from that suffered by other shareholders, or a wrong involving a contractual right of a shareholder which exists independently of any right of the corporation. For a plaintiff to have standing to bring an individual action, he must be injured directly or independently of the corporation.[77]

The court reiterated that these principles apply both to claims against the corporation itself and to claims against the corporation's officers and directors.[78] The court noted that certain categories of claims—namely, "claims related to election procedures, breach of fiduciary duties, negligent misuse of corporate funds, usurpation of corporate opportunities, personal use of assets without sufficient compensation, mismanagement, and corporate waste"—have been held not to be "separate and distinct causes of action creating a right of direct action in an individual member."[79] After reviewing the allegations in NWP's complaint and the summary judgment record, the court of appeals concluded that NWP's "allegations are devoid of any separate and distinct injury that would allow it to sue individually," and that, as a

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owner members' [of Kennestone] by engaging in self-dealing and excess billing, failing to prepare annual budget reports and call annual meetings, and violating the Declaration and Bylaws by receiving compensation." *Id.* at 273, 855 S.E.2d at 38.

75. *Id.* at 273–74, 855 S.E.2d at 38. The question was whether NWP (as a member of Kennestone) was authorized to bring its claims against Kennestone and Kennestone's director in NWP's individual capacity or whether NWP was required to pursue those claims in the name of Kennestone, in a derivative proceeding, for the benefit of all of Kennestone's members. The court of appeals noted that it was undisputed that NWP was statutorily barred from bringing a derivative action because it did not own the requisite percentage of voting power in Kennestone. *Id.* (citing O.C.G.A. § 14-3-741 (2021)). So, the question on appeal was whether Georgia law permitted NWP to pursue its claims in its own name for its own benefit. This is often the case when shareholders bring claims against the corporations they own and their corporate officers.

76. *North Walhalla Properties, LLC*, 358 Ga. App. at 274, 855 S.E.2d at 38.

77. *Id.*

78. *Id.* at 275, 855 S.E.2d at 38.

79. *Id.*

result, "the trial court properly concluded that [NWP] lacked standing to bring its claims against Kennestone and [Kennestone's director]."[80] The harms alleged by NWP, in other words, were harms suffered by all of Kennestone's members, not solely by NWP.

Rather than affirming the trial court's grant of summary judgment in favor of the defendants, however, the court of appeals vacated that order and remanded the case with directions that it be dismissed—because the question of a shareholder's standing raises an issue of subject matter jurisdiction and not the merits of the shareholder's claim.[81]

H. Callicott v. Scott

In *Callicott v. Scott*,[82] the Georgia Court of Appeals held that a minority shareholder lacked standing to bring a direct action against the majority shareholders in a closely held corporation.[83] Instead, the shareholder was required to bring her claims as a derivative action on behalf of the corporation itself.[84]

Terilyn Callicot was a minority shareholder in a corporation named Homeowners Mortgage of America, Inc. (HOMA). Callicot brought a direct action against HOMA's other shareholders, who controlled a majority of HOMA's shares, and those shareholders' affiliated business entities for various breaches of fiduciary duty.[85] The defendants moved for summary judgment, arguing that Callicot lacked standing to pursue her claims individually and that, instead, Callicot should have pursued her claims in a derivative action.[86]

The Cobb County Superior Court denied the defendants' motion for summary judgment, finding that the reasons requiring a derivative

80. *Id.* at 275, 855 S.E.2d at 39.

81. *Id.* at 277, 855 S.E.2d at 40.

82. 357 Ga. App. 780, 849 S.E.2d 547 (2020).

83. *Id.* at 787, 849 S.E.2d at 553.

84. *Id.*

85. *Id.* at 780, 849 S.E.2d at 548–49. In support of her fiduciary duty claims, Callicott alleged that the HOMA's majority members:

> [B]reached their fiduciary duties to HOMA by inter alia (1) entering into contracts with the [other entity] defendants "on commercially unreasonable terms while contracting under a conflict-of-interest with respect to those entities"; (2) devoting their loyalty and care to the [other entity] defendants during times they were obligated to be performing services for HOMA; (3) usurping corporate opportunities by siphoning fees away from HOMA to [another entity defendant]; and (4) transferring millions of dollars in additional funds belonging to HOMA to themselves and third parties. *Id.* at 784, 849 S.E. at 551.

86. *Id.* at 784–85, 849 S.E.2d at 551.

action did not apply.[87] The court of appeals reversed the denial of summary judgment.[88] It concluded that Callicot's allegations did not raise individual harms and that, separately, the creditor-protection rationale that ordinarily counsels in favor of requiring a derivative action did apply. The court of appeals thus reversed the trial court's order denying summary judgment to HOMA's majority members and their affiliated business entities on Callicott's claims.[89]

I. Lambeth v. Three Lakes Corporation

The component of the business judgment rule that permits corporate officers and directors to assert their reliance on the advice of legal counsel as a defense to tort claims against them—O.C.G.A. § 14-2-830(b)[90]—does not protect officers or directors against fiduciary duty claims unrelated to the matters for which the corporation sought and received legal advice.[91]

In *Lambeth v. Three Lakes Corporation*, the Georgia Court of Appeals held that the "reliance on professional advice" component of the business judgment rule[92] does not shield corporate officer and directors from fiduciary duty claims that are based on conduct unrelated to the matters for which professional advice was sought, received, and relied on.[93]

In 2004, Spencer and Sara Lambeth bought a home in Sandy Springs in a subdivision named Lake Forest. The subdivision had three lakes—an upper, a middle, and a lower—and each lake had a dam associated with it. The Lambeths' property adjoined the "lower" lake.[94] In 1964, a company named Three Lakes Corporation (TLC) had been incorporated to hold title to the lakes and to maintain them for the benefit of TLC's members. Each owner of property adjoining a lake became a member of

87. *Id.* at 785, 849 S.E.2d at 551.

88. *Id.* at 781, 849 S.E.2d at 549.

89. *Id.* at 789, 849 S.E.2d at 554. "[W]e agree with the defendants that Callicott failed to allege a special injury that would give her standing to pursue her claims directly." *Id.* at 787, 849 S.E.2d at 553. "Here, Callicott's direct action could circumvent [HOMA's creditor's] rights as a creditor because any recovery would go to Callicott, and not HOMA. [] Because [HOMA had] a creditor in need of protection, the exception permitting a direct action instead of through a derivative suit cannot be applied in this case." *Id.* at 789, 849 S.E.2d at 554.

90. O.C.G.A. § 14-2-830(b) (2021).

91. Lambeth v. Three Lakes Corp., 357 Ga. App. 546, 550, 851 S.E.2d 181, 184 (2020).

92. *See* O.C.G.A. § 14-2-830 (2021).

93. *Lambeth*, 357 Ga. App. at 550, 851 S.E.2d at 184.

94. *Id.* at 546, 851 S.E.2d at 182.

TLC—including the Lambeths. The dams were jointly owned by TLC, the City of Atlanta, and Sandy Springs.[95]

Soon after purchasing his home, Spencer Lambeth inspected the dams and noticed that a buildup of debris in the upper-lake dam was causing water to flow over its emergency spillway.[96] He informed TLC of the problem, but TLC took no action. In 2006, Spencer inspected the lakes and dams with a TLC board member named Neal Sweeney. Sweeney reported in an email to TLC's board of directors that the upper-lake dam was blocked and that water was spilling over its emergency spillway. In response, TLC engaged an engineer named Mike Ballard to inspect the lakes and dams. Ballard made a recommendation in November 2008 that certain trees and vegetation be removed from the slopes of the dams and that the lower-lake dam's downstream slope be flattened. Ballard's report said that the lower-lake dam would probably be classified as a "Category 1 (high hazard) dam" under regulations issued by the Georgia Environmental Protection Division (EPD). Spencer later testified that no action was taken on the issues raised in his report.[97]

In 2009 an engineering firm engaged by TLC classified the lower-lake dam as a Category 1 dam. The engineering firm's report concluded that: (i) a failure of the lower-lake dam would affect eleven buildings and would flood area residences, (ii) ten structures were in the flood-inundation zone, and (iii) the lower-lake dam posed a serious risk of destruction and loss of life.[98]

In May 2009, the EPD sent TLC a letter informing the company of the dam's reclassification, giving instructions for remediation, and giving 180 days for TLC to apply for a permit from EPD to operate the dams.[99] No permit was ever obtained. In September 2009, TLC acknowledged partial ownership of the dams but said it was not obligated to take further action to repair the dam. In May 2012 another engineering firm, hired by Sandy Springs, issued a report noting the deficiencies of the lower-lake dam.[100]

In May 2013 the EPD sent TLC another warning letter about the condition of the dams and TLC's obligation to inspect them and to file reports with the EPD.[101] Two years later an engineering firm hired by TLC, Carter Engineering, represented by Brian Kimsey, issued a report

95. *Id.* at 546–47, 851 S.E.2d at 182.
96. *Id.* at 547, 851 S.E.2d at 182.
97. *Id.*
98. *Id.*
99. *Id.* at 547, 851 S.E.2d at 182–83.
100. *Id.* at 547–48, 851 S.E.2d at 183.
101. *Id.* at 548, 851 S.E.2d at 183.

concluding that TLC needed to work with Sandy Springs and the City of Atlanta to devise a plan to bring the dams into compliance with EPD standards. From 2015 to 2016, Sandy Springs removed trees from TLC property and drained the lower lake of its water, creating a dry lakebed overgrown with weeds.[102]

The Lambeths sued TLC asserting that TLC had breached its fiduciary duties in failing to maintain the lakes and dams. Specifically, the Lambeths alleged that:

> TLC failed (from 2009 through 2017) to protect its and its members' interests as required by the corporate charter by, inter alia, failing to properly maintain the lakes and dams, allowing trees and vegetation to grow on all three dams, allowing certain deficiencies to exist, failing to inspect or determine the condition of the dams, and failing to comply with the EPD's requirements regarding dam permits and inspections.[103]

They additionally alleged:

> [T]he failure to address instances of trespass by Sandy Springs's contractors, failure to seek permission of members before allowing Sandy Springs's representatives to undertake activities impacting their properties, failure to address the unsafe conditions and deficiencies of the dams, failure to maintain control of TLC property and the relinquishment of control to the Cities, and failure to participate in decision-making processes regarding work related to the lower lake and dam.[104]

The Lambeths sought money damages to account for the diminution in the value of their property and sought a temporary restraining order and an interlocutory injunction requiring TLC to restore water to the lower lake; to secure an EPD permit for the dam; and to devise a remediation plan.[105] TLC moved for summary judgment against the Lambeths' claims based on the business judgment rule. The Fulton County Superior Court granted TLC's motion, concluding that the business judgment rule barred the claims.[106]

Under Georgia law, corporate officers and directors owe fiduciary duties to a corporations' shareholders, and a corporation has a fiduciary

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102. *Id.*
103. *Id.*
104. *Id.* at 548–49, 851 S.E.2d at 183.
105. *Id.* at 549, 851 S.E.2d at 183.
106. *Id.* at 549, 851 S.E.2d at 184.

duty to protect its property for the benefit of its shareholders.[107] The business judgment rule—codified at O.C.G.A. § 14-2-830:

> [P]recludes claims against officers and directors for their business decisions that sound in ordinary negligence, except to the extent that those decisions are shown to have been made without deliberation, without the requisite diligence to ascertain and assess the facts and circumstances upon which the decisions are based, or in bad faith.[108]

The rule requires that corporate officers and directors act with "good faith and with the degree of care an ordinarily prudent person in a like position would exercise under similar circumstances."[109] In discharging their duties, officers and directors are entitled to rely on "[i]nformation, data, opinions, reports, or statements provided by . . . legal counsel . . . or other persons as to matters involving the skills, expertise, or knowledge reasonably believed to be reliable and within such person's professional or expert competence."[110] Under the business judgment rule, officers and directors are presumed to have discharged their duties in good faith and to have exercised ordinary care, but that presumption can be rebutted by evidence of gross negligence.[111]

Invoking the "reliance rule" set forth in O.C.G.A. § 14-2-830(b), TLC argued that the business judgment rule precluded the Lambeths' claims because TLC sought, received, and relied on legal advice from three lawyers in deciding how to deal with the lakes and dams.[112] The legal advice sought and received by TLC, however, concerned only the draining of the lake by Sandy Springs and the City of Atlanta and whether TLC should sue the cities for having done so. Importantly, however, TLC did not seek or receive legal advice concerning any of the conduct underlying the Lambeths' breach of fiduciary duty claims, and none of their claims were based on TLC's failure to sue the cities for their draining of the lake. Nevertheless, the trial court granted summary judgment in favor of TLC, concluding that the Lambeths' tort claims were barred by the business judgment rule.[113]

The court of appeals, however, reversed the grant of summary judgment.[114] The court observed that the

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107. *Id.*
108. *Id.*
109. O.C.G.A. § 14-2-830(a) (2021).
110. O.C.G.A. § 14-2-830(b)(2) (2021).
111. O.C.G.A. § 14-2-830(c) (2021).
112. *Lambeth*, 357 Ga. App. at 550, 851 S.E.2d at 184.
113. *Id.* at 551, 851 S.E.2d at 185.
114. *Id.*

> Lambeths set out in their complaint numerous allegations of TLC's breaches, neglect, and failures to act in accordance with its fiduciary duties (e.g., the failures to properly maintain the lakes and dams, to determine the condition of and address the unsafe condition of the dams, and to comply with dam regulations such as obtaining a dam operating permit).[115]

But, the court stressed TLC had failed to show that any of the legal advice it sought, received, or relied on—which, again, formed the basis of TLC's assertion of the business judgment rule—related to the claims asserted by the Lambeths.[116] Consequently, the "reliance rule" set forth in O.C.G.A. § 14-2-830(b) was unavailable to the Lambeths.[117]

III. THE GEORGIA STATE-WIDE BUSINESS COURT

The rules of the Georgia State-wide Business Court—which had been proposed but not adopted as of the writing of last year's Business Associations article—became effective on August 1, 2021.[118] As a result, the Uniform Superior Court Rules are no longer the governing rules of procedure in the business court, as they had been between August 1, 2020, and August 1, 2021.[119]

Readers should be aware of an order entered on October 27, 2020—authored by Judge Sara L. Doyle of the Georgia Court of Appeals, sitting by designation. The business court determined that O.C.G.A. § 15-5A-4(a)(3) strips the business court of subject matter jurisdiction to hear any case sought to be transferred to it by the petition of any party—namely a case filed originally in state or superior court—when any other party to the pending case files in the business court a timely objection to the petition to transfer.[120] Judge Doyle wrote, "[o]bjection is fatal to the transfer under the language of the governing statute."[121]

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115. *Id.* at 550–51, 851 S.E.2d at 185.

116. *Id.*

117. *Id.* at 551, 851 S.E.2d at 185.

118. Honorable Walter W. Davis, Judge, *Rules, Orders, and Forms*, Georgia State-wide Business Court, https://www.georgiabusinesscourt.com/rules-orders-forms/ (last visited Sept. 21, 2021).

119. *Id.*

120. *New Statewide Business Court Faces 'Fatal' Flaw*, Daily Report (Nov. 9, 2020), https://plus.lexis.com/api/permalink/7c6a7fea-e885-43e0-baac-fd4f491d59bb/?context=1530671 (citing Overlook Gardens Properties, LLC v. ORIX USA, L.P., No. 20-GSBC-0002 (Ga. Bus. Ct. Oct. 27, 2020) *vacated*, 2021 WL 1435183 (Ga. Bus. Ct. Mar. 25, 2021)).

121. *Id.*

In media coverage following the entry of that order, Judge Walter W. Davis, the sole judge of the business court, called the unilateral-objection rule imposed by the statute "an existential issue for the court."[122] It was hoped by Judge Davis and others that the Georgia General Assembly might pass legislation during the 2021 session to rectify the result created by the statute's language.[123] That has not yet happened. It remains to be seen whether the General Assembly will take up this issue during its 2022 legislative session.

122. *Id.*
123. *Id.*