

Business Associations

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This Article surveys noteworthy cases in the areas of corporate, securities, and partnership law decided during the survey period¹ 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. This Article also summarizes recent enactments by the Georgia General Assembly to the Official Code of Georgia Annotated (“O.C.G.A.”) with respect to banking and finance laws.²

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1. The survey period runs from June 1, 2004 through May 31, 2005.
2. No amendments were made to Title 14 (Corporations, Partnerships, and Associations) of the Official Code of Georgia Annotated (“O.C.G.A.”) during the 2005 Session of the Georgia General Assembly.

I. CORPORATIONS

A. *Piercing the Corporate Veil*

1. Corporation Allowed to Pierce its Own Veil for Claim Against Former Principal in Bankruptcy. In *Baillie Lumber Co. v. Thompson*,³ the Georgia Supreme Court addressed whether Georgia law allows the representative of a debtor to bring an alter ego claim against the corporation's former principal, and, if so, what measure of recovery is available.⁴ Bert F. Thompson ("Thompson") was the manager and the sole member of Piedmont Hardwood Flooring, LLC ("Piedmont"), a national manufacturer and distributor of hardwood flooring. Baillie Lumber Co. ("Baillie Lumber") sold lumber to Piedmont on an unsecured basis, and Piedmont did not pay for the lumber. On December 17, 2001, Piedmont filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code.⁵ As a result, Piedmont was allowed to operate its business as a debtor-in-possession, known as Icarus Holding, LLC ("Icarus"), to wind up the company.⁶

Prior to the bankruptcy filing, Thompson allegedly engaged in various financial irregularities, including misappropriating assets to make improvements to his personal hunting lodge, and to fund another company.⁷ These allegations caused Thompson to relinquish control of Piedmont voluntarily. After Piedmont filed its bankruptcy petition, Icarus filed a complaint against Thompson alleging that Thompson's misuse of Piedmont's assets constituted fraudulent transfers and entitled Icarus to recover the money that had been misappropriated.⁸

Baillie Lumber also filed a suit against Thompson in state court, alleging that Thompson was the alter ego of Icarus and should be personally liable for Piedmont's debts to Baillie Lumber. In response, Thompson filed for injunctive relief in bankruptcy court to prevent Baillie Lumber's state court claim from progressing and alleged that any alter ego claim against him was the property of the bankruptcy estate.⁹ The bankruptcy court held that the bankruptcy estate included the alter ego claim and that Baillie Lumber's claim was subject to the

3. 279 Ga. 288, 612 S.E.2d 296 (2005).

4. *Id.* at 288, 612 S.E.2d at 298.

5. 11 U.S.C. §§ 1101 to 1174 (2000 & Supp. 2005) (Bankr. Code).

6. *Baillie Lumber*, 279 Ga. at 288, 612 S.E.2d at 298.

7. *Id.* at 288 n.1, 612 S.E.2d at 298 n.1.

8. *Id.* at 288, 612 S.E.2d at 298.

9. *Id.* at 288-89, 612 S.E.2d at 298.

automatic stay of the bankruptcy court.¹⁰ Baillie Lumber appealed to the district court, which agreed with the bankruptcy court and held that a corporation may assert alter ego claims and, in the bankruptcy context, that alter ego claims are part of the bankruptcy estate.¹¹ Baillie Lumber then appealed to the Eleventh Circuit Court of Appeals.¹²

The Eleventh Circuit focused on Icarus's standing to bring the alter ego claim in bankruptcy court and held that "in order to bring an exclusive alter ego action under section 541 [of the Bankruptcy Code], a bankruptcy trustee's claim should (1) be a general claim that is common to all creditors and (2) be allowed by state law."¹³ The Eleventh Circuit acknowledged that the alter ego claim was common to all creditors, but the court was not convinced that a Georgia corporation could bring an alter ego claim against itself.¹⁴ Therefore, the Eleventh Circuit certified the issue to the Georgia Supreme Court.¹⁵

Under Georgia law, the alter ego doctrine allows the corporate entity to be ignored for liability purposes when the corporate form is abused and the corporation is used as a mere alter ego or business conduit of a person.¹⁶ Georgia courts have held that to meet this standard, the plaintiffs must demonstrate that "the shareholders disregarded the corporate entity and 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."¹⁷ The purpose of the alter ego doctrine is to remedy injustices when a party uses the corporate form to perpetuate fraud or evade responsibility in tort or contract.¹⁸ Moreover, because "equitable principles govern the alter ego doctrine,"¹⁹ alter ego claims are "appropriately granted only in the absence of adequate remedies at law."²⁰

The Georgia Supreme Court then turned to the question of whether a corporation, in this case Icarus, would be able to recover from its

10. *Id.* at 289, 612 S.E.2d at 298 (noting that because of the automatic stay, the court did not need to issue a separate injunction).

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*, 612 S.E.2d at 298-99.

15. *Id.*, 612 S.E.2d at 299.

16. *Id.*

17. *Id.* at 289-90, 612 S.E.2d at 299 (quoting *Heyde v. Xtraman, Inc.*, 199 Ga. App. 303, 306, 404 S.E.2d 607, 610 (1991) (citation and punctuation omitted)).

18. *Id.* at 290, 612 S.E.2d at 299 (citing *Heyde*, 199 Ga. App. at 306, 404 S.E.2d at 610).

19. *Id.* (citing *Acree v. McMahan*, 276 Ga. 880, 883, 585 S.E.2d 873, 875) (citations omitted).

20. *Id.* (quoting *Acree*, 276 Ga. at 883, 585 S.E.2d at 875) (citations omitted).

principal under the alter ego theory of piercing the corporate veil.²¹ The supreme court alluded to *Pickett v. Paine*,²² in which it noted the court's "reluctan[ce] to disregard the corporate entity except where third parties were involved . . . and director or shareholder liability was in question, or where public policy might require looking beyond the corporate structure in the public interest."²³ In subsequent decisions applying the reasoning in *Pickett*, the Georgia Court of Appeals has been reluctant to confine the alter ego doctrine to cases involving third parties.²⁴ In concluding that an alter ego claim may be brought by persons other than third parties, the Georgia Supreme Court reasoned that:

it is clear that Georgia courts have extended the veil-piercing doctrine beyond traditional suits by a third-party creditor, to cases where application of the doctrine is necessary "to remedy injustices which arise where a party has over extended his privilege in the use of a corporate entity in order to defeat justice, perpetuate fraud or evade contractual or tort responsibility."²⁵

The court next examined the application and purpose of the automatic stay in bankruptcy.²⁶ In particular, the court noted that the automatic stay operates "to protect the debtor's assets, provide temporary relief from creditors, and further equity of distribution among the creditors by forestalling a race to the courthouse."²⁷ The court concluded that when applied to the facts of *Baillie Lumber*, a determination that alter ego claims are outside of the bankruptcy estate and not subject to the automatic stay "would allow a creditor to circumvent the bankruptcy process and would 'undercut the general bankruptcy policy of ensuring that all similarly-situated creditors are treated fairly.'"²⁸ Although the Georgia Supreme Court confirmed that the alter ego doctrine could be applied in cases not involving third parties, such as on public policy grounds, in light of the benefit the automatic stay provides to all similarly-situated creditors, the court held that the "third-party benefit"

21. *Id.*, 612 S.E.2d at 298.

22. 230 Ga. 786, 199 S.E.2d 223 (1973).

23. *Baillie Lumber*, 279 Ga. at 290, 612 S.E.2d at 298 (quoting *Pickett*, 230 Ga. 786, 791, 199 S.E.2d 223, 227) (emphasis added).

24. *Id.* at 291, 612 S.E.2d at 299.

25. *Id.*, 612 S.E.2d at 299-300 (quoting *Cheney v. Moore*, 193 Ga. App. 312, 312-13, 387 S.E.2d 575, 575-76 (1989)).

26. *Id.*, 612 S.E.2d at 300.

27. *Id.* (quoting *GATX Aircraft Corp. v. M/V Courtney Leigh*, 768 F.2d 711, 716 (5th Cir. 1985)).

28. *Id.* (quoting *In re S.I. Acquisition*, 817 F.2d 1142, 1153 (5th Cir. 1987)).

requirement was met in the case of an insolvent company under federal bankruptcy laws.²⁹ The court reasoned that the claim, if successful, would “necessarily benefit third parties by providing more money with which to satisfy unsecured claims.”³⁰

In addition to Georgia law, the court was persuaded by the decisions of the Third Circuit Court of Appeals and several decisions of the federal bankruptcy courts in Georgia.³¹ In particular, while noting that it was “strange to allow a corporation to pierce its own veil,” the Third Circuit held that “[b]ecause piercing the corporate veil or alter ego causes of action are based upon preventing inequity or unfairness, it is not incompatible with the purposes of the doctrines to allow a debtor corporation to pursue a claim based upon such a theory.”³²

Based on the foregoing discussion and the reasoning that “Georgia alter ego law is not focused solely on the relationships between parties, but also is premised on equitable principles designed to prevent unjust treatment in appropriate circumstances,” the Georgia Supreme Court held that Icarus had a right to pursue an alter ego claim against Thompson.³³ Moreover, the court stated that it would be “extremely unlikely” that a corporation would initiate an alter ego action outside the bankruptcy context and reiterated that piercing the corporate veil was appropriate only in instances where no adequate remedy at law exists.³⁴ Finally, regarding the measure of recovery, the court held that “where the corporate entity is disregarded, a principal found liable under an alter ego theory should be liable for the entirety of the corporation’s debt.”³⁵

2. Insolvency Is a Precondition to Pierce the Corporate Veil. In *Perry v. Unum Life Insurance Co.*,³⁶ the United States District Court for the Northern District of Georgia granted the defendant’s motion to dismiss and did not pierce the corporate veil of Unum Life Insurance Co.

29. *Id.*

30. *Id.*

31. *Id.* at 291-92, 612 S.E.2d at 300. *See, e.g.,* *Phar-Mor, Inc. v. Coopers & Lybrand*, 22 F.3d 1228, 1240 n.20 (3d Cir. 1994); *In re Adam Furniture Indus.*, 191 B.R. 249, 254 (Bankr. S.D. Ga. 1996); *In re City Communications*, 105 B.R. 1018, 1022 (Bankr. N.D. Ga. 1989).

32. *Baillie Lumber*, 279 Ga. at 291-92, 612 S.E.2d at 299-300 (quoting *Phar-Mor*, 22 F.3d at 1240 n.20).

33. *Id.* at 292, 612 S.E.2d at 300 (citing *Farmer’s Warehouse of Pelham v. Collins*, 220 Ga. 141, 150, 137 S.E.2d 619, 625 (1964)).

34. *Id.*

35. *Id.* at 293, 612 S.E.2d at 301.

36. 353 F. Supp. 2d 1237 (N.D. Ga. 2005).

of America (“Unum Life”).³⁷ Toni Perry, who suffered from multiple sclerosis and diabetes, was denied continuation of benefits based on Unum Life’s conclusion “that there [was] no objective medical evidence to support total disability.”³⁸ In an effort to hold UnumProvident Corporation (“UnumProvident”), the parent corporation of Unum Life, liable under Unum Life’s policy, Perry’s complaint included an allegation that Unum Life was the alter ego for UnumProvident.³⁹ In granting Unum Life’s motion to dismiss, the court held that Georgia law requires, as a precondition to piercing the corporate veil, that the defendant corporation be insolvent.⁴⁰ Perry never alleged that Unum Life had insufficient assets and, accordingly, the court dismissed Perry’s claim with respect to UnumProvident.⁴¹

B. Miscellaneous

1. Bylaw Provision Not Deemed a Restraint on Trade. In *Albany Bone & Joint Clinic, P.C. v. Hajek*,⁴² the Georgia Court of Appeals considered whether a provision in a corporation’s bylaws valuing the shares at book value constituted a restraint on trade.⁴³ Phillip D. Hajek, M.D. was a member of Albany Bone & Joint Clinic, P.C. (“Clinic”) with two other doctors. In April 2003 Hajek left his position with the Clinic and sought compensation for his Clinic shares. The parties disagreed regarding the method for valuing the shares, and Hajek filed suit against the Clinic. In response, the Clinic alleged that its bylaws established the value of the shares as the “book value.” Hajek argued that the bylaws did not govern the method of valuation because the portion of the bylaws that addressed the method of valuation was void as impermissibly broad and as an illegal restraint on trade. In addition, Hajek argued that because he should be treated as a dissenting shareholder, his shares should be valued in accordance with the pertinent O.C.G.A. provision.⁴⁴ The trial court ruled for Hajek, and the Clinic appealed.⁴⁵

In its analysis, the court of appeals first addressed the relevant provision of the Clinic’s bylaws, which stated in part:

37. *Id.* at 1237.

38. *Id.* at 1238.

39. *Id.* at 1238-39.

40. *Id.* at 1240.

41. *Id.*

42. 272 Ga. App. 464, 612 S.E.2d 509 (2005).

43. *Id.* at 464, 612 S.E.2d at 509.

44. O.C.G.A. §§ 14-2-1327, 14-7-5 (2005).

45. *Albany Bone & Joint Clinic*, 272 Ga. App. at 464-65, 612 S.E.2d at 511.

If any shareholder of the corporation for any reason ceases to be duly licensed to practice medicine in the State of Georgia, or upon the death or adjudication of incompetence of a shareholder as an officer, or upon the severance of a shareholder as an officer, agent, or employee of the corporation, without first obtaining the written consent of all other shareholders shall become a shareholder or an officer, director, agent, or employee of another professional service corporation authorized to practice medicine in Georgia, . . . the shares of such shareholder in this corporation shall then and thereafter have no voting rights of any kind, shall not be entitled to any dividend or rights to purchase shares of any kind which might be declared thereafter by the corporation, and shall be forthwith transferred, sold and purchased or redeemed at such price and value and only in the manner following:

(a)(1) Except upon the death, permanent disability or termination of employment by normal retirement, the purchase or redemption price for such shares shall be the book value of such shares as of the end of the calendar month preceding the occurrence of such event. The term “book value” shall mean the proportionate value at which such shares are carried and shown on the books and records of the corporation[.] . . . [N]o amounts of values shall be included in such “book value” for good will or firm name, or leases or other intangible assets, or for work in process, or for fees billed but uncollected.

(2) Upon death, permanent disability, or termination of employment by normal retirement, the purchase or redemption price of such shares shall be agreed upon between the stockholder and the corporation or other stockholders as the case may be. In the event the parties are unable to agree as to the sale price of the stock, then the value shall be as determined by arbitration as soon as possible. . . . The value of all stock of the corporation shall include [certain insurance proceeds and accounts receivable].⁴⁶

The trial court found that “paying Hajek the book value for his shares upon his departure from the Clinic (instead of the potentially higher value available when a shareholder dies, becomes disabled, or retires) constituted a ‘penalty’ imposed on shareholders who leave the Clinic to work for a competing professional corporation.”⁴⁷ As a result, the court concluded that the “penalty” was “in partial restraint of trade” and a “restrictive covenant” because the lower value obtained for the shares under such a valuation method would deter an individual from obtaining other employment instead of remaining with the Clinic.⁴⁸

46. *Id.* at 465-66, 612 S.E.2d at 511-12.

47. *Id.* at 466, 612 S.E.2d at 511.

48. *Id.*

The court of appeals then recited the four basic forms of restrictive covenants under Georgia law⁴⁹ and analyzed the bylaws in the context of whether they would violate Georgia law as a restrictive non-competition agreement.⁵⁰ According to the court, a non-competition covenant will be upheld if “the restraint imposed is reasonable, is founded on a valuable consideration, and is reasonably necessary to protect the interest of the party in whose favor it is imposed, and does not unduly prejudice the interests of the public.”⁵¹ In holding that the provision of the bylaws did not violate Georgia law, the court of appeals noted that the provision in no way restricted the right of Hajek to practice medicine, did not require him to keep any information confidential, and did not prevent him from soliciting his former patients.⁵² The court of appeals further held that the bylaws did not constitute a financial “penalty” because nothing in them prohibited a shareholder from joining a competitor.⁵³ The court reasoned that the valuation of the stock would be the same whether Hajek left the Clinic to work for a competitor or for any other reason.⁵⁴ Therefore, because no differing treatment between working for a competitor or non-competitor existed, the court of appeals overturned the trial court and concluded that the bylaws did not create an illegal restraint on trade.⁵⁵ Consequently, the court upheld the valuation of the stock at book value pursuant to the bylaws.⁵⁶

2. Entity Held as “Successor” and Liable for Debt. *General Star Indemnity Co. v. Elam Motorsports Technologies, Inc.*⁵⁷ came before the United States District Court for the Northern District of Georgia on a motion for partial summary judgment.⁵⁸ General Star Indemnity Co. (“General”) insured a number of Indianapolis Racing League (“IRL”) racecars against on-track accident damage. In connection with this program, General paid \$400,000 to G Force, LLC (“GFLLC”) as an inventory deposit to fund the immediate delivery of vehicle parts

49. *Id.* The four basic types of restrictive covenants in Georgia are noncompetition, nonsolicitation of customers, nonrecruitment of employees, and nondisclosure of confidential information. *Id.*

50. *Id.* at 466-67, 612 S.E.2d at 511-12.

51. *Id.* at 467, 612 S.E.2d at 512 (quoting *Swartz Invs. v. Vion Pharm.*, 252 Ga. App. 365, 367, 556 S.E.2d 460, 461 (citations and punctuation omitted)).

52. *Id.* at 467-68, 612 S.E.2d at 513.

53. *Id.* at 468, 612 S.E.2d at 513.

54. *Id.*

55. *Id.*

56. *Id.*

57. 356 F. Supp. 2d 1333 (N.D. Ga. 2004).

58. *Id.* at 1334.

to the IRL teams. At the end of the 1999 season, Elam Motorsports Technologies (“EMT”) acquired GFLLC and its parent company, G Force Technologies, Ltd. (“Company”). At least twelve different EMT subsidiaries provided parts to the IRL teams.⁵⁹

In its lawsuit, General alleged that EMT caused GFLLC to stop supplying parts to IRL teams in October 1999 when GFLLC moved its corporate headquarters from Colorado to Braselton, Georgia. General renewed its contract with GFLLC and restored the balance of its inventory deposit to \$400,000. The deposit was not diminished during the 2000 season. As a result, General did not renew the program for the next year and demanded its deposit back from G Force in Georgia, Inc. (“GFGA”), incorporated by EMT in Georgia in February 2001.⁶⁰ GFLLC continued to exist until November 1, 2000. Thereafter, GFGA continued in the same line of business as had been conducted by GFLLC in Colorado.⁶¹ At EMT’s instruction, GFGA made only one \$50,000 payment to General. General then brought suit to recover the remaining amount, and GFGA agreed to settle the case. After the settlement, General learned that GFGA was insolvent. GFGA had no officers, directors, or employees, and EMT employees conducted all of its business. In 2002 GFGA ceased to do business, and EMT officially took over all business functions previously performed by GFGA. EMT also assumed and paid GFGA debts, except those to General. General then brought action against GFGA and EMT to recover the settlement amount.⁶²

General brought its claim for the enforcement of the settlement amount resulting from GFGA’s failure to return the inventory deposit based on three arguments: (1) EMT was the successor corporation to GFGA and liable for its debt to General, (2) EMT was directly liable for failure to return the deposit, and (3) EMT violated its fiduciary duties to General.⁶³

In addressing the first allegation, the trial court reviewed the standard for determining when an entity is a successor of another entity, noting that “[g]enerally, ‘a corporation that purchases or otherwise acquires the assets of a second corporation does not assume the debts

59. *Id.* at 1334-35.

60. The court was not certain if General contracted with GFLLC or GFGA. However, the court noted that it was irrelevant because both were wholly owned EMT subsidiaries. *Id.* at 1335 n.3.

61. *Id.* at 1335.

62. *Id.* at 1335-36.

63. *Id.* at 1337-38.

and liabilities of the second corporation.”⁶⁴ There are, however, exceptions to this general rule. For example, the “mere continuation” doctrine applies in instances when the successor is a “mere continuation” of the selling corporation, and a “common identity of the officers, directors, and stockholders in the selling and purchasing corporations” exists.⁶⁵ Georgia courts apply the mere continuation doctrine when there is common identity of ownership (i.e., when the same individual or entity owned both the dissolved entity and the successor entity).⁶⁶

EMT argued that EMT Racing Corp. (“EMT Racing”), a wholly-owned subsidiary of EMT, acquired GFGA’s assets and liabilities. However, three months after EMT Racing allegedly purchased the assets and assumed the liabilities of GFGA, EMT purchased the assets and assumed the liabilities of EMT Racing.⁶⁷ As a result, the court noted that EMT was the undisputed successor corporation of GFGA because EMT acquired all of GFGA’s assets and assumed all of its liabilities.⁶⁸ No change in ownership or management occurred, and the business did not change because of the acquisition by EMT.⁶⁹ Moreover, GFGA never had officers or employees, because EMT officers and employees filled those roles.⁷⁰ EMT admitted that “the only change was in what books the expenses were run through.”⁷¹

In granting General’s motion for partial summary judgment, the court found that “there was complete identity of ownership and virtual identity in management.”⁷² Thus, “the requirements for a finding that the newly consolidated EMT entity [was] a mere continuation of GFGA [were] clearly met.”⁷³

It is interesting to note that the plaintiff’s complaint included a claim for piercing the corporate veil, but the court did not address this claim. In the absence of holding EMT liable as a successor, the court may have concluded that GFGA was a mere instrumentality and the alter ego of EMT and, therefore, supported a veil piercing claim.

64. *Id.* at 1338 (citing *Bud Antle, Inc. v. E. Foods, Inc.*, 758 F.2d 1451, 1456 (11th Cir. 1985)).

65. *Id.* (quoting *Bud Antle*, 758 F.2d at 1459).

66. *Id.*

67. *Id.* at 1339.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

3. Documents Disclosed to the Securities and Exchange Commission (“SEC”) Not Protected by the Work Product Doctrine and Unjust Enrichment Not Found. In *McKesson Corp. v. Green*,⁷⁴ the Georgia Supreme Court considered whether a party waived work-product protection when providing audit documents to the SEC, and whether a claim for unjust enrichment was compensable when the shareholders of a company that merged out of existence received more consideration for their shares than they would have absent accounting fraud.⁷⁵ The *McKesson* case resulted from a merger between two publicly-traded corporations, McKesson Corporation (“McKesson”) and HBO & Company (“HBOC”). McKesson acquired HBOC in a stock-for-stock deal in which McKesson purchased shares of HBOC stock at an exchange ratio that was computed, in part, in reliance on the respective representations and warranties of McKesson and HBOC. McKesson claimed that HBOC’s stock had been overvalued because of accounting fraud and that McKesson had overpaid for the stock.⁷⁶

When the accounting fraud was revealed, McKesson retained an outside law firm, which subsequently retained an outside accounting firm to perform an audit. McKesson voluntarily provided a copy of the 180-page report compiled in the audit to the SEC and the United States Attorney’s office, both of which were performing their own investigations of HBOC and McKesson. McKesson provided the documents pursuant to confidentiality agreements that specifically preserved work-product protections.⁷⁷

Several McKesson shareholders, including the plaintiffs who were former shareholders of HBOC, filed an action alleging that the decline in McKesson’s stock value resulted from the accounting fraud. McKesson counterclaimed, seeking damages for unjust enrichment on the grounds that HBOC shareholders received more shares of McKesson stock than they should have received because the accounting fraud inflated the value of HBOC stock. The superior court granted a motion to compel the production of the audit documents and denied a motion to dismiss McKesson’s counterclaim. The court of appeals affirmed the motion to compel and reversed the denial of the motion to dismiss McKesson’s counterclaim.⁷⁸

74. 279 Ga. 95, 610 S.E.2d 54 (2005).

75. *Id.* at 95, 610 S.E.2d at 56.

76. *Id.*

77. *Id.*, 610 S.E.2d at 55.

78. *Id.*, 610 S.E.2d at 55-56.

Focusing on the work-product issue, McKesson claimed the court of appeals erred in holding that McKesson waived its work-product protection by providing the documents to the SEC.⁷⁹ McKesson argued that (1) the burden had been improperly placed on McKesson to prove it had not waived the protection, (2) providing the documents to the SEC did not waive the protection, and (3) the confidentiality agreements with the SEC sufficiently maintained the work-product protection for the documents.⁸⁰

First, the Georgia Supreme Court confirmed that Georgia law is “in line” with the majority of jurisdictions in that “the burden of proving a waiver of work-product protection lies on the party *asserting* the waiver.”⁸¹ Next, the court held that nothing in the court of appeals’ opinion “explicitly or implicitly” indicated that the court of appeals placed the burden on McKesson.⁸²

Second, the court confirmed that the “prevailing rule [is] that disclosure to an adversary, real or potential, forfeits work-product protection.”⁸³ Despite McKesson’s argument that it shared a “common interest” with the SEC, the court concluded that the appellate court was justified in holding that McKesson and the SEC had either an actual or potential adversarial relationship when the audit documents were provided to the SEC.⁸⁴ The court reiterated that no matter how rational disclosure to a government agency may be, the objectives for such disclosure, for example, to “forestall prosecution (if the charges are unfounded) or to obtain lenient treatment (in the case of well-founded allegations),” are not applicable to the foundations of the work-product doctrine.⁸⁵ Thus, even though the burden was on the plaintiffs to prove the waiver, the court concluded that McKesson had waived its work-product protection.⁸⁶

Third, the Georgia Supreme Court held that the confidentiality agreement “was far from airtight” and could not reasonably ensure that

79. *Id.*, 610 S.E.2d at 56.

80. *Id.* at 95-96, 610 S.E.2d at 56.

81. *Id.* at 96, 610 S.E.2d at 56 (emphasis added). By comparison, the burden of proving a waiver of the attorney-client privilege is on the party *claiming* the privilege. See *McKesson HBOC, Inc. v. Adler*, 254 Ga. App. 500, 503, 562 S.E.2d 809, 813 (2002).

82. *McKesson*, 279 Ga. at 96, 610 S.E.2d at 56.

83. *Id.* (quoting *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 306 n.28 (6th Cir. 2002)).

84. *Id.* (citing *United States v. Massachusetts Inst. of Tech.*, 129 F.3d 681, 687 (1st Cir. 1997); *United States v. Stewart*, 287 F. Supp. 2d 461, 468-69 (S.D.N.Y. 2003)).

85. *Id.* at 96-97, 610 S.E.2d at 56 (quoting *Westinghouse Elec. Corp. v. Republic of Phil.*, 951 F.2d 1414, 1429-30 (3d Cir. 1991)).

86. *Id.*, 610 S.E.2d at 56-57.

the audit documents would remain confidential.⁸⁷ More specifically, the court noted that the SEC was permitted to disclose information in the audit documents that it deemed to be “in furtherance of the [SEC’s] discharge of its duties and responsibilities.”⁸⁸

The court then reviewed McKesson’s counterclaim regarding the liability of the HBOC shareholders to McKesson under an unjust enrichment theory.⁸⁹ The court reasoned that this claim was without merit for two reasons.⁹⁰ First, the court noted that the shareholders and HBOC were two separate and distinct entities, and the shareholders could not be held responsible for acts of fraud by HBOC.⁹¹ Second, McKesson never alleged that the shareholders controlled HBOC or used the corporate form to defraud McKesson.⁹² Therefore, the court had no reason to disregard the corporate form and affirmed the court of appeals’ denial of the counterclaim.⁹³

II. SECURITIES

A. *Scienter and Reasonable Investigation Required in Securities Fraud Action*

In *Keogler v. Krasnoff*,⁹⁴ the Georgia Court of Appeals analyzed alleged securities fraud arising from the conduct of a mortgage company.⁹⁵ SGE Mortgage Funding Company (“SGE”) operated by obtaining funds from individual investors and loaning those funds to people for home equity loans. SGE’s largest investor was an individual named Robert Krasnoff, whose investments totaled more than \$2 million. In 1997 Krasnoff’s attorney introduced William Keogler, the plaintiff, to Krasnoff. Krasnoff explained to Keogler that investments in SGE were “sound financial investments” due to a “security package” that contained several documents for all loans.⁹⁶ Krasnoff also told Keogler that SGE

87. *Id.* at 97, 610 S.E.2d at 57.

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.* at 97-98, 610 S.E.2d at 57 (citing *Exch. Bank of Macon v. Macon Constr. Co.*, 97 Ga. 1, 7, 25 S.E. 326, 328 (1895)).

92. *Id.* at 98, 610 S.E.2d at 57.

93. *Id.*

94. 268 Ga. App. 250, 601 S.E.2d 788 (2004).

95. *Id.* at 250, 601 S.E.2d at 788.

96. *Id.* at 251-52, 601 S.E.2d at 789-90. The documents were

(1) an underlying promissory note from a borrower to SGE; (2) a recorded deed to secure debt; (3) a fully executed assignment in recordable form; (4) a title insurance policy insuring that the deed to secure debt was in first position; and

had an excellent track record and was a good investment. Keogler initially invested \$257,634.14 in SGE and did not request any additional financial information about SGE. After making his initial investment, Keogler requested copies of the loan documents on several occasions but never received them. Despite never receiving the requested documents, Keogler loaned over \$500,000 in additional funds to SGE.⁹⁷

In January 1998 several of SGE's checks to its investors bounced. The checks were reissued, and SGE's bank admitted fault. However, during the next six months, it became apparent that other problems with SGE existed. As a result, two investors in SGE other than Keogler, one of whom was a certified public accountant, formed a volunteer committee to evaluate the reasons for SGE's problems. By September 1998 Steven Cason, SGE's founder and president, resigned, and several employees pleaded guilty to concealing Cason's alleged fraudulent conduct. Keogler filed suit against Krasnoff and Cason alleging securities fraud, common law fraud, fraudulent conveyance, conspiracy, and bad faith. The trial court entered a directed verdict against Cason and found in favor of Krasnoff.⁹⁸

Keogler appealed the trial court's ruling regarding Krasnoff and alleged that the trial court erred in its instructions regarding the securities fraud claim because the instructions indicated that scienter was required to find that an individual had committed securities fraud.⁹⁹ The court of appeals concluded that this contention was without merit.¹⁰⁰ The jury instructions were "virtually verbatim"¹⁰¹ from *GCA Strategic Investment Fund v. Joseph Charles & Associates*.¹⁰² In *GCA Strategic Investment Fund*, the court of appeals held that in evaluating the Georgia securities fraud statute,¹⁰³ a plaintiff must make the same allegations required by federal law in section 10(b) of the Securities Exchange Act of 1934, as amended¹⁰⁴ ("Exchange Act"), which includes an express requirement of scienter.¹⁰⁵ The court

(5) an appraisal confirming that the value of the property exceeded the outstanding debt.

Id., 601 S.E.2d at 790.

97. *Id.* at 252, 601 S.E.2d at 790.

98. *Id.*

99. *Id.* at 252-53, 601 S.E.2d at 791.

100. *Id.* at 253-54, 601 S.E.2d at 791.

101. *Id.* at 254, 601 S.E.2d at 791.

102. 245 Ga. App. 460, 537 S.E.2d 677 (2000).

103. O.C.G.A. § 10-5-12(a) (2000 & Supp. 2005).

104. 15 U.S.C. § 78(j)(b) (2000 & Supp. 2005).

105. *Krasnoff*, 268 Ga. App. at 254, 601 S.E.2d at 791 (citing *GCA Strategic Inv. Fund*, 245 Ga. App. 460, 463-64, 537 S.E.2d 677, 682-83 (2000)).

stated that common law fraud, as well as Georgia securities law, requires scienter and held that the instruction was appropriate.¹⁰⁶

Keogler also alleged that the instruction was reversible error because it required the plaintiffs to show that “with the exercise of reasonable diligence [Keogler] still could not have discovered the truth behind the fraudulent misrepresentation or omission.”¹⁰⁷ The court, without further analysis, stated that even in the context of securities fraud, such justifiable reliance must be demonstrated by a plaintiff seeking to recover.¹⁰⁸

Keogler’s second allegation of error was that the trial court failed to charge the jury that “reckless representation” of facts as true is actionable as fraud even without scienter.¹⁰⁹ The court of appeals held that the charge given to the jury stating that “fraudulent or reckless misrepresentation of facts as true, which the party may know to be false, if intended to deceive, is equivalent to knowledge of the falsehood,” was accurate.¹¹⁰ Therefore, Keogler’s proposed charge was not required, and the trial court did not commit reversible error.¹¹¹

In summary, the court of appeals affirmed the trial court’s jury charges and held that Georgia law requires scienter and reasonable reliance to recover under Georgia’s securities laws.¹¹² In so holding, *Keogler* (1) establishes Georgia as “the first and only state to find a scienter requirement under a civil liability provision modeled on section 410(a)(2) of the Uniform Securities Act of 1956¹¹³ (“Uniform Securities Act”) and section 12(a)(2) of the Securities Act of 1933,¹¹⁴ (2) makes Georgia and Washington the only states requiring proof of reliance, and (3) makes Georgia and Louisiana the only states requiring an affirmative duty of investigation by purchasers of securities.¹¹⁵ The decision in *Keogler* creates a new level of analysis for Georgia plaintiffs in determining whether to pursue recovery under Georgia’s securities laws or federal securities laws and may impede claims that previously would have been pleaded under Georgia law.

106. *Id.*

107. *Id.* at 253, 601 S.E.2d at 791.

108. *Id.* at 254, 601 S.E.2d at 791.

109. *Id.*, 601 S.E.2d at 792.

110. *Id.* See 1 COUNCIL OF SUPERIOR COURT JUDGES OF GEORGIA, SUGGESTED PATTERN JURY INSTRUCTIONS: CIVIL CASES XIV(D) (3d ed. 1991).

111. *Keogler*, 268 Ga. App. at 254-55, 601 S.E.2d at 792.

112. *Id.*

113. Unif. Sec. Act §§ 101-419, 7(c) U.L.A. 109-322 (2000 & Supp. 2005).

114. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (2000 & Supp. 2002).

115. J. Steven Parker & Jason R. Doss, *Georgia Securities Act—Let the Buyer Beware*, GA. B.J., June 2005, at 14, 15.

B. Willful Violation—What Does it Mean?

In *Cox v. Garvin*,¹¹⁶ the Georgia Supreme Court reversed the court of appeals and held that the term “willful violation” under the Georgia Securities Act of 1973¹¹⁷ (“GSA”) merely requires a party to knowingly and intentionally *commit* the action which violates the GSA, not that it knowingly and intentionally *violate* the GSA.¹¹⁸ In 2000 the Georgia Commissioner of Securities concluded that a sale-leaseback program involving payphones was an investment contract governed by the GSA.¹¹⁹ The superior court affirmed the Commissioner’s conclusion, but the court of appeals, in reversing and remanding, held that “the term ‘willfully’ in [O.C.G.A. section] 10-5-13(a)(1)(A)(iv) required a knowing and intentional violation of the [GSA] in order for civil penalties authorized therein to be imposed.”¹²⁰ The Georgia Supreme Court granted certiorari to consider whether the court of appeals erred in its determination of the legal standard for the determination of “willfully.”¹²¹

The court of appeals based its decision on *Greenhill v. State*,¹²² in which “‘willfully’ as used in the felony criminal provisions of [O.C.G.A. section] 10-5-24 meant knowingly and intentionally violating the [GSA].”¹²³ In *Greenhill*, the jury was instructed that “‘willful means knowingly and intentionally *committing the acts* that constituted the violation.”¹²⁴ As a result, the Georgia Supreme Court stated that *Greenhill* “requires only that a party knowingly and intentionally commit the acts that constitute the violation, not that the person

116. 278 Ga. 903, 607 S.E.2d 549 (2005).

117. O.C.G.A. §§ 10-5-1 to -24 (2000 & Supp. 2005).

118. *Cox*, 278 Ga. at 903, 607 S.E.2d at 550 (emphasis added). Although the Georgia Supreme Court reversed the court of appeals, Justice Carley dissented. *Id.* at 907, 607 S.E.2d at 552 (Carley, J., dissenting). In sum, Justice Carley argued that “different words in the same act must be given different meanings.” *Id.* at 909, 607 S.E.2d at 554 (Carley, J., dissenting). Further, because subparagraph (A)(iv) refers to “willful violation” and subparagraph (C) refers to “willfulness of the conduct,” the court should have affirmed the court of appeals conclusion that willful violation means a knowing and intentional violation. *Id.* at 909-10, 607 S.E.2d at 554 (Carley, J., dissenting).

119. *Id.* at 904, 607 S.E.2d at 550. For a discussion of the facts, see Paul A. Quirós, Lynn Scott, William B. Shearer III, and James F. Brumsey, *Business Associations*, 56 MERCER L. REV. 77, 85-88 (2004).

120. *Cox*, 278 Ga. at 904, 607 S.E.2d at 550.

121. *Id.* at 903, 607 S.E.2d at 550.

122. 199 Ga. App. 218, 404 S.E.2d 577 (1991).

123. *Cox*, 278 Ga. at 905, 607 S.E.2d at 551.

124. *Id.* (quoting *Greenhill*, 199 Ga. App. at 220, 404 S.E.2d at 581 (1991) (emphasis supplied)).

knowingly intend to violate the [GSA] . . . [and] fails to provide authority for the holding that a party must knowingly violate the [GSA].”¹²⁵ The Georgia Supreme Court also referenced and quoted the official comment to section 412 of the Uniform Securities Act,¹²⁶ which states, in part, that “[p]roof of evil motive or intent to violate the law or knowledge that the law was being violated is not required.”¹²⁷

The Georgia Supreme Court was similarly persuaded by (1) the federal courts’ interpretation that “‘willfully’ simply requires the intentional doing of the wrongful acts—no knowledge of the rule or regulation is required,”¹²⁸ and (2) various state courts’ refusal “to adopt a requirement that the person intended to violate the law.”¹²⁹ Finally, the court noted that “strong policy reasons” existed for reversing the court of appeals.¹³⁰ In particular, the court stated that the GSA must be “broadly and liberally construed” to protect investors.¹³¹ Furthermore, adopting the interpretation applied by the court of appeals would make it nearly impossible to impose civil liability on a seller of securities “unless the seller had been the subject of a prior action for selling virtually the same securities.”¹³²

C. Motions to Dismiss Securities Fraud: Granted in Part, Denied in Part

The United States District Court for the Northern District of Georgia addressed myriad securities fraud and related issues in *In re AFC Enterprises, Inc. Securities Litigation*.¹³³ In this case, a class action suit was brought against the merchant banking firm Freeman Spogli & Co. (“Freeman Spogli”), Penman Private Equity and Mezzanine Fund, L.P. (“Penman”), AFC Enterprises (“AFC”), the Officer Defendants,¹³⁴

125. *Id.*

126. Unif. Sec. Act § 412, 7(C) U.L.A. 312-13 (2000 & Supp. 2005).

127. *Cox*, 278 Ga. at 905-06, 607 S.E.2d at 552 (quoting Unif. Sec. Act § 508 cmt. 2, 7(C) U.L.A. 92 (2000 & Supp. 2005)).

128. *Id.* at 906, 607 S.E.2d at 552 (citations omitted).

129. *Id.* (citations omitted).

130. *Id.*

131. *Id.*

132. *Id.*

133. 348 F. Supp. 2d 1363 (N.D. Ga. 2004).

134. “Officer Defendants” are Frank J. Belatti, Gerald J. Wilkins, Dick R. Holbrook, and Samuel N. Frankel. *Id.* at 1368.

the Director Defendants,¹³⁵ and the Underwriter Defendants,¹³⁶ which are all referred to collectively as the Defendants.¹³⁷

AFC is a publicly-traded company that at the time of the filing of the suit, was engaged in the ownership, operation, and franchising of fast-food restaurants.¹³⁸ AFC was founded in 1992 in Atlanta, Georgia and received substantial investments from Freeman Spogli and Penman in 1996. In 1997 AFC reported its first profit of \$8.8 million. In 1998 AFC acquired Seattle Coffee Company and Cinnabon International, Inc. AFC continued to expand through 2001, with an initial public offering of 9,375,000 shares of common stock and a second offering of 7,000,000 shares later in 2001.¹³⁹

Arthur Andersen ("Andersen") acted as AFC's outside accountant and auditor from its founding until April 2002, when AFC hired KPMG, LLP ("KPMG") to replace Andersen. In early 2003 KPMG conducted a detailed review of AFC's accounting policies and discovered multiple accounting irregularities. Consequently, AFC announced its earnings would be restated for periods dating back to fiscal year 2000. The announcement stated that AFC's actual income for the restated periods was substantially lower than initially reported, with variations ranging from twenty-one to ninety-two percent. The price of AFC stock decreased significantly, losing twenty-one percent of its overall value.¹⁴⁰

The day after the announcement of the restatement of earnings, James Nugent, the original plaintiff, filed a securities fraud action alleging that AFC, and two of the Officer Defendants, Belatti and Wilkins, knowingly or recklessly employed accounting methods that ignored generally accepted accounting principles ("GAAP") and misrepresented the condition of AFC's business to inflate AFC's stock price. Other suits followed, and eventually, the cases were consolidated into one class action.¹⁴¹

Five claims were asserted against the various defendants: (1) a claim against AFC, the Underwriter Defendants, the Officer Defendants, and

135. *Id.* "Director Defendants" are Mark J. Doran, Paul Farrar, Matt L. Figel, Kelvin Pennington, John M. Roth, Ronald P. Spogli, Peter Starrett, and William M. Wardlaw. *Id.*

136. *Id.* The Underwriter Defendants are Goldman Sachs & Co., Credit Suisse First Boston Corp., and Deutsche Banc Alex Brown. *Id.*

137. *Id.* The Officer Defendants, the Director Defendants, and the Underwriter Defendants are collectively referred to as the "Defendants." *Id.*

138. *Id.* The restaurants are Popeye's Chicken and Biscuits, Church's Chicken, Cinnabon, Seattle's Best Coffee, and Torrefazione Italia Coffee. *Id.* at 1367.

139. *Id.* at 1367.

140. *Id.* at 1367-68.

141. *Id.* at 1368.

the Director Defendants pursuant to section 11 of the Securities Act of 1933, as amended¹⁴² (“Securities Act”) for alleged misstatements in the registration statement and prospectus; (2) a claim against the Officer Defendants, the Director Defendants and Freeman Spogli as controlling persons of AFC under section 15 of the Securities Act;¹⁴³ (3) a claim against AFC, Belatti, Wilkins, Holbrook, and Pennington for violating section 10(b) of the Securities Exchange Act of 1934, as amended¹⁴⁴ (“Exchange Act”) and Rule 10b-5¹⁴⁵ promulgated under the Exchange Act; (4) a claim against Belatti, Wilkins, Holbrook, Pennington, Roth, Spogli, Freeman Spogli, and Penman as alleged controlling persons of AFC pursuant to section 20(a) of the Exchange Act;¹⁴⁶ and (5) a claim for insider trading in violation of section 20A of the Exchange Act¹⁴⁷ against Belatti, Frankel, Freeman Spogli, and Penman.¹⁴⁸

The district court addressed whether each claim should be dismissed in light of the actions of each defendant or group of defendants.¹⁴⁹ The court first addressed the Exchange Act claims and, specifically, the alleged accounting fraud.¹⁵⁰ The court cited section 10(b) of the Exchange Act as making “it unlawful [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe.”¹⁵¹ The court focused on the language of Rule 10b-5 promulgated under the Exchange Act that states:

It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.¹⁵²

142. Securities Act of 1933, 15 U.S.C. § 77k (2005).

143. 15 U.S.C. § 77o (2000 & Supp. 2005).

144. 15 U.S.C. § 78j(b) (2000 & Supp. 2005).

145. 17 C.F.R. § 240.10b-5 (2005).

146. 15 U.S.C. § 78t(a) (2000 & Supp. 2005).

147. 15 U.S.C. § 78t-1 (2000 & Supp. 2005).

148. *In re AFC Enter.*, 348 F. Supp. 2d at 1368-69.

149. *Id.* at 1369.

150. *Id.*

151. *Id.* (quoting 15 U.S.C. § 78j(b)).

152. *Id.* (quoting 17 C.F.R. § 240.10b-5 (2005)).

The district court acknowledged the private right of action under Rule 10b-5, stating that “a plaintiff must show ‘(1) a false statement or omission of material fact (2) made with scienter (3) upon which the plaintiff justifiably relied (4) that proximately caused the plaintiff’s injury.’”¹⁵³

The district court addressed the allegations of false statements in the prospectus and financial statements during the relevant time periods and noted that the incorrect financial statements were actionable, but not the accounting errors.¹⁵⁴ In their motion to dismiss, the defendants alleged there was not a sufficiently specific allegation of fraud as required by the Private Securities Litigation Reform Act¹⁵⁵ (“PSLRA”). The PSLRA requires a specification of each statement that is misleading and the reasons why it is misleading.¹⁵⁶ The defendants argued that the allegedly false statements had not been attributed to individual defendants, and the fraud count should be dismissed.¹⁵⁷ In opposition, the plaintiffs relied on the “group pleading doctrine,” which allows a plaintiff to presume in pleadings that statements in prospectuses, press releases, or other “group published information” are the collective actions of the officers or directors of a corporation.¹⁵⁸ The district court, however, recognized that “[t]here are differences of opinion in the circuit courts as to the viability of the group pleading doctrine in the wake of the [PSLRA].”¹⁵⁹ In upholding the group pleading doctrine, the court noted that the Eleventh Circuit concluded that “the policy rationale supporting use of the doctrine, articulated in numerous decisions in this district, remains persuasive provided that application of the doctrine is kept within proper bounds.”¹⁶⁰ In this case, the proper bounds included creating “a rebuttable presumption that applies to a limited number of persons within a given company who should expect to be held accountable for the company’s public statements.”¹⁶¹

The district court next confirmed that claims under the Exchange Act require proof of scienter.¹⁶² Scienter is “a state of mind involving

153. *Id.* (quoting *Robbins v. Koger Props., Inc.*, 116 F.3d 1441, 1447 (11th Cir. 1997)).

154. *Id.* at 1370.

155. Private Securities Litigation Reform Act, 15 U.S.C. § 78u4(b)(3)(A) (2000 & Supp. 2005).

156. *In re AFC Enter.*, 348 F. Supp. 2d at 1370.

157. *Id.*

158. *Id.*

159. *Id.* at 1371.

160. *Id.*

161. *Id.*

162. *Id.*

intent to deceive or severe recklessness” with regard to the truth of statements.¹⁶³ The court noted that a plaintiff must allege facts “sufficiently demonstrating each [D]efendant’s state of mind regarding his or her alleged violations.”¹⁶⁴

With respect to Belatti, Holbrook, and Pennington, the court noted that GAAP violations alone were not sufficient to create an inference of fraud.¹⁶⁵ “However, violations of GAAP, when coupled with other evidence of fraud, can create a strong inference of scienter.”¹⁶⁶ The district court further stated that additional evidence of fraud may include the nature, number, size, or frequency of overstatements.¹⁶⁷ Because the accounting errors identified in *In re AFC Enterprises* were merely errors in accrual of income and expenses and not substantial when compared to AFC’s entire business, the court concluded these defendants did not have the requisite scienter.¹⁶⁸ Consequently, the errors did not rise to the level of attempts to fabricate revenue or conceal expenses.¹⁶⁹ Moreover, “[a]ny inference that the Director Defendants knew of the GAAP violations [was] also mitigated by AFC’s reliance on an outside accounting firm to audit its financials.”¹⁷⁰

Furthermore, while the plaintiffs alleged that the defendants had the motive and opportunity to commit fraud, the court noted that motive and opportunity coupled with insider sales, which were not out of the ordinary course of business, were also not sufficient to meet the scienter requirement.¹⁷¹ Similar to the plaintiffs’ other allegations, the court reasoned that while the defendants’ compensation, including bonuses and stock options, could motivate executives to engage in fraud, their compensation was standard and could not be the sole basis to plead scienter.¹⁷² The court similarly rejected the plaintiffs’ final claim that the defendants manipulated books to meet market expectations.¹⁷³

163. *Id.*

164. *Id.* (quoting *Phillips v. Scientific-Atlanta, Inc.*, 374 F.3d 1015, 1018 (11th Cir. 2004)).

165. *Id.* at 1372 (citing *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542, 553 (6th Cir. 1999); *Lovelace v. Software Spectrum Inc.*, 78 F.3d 1015, 1020-21 (5th Cir. 1996); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1426 (9th Cir. 1994); and *Barr v. Matria Healthcare, Inc.*, 324 F. Supp. 2d 1369, 1384 (N.D. Ga. 2004)).

166. *Id.*

167. *Id.*

168. *Id.* at 1372-73.

169. *Id.* at 1372.

170. *Id.* at 1374.

171. *Id.* at 1373-74.

172. *Id.* at 1374.

173. *Id.*

With regard to AFC and Wilkins, the former Chief Financial Officer of AFC, the court viewed the scienter element differently.¹⁷⁴ The court held that based on his position and his training as a certified public accountant, Wilkins knew or should have known of the fraudulent practices.¹⁷⁵ Furthermore, the court noted that if the claim was adequately pleaded as to Wilkins, it was adequately pleaded against AFC.¹⁷⁶

The court then examined the plaintiffs' assertions of insider trading against Belatti, Holbrook, Frankel, Freeman Spogli, and Penman.¹⁷⁷ Insider-trading claims are predicated on section 10(b) violations of the Exchange Act, and because the plaintiffs failed to establish scienter, one of the elements in a section 10(b) claim, they automatically failed to establish an insider-trading claim.¹⁷⁸

The plaintiffs also asserted "controlling person" liability against Belatti, Wilkins, Holbrook, Pennington, Roth, Freeman Spogli, and Penman. Persons are liable as controlling persons if they have the power to control the general affairs of the entity in question and have the power to control, directly or indirectly, the corporate policy that resulted in the liability.¹⁷⁹ Without much analysis, the court determined that the allegations made in the pleadings with respect to these individuals were sufficient to avoid dismissal on this count.¹⁸⁰

Furthermore, the plaintiffs asserted additional claims related to allegedly misleading disclosures made by AFC under section 11 of the Securities Act; specifically on grounds that "[s]cienter is not an element of a section 11 claim."¹⁸¹ For a section 11 claim, the plaintiff must show that some type of security was purchased in a registered offering, and the registration statement contained materially false statements or omissions of material fact.¹⁸²

The defendants argued that the plaintiffs' section 11 claim should be dismissed because Federal Rule of Civil Procedure 9(b)¹⁸³ requires "averments of fraud" to be pleaded with particularity.¹⁸⁴ More impor-

174. *Id.* at 1375.

175. *Id.*

176. *Id.* (citing *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 366 (5th Cir. 2004)).

177. *Id.*

178. *Id.*

179. *Id.* at 1376 (citing *Brown v. Enstar Group, Inc.*, 84 F.3d 393, 396 (11th Cir. 1996)).

180. *Id.*

181. *Id.* (citing *Herman & MacLeany v. Huddleston*, 459 U.S. 375, 382 (1983)).

182. *Id.*

183. FED. R. CIV. P. 9(b).

184. *In re AFC Enter.*, 348 F. Supp. 2d at 1376.

tantly, the Director Defendants asserted that the plaintiffs did not have standing to bring a section 11 claim because the price of AFC stock at that time was actually higher than the price paid by the plaintiffs, and therefore, the plaintiffs did not suffer any damages.¹⁸⁵ The court, however, noted that in calculating damages in such a claim, the measure would be the difference in price paid for the security from the value of the security at the time the suit was brought, and not at the time the amended complaint was filed.¹⁸⁶ The court held that the amended complaint related back to the date of the original filing.¹⁸⁷

AFC also alleged that the section 11 claim should be dismissed because AFC relied on experts to compile the information in the prospectus, and it was reasonable for AFC to rely on the experts compiling the information.¹⁸⁸ The court noted that whether the reliance was reasonable was a fact-intensive inquiry and could not be resolved in a motion for summary judgment.¹⁸⁹ The court reasoned that two of the defendants did not sign the prospectus and were not directors at the time of the registration statement; therefore, they were not proper defendants to a section 11 claim.¹⁹⁰

Additionally, the plaintiffs alleged that the Director Defendants, the Officer Defendants, and Freeman Spogli were liable under section 15 of the Securities Act as persons who had sufficient control to direct or cause the direction of management through ownership of voting securities or otherwise.¹⁹¹ The court explained that “[t]o plead control person liability under section 15, a plaintiff must allege that the defendant had the power to control both the general operations of the offending corporation and the specific corporate policy that resulted in the offense.”¹⁹² Regarding the Director Defendants, the court did not dismiss the allegations because the plaintiffs alleged that the Director Defendants had extensive participation in day-to-day affairs, had the power to control AFC’s operations, and had control over the registration statements and prospectuses.¹⁹³ With respect to the Officer Defendants, only one defendant disputed being a controlling person.¹⁹⁴ The

185. *Id.* at 1379.

186. *Id.* at 1380.

187. *Id.* at 1379 (citing *Alpern v. UtiliCorp. United, Inc.*, 84 F.3d 1525, 1541-44 (8th Cir. 1996)).

188. *Id.* at 1380.

189. *Id.*

190. *Id.*

191. *Id.* at 1380-81 (citing 17 C.F.R. § 230.405 (2004)).

192. *Id.* at 1381. See *Brown*, 84 F.3d at 396.

193. *In re AFC Enter.*, 348 F. Supp. 2d at 1381.

194. *Id.*

court stated that this contention was outside the pleadings and, therefore, more properly dealt with in a motion for summary judgment.¹⁹⁵ With regard to Freeman Spogli, the court denied the motion to dismiss because the pleadings indicated Freeman Spogli owned 47.8% of AFC and appointed six of eleven directors.¹⁹⁶

D. Violation of Securities Laws and Unjust Enrichment Survive Summary Judgment

In *APA Excelsior III, L.P. v. Windley*,¹⁹⁷ the United States District Court for the Northern District of Georgia addressed alleged violations of securities laws resulting from a foreclosure sale in which minority shareholders of a parent corporation alleged secret negotiations, violations of securities laws, and breaches of fiduciary duties that resulted in the shareholders being “wrongfully frozen out in connection with a transfer and acquisition of corporate assets.”¹⁹⁸

Rod Windley founded Healthfield, Inc. (“HFI”), a healthcare services company, in 1986. The plaintiffs purchased \$8 million of HFI stock in 1992. Pursuant to a 1996 merger agreement, HFI became a wholly-owned subsidiary of Healthfield Holdings, Inc. (“HHI”) via a reverse triangular merger, and the plaintiffs’ shares of HFI stock automatically converted into shares of HHI.¹⁹⁹

The only asset of HHI was the stock of HFI. As part of the plaintiffs’ shareholder rights, they were entitled to appoint three directors to HHI’s board of directors. By 1998 HHI and HFI began experiencing financial difficulty. Consequently, Windley, who had lost the plaintiffs’ collective trust and was deemed to be underperforming as president and chief executive officer, was replaced.²⁰⁰

To help alleviate the financial burdens, HHI refinanced its debt with Finova Capital Corporation (“Finova”). As part of the refinancing, HHI granted a security interest in all of its assets, including its stock in HFI, to Finova, and Windley loaned an additional \$2 million to HHI and personally guaranteed \$2 million of the Finova loan. HHI and HFI continued to struggle, and in 1999 Finova sent its first default notice to HHI. Even though HHI was in default, Windley continued to loan

195. *Id.* at 1382.

196. *Id.*

197. 329 F. Supp. 2d 1328 (N.D. Ga. 2004).

198. *Id.* at 1334.

199. *Id.* at 1338.

200. *Id.* at 1338-39.

additional funds to HHI and HFI to cover payroll and other expenses.²⁰¹

In June 2000 Finova sent a letter to HHI demanding payment and requesting a meeting.²⁰² At the meeting, “Finova indicated that HHI needed to find a buyer for HFI, or obtain other financing” because Finova was considering foreclosing the loan.²⁰³ HHI solicited proposals and entered into a non-binding letter of intent with a potential acquirer of some, but not all, of the equity in HHI. However, no binding offer was made because of the potential acquirer’s concern that Finova would require full repayment of the loans.²⁰⁴

In 2001 Finova, experiencing its own financial difficulties, filed for bankruptcy; consequently, plaintiffs anticipated that Finova would be more likely to require full payment of its loan. Once Finova was in bankruptcy, the plaintiffs contended that Windley and HHI entered into secret discussions to continue business with Finova.²⁰⁵

Finova sent its formal notice of foreclosure upon the assets of HHI on February 22, 2001, and set the foreclosure sale for March 9, 2001.²⁰⁶ In a teleconference on March 8, 2001, in which all of the plaintiffs participated, HHI’s board discussed potential options for HHI and HFI. Bankruptcy was discussed, but ultimately rejected. Both Windley and the plaintiffs announced intentions to bid for HFI at the foreclosure sale, and no director raised any concerns or objections.²⁰⁷ In addition, in anticipation of the auction, Windley organized Four Seasons Healthcare, Inc. (“FSHI”) and Four Seasons Healthcare, LLC (“FSHLLC”) (collectively “Four Seasons”).²⁰⁸

Of the twenty bidders who performed due diligence on HFI, only FSHI and Phoenix Group attended the auction.²⁰⁹ None of the plaintiffs attended or participated in the auction. FSHI placed the only bid for HFI. FSHI financed the purchase with funds from Finova and \$500,000 wired out of HFI’s operating accounts on March 5, 2001.²¹⁰

The plaintiffs filed an action alleging eight counts against the defendants, ranging from violations of federal securities laws to common law fraud, in addition to breach of fiduciary duty, breach of the covenant

201. *Id.* at 1339-40.

202. *Id.* at 1340.

203. *Id.*

204. *Id.*

205. *Id.* at 1341.

206. *Id.*

207. *Id.* at 1344.

208. *Id.* at 1334.

209. *Id.* at 1345.

210. *Id.* at 1343-45.

of good faith and fair dealing, and unjust enrichment.²¹¹ The defendants moved for summary judgment on all of the plaintiffs' claims, and the plaintiffs moved for summary judgment on certain claims and the defendants' counterclaim.²¹² After thoroughly discussing each claim, the court found that the following securities and corporate claims survived the motions for summary judgment because genuine issues of material fact existed: (1) the plaintiffs' claim that HHI was liable for securities violations under section 10(b) of the Securities Act based on Windley's actions; (2) the plaintiffs' claim that Windley was liable as a controlling person under section 20(a) of the Exchange Act; and (3) the plaintiffs' claim for unjust enrichment against Windley.²¹³

With regard to the section 10(b) claim, the court first noted that the plaintiffs were not "purchasers" or "sellers" of securities as required to establish standing under section 10(b).²¹⁴ However, the court also "consider[ed] itself bound by former Fifth Circuit authority applying the forced seller doctrine."²¹⁵ The "forced seller doctrine" permits a shareholder, who otherwise is not a "seller," to be "treated as a seller when [the nature of] his investment has been so fundamentally changed" from an interest in a going enterprise into a right solely to a payment of money for his shares.²¹⁶ Neither the plaintiffs nor the defendants argued whether the forced seller doctrine applied in this case.²¹⁷ Nevertheless, the trial court found that it was improper to dispose of the issue on a summary judgment motion and instructed the parties to be prepared to present arguments and evidence on the issue at pre-trial conferences.²¹⁸

The court assumed the plaintiffs would have standing to bring the section 10(b) claim.²¹⁹ In evaluating the substantive issues of the securities fraud claims, the court analyzed the elements required under section 10(b) and Rule 10b-5: "(1) a misstatement or omission of a

211. *Id.* at 1345-46.

212. *Id.* at 1338.

213. *Id.* at 1368.

214. *Id.* at 1347-48.

215. *Id.* at 1348.

216. *Id.* (citing *Dudley v. Se. Factor & Fin. Corp.*, 446 F.2d 303, 307 (5th Cir. 1971)).

217. *Id.* The "forced seller doctrine" applies when there is "(1) a drastic reduction in the value of plaintiff's investment; (2) a causal relationship between the alleged fraud and the altered nature of the plaintiff's investment; and (3) an elimination of the prior business entity as a result of the complained-of business transactions." *Id.* While the court concluded that the first two elements were satisfied, the court held that without further evidence, it was impossible to prove whether the third element was satisfied. *Id.*

218. *Id.* at 1348, 1368.

219. *Id.* at 1346, 1350.

material fact, (2) made with scienter, (3) on which plaintiff relied, (4) that proximately caused his injury.²²⁰ With respect to material false statements, the court concluded that

there [were] genuinely disputed issues of material fact with respect to at least three misrepresentations or material omissions: Windley's omission in not disclosing that he was using \$500,000 of company money in support of his bid; [Windley's] omission in not disclosing his pre-foreclosure negotiations with Finova; and [Windley's] statements implying that the cost of restructuring the Finova loan would require payment of the entire loan.²²¹

The parties did not dispute the element of scienter.²²² The court determined that in the context of the forced seller doctrine, a plaintiff need not show reliance because "[r]eliance is 'unnecessary in the limited instance when no volitional act is required and the result of a forced sale is exactly that intended by the wrongdoer.'"²²³ Finally, with regard to causation, the court noted that the plaintiffs must show the falsehood proximately or reasonably caused the loss.²²⁴ In this case, the plaintiffs argued that the failure to disclose the information caused them not to bid, which resulted in a loss. The defendants contended that, even without the bid, the plaintiffs would have suffered a loss.²²⁵ The court determined that the issue of whether the plaintiffs would have made a bid but for the lack of information was a factual issue not appropriate for summary judgment.²²⁶

The court reasoned that if HHI was liable for securities violations under section 10(b) and Rule 10b-5, Windley might be liable as a controlling person under section 20(a) of the Exchange Act.²²⁷ Therefore, Windley would be liable if he controlled HHI at the time HHI violated the securities laws.²²⁸ Even though Windley was not the president and chief executive officer, he was (1) the chairman of the board of directors, (2) the main contact for HHI, (3) the chief negotiator on behalf of HHI, and (4) had the authority to withdraw the \$500,000

220. *Id.* at 1350. See *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1202 (11th Cir. 2001); *Robbins v. Koger Props., Inc.*, 116 F.3d 1441, 1447 (11th Cir. 1997); *Ross v. Bank South, N.A.*, 885 F.2d 723, 728 (11th Cir. 1989) (en banc).

221. *A.P. Excelsior*, 329 F. Supp. 2d at 1350.

222. *Id.* at 1351.

223. *Id.* (quoting *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 635 (2d Cir. 1967)).

224. *Id.* at 1352.

225. *Id.* at 1352-53.

226. *Id.* at 1353.

227. *Id.* at 1355.

228. *Id.*

without the knowledge of HHI's executives or other board members.²²⁹ The court held that the "evidence [was] more than sufficient to show that Windley controlled HHI generally and with reference to [the actions giving rise to the alleged securities laws violations]."²³⁰

Finally, the plaintiffs claimed that Windley's receipt of the \$500,000 on March 5, 2001, constituted unjust enrichment.²³¹ Under Georgia law, "[u]njust enrichment is an equitable concept [that] applies when . . . there is no legal contract . . . [and] the party sought to be charged has been conferred a benefit by the party contending an unjust enrichment which the benefited party equitably ought to return or compensate for."²³² In this case, the court noted that the \$500,000 was "at least one benefit obtained" by Windley and thus, permitted the unjust enrichment claim to proceed.²³³

III. PARTNERSHIPS

In *Accolades Apartments, L.P. v. Fulton County*,²³⁴ the Georgia Supreme Court reversed the Georgia Court of Appeals and held that the public filing of a statement of partnership conclusively establishes the existence of a partnership.²³⁵ This case involved the proper distribution of \$200,000 of condemnation proceeds. *Accolades Apartments, L.P.* ("Accolades Apartments") claimed the proceeds belonged to it as partnership property. The Georgia Department of Revenue and Coyote Portfolio, LLC ("Coyote") each claimed ownership as a result of judgments against Consolidated Equities Corporation ("CEC"), one of the joint venture partners in *Accolades Apartments*. If the court determined *Accolades Apartments* to be a partnership, then the \$200,000 of condemnation proceeds would be protected as partnership property. Otherwise, the Georgia Department of Revenue and Coyote would receive the proceeds as judgment creditors.²³⁶

In 2001 the Georgia Supreme Court heard this case for the first time.²³⁷ At that time, the court held that "a joint venture could be a partnership, despite calling itself a joint venture, depending 'on the

229. *Id.*

230. *Id.*

231. *Id.* at 1366.

232. *Id.* (quoting *St. Paul Mercury Ins. Co. v. Meeks*, 270 Ga. 136, 137, 508 S.E.2d 646, 648 (1998)).

233. *Id.*

234. 279 Ga. 257, 612 S.E.2d 284 (2005).

235. *Id.* at 257, 612 S.E.2d at 285.

236. *Id.* at 257-58, 612 S.E.2d at 285-86.

237. *Accolades Apartments, L.P. v. Fulton County*, 274 Ga. 28, 549 S.E.2d 348 (2001).

rights and responsibilities assumed by the joint venturers.’”²³⁸ Therefore, “if a joint venture is in actuality a partnership . . . real property acquired in the name of the joint venture will be considered partnership property . . . [and] not subject to execution by the judgment creditor of an individual partner.’”²³⁹

After the 2001 ruling, the court remanded the case to the trial court, and the parties appealed again to the court of appeals. Both the trial court and the court of appeals held that the mere filing of a statement of partnership, without any more evidence, was insufficient to prove the formation of a partnership.²⁴⁰ As a result, the lower courts examined the specific facts and determined that the actual business relationship between CEC and John Hancock Mutual Insurance Company, the other joint venture partner in Accolades Apartments, did not prove the existence of a partnership.²⁴¹

The Georgia Supreme Court reversed the court of appeals and stated the general rule that “[a] partnership can be formed in one of two ways: by express agreement or by implied agreement.”²⁴² In this case, the Georgia Supreme Court held that “[i]f publicly filed, a statement of partnership clearly evidences an intention for the entity to be treated as a partnership.”²⁴³

The court also analyzed public policy considerations.²⁴⁴ In particular, the court stated that “[t]hird parties must be able to rely on publicly filed documents[,]” and to hold otherwise “would frustrate the legislature’s purpose in allowing statement of partnerships to be publicly filed.”²⁴⁵

Finally, the court relied on the concept that “a statement of partnership is unique to the partnership code, and there is no discernable reason for parties to execute and publicly file such a document other than to agree among themselves, and to put third parties on notice, that they are in fact a partnership.”²⁴⁶

238. *Accolades Apartments*, 279 Ga. at 258, 612 S.E.2d at 286 (quoting *Accolades Apartments*, 274 Ga. at 30, 549 S.E.2d at 351).

239. *Id.* (quoting *Accolades Apartments*, 274 Ga. at 30, 549 S.E.2d at 351).

240. *Accolades Apartments*, 279 Ga. at 257, 612 S.E.2d at 285; see *Accolades Apartments, L.P. v. Fulton County*, 267 Ga. App. 197, 199, 598 S.E.2d 910, 912 (2004); see generally Paul A. Quirós, Lynn Scott, William B. Shearer III, and James F. Brumsey, *Business Associations*, 56 MERCER L. REV. 77, 94-95 (2004).

241. *Accolades Apartments*, 267 Ga. App. at 198-99, 598 S.E.2d at 912.

242. *Accolades Apartments*, 279 Ga. at 258, 612 S.E.2d at 286.

243. *Id.*

244. *Id.* at 259, 612 S.E.2d at 287.

245. *Id.*

246. *Id.* at 258, 612 S.E.2d at 286.

IV. LEGISLATIVE

In its 2005 session, the Georgia General Assembly made no substantive revisions to Title 10²⁴⁷ or Title 14²⁴⁸ of the O.C.G.A. regarding securities, corporations, partnerships, or associations. However, the Georgia General Assembly amended Title 7 (1) to provide supplemental definitions relating to financial institutions;²⁴⁹ (2) to revise timing for meeting notices;²⁵⁰ (3) to promote parity with federal financial institutions;²⁵¹ (4) to prohibit certain persons from participating in financial institutions;²⁵² (5) to allow Georgia and federal courts access to financial information;²⁵³ (6) to lengthen the time for closure of stock transfer books;²⁵⁴ (7) to protect the shareholders during bank conversions, mergers, and consolidations;²⁵⁵ (8) to require notice to the department when articles are amended;²⁵⁶ and (9) to update the financial requirements for licensure of mortgage brokers.²⁵⁷

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247. O.C.G.A. §§ 10-1-1 to -14-30 (2004 & Supp. 2005).
248. O.C.G.A. §§ 14-2-101 to -11-1109 (2004 & Supp. 2005).
249. O.C.G.A. § 7-1-4 (2004 & Supp. 2005).
250. O.C.G.A. § 7-1-6 (2004 & Supp. 2005).
251. O.C.G.A. § 7-1-61(a)(1) (2004 & Supp. 2005).
252. O.C.G.A. § 7-1-71 (2004 & Supp. 2005).
253. O.C.G.A. § 7-1-360 (2004 & Supp. 2005).
254. O.C.G.A. § 7-1-433 (2004 & Supp. 2005).
255. O.C.G.A. § 7-1-550 (2004 & Supp. 2005).
256. O.C.G.A. § 7-1-634 (2004 & Supp. 2005).
257. O.C.G.A. §§ 7-1-1000, -1003, -1003.2 (2004 & Supp. 2005).