# **Business Associations**

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This Article surveys noteworthy cases in the areas of corporate, securities, partnership, and banking law decided during the survey period<sup>1</sup> 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. The Article also summarizes recent enactments of the Georgia General Assembly with respect to the foregoing subject matters.

## I. CORPORATIONS

#### A. Piercing the Corporate Veil

Under the typical veil-piercing scenario, a third-party creditor or claimant asks a court to set aside the legal fiction that a corporation is its own entity, separate and distinct from its owners. Under most circumstances the courts honor this legal fiction to preserve the corporate form, which, in turn, generally shields investors in a corpora-

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<sup>1.</sup> The survey period runs from June 1, 2002 through May 31, 2003.

tion from liability and encourages investment and growth in business.<sup>2</sup> However, courts in America have long since recognized that the distinction between the corporation and its owners is not absolute. For example, in 1905, Judge Sanborn, writing for the United States District Court for the Eastern District of Wisconsin, delivered what is often regarded as the classic iteration of the corporate veil-piercing doctrine:

If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.<sup>3</sup>

Though the language used by the Georgia courts to describe the doctrine varies to some degree from that of Judge Sanborn, the concept is the same—if the separate personalities of the corporation and its owner no longer exist, such that the corporation serves as the alter ego or business conduit of its owner, then equitable principles of the law will intervene and hold the owner liable for the debts of the corporation.<sup>4</sup>

The most interesting veil-piercing case decided by the Georgia courts during the survey period did not concern a creditor seeking to pierce the corporate veil in order to hold the owner liable for corporate debts; but rather, a third-party creditor sought to pierce the corporate veil in order to hold the corporation liable for the debts of a shareholder.<sup>5</sup> This concept is commonly referred to as "reverse piercing of the corporate veil."<sup>6</sup> The reverse piercing concept is not nearly as weathered or

<sup>2.</sup> See, e.g., Hayes v. Collins, 245 Ga. App. 704, 538 S.E.2d 785 (2000).

<sup>3.</sup> United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 255 (E.D. Wis. 1905). Georgia courts often use substantively similar phraseology in describing the concept. See, e.g., J & J Materials, Inc. v. Conyers Seafood Co., 214 Ga. App. 63, 64-65, 446 S.E.2d 781, 782-83 (1994); Clark v. Cauthen, 239 Ga. App. 226, 227, 520 S.E.2d 477, 479 (1999); Int'l Telecomms. Exch. Corp. v. MCI Telecomms. Corp., 892 F. Supp. 1520, 1551-52 (N.D. Ga. 1995).

 $<sup>4.\;</sup>$  See Derbyshire v. United Builders Supplies, Inc., 194 Ga. App. 840, 844, 392 S.E.2d 37, 40 (1990).

Acree v. McMahan, 258 Ga. App. 433, 574 S.E.2d 567 (2002), cert. granted, 2003 WL 21709627 (Ga. Feb. 25, 2003).

 $<sup>6.\,</sup>$  The concept of "reverse piercing" technically encompasses two distinct scenarios. Gregory S. Crespi describes the two concepts as follows:

<sup>[&</sup>quot;Insider"] reverse piercing cases involve a dominant shareholder or other controlling insider who attempts to have the corporate entity disregarded to avail the insider of corporate claims against third parties or to bring corporate assets under the shelter of protection from third party claims that are available only for assets owned by the insider. . . . ["Outsider"] reverse piercing cases, however, involve a third party claimant who files an action against the corporate insider

heralded<sup>7</sup> as the more common version of the doctrine described above. But the reverse piercing concept has begun to gather momentum in certain jurisdictions,<sup>8</sup> and, during the survey period, Georgia was no exception.

1. Court of Appeals Upholds Jury Charge Allowing Reverse Piercing of the Corporate Veil; Supreme Court Reverses. In Acree v. McMahan, the court of appeals affirmed a jury verdict in favor of reverse piercing of the corporate veil to hold a corporation liable for the debts of its shareholder. Dr. Russell Acree was the principal shareholder of Memorial Health Services, Inc. ("MHS"), a corporation formed for the purpose of managing and purchasing hospitals in south Georgia. In 1990 Acree recruited Dr. Howard McMahan and Dr. Gene Jackson to relocate to Ocilla, Georgia, where Acree was finalizing plans to manage the Irwin County Hospital. Acree, McMahan, and Jackson formed a corporation, AJM, Inc., to organize the structure of their practice, whereby Jackson and McMahan would be on the hospital's staff and generally assist in working to turn around the hospital's finances. Each principal was a one-third owner of AJM, Inc. They agreed that, if

and attempts to pierce the corporation to subject corporate assets to this claim; these cases can also involve a third party claimant who attempts to assert that claim against the corporation in an action between the corporation and the third party.

Gregory S. Crespi, *The Reverse Pierce Doctrine: Applying Appropriate Standards*, 16 J. CORP. L. 33, 37 (1990).

7. Interestingly, the first published article on the reverse piercing concept was published by the Mercer Law Review in a student note written by W. Lawrence Fletcher. W. Lawrence Fletcher, Note, *Piercing the Corporate Veil: It Can Work in Reverse*, 33 MERCER L. REV. 633 (1982). Mr. Fletcher examined the Fifth Circuit's decision in *FMC Fin. Corp. v. Murphree*, 632 F.2d 413, 424 (5th Cir. 1980), in which there was sufficient evidence to create a jury question of whether to hold a subsidiary liable for the acts of its parent. Mr. Fletcher concluded:

In the final analysis, the result in *FMC Finance* is a good one. Indeed, it recognizes that, while the traditional corporate law concept of limited liability will not be lightly dismissed, neither a subsidiary nor a corporation will any longer be able to avoid liability when, due to the existence of a control relationship between the parent and subsidiary and some type of misrepresentation, injury or injustice results to a third party.

Fletcher, supra, at 646.

- 8. See, e.g., LFC Mktg. Group Inc. v. Loomis, 8 P.3d 841 (Nev. 2000) (allowing judgment creditor to reach corporate assets controlled by judgment debtor); Shamrock Oil & Gas Co. v. Etheridge, 159 F. Supp. 693 (D. Colo. 1958) (court reverse pierced corporation to attach its assets to satisfy judgment against officer and shareholder of corporation).
- 9. 258 Ga. App. 433, 574 S.E.2d 567 (2002), cert. granted, 2003 WL 21709627 (Ga. Feb. 25, 2003).
  - 10. Id. at 438, 574 S.E.2d at 572.

the hospital was sold to AJM, Inc., McMahan and Jackson could participate in the equity ownership of the hospital. After disagreements arose between Acree, on one hand, and Jackson and McMahan on the other hand, Acree agreed (in his individual capacity) to buy out the other two for \$750,000 each, to be paid in installments. For over a year, Acree caused both MHS and the hospital to make the required payments owed by Acree to McMahan and Jackson. Subsequently, Jackson moved away and Acree ceased making payments to McMahan, citing unhappiness with McMahan's continued performance under the terms of the buyout agreement. McMahan brought suit against Acree and MHS to recover damages for breach of contract. Following the trial, the judge instructed the jury that even though the agreement was between McMahan and Acree in his individual capacity, it could find MHS liable if it found sufficient evidence to pierce the corporate veil.<sup>11</sup>

The jury returned a verdict in favor of McMahan. Acree and MHS appealed. On appeal Acree and MHS contended that the trial court erred in its charge to the jury because reverse veil-piercing (which would allow MHS to be liable for Acree's debts) is not available under Georgia law. 12 Finding that McMahan presented sufficient evidence of abuse of the corporate form to submit the veil-piercing issue to the jury, 13 the court of appeals turned to the issue of whether the concept of reverse piercing is available under Georgia law.<sup>14</sup> The court rejected as inconclusive two cases on which MHS relied in support of its contention that reverse veil-piercing is unavailable in Georgia.<sup>15</sup> declared, "[so] long as it is properly pierced under applicable law, we see no reason why the corporate 'veil' should not be a membrane permeable from either direction, permitting liability to move either into or out of the corporate form, to serve the interests of justice and prevent fraud."16 The Georgia Supreme Court granted certiorari in February 2003 to review the issue of whether reverse piercing of the corporate veil is available under Georgia law. 17

<sup>11.</sup> Id. at 433-35, 574 S.E.2d at 569-70.

<sup>12.</sup> Id. at 433, 437, 574 S.E.2d at 569, 572.

Id. at 436, 574 S.E.2d at 571.

<sup>14.</sup> Id. at 437, 574 S.E.2d at 572.

<sup>15.</sup> *Id.* at 437-38, 574 S.E.2d at 572. *See* Gwinnett Prop., N.V. v. G+H Montage GmbH, 215 Ga. App. 889, 453 S.E.2d 52 (1994); Hogan v. Mayor & Aldermen of Savannah, 171 Ga. App. 671, 320 S.E.2d 555 (1984). The court of appeals in *Acree* denied that either of these cases was a pronouncement that reverse piercing is not available in Georgia. 258 Ga. App. at 437-38, 574 S.E.2d at 572.

<sup>16. 258</sup> Ga. App. at 438, 574 S.E.2d at 572.

<sup>17.</sup> Acree v. McMahan, No. S03G0500, 2003 WL 21709627 (Ga. Feb. 25, 2003).

In a case of first impression, the supreme court reversed the court of appeals, 18 stating, "We reject reverse piercing, at least to the extent that it would allow an 'outsider,' such as a third-party creditor, to pierce the veil in order to reach a corporation's assets to satisfy claims against an individual corporate insider." Relying on the decisions and reasoning of a number of foreign jurisdictions, 20 the court stated, "Reverse alter ego is an equitable doctrine; it stretches the imagination, not to mention the equities, to conceive of how someone wholly outside the corporation may be used to pierce the corporate veil from within." The court continued:

"The [outsider] reverse-pierce theory presents many problems. It bypasses normal judgment-collection procedures, whereby judgment creditors attach the judgment debtor's shares in the corporation and not the corporation's assets. Moreover, to the extent that the corporation has other non-culpable shareholders, they obviously will be prejudiced if the corporation's assets can be attached directly. In contrast, in ordinary piercing cases, only the assets of the particular shareholder who is determined to be the corporation's alter ego are subject to attachment."<sup>22</sup>

The court further reasoned that the possibility of losing out to an individual shareholder's creditors would unsettle the expectations of the corporation's creditors who understand their loans to be secured by corporate assets.<sup>23</sup> Because the concept of disregarding the corporate form is based on equitable principles, the court continued, "it is appropriately granted only in the absence of adequate remedies at law."<sup>24</sup> Finally, the court cited a case on which Acree unsuccessfully relied at the appellate level by stating, "[a]llowing outsider reverse piercing claims would constitute a radical change to the concept of piercing the corporate veil in this state and, thus, should be created by the General Assembly and not by this Court."<sup>25</sup> Because McMahan prevailed against Acree individually, it was not necessary to disregard

<sup>18.</sup> Acree v. McMahan, 276 Ga. 880, 585 S.E.2d 873 (2003).

<sup>19.</sup> *Id.* at 881, 585 S.E.2d at 874. The supreme court's opinion was delivered after the end of the survey period, but is included in this Article for clarity.

<sup>20.</sup> See Floyd v. Internal Revenue Serv., 151 F.3d 1295, 1299-1300 (10th Cir. 1998); Cascade Energy & Metals Corp. v. Banks, 896 F.2d 1557, 1577 (10th Cir. 1990); Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265, 267 (2d Cir. 1929).

<sup>21. 276</sup> Ga. at 881, 585 S.E.2d at 874 (quoting Estate of Daily v. Title Guar. Escrow Serv., 178 B.R. 837, 845 (D. Haw. 1995)).

<sup>22.</sup> Id. at 882, 585 S.E.2d at 874 (quoting Cascade Energy, 896 F.2d at 1577).

<sup>23.</sup> Id.

<sup>24.</sup> Id. at 883, 585 S.E.2d at 875 (quoting Floyd, 151 F.3d at 1300).

<sup>25.</sup> Id. (citing Hogan, 171 Ga. App. at 674, 320 S.E.2d at 558).

the corporate entity for McMahan to enforce his rights under the contract.<sup>26</sup>

Court of Appeals Upholds Jury Verdict Piercing the 2. Corporate Veil. In a textbook piercing of the corporate veil under Georgia law, the court of appeals affirmed a jury verdict holding an owner personally liable for the debts of three corporations in Scott Brothers v. Warren. 27 In Scott Brothers, Danny Warren entered into an agreement with Scott Brothers, Inc., a corporation owned by Robert and Glenn Scott. Pursuant to the agreement, Warren would supply video cassette and gaming machines to be rented to customers of a chain of video rental stores owned by Scott Brothers. Unbeknownst to Warren, a number of the machines were also in video stores owned by Scott Development, Inc. and Scott Entertainment, Inc., both of which Glenn Scott owned exclusively. Revenues from the rentals and any replacement costs for lost or stolen machines were to be shared equally between Warren and Scott Brothers. After three years of regular payments, Scott Brothers refused to make further payments. When Warren attempted to retrieve his 544 machines, he discovered that 311 of the machines were missing. Scott Brothers then refused to pay Warren his share of the past due rentals and replacement costs. Warren sued Robert and Glenn Scott and each of their companies for breach of contract. Following a denial of defendants' motion for a directed verdict, the jury pierced the corporate veil, finding Glenn Scott and the three companies liable for breach of contract.<sup>28</sup>

On appeal the court reiterated the oft-cited language from *Derbyshire* v. *United Builders Supplies*, *Inc.*, <sup>29</sup> stating that to prevail on a veil-piercing claim

"[i]t must be shown that the stockholders' disregard of the corporate entity made it a mere instrumentality for the transaction of their own affairs; that there is such unity of interest and ownership that the separate personalities of the corporation and the owners no longer exist; and to adhere to the doctrine of corporate entity would promote injustice or protect fraud."<sup>30</sup>

<sup>26</sup>. Id. (citing Farmers Warehouse v. Collins, 220 Ga. 141, 151, 137 S.E.2d 619, 626 (1964)).

<sup>27. 261</sup> Ga. App. 285, 288, 582 S.E.2d 224, 227 (2003).

<sup>28.</sup> Id. at 285-86, 582 S.E.2d at 225-26.

<sup>29. 194</sup> Ga. App. 840, 392 S.E.2d 37 (1990).

<sup>30. 261</sup> Ga. App. at 288, 582 S.E.2d at 227 (quoting *Derbyshire*, 194 Ga. App. at 844, 392 S.E.2d at 40).

Applying the test set forth in *Derbyshire* to the facts in *Scott Brothers*, the court was persuaded by the following to uphold the veil-piercing: (1) the corporations loaned money to Glenn Scott while they were insolvent; (2) he continued to draw a salary from the corporations after they had sold their assets and were insolvent; (3) he ran the three companies as a single unit, interchanging management, bookkeeping, and trade names for all three and not informing third parties (including Warren) that there were three different corporate owners of the video stores; and (4) he sold the assets of all three corporations for one lump sum, with the proceeds of the sale going solely to him.<sup>31</sup> Based on this evidence, the court concluded that the trial court did not err in denying Glenn Scott's motion for directed verdict on the issue of piercing the corporate veil.<sup>32</sup> This case exemplifies the type of facts Georgia courts are likely to find persuasive to disregard the corporate form.

3. Summary Judgment Against Piercing the Corporate Veil **Upheld.** In an apparent attempt to salvage something positive from an investment nightmare, the original plaintiffs in Albee v. Krasnoff<sup>83</sup> sought relief from a fifty percent equity owner of a real estate investment company under the veil-piercing doctrine to no avail. Approximately one hundred investors, through an investment firm, contributed significant amounts of money to Casko Investment Co., a real estate investment company half-owned by Robert Krasnoff, only to see the company pilfered and their money embezzled by the other fifty percent owner, John Steven Cason Sr., to finance gambling trips on private jets and other personal expenses. In exchange for making loans to Casko, the investors received monthly principal and interest payments. Although the loans were made to Casko, the entity that serviced the loans was SGE Mortgage Finance Company, a corporation owned forty percent by Krasnoff and sixty percent by Cason. Once it was discovered that Cason had embezzled money from SGE, rendering it insolvent to the investors' detriment of approximately \$5 million, the investors sued Krasnoff,34 Krasnoff's wife, and the Krasnoff Family Irrevocable Trust on a myriad of claims. These claims included, among others, breach of fiduciary duty, fraud, and piercing the corporate veil. Each of the claims against Krasnoff and the others was eventually dismissed at trial.<sup>35</sup>

<sup>31.</sup> Id.

<sup>32.</sup> Id.

<sup>33. 255</sup> Ga. App. 738, 566 S.E.2d 455 (2002).

<sup>34.</sup> Note that Krasnoff himself lost over \$2 million as a result of the failure of the two entities. *Id.* at 739, 566 S.E.2d at 457.

<sup>35.</sup> Id., 566 S.E.2d at 457-58.

With respect to the veil-piercing claim, the court of appeals affirmed the trial court's grant of summary judgment.<sup>36</sup> The court was persuaded by the facts that (1) the investors' advisors knew that Casko was a shell corporation with no assets and that SGE serviced the loan agreements, and (2) Cason's embezzlement was the only evidence of abuse of the corporate form.<sup>37</sup> Thus, the corporate veil could not be pierced with respect to Krasnoff.<sup>38</sup>

#### B. General

1. Corporate Fiduciary of Insolvent Corporation Not Entitled to Prefer Itself Over Other Corporate Creditors. Under Georgia law, creditors are entitled to relief from insolvent debtors' attempts to fraudulently transfer assets with the actual intent of defrauding or In Hodge v. Howes, 40 Howes sued Kings Bay evading creditors.<sup>39</sup> Chrysler Plymouth Dodge for wrongful foreclosure, trespass, conversion, and personal injury. Between the time of the filing of the suit and the judgment, Hodge, the chief executive officer and sole shareholder of Kings Bay, sold all of the assets of the corporation and caused the proceeds to be distributed to himself. Because Kings Bay was insolvent, Howes could not collect his \$36,212 default judgment. Howes then brought suit against Hodge personally, alleging that Hodge was liable for the judgment previously entered against Kings Bay to the extent of the distributions the corporation made to Hodge. The trial court granted summary judgment to Howes on the merits and awarded damages in the amount of \$36,212. Hodge appealed, contending that summary judgment was improper because issues remained for the jury regarding whether he had exercised bad faith in causing the fraudulent transfers to be made.41

The court of appeals rejected Hodge's arguments, stating, "Officers/directors of corporations may be held personally liable for corporate indebtedness when they make preferential transfers of corporate assets to themselves while the corporation is insolvent. Thus, [the court] must determine whether the corporation was insolvent at the time the

<sup>36.</sup> Id. at 743, 566 S.E.2d at 460.

<sup>37.</sup> Id.

<sup>38.</sup> Id.

<sup>39.</sup> See O.C.G.A.  $\S$  9-3-35 (Supp. 2003); Uniform Fradulent Transfers Act, O.C.G.A.  $\S$  18-2-70 to -80 (Supp. 2003).

<sup>40. 260</sup> Ga. App. 107, 578 S.E.2d 904 (2003).

<sup>41.</sup> Id. at 107-08, 110, 578 S.E.2d at 905-07.

transfers were made."<sup>42</sup> Although the general assembly did not intend that the taking party be liable "'solely upon the fraudulent conveyance without proof of bad faith, actual fraud, or conspiracy,"<sup>43</sup> in this case, Hodge knew about Howes's lawsuit when he caused the conveyance of the assets; therefore, his liability arose from his actions in bad faith and not "solely upon the fraudulent conveyance."<sup>44</sup>

# C. Legislative Changes

- 1. Certificates of Authority for the Transaction of Business in Georgia by Foreign Business Associations. The Georgia General Assembly amended the Official Code of Georgia Annotated ("O.C.G.A.") to provide a set civil penalty of \$500 for foreign corporations, limited partnerships, and limited liability companies transacting business in the state without a certificate of authority, as opposed to the annual penalty of this amount previously assessed. Additionally the general assembly streamlined the application for a certificate of authority for foreign corporations by (a) limiting the information required to be supplied about the officers of the entity to the chief executive officer, the chief financial officer, the secretary, and others holding similar positions (as opposed to requiring such information for all directors and officers), and (b) removing the requirement that the foreign corporation's duration be included on the application.
- 2. Corrections of Documents Filed with Secretary of State. To correct a document filed with the Secretary of State, the person seeking correction must now describe the document being corrected in the articles of correction, as opposed to simply attaching the defective document to the articles of correction.<sup>48</sup>
- **3. Foreign Corporation Name Registration.** The general assembly repealed the provisions of O.C.G.A. section 14-2-403 that

<sup>42.</sup> *Id.* at 110, 578 S.E.2d at 906 (quoting Randall & Neder Lumber Co. v. Randall, 202 Ga. App. 497, 499, 414 S.E.2d 718, 720 (1992)).

<sup>43.</sup> *Id.* at 110-11, 578 S.E.2d at 907 (quoting Kesler v. Veal, 257 Ga. 677, 678, 362 S.E.2d 215 (1987)).

<sup>44.</sup> Id. at 111, 578 S.E.2d at 907.

<sup>45.</sup> O.C.G.A. § 14-2-122 (2003); O.C.G.A. § 14-2-1502(b); O.C.G.A. § 14-9-907(c)(2) (2003); O.C.G.A. § 14-11-711(c)(2) (2003).

<sup>46.</sup> O.C.G.A. § 14-2-1503(a)(6) (2003).

<sup>47.</sup> Id. § 14-2-1503(a)(3).

<sup>48.</sup> O.C.G.A. § 14-2-124(b)(1)(A) (2003); O.C.G.A. § 14-3-124(b)(1)(A) (2003); O.C.G.A. § 14-9-206.3(b)(1)(A) (2003); O.C.G.A. § 14-11-211(b)(1)(A) (2003).

allowed foreign corporations to register their unique corporate names in Georgia to ensure later availability (i.e., for future expansion).<sup>49</sup>

#### II. SECURITIES

A. "Mere Puffery" by Officer of Corporation Not Actionable Under Fraud or Negligent Misrepresentation Theories

In Next Century Communications Corp. v. Ellis,<sup>50</sup> Next Century Communications Corporation ("Next Century"), a shareholder of iXL, filed suit against Betram Ellis, the chairman and chief executive officer of iXL, following a sharp decline in the value of iXL's stock.<sup>51</sup> On appeal from the trial court's dismissal for failure to state a claim, the United States Court of Appeals for the Eleventh Circuit affirmed the dismissal.<sup>52</sup> The court held that the complaint filed by Next Century, alleging fraud and negligent misrepresentation, did not state claims on which relief could be granted.<sup>53</sup>

iXL made a public offering of seven million shares of its stock on November 19, 1999, when Next Century was already a shareholder of the company. In connection with this issuance, certain iXL shareholders, including Next Century, entered into a "lock up" agreement, pursuant to which each party agreed not to sell any shares of iXL until February 17, 2000. Four days before the expiration of the lock up period, Ellis distributed a memorandum to the shareholders who were parties to the lock up agreement. The memorandum encouraged them not to sell their shares immediately upon termination of the lock up period, stating that a large sell-off would have a negative impact on the price of the company's stock.<sup>54</sup> Specifically, the memorandum stated:

I think our share price will start to stabilize and then rise as our Company's strong performance continues. . . . I am not telling you cannot sell any of your shares. [sic.] Instead, I am telling you that I personally think you would be mistaken to sell any of your shares now. . . . If we all wait at least one more month, we could turn this downdraft around. . . . I can only ask for your individual cooperation. I cannot dictate what you can or cannot do.  $^{55}$ 

<sup>49. 2002</sup> Ga. Laws 989.

<sup>50. 318</sup> F.3d 1023 (11th Cir. 2003).

<sup>51.</sup> Id. at 1025.

<sup>52.</sup> *Id*.

<sup>53.</sup> Id. at 1030

<sup>54.</sup> Id. at 1026.

<sup>55.</sup> Id.

Additionally, Ellis provided instructions for selling shares to any shareholders desiring to do so. Next Century did not sell its shares on or around February 17, 2000, when the shares were valued at \$40 per share. When Next Century finally sold its shares pursuant to a merger between iXL and Scient Corporation in November 2000, the share price had plummeted to \$0.29 per share. Based on the difference in share prices, Next Century lost a total of \$27,851,601.25 by not selling immediately upon the expiration of the lock up period.<sup>56</sup>

To state a claim for fraud under Georgia law, the complainant must prove the existence of five elements: "(1) false representation by defendant; (2) scienter; (3) intent to induce the plaintiff to act or refrain from acting; (4) justifiable reliance by the plaintiff; and (5) damage to the plaintiff."57 Affirming the trial court's dismissal of the complaint, the Eleventh Circuit focused on Ellis's statement, "'I think our share price will start to stabilize and then rise as our Company's strong performance continues."58 The court concluded that the first half of the sentence was not actionable as fraud because "it is framed as mere opinion as to future events."59 Regarding the second half of the sentence, the court stated, "Ellis's characterization of iXL's performance as 'strong' is not the sort of empirically verifiable statement that can be affirmatively disproven, as it is inherently a label expressive of, and generated by, opinion."60 Additionally, in concluding that Next Century could not have justifiably relied on the statements made by Ellis when it decided not to sell its shares upon the expiration of the lock up period,<sup>61</sup> the court was persuaded by the fact that Next Century was a financially sophisticated investor and that Ellis's memorandum contained caveats that iXL's stock had been on a downward track and procedures to sell shares if a shareholder so desired. 62 Because the court determined that there could not have been any justifiable reliance by Next Century on Ellis's statements under the fraud claim, Next Century's negligent misrepresentation claim also failed because the "reasonable reliance" element of such a claim was not met by Next

<sup>56.</sup> *Id* 

<sup>57.</sup> *Id.* at 1027 (quoting Ades v. Werther, 256 Ga. App. 8, 11, 567 S.E.2d 340, 343 (2002)).

<sup>58.</sup> Id.

<sup>59.</sup> *Id*.

<sup>60.</sup> Id. at 1028.

<sup>61.</sup> Id. at 1029.

<sup>62.</sup> Id. at 1029-30.

Century.<sup>63</sup> Thus, the trial court's dismissal of the action for failure to state a claim for which relief could be granted was proper.<sup>64</sup>

B. "Ponzi Scheme" Investment Instruments Offering Fixed Rates of Return Constitute "Securities" Under Georgia's Blue Sky Laws

In Rasch v. State, 65 the Georgia Court of Appeals affirmed the conviction of defendant Rasch on several counts of securities fraud in connection with his operation of a "Ponzi scheme,"66 but it reversed the trial court regarding certain counts of securities fraud because all of the elements of fraud were not met. 67 In Rasch the defendant/appellant induced six individuals (the "Investors") to entrust him with various sums ranging from \$10,000 to \$158,640. In exchange, Rasch agreed to repay their principal plus various percentage-based rates of return. In some (but not all) of the cases, the evidence showed that Rasch promised to "invest" the victims' funds in various schemes on behalf of the Investors. In each case, Rasch used the money entrusted to him to pay his personal expenses or to pay other Investors who were owed payments under their respective agreements with Rasch. The facts with respect to each Investor varied to some degree regarding the names of the instrument executed by the Investor, the promised percentage returns on principal, and the nature of the "investments" themselves. At trial, the jury found Rasch guilty of securities fraud under O.C.G.A. section 10-5-12(a)(2)<sup>68</sup> for his actions with respect to all of the Investors.<sup>69</sup>

After first determining that the arrangements entered into with Rasch constituted securities under Georgia's version of the "Howey Test," the

<sup>63.</sup> Id. at 1030.

<sup>64.</sup> Id.

<sup>65. 260</sup> Ga. App. 379, 579 S.E.2d 817 (2003).

<sup>66.</sup> *Id.* at 388, 579 S.E.2d at 824. The court described "Ponzi schemes" as follows: "The term '[P]onzi scheme' refers to an investment scheme whereby returns to investors are financed, not through the success of an underlying business venture, but from the principal sums of newly attracted investors. Typically, investors are promised large returns for their investments. Initial investors are actually paid the promised returns, attracting additional investors."

Id. at 379 n.1, 579 S.E.2d at 818 n.1 (quoting In re Primeline Securities Corp., 295 F.3d 1100, 1104 n.2 (10th Cir. 2002)).

<sup>67.</sup> Id. at 388, 579 S.E.2d at 824.

<sup>68.</sup> O.C.G.A. § 10-15-12(a)(2) (2000 & Supp. 2003). This section provides in pertinent part that it is unlawful for a person "(2) [i]n connection with an offer to sell, sale, offer to purchase, or purchase of any security, directly or indirectly: (A) to employ a device, scheme, or artifice to defraud." *Id.* 

<sup>69. 260</sup> Ga. App. at 379-83, 579 S.E.2d at 818-21.

<sup>70.</sup> Id. at 384, 579 S.E.2d at 821-22. The "Howey Test," as adopted by the Georgia courts, provides that "an instrument is a security if it is (1) 'an investment in a common

court turned to whether there was sufficient evidence to support the jury's conviction of Rasch on the numerous counts of securities fraud.<sup>71</sup> Though the court affirmed the jury's convictions on several of the securities fraud counts, it reversed the counts for which there was insufficient evidence.<sup>72</sup> Because the indictment charged that Rasch committed securities fraud by selling securities "upon the representation that said money would be invested on [the victims'] behalf, which representation was untrue and which constituted a device, scheme, and artifice to defraud,"<sup>73</sup> an essential element of the fraud claims was lacking when no evidence existed that Rasch actually promised to *invest* the monies for the victims.<sup>74</sup>

# C. Variable Life Insurance Policy is a "Covered Security" Under Securities Litigation Uniform Standards Act

In *Herndon v. Equitable Variable Life Insurance Co.*,<sup>75</sup> the Eleventh Circuit affirmed the dismissal of a class action for failure to state a claim upon which relief could be granted.<sup>76</sup> The court held that the variable life insurance policy at issue constituted a "covered security" under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), thereby requiring preemption by federal law.<sup>77</sup> In a case of first impression, the court determined that even though the variable annuity at issue contained a life insurance component (which was lacking in previous cases decided by federal courts),<sup>78</sup> the policy was a "covered security," thereby bringing any claim of fraud in connection therewith under the purview of SLUSA.<sup>79</sup> Because the fraud and other claims brought by the insured were couched in terms of state law rather

venture'; (2) 'premised on a reasonable expectation of profits'; [and] (3) 'to be derived from the entrepreneurial or managerial efforts of others.' *Id.*, 579 S.E.2d at 821 (quoting Tech Res., Inc. v. Estate of Hubbard, 246 Ga. 583, 584, 272 S.E.2d 314, 316 (1980)). *See* SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

73. Id. at 387, 579 S.E.2d at 823.

<sup>71. 260</sup> Ga. App. at 388, 579 S.E.2d at 824.

<sup>72.</sup> Id.

<sup>74.</sup> Id. at 388, 579 S.E.2d at 824.

<sup>75. 325</sup> F.3d 1252 (11th Cir. 2003).

<sup>76.</sup> Id. at 1255.

<sup>77.</sup> *Id.* at 1254; 15 U.S.C. §§ 77(p)(c), 78bb(f) (2000), 28 U.S.C. §§ 1331, 1367, 1441, 1446 (2000).

<sup>78. 325</sup> F.3d at 1254 (citing Dudek v. Prudential Sec., Inc., 295 F.3d 875, 878 (8th Cir. 2002); Patenaude v. Equitable Life Assurance Soc'y, 290 F.3d 1020, 1024 (9th Cir. 2002); Lander v. Hartford Life & Annuity Ins. Co., 251 F.3d 101 (2d Cir. 2001)).

<sup>79.</sup> Id.

than federal law, as required by SLUSA, the trial court properly dismissed the claims with prejudice.<sup>80</sup>

## D. Legislative Changes

The general assembly amended Georgia's "blue sky" law to include viatical investments in its definition of "security;" however, it specifically exempted such investments from the registration requirements of O.C.G.A. section 10-5-5. A "viatical investment" is defined as "the contractual right to receive any portion of the death benefit or ownership of a life insurance policy or certificate for consideration that is less than the expected death benefit of the life insurance policy or certificate." Additionally, the general assembly made it unlawful to sell or offer for sale any viatical investment without first filing a statement with the state's commissioner of securities containing a full description of the viatical investment in accordance with O.C.G.A. section 10-5-12(q). Section 10-5-12(q).

#### III. PARTNERSHIPS

#### A. Formation

Whereas corporations and other legal entities are formed upon a definitive act such as the filing of articles of incorporation or articles of organization with the Secretary of State in the jurisdiction of formation, the question of whether a partnership has been formed can present a difficult question of fact. For example, a partnership can arise from the relationship of two parties and their actions with respect to one another,

<sup>80.</sup> Id. at 1255.

<sup>81.</sup> O.C.G.A. § 10-5-2(a)(26) (2000 & Supp. 2003).

<sup>82.</sup> O.C.G.A. § 10-5-8(12) (Supp. 2003).

<sup>83.</sup> O.C.G.A. § 10-5-2(a)(32) (Supp. 2003). This section also lists certain transactions that are explicitly excepted from the definition of "viatical investments" as follows: (a) the sale or transfer of a death benefit or life insurance policy to a "viatical issuer" (as defined therein); (b) the assignment of a life insurance policy to a lender as collateral for a loan; (c) the obtaining of accelerated benefits from the issuer pursuant to a life insurance policy issued under the laws of Georgia or another state, and

<sup>([</sup>d]) the sale or transfer of any portion of the death benefit or ownership of a life insurance policy by an individual who enters into no more than one agreement in a calendar year regarding the transfer of life insurance policies insuring the life of only one person for consideration that is less than the death benefit, unless any third party receives, directly or indirectly, any fee, commission, or other remuneration in connection with said agreement.

Id. §§ 10-5-2(a)(32)(A) to (D).

<sup>84.</sup> O.C.G.A. § 10-5-12(q) (Supp. 2003).

regardless of whether the parties ever intended to form a "partnership." Therefore, determining whether a partnership has been formed often involves a highly probative review of the facts surrounding the parties' relationship. Such was the case in *Jerry Dickerson Presents, Inc. v. Concert/Southern Chastain Promotions*, <sup>85</sup> a fact-intensive partnership case decided by the court of appeals.

Jerry Dickerson Presents, Inc. ("Dickerson"), a former co-promoter of concerts featured at Chastain Park in Atlanta, filed suit against its former "partners," alleging trespass/taking of property, breach of contract with respect to multiple agreements, breach of fiduciary duty, breach of contractual expectation, tortious interference with contract, and "aiding and abetting breach of fiduciary duty." Affirming the trial court's grant of summary judgment to defendants on all claims, the court of appeals held that the facts, taken in the light most favorable to the nonmoving party, did not present a genuine issue of material fact as to whether a partnership existed between the parties.

Chastain Ventures ("Ventures") was formed in 1990 as a joint venture between Concert/Southern Chastain Promotions ("C/S") and Robert W. Woodruff Arts Center d/b/a Atlanta Symphony Orchestra ("Symphony") for the purpose of entering into a lease with the City of Atlanta for facilities comprising Chastain Park Amphitheater ("Chastain"). To secure the lease, Ventures sought to meet Atlanta's Minority Business Enterprise ("MBE") requirements by agreeing, in the lease with the City of Atlanta, to endeavor to sublease thirty-five percent of the available concert dates to qualified MBE promoters.<sup>89</sup>

Once the parties entered into the lease, Ventures entered into a sublease with Dickerson pursuant to which Dickerson had the right to sublet from C/S thirteen event dates at Chastain (the "Dickerson Dates"). Alternatively, the sublease provided that Dickerson had the right to "co-promote" the Dickerson Dates with C/S exclusively. The sublease also contained a reciprocal nontransfer provision and specifically disclaimed the creation of a joint venture between Ventures and Dickerson. Contemporaneously with entering into the sublease, Dickerson and C/S entered into a Promotion and Consulting Agreement (the "PC Agreement"), pursuant to which C/S would sublet all of the Dickerson Dates from Dickerson in exchange for thirty-five percent of the net profits up to an annual total of \$70,000. The terms of the PC

<sup>85. 260</sup> Ga. App. 316, 579 S.E.2d 761 (2003).

<sup>86.</sup> Id. at 316, 321, 579 S.E.2d at 763, 766-67.

<sup>87.</sup> Id. at 329, 579 S.E.2d at 772.

<sup>88.</sup> Id. at 322, 325, 579 S.E.2d at 767, 769-70.

<sup>89.</sup> Id. at 316-17, 579 S.E.2d at 763-64.

Agreement also provided as follows: (a) Dickerson would assist in the copromotion and production of concerts; (b) C/S would be the managing promoter of all events and would have to approve all of Dickerson's copromotion actions; (c) C/S would be entitled to all revenues generated from the Dickerson Dates above the \$70,000 fee; (d) all expenses, losses and debts incurred would be C/S's responsibility and were to be subtracted from revenues; and (e) neither party would be liable for the debts or obligations of the other. The PC Agreement also stated that no joint venture was to be created or implied thereby. The parties operated in accordance with the terms of the agreements for the majority of the term of Venture's lease with the City of Atlanta, with C/S co-promoting each of the Dickerson Dates in accordance with the terms described above. 90 During this time, Dickerson repeatedly held himself out to the City of Atlanta's Office of Contract Compliance (the authority responsible for monitoring MBE Compliance) as a joint venture partner of Ventures, pursuant to which Dickerson "share[d] profits or losses on a 65-35 basis" with Ventures.<sup>91</sup>

In March 1998, the three principal shareholders of the two partner corporations holding the joint venture interests in C/S sold one hundred percent of their interests in such corporations for approximately \$16 million. The sale included the two partner corporations' joint venture interests in C/S and C/S's joint venture interest with Symphony in Ventures. Approximately one year later, Dickerson demanded \$2.625 million, representing his thirty-five percent share of \$7.5 million presumed sale proceeds. Dickerson contended that a partnership arose from the City of Atlanta's ordinance requiring thirty-five percent minority participation and that the sale of the businesses effectively dissolved the partnership without making any distributions to Dickerson. However, the parties continued their relationship through the expiration of the lease, and Dickerson continued receiving payments from C/S as he had in the past. In 1999 Ventures began negotiating terms for a new ten-year lease with the City of Atlanta, at which point Dickerson demanded one hundred percent of the profits generated by concerts produced by C/S on the Dickerson Dates. When the city agreed to renew the lease with Ventures, C/S and Ventures agreed to look for a different minority-owned business to fulfill the City of Atlanta's MBE requirements.92

In trying to persuade the court that a partnership existed, Dickerson relied principally, if unsoundly, on a number of documents, several of

<sup>90.</sup> Id. at 317-19, 579 S.E.2d at 765.

<sup>91.</sup> Id. at 319, 579 S.E.2d at 765.

<sup>92.</sup> Id. at 319-20, 579 S.E.2d at 765-66.

which were prepared by Dickerson himself, that referred to Dickerson as a "joint venture partner" or "minority partner," or that "identifie[d] the name of the partnership as 'Chastain Ventures/Jerry Dickerson Presents, Inc.'" Judge Eldridge, clearly unimpressed by Dickerson's arguments, pointed out that to find this "evidence" of a "partnership," Dickerson had to sift through over seven thousand pages of transcript. 94

Turning to the merits of Dickerson's partnership claims, the court first pointed out that the use of the label, "joint venture partner" or "minority partner" does not demonstrate a legal partnership in and of itself. Furthermore, the court stated that the question of whether a partner in a joint venture is a legal partner is a question of fact had "depends on the rights and responsibilities assumed by the joint venturers." Citing Aaron Rents, Inc. v. Fourteenth Street Venture, L.P., he to court set forth the following factors that could indicate the existence of a partnership: (a) common enterprise, (b) the sharing of risk, (c) the sharing of expenses, (d) the sharing of profits and losses, (e) a joint right of control over the business, and (f) a joint ownership of capital.

With respect to Dickerson's claimed partnership with Ventures, the court noted that, of the three agreements at issue, the only agreement between Dickerson and Ventures was the sublease. Under the sublease, Dickerson had the right to lease thirty-five percent of the non-Symphony Chastain events at the same rental rate Ventures would charge any other lessee. Furthermore, Ventures did not share in the profits, losses, or liability incurred in connection with Dickerson's use of the Dickerson Dates. The court concluded that the sublease "does not in any fashion reflect an intent between Ventures and Dickerson to form a mutual legal 'entity." Finally, with respect to Ventures, the court determined that the sublease did not show evidence of a joint venture, much less a partnership. 104

<sup>93.</sup> Id. at 322, 579 S.E.2d at 767.

<sup>94.</sup> Id.

<sup>95.</sup> *Id.* at 322-23, 579 S.E.2d at 768.

<sup>96.</sup> Id. at 323, 579 S.E.2d at 768.

<sup>97.</sup> *Id.* (quoting Accolades Apartments v. Fulton County, 274 Ga. 28, 30, 549 S.E.2d 348, 351 (2001)).

<sup>98. 243</sup> Ga. App. 746, 533 S.E.2d 759 (2000).

<sup>99. 260</sup> Ga. App. at 323, 579 S.E.2d at 768 (quoting  $Aaron\ Rents$ , 243 Ga. App. at 747, 533 S.E.2d at 761).

<sup>100.</sup> Id. at 324, 579 S.E.2d at 768.

<sup>101.</sup> *Id*.

<sup>102.</sup> Id.

<sup>103.</sup> Id.

<sup>104.</sup> Id. (citing Accolades Apartments, 274 Ga. at 29-30, 549 S.E.2d at 349-50).

For similar reasons, the court reached the same conclusion regarding the relationship between Dickerson and C/S. 105 The only agreement entered into between C/S and Dickerson was the PC Agreement. 106 Recognizing that there was no evidence of a partnership between the parties thereto. 107 the court found the following factors persuasive: (a) if C/S exercised its option to sublease the Dickerson Dates from Dickerson pursuant to the terms of the sublease, it did so with complete responsibility for all loss associated with producing the events on those dates; (b) a maximum annual amount of \$70,000 was to be paid to Dickerson, regardless of total net profits; and (c) C/S was the managing promoter and possessed all rights to direct and control Dickerson's promotional efforts. 108 According to the court, "[t]his is hardly the 'equal right' to direct and control the promotion of the event dates reflective of a partnership or joint venture." Finally, after explaining that an MBE "Joint Venture Affidavit" filled out by Dickerson did not sufficiently create a joint venture or partnership, the court concluded its partnership discussion by referring to an April 27, 2000 letter written by Dickerson in which he stated, "[t]here is no partnership in existence between [Dickerson] pertaining to Chastain or any of its operations."110 The court agreed with Dickerson's own assessment. 111

# B. Foreclosure Sale of Limited Partner's Partnership Interest

Georgia statutory law provides that a limited partner's interest in a limited partnership is personal property. It should be no surprise that Georgia law further provides that a judgment creditor of a limited partner may apply to the court to charge the partnership interest of the indebted limited partner with payment of the unsatisfied part of the judgment debt, appoint receivers, or take such other actions as the court may deem necessary to satisfy the judgment. Is

In *Stewart v. Lanier Park Medical Office Building, Ltd.*, <sup>114</sup> the court of appeals affirmed the trial court's order of foreclosure by judicial sale of a limited partner's partnership interest to satisfy the limited partner's

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105. Id., 579 S.E.2d at 769.

106. Id.

107. Id.

108. Id.

109. Id.

110. Id. at 324-25, 579 S.E.2d at 769.

111. Id.

112. O.C.G.A. § 14-9A-49 (2003).

113. See O.C.G.A. § 14-9A-52 (2003).
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259 Ga. App. 898, 578 S.E.2d 572 (2003).

judgment debt to the partnership. <sup>115</sup> Lanier Park Medical Office Building, Ltd. ("Lanier Park"), a limited partnership, filed suit against one of its limited partners, Stewart, to recover arrearages for rent and operating expenses owed pursuant to the partnership agreement. The jury awarded the limited partnership \$172,794 plus interest for the arrearages, plus \$20,150 for attorney fees and litigation costs for bad faith and stubborn litigiousness. When Stewart failed to pay the judgment, the limited partnership moved for a forfeiture of Stewart's partnership interest, and the court issued a writ of *fieri facias* ("fi fa"). Lanier Park then applied for, and the court issued, an order charging Stewart's partnership interest to satisfy the unpaid judgment. Additionally, the court ordered that Stewart's partnership interest be foreclosed upon by judicial sale. Stewart appealed from this order. <sup>116</sup>

Affirming the trial court's order of judicial sale, the court of appeals held that the broad language of O.C.G.A. section 14-9A-52(a)<sup>117</sup> authorizes a trial court to order foreclosure by judicial sale of a limited partner's charged interest in certain circumstances.<sup>118</sup> Furthermore, the court stated that "[j]udicial sale may be appropriate where, for instance, it is apparent that distributions under the charging order will not pay the judgment debt within a reasonable amount of time."<sup>119</sup> Because issues regarding the final accounting and distribution of partnership assets could not be decided until Stewart paid his debt to the partnership, and the trial court determined that foreclosure was the only reasonable means of getting the debt paid, the court of appeals found no abuse of the trial court's discretion under O.C.G.A. section 14-9A-52.<sup>120</sup>

<sup>115.</sup> Id. at 901, 578 S.E.2d at 575.

<sup>116.</sup> Id. at 898-99, 578 S.E.2d at 573-74.

<sup>117.</sup> O.C.G.A. § 14-9A-52(a). This subsection provides in full:

On due application to a court of competent jurisdiction by any judgment creditor of a limited partner, the court may charge the interest of the indebted limited partner with payment of the unsatisfied amount of the judgment debt and may appoint a receiver and make all other orders, directions, and inquiries which the circumstances of the case may require.

Id. (emphasis added).

<sup>118. 259</sup> Ga. App. at 900, 578 S.E.2d at 574 (citing Nigri v. Lotz, 216 Ga. App. 204, 205, 453 S.E.2d 780, 781 (1995)).

<sup>119.</sup> Id. (citing Nigri, 216 Ga. App. at 205, 453 S.E.2d at 781).

<sup>120.</sup> Id., 578 S.E.2d at 575.

# C. Relationship of Partners to General Partnership

In Southcom Group, Inc. v. Plath, 121 the court of appeals reversed the trial court and held that an application for confirmation of an arbitration award, which named the partners of the losing partnership in the arbitration as party-defendants was sufficient to state a cause of action against the party-defendants even though they were not named in the arbitration award. 122 In Southcom Group, one of the parties to a marketing agreement, Southcom Group, Inc. ("Southcom"), obtained an arbitration award for breach of contract against Prolific Plastics, a general partnership composed of three partners. However, in its application to the Superior Court of Fayette County for confirmation of the arbitration award, Southcom named the three partners as partydefendants (rather than Prolific) in the caption of the application. The trial court dismissed the confirmation application for failure to state a claim for which relief may be granted against the three partners, and Southcom amended its application by adding a complaint against the Prolific Plastics partners individually. The trial court again dismissed the confirmation application for failure to state a claim against the partners. 123

In reversing the trial court, the court of appeals agreed with Southcom's contention that the application for confirmation sufficiently stated a cause of action against the three partners in their capacities as partners of Prolific Plastics. 124 The court explained the relevant common law principles as follows: "In Georgia, '[j]udgments may be entered and executed against partnerships, and service of process on one or more of the partners will authorize a judgment against the partnership binding all firm assets, and individually binding the property of the partners who are served." The court explained that, except in certain circumstances, all partners are jointly and severally liable for the debts and obligations of a general partnership. 126 The court then explained that a partnership is not an entirely separate legal entity from its owners, "[r]ather, it is but 'somewhat so; the partners, as to

<sup>121. 257</sup> Ga. App. 46, 570 S.E.2d 341 (2002).

<sup>122.</sup> *Id.* at 47, 570 S.E.2d at 342.

<sup>123.</sup> Id.

<sup>124.</sup> *Id*.

<sup>125.</sup> Id. at 47-48, 570 S.E.2d at 342 (quoting Atlanta Warehouses, Inc. v. Housing Auth. of Atlanta, 143 Ga. App. 588, 594, 239 S.E.2d 387, 393 (1977); citing Newton, Inc. v. Alex, 162 Ga. App. 664, 292 S.E.2d 121 (1982); Higdon v. Williamson, 10 Ga. App. 376, 73 S.E. 528 (1912)).

<sup>126.</sup> Id. at 48, 570 S.E.2d at 342 (quoting O.C.G.A. § 14-8-15(a) (2003)).

partnership debts, are joint contractors; and each is the agent of the other to a limited extent. When suit is brought for a debt due by the partnership, the plaintiff may hold the individual partners liable by serving them." 127

# D. Legislative Changes

The general assembly expanded O.C.G.A. section 14-9-104(b) to add professional corporations and limited liability companies (domestic and qualified foreign) to the list of entities that may serve as registered agents of limited partnerships.<sup>128</sup>

#### IV. BANKING

#### A. Foreclosure on Guarantor's Interest in Limited Liability Company

In *Hopson v. Bank of North Georgia*, <sup>129</sup> the court of appeals held that a bank was entitled to foreclose on a loan guarantor's interest in a limited liability company ("LLC") even though the collateral at issue was only an economic interest as opposed to an entire membership interest in the LLC. <sup>130</sup> The Bank of North Georgia loaned an initial amount of \$300,000 to RCI Housing Partners I ("RCI"), a Georgia LLC in which Hopson was a member. As a condition to the loan, the bank required Hopson to personally guarantee the loan and assign as security all of his right, title, and interest as a member in Nine Arbor Partners ("NAP"), another Georgia LLC. The bank made additional loans to Hopson and Ronald Curry, the other member of RCI, in the amounts of \$732,000 and \$275,000, each of which were secured by Hopson's interest in RCI. RCI defaulted on the loans, and the bank sought to foreclose on Hopson's interest in NAP. The trial court granted the bank's petition to foreclose, and Hopson appealed. <sup>131</sup>

Hopson's principal argument on appeal was that NAP's operating agreement precluded the bank from taking a security interest in his LLC membership interest because the operating agreement provided that an interest in the LLC could not be transferred without the prior written

<sup>127.</sup> *Id.*, 570 S.E.2d at 342-43 (quoting *Atlanta Warehouses*, 143 Ga. App. at 594, 239 S.E.2d at 393).

<sup>128.</sup> O.C.G.A. § 14-9-104(b) (2003).

<sup>129. 258</sup> Ga. App. 360, 574 S.E.2d 411 (2002).

<sup>130.</sup> Id. at 362-63, 574 S.E.2d at 413.

<sup>131.</sup> Id. at 360-61, 574 S.E.2d at 412.

consent of all of its members (which the bank did not obtain). Specifically, the NAP operating agreement provided:

11.01 *General*. Except as otherwise specifically provided herein, neither a Member nor an Economic Interest Owner shall have the right to: a) sell, assign, pledge, hypothecate, transfer, exchange or otherwise transfer for consideration (collectively, "Sale"). . . . 11.02 *Transferee Not Member in Absence of Unanimous Consent*. (a) Notwithstanding anything contained herein to the contrary, if all of the remaining Members do not approve by unanimous written consent [the proposed sale of the membership interest or economic interest], then the proposed transferee or donee shall have no right to participate in the management of the business and affairs of the Company or to become a Member. The transferee shall be merely an Economic Interest Owner. 133

As the court pointed out, however, nothing in the above language prevented a member from transferring his interest without consent; rather, it specifically contemplated the transfer of a purely economic interest without consent. Furthermore, the court held that because the parties attached the operating agreement and expressly made it a part of the security agreements executed by Hopson, the two agreements had to be interpreted in conjunction with each other. As a result, the court determined that the bank took a purely economic interest in NAP in accordance with the terms of the operating agreement. The court concluded that foreclosure on an "economic interest" in an LLC was in accordance with the provisions of the Georgia Limited Liability Company Act. Company Act.

## B. Proper Payment of Construction Loan Draws

The question for the court of appeals in Mustaqeem- $Graydon\ v$ .  $SunTrust\ Bank^{138}$  was whether the bank's payments to a contractor were properly made under the terms of the lender's construction loan to the owner of a music conservatory. In this case, the lender committed to loan Mustaqeem-Graydon ("Graydon") \$310,000 to finance the

<sup>132.</sup> Id. at 361, 574 S.E.2d at 412.

<sup>133.</sup> Id.

<sup>134.</sup> Id. at 362, 574 S.E.2d at 413.

<sup>135.</sup> Id.

<sup>136.</sup> Id.

<sup>137.</sup> Id. at 362-63, 574 S.E.2d at 413 (citing O.C.G.A. §§ 14-11-101(13), -502, -503, -601 (2003)).

<sup>138. 258</sup> Ga. App. 200, 572 S.E.2d 455 (2002).

purchase and renovation of an older building located in Albany, Georgia. 139 The draw note signed by Graydon provided that "disbursements will be made at the sole discretion of the Lender unless the Lender has otherwise specifically made a legally binding commitment to make disbursements hereunder."140 The conservatory guaranteed the loan to Graydon. Following an initial draw on the loan account for the final payment of the acquisition price, a draw in the amount of \$36,000 was made on the note and placed in Graydon's checking account to cover the contractor's first renovation bill in the amount of \$35,635. Graydon testified that he had discussed his dissatisfaction with the contractor's work at this point and that the bank informed him that if he did not pay, the contractor could walk off the job. Graydon wrote a check from a different account for the full amount of the bill, but the check bounced. Graydon then paid the contractor \$30,000 via a cashier's check from the other account. Not surprisingly, the contractor contacted the lender's loan officer to discuss setting up a more secure form of payment. The loan officer replied that Graydon would have to authorize any such arrangement. Afterwards, Graydon wrote a number of memos to the bank and the contractor, seemingly authorizing the bank to issue funds directly to the contractor, so the bank transferred the funds to the contractor's account. Eventually, the contractor submitted its third renovation bill, which exceeded the balance left on the construction draw note. A few weeks later, Graydon sent a memo to the lender expressing his intent to pay the amounts owing on the loan and asking for a temporary forbearance of collections on the matured note. Graydon had not paid any principal or interest due on the note. Additionally, Graydon's checking account at SunTrust was overdrawn by approximately \$6000. The bank sent Graydon and the conservatory a notice of default and informed them that it would be seeking fifteen percent attorney fees if the balance remained unpaid. Graydon sued SunTrust and its parent company for breach of contract, negligent distribution of loan proceeds, fraud, negligent misrepresentation, and conspiracy. The trial court granted summary judgment to SunTrust on all claims. 141

First, the court of appeals affirmed the grant of summary judgment to SunTrust Banks, Inc., the lender's parent corporation, because it was not

<sup>139.</sup> Id. at 202, 572 S.E.2d at 458. The total cost of the acquisition of the property and the renovations was approximately \$540,000. Graydon obtained a loan from the City of Albany for \$200,000 and planned to raise the additional \$30,000 to \$40,000 in order to meet his contractual obligations with the contractor. Id.

<sup>140.</sup> Id

<sup>141.</sup> Id. at 201-04, 207, 572 S.E.2d at 457-59, 461.

a party to any of the transactions. 142 Next, with respect to Graydon's claim that the last two disbursements to the contractor were made without his consent, the court held that there was no genuine issue of material fact because Graydon did not contest that he sent the memos authorizing the bank to disburse funds to the contractor at its discretion. 143 Furthermore, the court determined that the loan agreement unambiguously provided that disbursements would be made at the lender's sole discretion unless the lender had otherwise made a legally binding written commitment to make disbursements. 144 court affirmed the trial court's grant of summary judgment on Graydon's claim of negligent inspection by the lender. Because nothing in the record indicated that the bank undertook the inspection of the property on Graydon's behalf, summary judgment was proper.<sup>146</sup> Additionally, the court affirmed the trial court's grant of summary judgment on Graydon's fraud claim (and consequently, the conspiracy to commit fraud claim) regarding the second draw of \$26,012.50 because Graydon authorized in writing the bank's fulfillment of the contractor's draw requests by electronic funds transfer.<sup>147</sup> Based on the above reasoning, the court affirmed the trial court's grant of summary judgment in favor of the lender.148

# C. Disbursement of Proceeds of Certificate of Deposit "Upon Proper Request"

In South v. Bank of America,<sup>149</sup> the court of appeals affirmed the trial court's grant of summary judgment to the bank, which upon a telephonic request by one of the owners of a certificate of deposit ("CD") disbursed the proceeds of the jointly owned CD to the detriment of the other owner.<sup>150</sup> The more avid and attentive readers of the Mercer Law Review may recall the underlying facts of the case from two years ago<sup>151</sup> as follows:

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142. Id. at 205, 572 S.E.2d at 460.
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<sup>143.</sup> Id.

<sup>144.</sup> Id. at 206, 572 S.E.2d at 460.

<sup>145.</sup> Id.

<sup>146.</sup> Id., 572 S.E.2d at 461.

<sup>147.</sup> Id. at 206-07, 572 S.E.2d at 461.

<sup>148.</sup> Id. at 207, 572 S.E.2d at 461.

<sup>149. 260</sup> Ga. App. 91, 579 S.E.2d 80 (2003).

<sup>150.</sup> Id. at 96, 579 S.E.2d at 83.

<sup>151.</sup> See Paul A. Quirós, Lynn S. Scott & James F. Brumsey, Business Associations, 53 MERCER L. REV. 109 (2001).

Louise South purchased an eighteen-month CD from NationsBank for \$40,000 in April 1993 in the names of both herself and her son, Harry South, without informing Harry that she had made him a joint owner of the CD. Louise redeemed the CD for its matured value in October 1994 by making a telephone request to the bank, and the bank deposited the proceeds from the CD into Louise's bank account. Following her death in 1999, Harry learned of the above transactions and filed suit against NationsBank's successor, Bank of America, alleging that by negotiating the original CD without his knowledge or consent, the bank violated his ownership rights, converted the proceeds of the CD, and breached its contract. <sup>152</sup>

In the original case before the court of appeals, the court reversed the trial court's grant of judgment on the pleadings for the bank because a question of fact existed as to whether the proceeds of the CD were issued pursuant to a "proper request" as defined by O.C.G.A. section 7-1-810(12). Following the previous appeal, the parties submitted additional evidence, and the trial court granted the bank's motion for summary judgment on the grounds that Louise South made a proper request to negotiate the certificate. Harry South appealed. 154

On appeal, South first contended that an issue of material fact existed as to whether Louise actually made the telephone request. However, the bank offered direct testimonial evidence of an employee, Connelly, who stated that she had received and processed Louise's telephonic request to negotiate the CD. Additionally, Connelly filled out several withdrawal, redemption, and new account slips as well as other transaction confirmation forms, which were all entered into evidence. Connelly testified that she completed several other transactions for Louise before her death, all in accordance with the bank's policies allowing such transactions. South contended that the following three facts constituted direct evidence that his mother did not authorize the negotiation of the CD: (a) the bank did not produce any written policies and procedures relevant to the transaction; (b) the bank did not produce a depositor's agreement for the CD account opened by Louise following the redemption of the CD at issue; and (c) Louise signed no document authorizing the redemption of the CD. 155 South also offered circumstantial evidence that "his mother 'would never conduct bank transactions over the phone,"156 and that he suspected that his sister may have placed the

<sup>152</sup> Id at 143

<sup>153. 260</sup> Ga. App. at 92, 579 S.E.2d at 81; O.C.G.A. § 7-1-810(12) (1997).

<sup>154. 260</sup> Ga. App. at 92, 579 S.E.2d at 81.

<sup>155.</sup> Id. at 93-94, 579 S.E.2d at 81-82.

<sup>156.</sup> Id.

authorizing call and taken the proceeds.<sup>157</sup> The court dismissed this "evidence" on the grounds that it was irrelevant because it merely showed that the bank's procedures may not have been precisely followed, or that it was otherwise circumstantial.<sup>158</sup> Because "circumstantial evidence has no probative value against positive and uncontradicted evidence that no such fact exists, provided that the circumstantial evidence may be construed consistently with the direct evidence," <sup>159</sup> the court held that summary judgment was appropriate. <sup>160</sup>

Finally, South contended that an issue of fact existed concerning whether his mother made a "proper request for withdrawal" under O.C.G.A. section 7-1-810(12)<sup>161</sup> because Connelly admitted that she did not obtain a withdrawal confirmation signed by Louise South in accordance with bank policy, nor did she personally document the telephonic transaction. However, as the court pointed out, South confused the "request for payment with the bank's need to document the request for payment after the fact." Thus, South's contention was without merit. 164

# D. Preemption of Georgia Law by Federal Law Allowing Banks to Charge Fees to Non-Accountholders for Check-Cashing Services

In *Bank of America*, *N.A. v. Sorrell*, <sup>165</sup> Bank of America filed suit against the Georgia Department of Banking and Finance, challenging state laws prohibiting Georgia banks from charging check-cashing fees to non-accountholders. <sup>166</sup> The relevant provisions of Georgia law provide as follow:

"No financial institution, savings bank, national bank, or state or federal credit union or savings and loan association may charge any fee of any kind to a person or corporation who does not have an account with that institution for cashing a check or other instrument which is payable to such person or corporation and is drawn on the account of another person or corporation with that institution." <sup>167</sup>

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157. Id.
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<sup>158.</sup> Id. at 94-95, 579 S.E.2d at 82-83.

<sup>159.</sup> *Id.* at 94, 579 S.E.2d at 82 (quoting Lane v. Spragg, 224 Ga. App. 606, 607-08, 481 S.E.2d 592, 594 (1997)).

<sup>160.</sup> Id. at 96, 579 S.E.2d at 83.

<sup>161.</sup> O.C.G.A. § 7-1-810(12) (1997).

<sup>162. 260</sup> Ga. App. at 95, 579 S.E.2d at 83.

<sup>163.</sup> Id.

<sup>164.</sup> *Id*.

<sup>165. 248</sup> F. Supp. 2d 1196 (N.D. Ga. 2002).

<sup>166.</sup> Id. at 1198.

<sup>167.</sup> Id. (quoting O.C.G.A. § 7-1-239.5 (1997)).

Additionally, O.C.G.A. section 7-1-372<sup>168</sup> provides that a "commercial bank shall pay all checks drawn on it at par and shall make no charge for the payment of such checks."<sup>169</sup> As the court pointed out, these two provisions, taken together, prevent banks in Georgia from charging a check-cashing fee to non-accountholders. <sup>170</sup>

The Office of the Comptroller of the Currency ("OCC"), the federal agency within the Treasury Department responsible for administering the National Bank Act, filed an amicus curiae brief supporting Bank of America. 171 Additionally, in a previous opinion letter to Bank of America, the OCC informed Bank of America that it was authorized "under 12 U.S.C. § 24(Seventh) and 12 C.F.R. § 7.4002(a), to charge the non-relationship customer check cashing convenience fee."172 Showing deference to the OCC as an agency interpreting a law under which it acts (especially when it interprets its own regulations), 173 the court concluded that "[the] federal banking law permits banks to charge fees to non-accountholders for cashing checks drawn on that bank." As such, the National Bank Act directly conflicted with the Georgia statutes, so there was no issue of fact that would preclude summary judgment. 175 Additionally, because Bank of America succeeded on the merits and had testified that "it loses hundreds of thousands of dollars of revenue each month" 176 as a result of not charging non-accountholders for check-cashing services, the court permanently enjoined the Georgia Department of Banking and Finance from enforcing the Georgia laws.177

#### E. Legislative Changes

1. Objectives for Entities Under Supervision of Department of Banking and Finance that are not Financial Institutions. The general assembly amended O.C.G.A. section 7-1-3(a)(10)<sup>178</sup> to provide objectives for the supervision of nonfinancial institutions such as check

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168. O.C.G.A. § 7-1-372 (1997).
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<sup>169.</sup> Id.

<sup>170. 248</sup> F. Supp. 2d at 1198.

<sup>171.</sup> Id. at 1199.

<sup>172.</sup> Id.

<sup>173.</sup> Id. (citing United States v. Mead Corp., 533 U.S. 218, 231 n.13 (2001)).

<sup>174.</sup> Id. (citing Wells Fargo Bank Texas, N.A. v. James, 184 F. Supp. 2d 588, 590-91 (W.D. Tex. 2001)).

<sup>175.</sup> Id.

<sup>176.</sup> Id.

<sup>177.</sup> Id. at 1200.

<sup>178.</sup> O.C.G.A. § 7-1-3(a)(10) (1997 & Supp. 2003).

cashers, mortgage lenders, and brokers by the Department of Banking and Finance (the "Department"). Such objectives include: (a) the supervision and examination of their business affairs to ensure they are operating in accordance with Georgia law; 180 (b) the protection of consumer interests and service by these entities; 181 and (c) the simplification and modernization of the law governing such entities and the delegation of rulemaking power and administrative discretion to the Department. 182

**2. Restrictions on Commissioner, Deputy Commissioners, and Examiners.** The general assembly expanded the scope of Department employees covered by O.C.G.A. section 7-1-37(a)<sup>183</sup> (relating to receipt of gifts, money, and property from financial institutions) to cover any Department employee with financial institution or licensee supervisory responsibilities.<sup>184</sup> This section was also expanded so that covered Department employees may not give any money or property as a gift to any financial institution (or its directors, officers, agents, employees, attorneys, or subsidiaries) unless the gift is consistent with the state's ethics in government policy.<sup>185</sup>

The commissioner, a deputy commissioner, a Department employee with financial institution or licensee supervisory responsibilities, or an examiner may be permitted to own securities of a financial institution under any of the following circumstances: (a) "if the security was obtained prior to commencement of employment with the [D]epartment;" (b) "if the ownership . . . was acquired through inheritance; gift; stock split or dividend; merger, acquisition, or other change in corporate structure;" or otherwise without intent of such employee to acquire the interest; or (c) if the security is part of an investment fund, provided that a thirty percent threshold of funds invested in the securities of one or more FDIC-insured depository institutions is not exceeded. Additionally, examiners may not examine financial

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179. Id.
180. Id. § 7-1-3(a)(10)(A).
181. Id. § 7-1-3(a)(10)(B).
182. Id. § 7-1-3(a)(10)(C).
183. O.C.G.A. § 7-1-37(a) (1997 & Supp. 2003).
184. Id.
185. Id. § 7-1-37(a)(3).
186. Id. § 7-1-37(e)(1)(A).
187. Id. § 7-1-37(e)(1)(B).
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189. Id. § 7-1-37(e)(1)(C).

institutions in which they own securities under (a) and (b) above. <sup>190</sup> Amendments to this chapter also set forth certain restrictions on giving and receiving money or property as gifts or loans from licensees unless certain requirements are met. <sup>191</sup>

- **3. Electronic Collection of Fees by Department.** The general assembly authorized the Department to collect examination, license, registration, and supervision fees via any manner deemed efficient, including electronic means. <sup>192</sup>
- **4. Fulfillment of Vacancies on Supervisory Committee of Credit Unions.** O.C.G.A. section 7-1-656<sup>193</sup> assigns the board of directors of a credit union the duty of filling vacancies on its supervisory committee until a successor is elected and qualified. <sup>194</sup>
- **5.** Deletion of Concept of "Risk Assets" with Respect to Credit Unions. The general assembly deleted the definition of "risk assets" (with respect to the level of capital and reserves required to be held by credit unions) in its entirety. <sup>195</sup>
- **6. Exemption of National Banks and Credit Unions from Licensing Requirements as Check Cashers.** O.C.G.A. section 7-1-709(a)<sup>196</sup> as amended exempts national banks, trust companies, credit unions, building and loan associations, and savings and loan associations from licensing requirements as check cashers. <sup>197</sup>
- 7. Background Checks for Mortgage Business Policymakers (Directors and Officers). O.C.G.A. section 7-1-1004<sup>198</sup> was rewritten to authorize the Department to conduct investigations as it deems necessary on any individual directing the affairs or establishing the policy for a licensed mortgage business, including its officers, directors, or the equivalent, to determine that such people are of good character and ethical reputation.<sup>199</sup> The Department was also given broad rulemaking authority to establish minimum education or experience

<sup>190.</sup> Id. § 7-1-37(f).

<sup>191.</sup> Id. § 7-1-37(g).

<sup>192.</sup> O.C.G.A. § 7-1-41 (1997 & Supp. 2003).

<sup>193.</sup> O.C.G.A. § 7-1-656 (1997 & Supp. 2003).

<sup>194.</sup> Id. § 7-1-656(a)(5).

<sup>195.</sup> O.C.G.A. § 7-1-668 (1997); 1974 Ga. Laws 705.

<sup>196.</sup> O.C.G.A. § 7-1-709(a) (1997 & Supp. 2003).

<sup>197.</sup> Id.

<sup>198.</sup> O.C.G.A. § 7-1-1004 (1997 & Supp. 2003).

<sup>199.</sup> Id.

requirements for applicants for mortgage brokers licenses and renewals.<sup>200</sup> Additionally, every licensee and applicant is authorized and required to obtain background checks on its employees.<sup>201</sup>

**8.** Advertising by Mortgage Lenders. All advertisements of mortgage lenders in Georgia are now required to contain the license number of the licensee or registrant. Licensees licensed in more than one state who are advertising in Georgia must include Georgia in its listing of states in which the advertiser is licensed. Licenseed.

<sup>200.</sup> Id. § 7-1-1004(c).

<sup>201.</sup> Id. § 7-1-1004(f).

<sup>202.</sup> O.C.G.A. § 7-1-1016(2) (1997 & Supp. 2003).

 $<sup>203. \</sup>quad Id.$