Chapter 1

Director and Officer Liability

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1-1 INTRODUCTION

Directors and officers of a corporation incorporated in Georgia owe fiduciary duties to the corporation and its shareholders and may become liable to either or both for their failure to perform these duties adequately. A director or officer can also become personally liable to third parties for acts undertaken on behalf of the corporation and can become personally responsible for the corporation's debts if the corporation's separate existence and rights are not properly observed.

The various acts and circumstances that may give rise to director and officer liability under Georgia law are the subject of this chapter. In addition, this chapter discusses legal principles and other measures that may limit or eliminate a corporate fiduciary's liability, including the business judgment rule, the reliance defense, exculpation provisions, and indemnification and insurance.

1-1:1 Choice of Law; Internal Affairs Doctrine

Georgia's substantive corporate law defines the various obligations and liabilities of officers and directors of Georgia corporations.[1] Many key principles of Georgia corporate law are codified in the Georgia Business Corporations Code (GBCC).[2] The GBCC is based on the Model Business Corporation Act

1. *Childs v. RIC Grp., Inc.*, 331 F. Supp. 1078 (N.D. Ga. 1970).
2. O.C.G.A. § 14-2-101 et seq.

(Model Act),[3] but also draws from Georgia common law principles and, less frequently, the law of other states, particularly Delaware and New York. Georgia's common law principles of corporate governance have continued independent vitality parallel to the GBCC.

Georgia courts are generally required to apply foreign substantive law when the dispute concerns the duties of a director or officer of a non-Georgia "foreign" corporation.[4] Georgia recognizes the "internal affairs doctrine," which provides that disputes concerning "the relations inter se of the corporation, its shareholders, directors, officers or agents" are governed by the law of the state of incorporation.[5] The internal affairs doctrine is codified at O.C.G.A. § 14-2-1505(c), which provides that the state's power to require foreign corporations to obtain a certificate of authority to transact business in Georgia "does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state."[6]

The internal affairs doctrine is well-recognized in most if not all states, meaning that in disputes concerning the internal affairs of a Georgia corporation that arise outside of Georgia, the substantive principles of Georgia corporate governance law should apply. Given the internal affairs doctrine, choice of law issues are less frequently disputed in director-officer liability matters than in many other tort-based cases. At the same time, it should not be assumed that every issue in a director or officer liability case will be decided based on the law of the state of incorporation.[7] Matters considered to be procedural rather than substantive are to be decided under the law of the forum state.

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3. O.C.G.A. § 14-2-101 cmt.; *see also* Model Bus. Corp. Act (2011). The GBCC was enacted in 1988 and was based primarily upon the 1984 Revised Model Business Corporation Act. *See* Ga. L. 1988, p. 1070. Although some provisions of the GBCC have been revised since 1988 to make them consistent with corresponding revisions to the Model Act, others have not been revised.

4. *See, e.g., Rigby v. Flue-Cured Tobacco Coop.*, 327 Ga. App. 29, 40, 755 S.E.2d 915, 925 (2014) (applying North Carolina law as to the duties owed by directors of a North Carolina corporation).

5. *Diedrich v. Miller & Meier & Assocs.*, 254 Ga. 734, 735-36, 334 S.E.2d 308, 310 (1985); *see also* O.C.G.A. § 14-2-1505.

6. O.C.G.A. § 14-2-1505(c).

7. *See In re Friedman's Inc.*, 394 B.R. 623, 632 (S.D. Ga. 2008) (law of state of incorporation does not govern issue of whether a corporate officer's knowledge will be imputed to the corporation); *Rigby v. Flue-Cured Tobacco Coop.*, 327 Ga. App. 29, 35 n.5,

1-1:2 Georgia Principles of Corporate Governance: Comparison With Other States

Georgia substantive and procedural law as to director and officer liability often differs not only from Delaware law, but also from the law of other states whose corporate codes are based on the Model Act. The GBCC, for example, authorizes adoption of broader, objective measures of director exculpation[8] and indemnification of directors, including the authorization of indemnification of derivative action settlements,[9] unlike the corresponding provisions of the Delaware General Corporation Law (DGCL).[10] The GBCC also confers on officers an express right to rely on the opinions of trusted professionals and staff,[11] a provision that is lacking in the DGCL. Since these differences can be outcome-determinative, litigants should immediately consider whether Georgia law applies and closely examine the Georgia provisions on the issue.

1-2 DUTIES OF CORPORATE DIRECTORS AND OFFICERS IN GEORGIA

1-2:1 General Considerations

The relationship between a corporation and its directors and officers is fiduciary in character. While directors and officers are not technically trustees, they are held to a fiduciary standard of utmost good faith and loyalty.[12] Fiduciary duties are owed both to the corporation and its shareholders.[13]

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755 S.E.2d 915, 922 n.5 (2014) (Georgia statutes of limitation applicable notwithstanding that North Carolina corporate law applied to substance of claims).

8. O.C.G.A. § 14-2-202(b)(4).

9. O.C.G.A. § 14-2-856.

10. 8 Del. C. §§ 102(b)(7); 145.

11. O.C.G.A. § 14-2-842(b).

12. *Oliver v. Oliver*, 118 Ga. 362, 45 S.E. 232 (1903); *McEwen v. Kelly*, 140 Ga. 720, 79 S.E. 777 (1913); *Quinn v. Cardiovascular Physicians, P.C.*, 254 Ga. 216, 217, 326 S.E.2d 460, 463 (1985).

13. *Super Valu Stores, Inc. v. First Nat'l Bank of Columbus, Ga.*, 463 F. Supp. 1183, 1196 (M.D. Ga. 1979) (holding that duty is "owed to the corporation which possesses the cause of action for breach of that duty"); *Enchanted Valley RV Resort, Ltd. v. Weese*, 241 Ga. App. 415, 423, 526 S.E.2d 124, 131 (1999) (holding that directors and officers are "charged with serving the interests of the corporation as well as the stockholders").

Georgia common law generally holds officers to the same standard as directors and affords them the same defenses.[14] The GBCC's provisions establishing standards of conduct for directors, O.C.G.A. § 14-2-830, and for officers, O.C.G.A. § 14-2-842, are similarly worded.[15] However, an officer's fiduciary relationship with the corporation arises from the employment relationship,[16] and only officers who have "discretionary authority" are subject to the requirements of O.C.G.A. § 14-2-842.

The corporate fiduciary must do more than look out for the profitability of the corporation as a whole. Rather, the duty of good faith extends to the fair treatment of minority shareholders as well, at least with respect to transactions with minority shareholders.[17] Georgia courts are particularly vigilant regarding the need to protect minority shareholders in cases involving close corporations, given that no public market exists for the stock of close corporations, so minority shareholders ordinarily cannot easily protect themselves by liquidating their shares.[18] Nonetheless, the same basic fiduciary duties of good faith and loyalty are owed by corporate fiduciaries regardless of the particular characteristics of the corporation.[19]

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14. *See Flexible Prods. Co. v. Ervast*, 284 Ga. App. 178, 643 S.E.2d 560 (2007).

15. Though an officer's standard of conduct under O.C.G.A. § 14-2-842 is similar to that of a director under O.C.G.A. § 14-2-830, the commentary to § 14-2-842 suggests that officers may, as a practical matter, have a more limited right to rely on the professional expertise of third parties given their greater familiarity with the corporation's affairs. O.C.G.A. § 14-2-842 cmt. (2016). In addition, the commentary suggests that officers who are not directors and who do not have discretionary authority "may be judged by a narrower standard" in some cases, though it does not suggest what that narrower standard might be. O.C.G.A. § 14-2-842. It should be noted that the comments in the GBCC are prepared by the drafters of the code provisions and are helpful in illuminating the thinking and intent behind the choice of language and the drafters' intent. However, they serve no official status and may be rejected by the courts in interpreting the statutory language. *See Service Corp. Int'l v. H.M. Patterson & Son*, 263 Ga. 412, 415 n.5, 434 S.E.2d 455, 458 (1993) (rejecting the GBCC comment and using principles of statutory construction to interpret O.C.G.A. §§ 14-2-853 and 14-2-862).

16. *Rome Indus., Inc. v. Jonsson*, 202 Ga. App. 682, 683, 415 S.E.2d 651, 652 (1992).

17. *Quinn v. Cardiovascular Physicians, P.C.*, 254 Ga. 216, 217-18, 326 S.E.2d 460, 463-64 (1985); *Comolli v. Comolli*, 241 Ga. 471, 475, 246 S.E.2d 278 (1978) ("Directors may decide in good faith what is best for the corporation, but this interest must be consistent with good faith to the minority stockholder.").

18. *Comolli v. Comolli*, 241 Ga. 471, 474, 246 S.E.2d 278, 281 (1978); *Marshall v. W.E. Marshall Co.*, 189 Ga. App. 510, 512, 376 S.E.2d 393, 396 (1988). For a further discussion of the fiduciary duties owed to minority shareholders, *see* Chapter 3, § 3-2:5.2.

19. This observation holds true even for statutory close corporations. *See* O.C.G.A. § 14-2-901 et seq. While the GBCC grants more extensive remedies to outside minority

1-2:1.1 Duties Owed to Third Parties

In some situations, fiduciary duties may be owed to persons other than the corporation's shareholders. When a corporation becomes insolvent, directors and officers become bound to manage the remaining assets of the corporation for the benefit of creditors and may be held to trust standards in the process.[20]

The GBCC permits the corporation to adopt charter provisions authorizing directors and officers to consider the interests of constituencies, such as employees, customers, suppliers, or creditors, but does not thereby extend fiduciary duties to those groups.[21] Permitting the consideration of other constituencies' interests is designed to preclude shareholder claims that directors and officers violate their duties of loyalty to shareholders by including in their decision making the potentially competing interests of these other constituencies.

1-2:1.2 Heightened Director and Officer Duties

It remains an open question whether directors and officers are subject to heightened duties by virtue of having particular training or expertise in a given area, such as a law degree. The commentary in the GBCC suggests that this might be the case,[22] but there is little decisional authority on the point, and none in Georgia.[23]

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shareholders of corporations that opt to assume statutory close corporation status, the basic duties and obligations of directors and officers are the same. *See* Chapter 3, § 3-2:5.

[20] *Matter of Concrete Prods.*, 208 B.R. 1000, 1007 (Bankr. S.D. Ga. 1996). *See* discussion in § 1-12.

[21] *Matter of Munford, Inc.*, 98 F.3d 604, 611 (11th Cir. 1996). A corporation may provide in its articles of incorporation that directors may consider the interests of the corporation's employees, customers, suppliers, creditors of the corporation and its subsidiaries, the communities in which the corporation's facilities are located, and "all other factors such directors consider pertinent." O.C.G.A. § 14-2-202(b)(5).

[22] *See* O.C.G.A. §§ 14-2-830 cmt. (2016); 14-2-842 cmt. (2016). The commentary to Section 830 was taken verbatim from the 1984 Revised Model Business Corporation Act, and is similar to the position endorsed by the American Law Institute (ALI). *See* American Law Institute, Principles of Corporate Governance § 401 cmt. (f) (1994).

[23] For decisions in other jurisdictions on the issue of whether attorneys may be subject to differential duties, *see Rowen v. Le Mars Mutual Ins. Co. of Iowa*, 282 N.W.2d 639, 652 (Iowa 1979) (holding that "legal counsel, the corporation's banker, retired executives of the corporation, [and] representatives of major corporate suppliers or customers" should not be classified as outside directors) and *Crown v. Hawkins Co., Ltd.*, 910 P.2d 786, 794 (Idaho 1996) (declining to impose heightened duties on attorney-director who maintained separate legal practice during time of directorship and who performed only minor and ministerial legal services for the corporation).

Another open question is whether directors owe heightened duties in connection with change of control transactions based on the *Revlon* doctrine,[24] under which a duty to maximize shareholder value under limited circumstances has been recognized by Delaware courts. To date, the Georgia appellate courts have not extended the *Revlon* doctrine to Georgia law or decided whether directors of Georgia corporations can ever be subject to heightened duties in considering potential change of control transactions.

The Georgia Supreme Court has rejected a heightened standard of conduct in holding that the actions of trustees who serve as directors and officers of corporations in which a trust owns a minority interest must be assessed using corporate, not trust, standards of conduct when they are acting in their capacities as directors and officers.[25]

1-2:2 Statutory Duties and Liabilities Under the Georgia Business Corporation Code

The standard of care that a director or officer of a Georgia corporation must exercise is, in part, prescribed by statute. Historically, the GBCC required directors and officers to discharge their duties "in a manner [they] believe in good faith to be in the best interests of the corporation [and] with the care an ordinarily prudent person in a like position would exercise under similar circumstances."[26] The 2017 amendment to the GBCC, effective July 1, 2017, restates the standard of care using slightly different phrasing, providing that directors and officers "shall perform [their] duties . . . in good faith and with the degree of care an ordinarily prudent person in a like position would exercise under similar circumstances."[27] As discussed in greater detail in the sections below, the 2017 amendment does not appear to meaningfully change the standard of care itself, but it significantly alters the standard of *liability* by modifying the level of culpability required for claims asserting violations of the duty of care.[28]

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24. *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).
25. *Rollins v. Rollins*, 294 Ga. 711, 716, 755 S.E.2d 727, 731 (2014).
26. O.C.G.A. § 14-2-830 (2016); O.C.G.A. § 14-2-842 (2016).
27. O.C.G.A. § 14-2-830 (2017); O.C.G.A. § 14-2-842 (2017).
28. *See* §§ 1-2:2, 1-2:3, 1-3.

In evaluating challenges to a director's or officer's decisions or actions that allege a breach of the duty of care, there are now two threshold questions that must be resolved. The first is whether the challenge focuses on the process leading to the decision or action, rather than on the wisdom of the resulting decision or action. In the seminal *FDIC v. Loudermilk* decision in 2014, the Georgia Supreme Court held that statutory formulations of the duty of care are designed to address only the process through which a decision is made or an action is taken, consistent with the longstanding Georgia common law principle that courts should not examine the wisdom of business decisions absent a showing of fraud, bad faith or an abuse of discretion, which the Court held to be equivalent to aspects of the business judgment rule followed in other jurisdictions.[29] Under *Loudermilk*, it is appropriate for courts to examine process-related questions, such as whether a director or officer took appropriate steps to be properly informed, under the applicable statutory framework. Courts should not, however, examine the wisdom of a decision itself if the facts show that the decision was made in compliance with the statutory standard.

The second question concerns the level of culpability that must be shown for liability to attach. The *Loudermilk* Court held that the statutory standard of liability for violations of the duty of care was essentially the same as the standard of care itself, which it interpreted to mean that directors and officers could be held liable for ordinary negligence based on a lack of ordinary care in the decision-making process.[30] In recognizing the possibility of an ordinary negligence claim against directors and officers, the Court rejected and overruled earlier decisions of the Georgia Court of Appeals holding that the business judgment rule established a standard of review that categorically foreclosed ordinary negligence claims.[31]

The 2017 amendment to the GBCC addresses this aspect of the *Loudermilk* decision, drawing a clearer distinction between the standard of care (which is essentially unchanged) and the standard

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[29] *See FDIC v. Loudermilk*, 295 Ga. 579, 590-91, 761 S.E.2d 332, 341 (2014) (examining the history and development of the GBCC's standard of care).

[30] *See FDIC v. Loudermilk*, 295 Ga. 579, 585-86, 761 S.E.2d 332, 338 (2014).

[31] *See Flexible Prods. Co. v. Ervast*, 284 Ga. App. 178, 182, 643 S.E.2d 560, 564-65 (2007), *overruled by FDIC v. Loudermilk*, 295 Ga. 579, 761 S.E.2d 332 (2014); *Brock Built, LLC v. Blake*, 300 Ga. App. 816, 821, 686 S.E.2d 425, 430 (2009) (same).

of review that courts should follow in cases involving process-related claims under the standard of care.[32] The 2017 amendments to O.C.G.A. § 14-2-830 and § 14-2-842 eliminate language in the prior versions of those statutes (which were in effect at the time of *Loudermilk*), providing that directors or officers would not be liable to the corporation or its shareholders if they performed their duties in compliance with the statutory standard of care. In its place, the amendments create a statutory presumption that the decision-making process a director or officer followed was conducted in good faith and that the director or officer exercised ordinary care.[33] This presumption may be rebutted by evidence that such process constitutes "gross negligence," which the statute defines as a "gross deviation of the standard of care of a director or officer in a like position under similar circumstances."[34] This effectively requires a party asserting a claim for breach of the duty of care to demonstrate gross negligence (or bad faith) before liability may be imposed on a director or officer.

Therefore, in light of *Loudermilk* and the 2017 amendment to the GBCC, a director or officer may have liability for a breach of the duty of care under the GBCC in making decisions, but only if the claim relates to the process followed by the director or officer, and only if the claimant is able to rebut the statutory presumption through a showing of bad faith or gross negligence.

The statutory standard of conduct is also incorporated into the GBCC's provisions regarding liability for wrongful distributions to shareholders when a corporation is insolvent or the distributions would render it insolvent. A director who votes for or assents to an unlawful distribution is personally liable to the corporation for the amount of the unlawful distribution, but only if the director violated the statutory standard of care.[35] A director's liability here can be direct or indirect, as any director held liable for an unlawful distribution has a statutory right to contribution from other directors who could have been held liable.[36]

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32. O.C.G.A. § 14-2-830(c) (2017); O.C.G.A. § 14-2-842(c) (2017).
33. O.C.G.A. § 14-2-830(c) (2017); O.C.G.A. § 14-2-842(c) (2017).
34. O.C.G.A. § 14-2-830(c) (2017); O.C.G.A. § 14-2-842(c) (2017).
35. O.C.G.A. § 14-2-832(a).
36. O.C.G.A. § 14-2-832(b).

1-2:3 Duty of Care; Standard of Care

Under the amended O.C.G.A. § 14-2-830, which became effective July 1, 2017, directors are required to exercise "the degree of care an ordinarily prudent person in a like position would exercise under similar circumstances."[37] This represents a slight reformulation of the prior statutory standard, which provided that "the care an ordinarily prudent person in a like position would exercise under similar circumstances."[38] The 2017 amendment also modifies the description of the duty of good faith, removing the language in the prior version specifying that the good faith be directed towards the best interests of the corporation.[39] The language of the new § 14-2-830 appears to require a more generalized good faith. It remains to be seen whether this will have any practical impact, particularly since the meaning of good faith in the corporate context is well developed in the case law.[40]

Addressing the prior version of the statute in *FDIC v. Loudermilk*, the Georgia Supreme Court found it to be "less demanding" than the ordinary prudence standard that is generally applicable in tort law because of the additional qualifying words "in a like position."[41] Ordinary diligence, as defined generally for purposes of Georgia's tort statutes, is "that degree of care which is exercised by ordinarily prudent persons under the same or similar circumstances," a generalized standard that makes no reference to the person's particular position.[42] The additional words "in a like position" mean that the conduct of directors of a corporation is to be measured against that of other directors of similarly situated corporations.[43]

The Georgia Supreme Court recognized that it is unreasonable to expect directors to exercise the same level of care and to devote the same level of attention to the affairs of their corporations as

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37. O.C.G.A. § 14-2-830(a) (2017).

38. O.C.G.A. § 14-2-830(a)(1) (2016).

39. O.C.G.A. § 14-2-830(a).

40. *See, e.g., Rollins v. Rollins,* 338 Ga. App. 308, 322, 790 S.E.2d 157, 168 (2016); *Lambeth v. Three Lakes Corp.*, 357 Ga. App. 546, 549, 851 S.E.2d 181, 184 (2020).

41. *See FDIC v. Loudermilk,* 295 Ga. 579, 594-95, 761 S.E.2d 332, 344 (2014) (quoting O.C.G.A. § 51-1-2).

42. O.C.G.A. § 51-1-2.

43. *See FDIC v. Loudermilk,* 295 Ga. 579, 594-95, 761 S.E.2d 332, 344 (2014) (analyzing comparable provisions of Georgia's banking code).

they would to their own affairs.[44] To hold directors to the tort law "prudent man" standard—that is, to require them to show the level of care and attention that they would devote to their own personal affairs—would cause directors to abandon their own affairs entirely, and would discourage reasonable persons from serving as directors.[45] A director's duty of care, therefore, does not equate to a duty to fully grasp all of the details of the corporation's affairs as if they were the director's own affairs.

In earlier decisions that appear to have continuing validity, the courts elaborated on the meaning of a director's duty of care, identifying conduct indicative of the board's proper performance of its policymaking and supervisory functions and the individual director's effective participation in that process. A director is expected to attend the meetings of the board with reasonable regularity and to exercise a "general supervision and control."[46] While directors may commit the active, day to day management of the business to officers, they can still be liable for their "neglect or inattention to the business."[47] A director also must act on an "informed basis," which necessarily entails generally informing themselves regarding the business, financial condition, and affairs of the corporation.[48] Directors "owe a duty to exercise reasonable care and prudence, and not be mere ornaments and figureheads."[49] They "cannot argue as a matter of law [that they are] entitled to summary judgment through nonparticipation and absence from meetings."[50]

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44. *See FDIC v. Loudermilk,* 295 Ga. 579, 595, 761 S.E.2d 332, 344 (2014) (quoting and analyzing *Woodward v. Stewart,* 149 Ga. 620, 624, 101 S.E. 749 (1919)).

45. *Woodward v. Stewart,* 149 Ga. 620, 624, 101 S.E. 749 (1919); *FDIC v. Loudermilk,* 295 Ga. 579, 595, 761 S.E.2d 332, 344 (2014).

46. *Woodward v. Stewart*, 149 Ga. 620, 624, 101 S.E. 749 (1919); *FDIC v. Loudermilk*, 295 Ga. 579, 595, 761 S.E.2d 332, 344 (2014).

47. *McEwen v. Kelly*, 140 Ga. 720, 79 S.E. 777 (1913).

48. *In re Intercat, Inc.*, 247 B.R. 911, 922 n.6 (Bankr. S.D. Ga. 2000).

49. *Boddy v. Theiling*, 129 Ga. App. 273, 276, 199 S.E.2d 379, 382 (1973) (physical precedent only).

50. *Boddy v. Theiling*, 129 Ga. App. 273, 276, 199 S.E.2d 379, 382 (1973) (opining that a "do-nothing director" cannot rely on inaction and lack of knowledge to avoid liability under Georgia's blue sky laws). *See also Gilbert v. Meason*, 137 Ga. App. 1, 5, 222 S.E.2d 835, 838 (1975).

Under the case law, included within the scope of the duty of care is a responsibility to prevent self-dealing, misappropriation of assets and corporate opportunities, and other breaches of the duty of loyalty by other directors, officers, and controlling shareholders.[51] Also included is a duty "to protect corporate property."[52]

Under O.C.G.A. § 14-2-830, these duties are tempered by the right of a director to rely on information from trustworthy sources and to rely on management if reasonably believed to be reliable and competent.[53]

There are several open questions of law in Georgia related to the scope of directors' duty of care. One such question is the extent to which problems brought to the directors' attention ("red flags") can heighten their duties such that they become required to take certain actions or inquire further, depriving them of the right to rely on management. Other jurisdictions have held that the failure of directors to respond to red flags may constitute gross negligence.[54]

Another unanswered question is whether in Georgia, directors may be liable under the so-called *Caremark* doctrine for failing adequately to monitor the corporation's compliance with relevant laws and regulations and any subsequent losses resulting from noncompliance.[55] To date, no Georgia state appellate court has relied on this theory, but two 2012-13 unpublished Georgia federal district court decisions addressed such claims asserted by the FDIC as receiver against former officers and directors of failed banks.[56]

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51. *McEwen v. Kelly*, 140 Ga. 720, 79 S.E. 777 (1913).

52. *Lambeth v. Three Lakes Corp.*, 357 Ga. App. 546, 549, 851 S.E.2d 181, 184 (2020).

53. O.C.G.A. § 14-2-830(b) (2017).

54. *Meyer v. Rigdon*, 36 F.3d 1375 (7th Cir. 1994); *FDIC v. Bierman*, 2 F.3d 1424, 1433 (7th Cir. 1993); *see also* American Law Institute, Principles of Corporate Governance § 4.01(a)(1) (1994) (stating that the duty of care "includes the obligation to make, or cause to be made, an inquiry when, but only when, the circumstances would alert a reasonable director or officer to the need therefor").

55. *In re Caremark International Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996) (recognizing that directors who fail to adequately monitor the corporation's activities for legal and regulatory compliance may be liable for noncompliance-related corporate losses, and mandating the establishment of an information and reporting system to enable directors to perform their supervisory responsibilities).

56. *See FDIC v. Miller*, No. 12-cv-00042, slip op. at 14 (N.D. Ga. Dec. 26, 2012) (holding that FDIC properly stated *Caremark* claim based on allegations that director failed to supervise loan officer who repeatedly violated internal policies); *FDIC v. Adams*, No. 12-cv-00726, slip op. at 17-18 (N.D. Ga. Mar. 21, 2013) (holding that FDIC's allegations of insufficient controls for supervising loan officers failed to meet "the high threshold of *Caremark* claims").

1-2:4 Duty of Loyalty

Corporate directors and officers are held to a standard of the "utmost good faith and loyalty."[57] As such, they may not prefer their own interests or the interests of others over those of the corporation. Directors and officers cannot use their official role in the corporation to obtain a personal advantage for themselves at the expense of the shareholders. Corporate fiduciaries cannot engage in direct competition with the corporation,[58] or engage in self-dealing or divert or commingle the corporation's assets and records for their own benefit.[59] A fiduciary also may not usurp "corporate opportunities" belonging to the corporation.[60]

A corporate fiduciary must always show "scrupulous loyalty" to the interests of minority shareholders.[61] A fiduciary's duty of good faith prohibits him from appropriating for himself the assets and property of the corporation, to the exclusion of minority shareholders.[62] Fiduciaries also cannot use their positions to freeze out minority shareholders in the absence of any legitimate corporate purpose.[63]

Violations of the duty of loyalty are not protected by the business judgment rule. In addition, the GBCC prohibits the corporation from attempting to limit a director's liability for violations of the duty of loyalty by specifically excluding the receipt of improper benefits, wrongful distributions to shareholders, and the misappropriation of corporate business opportunities from the permissible scope of exculpation clauses in the corporation's articles of incorporation.[64] It is also beyond the power of the corporation to indemnify a director or officer for such conduct.[65]

The duty of loyalty does not completely prohibit a director or officer from transacting with the corporation either directly

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57. *Union Circulation Co., Inc. v. Trust Co. Bank*, 143 Ga. App. 715, 240 S.E.2d 100 (1977).
58. *Brewer v. Insight Technology, Inc.*, 301 Ga. App. 694, 689 S.E.2d 330 (2009).
59. *Enchanted Valley RV Resort, Ltd. v. Weese*, 241 Ga. App. 415, 422, 526 S.E.2d 124, 130 (1999).
60. *See* § 1-5.
61. *Quinn v. Cardiovascular Physicians, P.C.*, 254 Ga. 216, 219, 326 S.E.2d 460, 464 (1985).
62. *Parks v. Multimedia Techs., Inc.*, 239 Ga. App. 282, 289, 520 S.E.2d 517, 524 (1999).
63. *Corbin v. Corbin*, 429 F. Supp. 276, 281 (M.D. Ga. 1977).
64. *See* § 1-10; O.C.G.A. § 14-2-202(b)(4).
65. *See* § 1-11:1; O.C.G.A. § 14-2-765.

or indirectly (such as through a second corporation owned or managed by the director or officer). However, such transactions may implicate Georgia's statutory scheme regarding conflicting interest transactions, as discussed in the next section.

1-2:5 Interested Party Transactions

A corporate transaction that is infected by a director's conflicting interests may be enjoined or set aside, and also may lead to an award for damages or other relief. The GBCC creates a statutory safe harbor and carefully defines the circumstances in which a director's conflicting interest in a transaction may give rise to liability or other relief.[66] The ultimate resolution of any claim based on an alleged conflict of interest will principally depend on the nature of the conflict, the magnitude and/or stage of the transaction, the adequacy of disclosure by the interested corporate fiduciary, the percentage of voting directors who are conflicted, the process and outcome of any director vote and/or shareholder vote on the transaction, and, in some cases, whether the transaction is deemed to be fair to the shareholders.

The statutory scheme with respect to conflicting interest transactions is intended to be exclusive.[67] If a transaction either does not meet the definition of a conflicting interest transaction as provided in O.C.G.A. § 14-2-860, or if it is a conflicting interest transaction but the corporation complies with the procedural conditions laid out in O.C.G.A. § 14-2-861, the transaction cannot be attacked based on the alleged conflict of interest.[68]

Several different types of conflicts can give rise to a conflicting interest transaction under the GBCC. The simplest is a direct and personal conflict in which the director is a party to the transaction or has a "beneficial financial interest" relating to the transaction that is of such significance that it could reasonably be expected to influence the director's judgment if called upon to vote on the transaction.[69] As the use of the term "reasonably" suggests, an

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66. O.C.G.A. § 14-2-860. The Georgia Code establishes parallel procedures to those discussed here for addressing officers' conflicting interest transactions. *See* O.C.G.A. § 14-2-864; *see also* Chapter 3, § 3-2:5.3e.

67. O.C.G.A. § 14-2-861 cmt.

68. O.C.G.A. § 14-2-861.

69. O.C.G.A. § 14-2-860(1)-(2).

objective standard is used to determine when a director's interest is strong enough to trigger the statutory scheme.[70] If even one director has such a conflict, the transaction must satisfy one of the curative conditions listed in O.C.G.A. § 14-2-861.

Conflicts involving persons other than the directors themselves may also trigger the need for compliance with O.C.G.A. § 14-2-861. A transaction is a conflicting interest transaction if any "related persons" are parties or have a beneficial financial interest that could exert an influence on the director's judgment.[71] The definition of "related persons" is intended to be exclusive and finite.[72]

Section 14-2-860(1)(B) addresses the multiple types of indirect director conflicts which arise through relationships with other persons or entities. The conflict can involve another entity of which the director is a director, general partner, agent or employee, or a controlling person of said entity, or even an entity that is "under common control with" said entity.[73] It can also involve a general partner, principal, or employer of the director, and is meant to capture persons and entities that might be in a position to influence the director, or to whom the director may owe fiduciary duties unrelated to the director's duties to the corporation.[74]

A conflicting interest transaction under O.C.G.A. § 14-2-860 need not be one undertaken by the corporation itself. Transactions involving a subsidiary or another entity in which the corporation has a controlling interest may also fall within the statute.[75] While Subsection (1)(B) significantly expands the universe of potential sources of conflict, its actual scope is limited by the fact that it only applies to transactions that require action by the board of directors or that are "of such character and significance to the corporation that it would in the normal course of business be brought" to the board for action.[76]

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70. O.C.G.A. § 14-2-860 cmt.

71. O.C.G.A. § 14-2-860(3).

72. The list of "related persons" includes the director's spouse (and spouse's parents and siblings), children, grandchildren, siblings, parents (and their spouses), any individual having the same home as the director, and any trust or estate of which any of the above-mentioned persons is a substantial beneficiary. O.C.G.A. § 14-2-860(3).

73. O.C.G.A. § 14-2-860(1)(B).

74. O.C.G.A. § 14-2-860(1)(B).

75. O.C.G.A. § 14-2-860(1).

76. O.C.G.A. § 14-2-860(1)(B).

The director's knowledge of the conflict is an essential element of any finding that a conflicted interest transaction exists, regardless of whether the conflict is direct or involves a related party or one of the persons or entities described in Subsection (1)(B). The director must know of the existence of the conflict "at the time of commitment," a specifically defined term, referring to the time when the transaction is consummated, or, where the transaction is pursuant to contract, the time when the corporation's burden of withdrawal from its contractual obligations "would entail significant loss, liability, or other damage."[77]

The fact that a transaction is deemed a conflicting interest transaction due to a director's conflicting interest, or even due to conflicting interests of all of the corporation's directors, does not by itself trigger any right to relief. The transaction still may not be enjoined or set aside, and may not give rise to any other sort of judicial relief, if one of the three conditions laid out in O.C.G.A. § 14-2-861 is satisfied. The burden is on the party defending the transaction, ordinarily the directors, to show that the transaction meets one of the three conditions.

The first two conditions involve compliance with one of two "safe harbor" provisions, O.C.G.A. § 14-2-862 and § 14-2-863. Section 862 permits the board of directors, or a committee established by the board to approve a conflicting interest transaction by a majority vote of "qualified directors,"[78] after full disclosure by the conflicted director or directors of the existence and nature of the conflicting interest as well as all facts material to a judgment as to whether to proceed with the transaction.[79] In cases where conflicted directors are unable to make the required disclosure because of a duty of confidentiality owed to another person, the required disclosure will be deemed sufficient if the conflicted director discloses the existence and nature of the conflicting interest and the inability to make a full disclosure, and then plays no part in

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77. O.C.G.A. § 14-2-860(5).

78. O.C.G.A. § 14-2-862; *Fisher v. State Mut. Ins. Co.*, 290 F.3d 1256, 1262 (11th Cir. 2002) (holding that the special committee's vote was proper under § 14-2-862 notwithstanding whether a conflicted director played a role in appointing members of the special committee).

79. O.C.G.A. § 14-2-862; *Dunaway v. Parker*, 215 Ga. App. 841, 847, 453 S.E.2d 43, 49-50 (1994) (holding that mere disclosure of the fact of the transaction, without disclosure of the nature of the conflict, constituted an insufficient basis for conclusions as to whether to proceed with the transaction).

the deliberations or vote.[80] In either case, to be effective, the majority vote must consist of at least two qualified directors.

Section 14-2-862 does not in any way prohibit conflicted directors from voting on the transaction, but they cannot count as qualified directors for purposes of establishing a quorum or majority vote.[81] Directors who are not conflicted can nonetheless fail to be considered "qualified directors" if they have a "familial, financial, professional or employment relationship" with a conflicted director and the relationship would reasonably be expected to influence their judgment.[82]

Under O.C.G.A. § 14-2-863, a conflicted interest transaction may also be ratified by a shareholder vote. To be effective, a majority of votes entitled to be cast must approve the transaction, following notice to the shareholders and disclosure to them of the same information required for disclosure under O.C.G.A. § 14-2-862, as well as an additional disclosure of the number of shares held by the conflicted director and/or related persons.[83]

If neither safe harbor provision applies, the director or other defendant bears the burden of showing that the transaction was fair to the corporation at the time of commitment.[84]

1-2:6 Duties Relating to Disclosure

While directors and officers have no general fiduciary duty of disclosure under the GBCC, statutory disclosure duties may arise in some situations. For instance, under O.C.G.A. § 14-2-1620, the corporation must prepare an annual balance sheet and profit and loss statement and furnish them to the shareholders on written request. If the financial statements are unaudited, "the president or the person responsible for the corporation's accounting records" must issue a statement stating whether the financial statements were prepared in accordance with generally accepted accounting

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80. O.C.G.A. § 14-2-862(b); *Fisher v. State Mut. Ins. Co.*, 290 F.3d 1256, 1261-62 (11th Cir. 2002) (holding that conflicted director's fiduciary duties owed as director of second corporation were sufficient to invoke § 14-2-862(b), which does not apply if the conflicted director, or a related person, is actually a party to the transaction).

81. O.C.G.A. § 14-2-862.

82. O.C.G.A. § 14-2-862.

83. O.C.G.A. § 14-2-863.

84. O.C.G.A. § 14-2-861(b)(3). *Cf. Rosenfeld v. Rosenfeld*, 286 Ga. App. 61, 66, 648 S.E.2d 399, 405 (2007).

principles and discuss accounting changes from the previous year.[85] A conflicted director is also under a duty to disclose conflicted interest transactions so that the corporation and the directors and officers can avail themselves of the safe harbor rules in O.C.G.A. §§ 14-2-862 and 14-2-863.[86]

Under the common law, given the officer and the shareholders' fiduciary relationship, shareholders "may rely implicitly, not only on what is said, but also on the supposition that nothing important will be left unsaid by the officer."[87] Whether this amounts to an independent and generally applicable fiduciary duty of disclosure, the breach of which may give rise to an action for damages or other relief, is unclear. Despite the quoted language above from *General Information Processing Systems*,[88] Georgia appellate courts have not, to date, recognized a broadly applicable duty of disclosure, or the "duty of candor" recognized in Delaware,[89] and that specific phrase has yet to appear in Georgia appellate court opinions on corporate governance issues.

It is clear, however, that when a director deals directly with outside minority shareholders in purchasing their shares, the director must disclose all known material facts relating to the value of the stock.[90] In this situation, a director cannot take advantage of his "superior access to such information conferred by his office."[91] Unlike other fiduciary duties described in this chapter, this particular duty of disclosure is not owed to the corporation itself.[92] A director also does not owe this duty of full disclosure to the other directors, except where one director has superior access to information

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85. O.C.G.A. § 14-2-1620(b).

86. *See* § 1-2:5.

87. *General Information Processing Sys. v. Sweeney*, 176 Ga. App. 315, 316, 335 S.E.2d 722, 723-24 (1985) (quoting *Oliver v. Oliver*, 118 Ga. 362, 45 S.E. 232 (1903)).

88. *General Information Processing Sys. v. Sweeney*, 176 Ga. App. 315, 335 S.E.2d 722 (1985). This case's precedential value to the disclosure issue is questionable since the undisclosed matter was the officer's misappropriation of corporate funds and the action was not for damages based on breach of duty to disclose, but rather for an accounting based on the misappropriation. The question of disclosure was relevant only to whether the statute of limitations was tolled by the defendant.

89. *See, e.g., Lynch v. Vickers Energy Corp.*, 383 A.2d 278 (Del. 1977) and *Malone v. Brincat*, 722 A.2d 5 (Del. 1998).

90. *Oliver v. Oliver*, 118 Ga. 362, 45 S.E. 232 (1903); *Childs v. RIC Grp., Inc.*, 331 F. Supp. 1078, 1081 (N.D. Ga. 1970).

91. *Childs v. RIC Grp., Inc.*, 331 F. Supp. 1078, 1081 (N.D. Ga. 1970).

92. *King Mfg. Co. v. Clay*, 216 Ga. 581, 585, 118 S.E.2d 581, 584 (1961).

about the value of the stock compared to the other directors, by virtue of that director's office or position.[93] This distinction exists because the duty of full disclosure is imposed to prevent directors from profiting from the inside information their positions in the corporation provides them, to the detriment of those who placed them in those positions.[94]

1-2:7 Corporate Waste Doctrine

Directors and officers may be held liable to account for "waste" of the corporation's assets or injury to its property resulting from a breach of fiduciary duty.[95] "It needs no citation of authority to conclude that corporate funds simply cannot be used to meet an officer's personal desires and obligations."[96] A corporate waste claim is also a common vehicle used to assert claims based on excessive compensation and benefits given to officers and other insiders.[97] If the compensation and/or benefits are commensurate with the value of the services rendered to the corporation, then no claim for corporate waste can be sustained.[98] A corporate waste claim need not be based on allegations that the defendants benefited themselves. Any claim that the corporation's assets have been lost or dissipated through neglect or a breach of fiduciary duty can form the basis for a claim.[99]

A claim based on waste to the corporation's assets belongs to the corporation and, therefore, must be brought derivatively.[100]

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93. *Childs v. RIC Grp., Inc.*, 331 F. Supp. 1078, 1083 (N.D. Ga. 1970).

94. *See* § 1-6 for further discussion of the relationship between the duty of disclosure and obligations relating to inside information.

95. *Enchanted Valley RV Resort, Ltd. v. Weese*, 241 Ga. App. 415, 423, 526 S.E.2d 124, 131 (1999); *Chalverus v. Wilson Mfg. Co.*, 212 Ga. 612, 613, 94 S.E.2d 736, 738 (1956).

96. *Corbin v. Corbin*, 429 F. Supp. 276, 281 (M.D. Ga. 1977).

97. *See, e.g., Benning v. Benning*, 239 Ga. 470, 470, 238 S.E.2d 111, 111-12 (1977) (claim based on excessive salary to corporation's president); *Farmers Union Warehouse of Metter v. Bird*, 224 Ga. 842, 843, 165 S.E.2d 148, 149 (1968) (claim based on excessive salaries and bonuses); *L.L. Minor Co., Inc. v. Perkins*, 246 Ga. 6, 8, 268 S.E.2d 637, 640 (1980) (claim based on allegations that corporation paid salary and furnished truck to employee for services that employee rendered on behalf of former officer's estate and not the corporation).

98. *See L.L. Minor Co., Inc. v. Perkins*, 246 Ga. 6, 12, 268 S.E.2d 637, 643 (1980).

99. *See, e.g., First Nat'l Bank of Tucker v. Hall*, 143 Ga. App. 300, 301, 238 S.E.2d 284, 285 (1977) (denying motion to dismiss corporate waste claim based on bank officer's failure to report known violations of bank's lending policies, resulting in numerous uncollectable loans).

100. *Pickett v. Paine*, 230 Ga. 786, 790, 199 S.E.2d 223, 230 (1973) ("As a general rule, a claim for misappropriation and waste of corporate assets by a director or officer of a

O.C.G.A. § 14-2-831 authorizes direct actions by the corporation or derivative actions by shareholders against directors or officers for "acquisition, transfer to others, loss or waste of corporate assets," as well as for the failure to perform or violation of duties in the management or disposition of corporate assets.[101] Waste of corporate assets is also one of the enumerated grounds that may give rise to a judicial dissolution under O.C.G.A. § 14-2-1430.[102]

1-3 THE BUSINESS JUDGMENT RULE IN GEORGIA

Georgia adheres to the business judgment rule, though its precise meaning and effect have been the subject of debate and litigation, particularly in recent years. Two recent developments have reshaped the business judgment rule, and in particular, how cases involving directors' and officers' exercise of the duty of care are to be reviewed by the courts.

In 2014, the Georgia Supreme Court held in *FDIC v. Loudermilk* that the business judgment rule was a settled principle of Georgia's common law prior to the enactment of any statutory standard of care for directors and officers, and that these statutes intended to leave the rule intact. The Court explained the rule as follows:

> [T]he business judgment rule makes clear that, when a business decision is alleged to have been made negligently, the wisdom of the decision is ordinarily insulated from judicial review, and as for the process by which the decision was made, the officers and directors are presumed to have acted in good faith and to have exercised ordinary care.[103]

The rule has also been described as a "presumption that in making a business decision[,] the directors of a corporation acted

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corporation belongs to the corporation and not its shareholders . . . ."); *William Goldberg & Co. v. Cohen*, 219 Ga. App. 628, 638, 466 S.E.2d 872, 882 (1995) ("Claims of mismanagement or waste of corporate assets and the concomitant devaluation of the shareholder's stock have generally been found to be derivative."); *see* § 1-8:2.

101. O.C.G.A. § 14-2-831(a)(1)(A), (B).

102. O.C.G.A. § 14-2-1430(2)(D); *Pickett v. Paine*, 230 Ga. 786, 797, 199 S.E.2d 223 (1973).

103. *FDIC v. Loudermilk,* 295 Ga. 579, 596, 761 S.E.2d 332, 345 (2014).

on an informed basis, in good faith[,] and in the honest belief that the action was taken in the best interests of the company."[104] Decisions prior to *Loudermilk* had held that the presumption is rebuttable by evidence that the director or officer engaged in fraud, bad faith, or an abuse of discretion.[105] If the presumption is not rebutted, the director or officer cannot be held personally liable for the challenged decision or action.[106]

As described in *Loudermilk*, the business judgment rule recognizes a critical distinction between the wisdom of business decisions and the process through which such decisions are made. Georgia courts have historically expressed a policy of non-interference with business decisions, recognizing that in most situations, directors and officers are more qualified to make business decisions than judges and juries.[107] At the same time, however, Georgia's common law has recognized that courts may inquire into whether corporate decision makers actually exercised judgment; that is, whether they acted with deliberation and exercised diligence and due care in the decision-making process.[108]

The *Loudermilk* Court also held, interpreting the then-existing versions of the statutory standards of care for bank directors and corporate directors and officers, that the business judgment rule does not supplant statutory standards of care requiring ordinary diligence, overruling two prior Georgia Court of Appeals decisions that held to the contrary.[109] Instead, both the business judgment rule and the GBCC recognize a distinction between claims regarding the decision-making process and claims

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104. *Cottle v. Storer Commc'n, Inc.,* 849 F.2d 570, 575 (11th Cir. 1988) (cited in *FDIC v. Loudermilk,* 295 Ga. 579, 581 n.2, 761 S.E.2d 332, 335 n.2 (2014)).

105. *Brock Built, LLC v. Blake,* 300 Ga. App. 816, 822, 686 S.E.2d 425, 430-31 (2009), *overruled on other grounds by FDIC v. Loudermilk,* 295 Ga. 579, 761 S.E.2d 332 (2014).

106. *Brock Built, LLC v. Blake,* 300 Ga. App. 816, 822, 686 S.E.2d 425, 430-31 (2009), *overruled on other grounds by FDIC v. Loudermilk,* 295 Ga. 579, 761 S.E.2d 332 (2014).

107. *See Smith v. Albright-England Co.,* 171 Ga. 544, 545, 156 S.E. 313 (1930); *Malone v. Armor Insulating Co.,* 191 Ga. 146, 150, 12 S.E.2d 299 (1940); *Regenstein v. Regenstein,* 213 Ga. 157, 97 S.E.2d 693 (1957); *Tallant v. Exec. Equities, Inc.,* 232 Ga. 807, 810, 209 S.E.2d 159 (1974); *FDIC v. Loudermilk,* 295 Ga. 579, 584, 761 S.E.2d 332, 337 (2014).

108. *See McEwen v. Kelly,* 140 Ga. 720, 723, 79 S.E. 777 (1913); *Woodward v. Stewart,* 149 Ga. 620, 629, 101 S.E. 749 (1919); *Shannon v. Mobley,* 166 Ga. 430, 432, 143 S.E. 582 (1928); *Mobley v. Russell,* 174 Ga. 843, 847-48, 164 S.E. 190 (1932); *FDIC v. Loudermilk,* 295 Ga. 579, 583, 761 S.E.2d 332, 336 (2014); *Lambeth v. Three Lakes Corp.*, 357 Ga. App. 546, 549, 851 S.E.2d 181, 184 (2020).

109. *See FDIC v. Loudermilk,* 295 Ga. 579, 594, 761 S.E.2d 332, 343 (2014).

that challenge the wisdom of the resulting decisions. Interpreting the prior versions of the standard of care statutes, the Court held that the presumption that the decision-making process was properly conducted could be overcome by evidence of ordinary negligence.[110]

The 2017 amendment to the GBCC, effective July 1, 2017, explicitly modifies the presumption described in *Loudermilk* by raising the burden on the party attempting to overcome the presumption. A party challenging a director's or officer's exercise of the duty of care must rebut the statutory presumption through evidence that the process leading to the challenged decision or action "constitutes gross negligence by being a gross deviation of the standard of care of a director or officer in a like position under similar circumstances."[111] In essence, the amendment establishes a gross negligence floor for personal liability as to claims for violation of the duty of care.

The amendments also write the words "business judgment rule" into the statute for the first time, providing that nothing in the standard of care statutes (O.C.G.A. §§ 14-2-830 and 14-2-842) shall "[d]eprive a director or officer of the applicability, effect, or protection of the business judgment rule."[112] This indicates that the business judgment rule has an existence independent of the GBCC and should be considered in conjunction with other protections that Georgia law affords to corporate directors and officers. Under the GBCC, directors and officers are entitled to rely upon certain information and reports by persons (including other officers and employees, legal counsel, public accountants, investment bankers and similar experts) that they reasonably believe to be reliable, as to matters reasonably believed to be within that person's professional or expert competence. They are also entitled to rely on the performance of other officers, employees and agents of the corporation believed to be reliable and competent.[113]

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110. *See FDIC v. Loudermilk,* 295 Ga. 579, 597, 761 S.E.2d 332, 345 (2014).

111. O.C.G.A. § 14-2-830(c) (2017); O.C.G.A. § 14-2-842(c) (2017).

112. O.C.G.A. § 14-2-830(d)(4) (2017); O.C.G.A. § 14-2-842(d)(4) (2017).

113. O.C.G.A. § 14-2-830(b) (2017); O.C.G.A. § 14-2-842(b) (2017); *Lambeth v. Three Lakes Corp.*, 357 Ga. App. 546, 549, 851 S.E.2d 181, 184 (2020).

1-4 RIGHTS OF RELIANCE ON OFFICERS, EMPLOYEES, PROFESSIONALS, COMMITTEES, AND EXPERT ADVISORS

Under the amended O.C.G.A. §§ 14-2-830 and 14-2-842, which became effective July 1, 2017, a director or officer is entitled to rely on both (1) the performance of other officers, employees or agents of the corporation whom the director or officer reasonably believed to be reliable and competent in the functions performed, and (2) "information, data, opinions, reports, or statements" provided by the corporation's officers employees or agents, or by legal counsel, public accountants, investment bankers, and other persons as to matters involving the skills, expertise, and knowledge reasonably believed to be reliable and within such person's professional or expert competence.[114] To avail themselves of the protections of the statute, directors and officers must establish a nexus between the advice sought and given and the matters alleged in the complaint.[115]

Under the prior versions of these statutes, directors had a right of reliance on information from management, but not on management's performance. The amended statute removes the tautological language in the prior version of the statute providing that directors and officers could not rely on said advice if they have knowledge concerning the matter that makes such reliance unwarranted.[116] It remains to be seen whether this will have any practical impact on cases in which the right to reliance is invoked, since both the prior and revised statutes require reliance to be "reasonable."

1-5 CORPORATE OPPORTUNITY DOCTRINE

A director or officer may be held liable to the corporation for "the appropriation, in violation of his duties, of any business

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114. O.C.G.A. § 14-2-830(b) (2017); O.C.G.A. § 14-2-842(b) (2017).

115. *Lambeth v. Three Lakes Corp.*, 357 Ga. App. 546, 549-51, 851 S.E.2d 181, 184-85 (2020).

116. O.C.G.A. § 14-2-830(b) (2016); O.C.G.A. § 14-2-842(b) (2016). The amendment to Section 14-2-830, however, deleted the director's right to rely on information provided by a duly authorized committee of the board, a change that may affect the internal reporting of boards that organize their decision-making process by delegating responsibilities to committees.

opportunity of the corporation."[117] The GBCC places additional emphasis on protecting corporations' business opportunities by prohibiting exculpation and indemnification of that liability and authorizing derivative actions to recover for it.[118] The threshold question is whether the opportunity in question is, in fact, a "corporate opportunity," which the Code leaves up to the courts to define.[119] Under Georgia common law, a corporate opportunity is a business opportunity (1) which the corporation is financially able to undertake, is within the corporation's line of business and would be of practical advantage to the corporation, and (2) in which the corporation has an interest or a reasonable expectancy. This definition contemplates a factual inquiry in which all relevant facts and circumstances are considered.[120]

The test applied by the court may depend on whether the party accused of usurping a corporate opportunity is an existing director or officer or a former one.[121] For existing directors or officers, Georgia courts apply the "line of business" test which looks to whether the opportunity is "intimately or closely related with the existing or prospective activities of the corporation."[122] For former directors and officers, Georgia courts apply the "interest or expectancy test," in which the court looks for the presence or absence of a "beachhead"–a preexisting right or relationship involving the corporation that could reasonably have been expected to be continued or renewed.[123] Specific contractual relationships are more

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117. O.C.G.A. § 14-2-831(a)(1)(C); *Parks v. Multimedia Techs., Inc.*, 239 Ga. App. 282, 520 S.E.2d 517 (1999).

118. O.C.G.A. §§ 14-2-202(b)(4); 14-2-856(b)(1); 14-2-857(a)(2)(A); 14-2-831(a)(1)(c).

119. *Phoenix Airline Servs., Inc. v. Metro Airlines, Inc.*, 260 Ga. 584, 587, 397 S.E.2d 699, 703 (1990); *Brewer v. Insight Technology, Inc.*, 301 Ga. App. 694, 696, 689 S.E.2d 330, 334 (2009); *Southeast Consultants, Inc. v. McCrary Engineering Corp.*, 246 Ga. 503, 509, 273 S.E.2d 112, 117 (1980).

120. *Phoenix Airline Servs., Inc. v. Metro Airlines, Inc.*, 260 Ga. 584, 587, 397 S.E.2d 699, 703 (1990).

121. *See In re Pervis*, 512 B.R. 348, 368 (Bankr. N.D. Ga. 2014).

122. *See In re Pervis*, 512 B.R. 348, 368 (Bankr. N.D. Ga. 2014).

123. *See, e.g., Bob Davidson & Associates, Inc. v. Norm Webster & Associates, Inc.*, 251 Ga. App. 56, 62, 553 S.E.2d 365, 370 (2001) (a "business opportunity" exists where the corporation has a legal or equitable interest in the opportunity or an "expectancy" growing out of a preexisting right or relationship); *Southeast Consultants, Inc. v. McCrary Engineering Corp.*, 246 Ga. 503, 509, 273 S.E.2d 112, 118 (1980) (holding that an engineering firm's preliminary study contract with a municipality created an expectancy with regard to a later planning contract for the project); *see also Quinn v. Cardiovascular Physicians, P.C.*, 254 Ga. 216, 218-19, 326 S.E.2d 460, 464 (1985) (holding that a prior one-year contract between a

likely to be considered corporate opportunity than vague, ongoing relationships with a corporation's regular customers.[124]

Once it is established that a corporate opportunity has been presented to the director or officer, the burden shifts and the director or officer must prove that there was no violation of the duties of loyalty and good faith.[125] If by embracing a corporate opportunity the director or officer's interests would be brought into conflict with those of the corporation, the law will not permit directors or officers to seize the opportunity for themselves.[126]

1-6 TRANSACTIONS AND CLAIMS INVOLVING CORPORATE SECURITIES

A director or officer is generally permitted to own the corporation's stock or its bonds or other debt obligations, and to transact with other shareholders for the purchase and sale of those securities. When purchasing or selling securities directly from a shareholder, a director has a duty to make a full disclosure of all known material facts relating to the value of the securities.[127] This duty is not owed to the corporation itself or to other directors.[128]

The rationale for the rule requiring a full disclosure of material information when purchasing or selling stock directly from a shareholder is that such information is a "quasi asset" of the

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professional corporation and a hospital authority gave rise to a reasonable expectation of continuation of the relationship); *Sewell v. Cancel*, 331 Ga. App. 687, 693-94, 771 S.E.2d 388, 394 (2015) (distinguishing *Quinn* where hospital's unilateral termination of contract left no business opportunity to be appropriated by directors of professional corporation).

124. *United Seal & Rubber Co., Inc. v. Bunting*, 248 Ga. 814, 816, 285 S.E.2d 721, 722 (1982) (distinguishing *Southeast Consultants* on the ground that no contractual relationship existed between the manufacturer and major purchasers of its products).

125. *Phoenix Airline Servs., Inc. v. Metro Airlines, Inc.*, 260 Ga. 584, 587, 397 S.E.2d 699, 703 (1990); *Parks v. Multimedia Techs., Inc.*, 239 Ga. App. 282, 295, 520 S.E.2d 517, 528 (1999) ("The obligation of officers and directors not to take for themselves opportunities that belong to the company is but specie of the command that fiduciaries act with undivided loyalty, and is another manifestation of the requirement of utmost good faith.") (internal quotes omitted).

126. *Parks v. Multimedia Techs., Inc.*, 239 Ga. App. 282, 288-89, 520 S.E.2d 517, 524 (1999); *Quinn v. Cardiovascular Physicians, P.C.*, 254 Ga. 216, 218, 326 S.E.2d 460, 463-64 (1985).

127. *See* § 1-2:6; *Oliver v. Oliver*, 118 Ga. 362, 45 S.E. 232 (1903).

128. *Henderson v. KMSystems, Inc.*, 188 Ga. App. 893, 899, 374 S.E.2d 550, 554-55 (1988). Presumably, officers who are not directors would owe similar duties, although there do not appear to be any decisions specifically so holding.

corporation, which like any other asset of the corporation is entrusted to the directors for the benefit of shareholders.[129]

While the rule is separate from and should not be confused with the federal prohibition against insider trading, at least one court has compared the director's duty when purchasing stock from shareholders to his responsibilities under the antifraud provisions of the Securities Exchange Act of 1934 and SEC Rule 10b-5.[130] Thus, in addition to the fiduciary duties of full disclosure owed by a director when dealing with a shareholder, communications made in connection with securities transactions may also implicate the antifraud provisions of the federal and/or state securities laws, and can give rise to common law fraud and negligent misrepresentation claims.[131]

Federal law broadly prohibits the use of "any manipulative or deceptive device," including misrepresentations and omissions of material fact, in connection with the purchase or sale of a security.[132] The words "in connection with" have been interpreted to mean that federal securities fraud claims may be brought only by persons who purchase or sell a security in connection with the fraud.[133] Similarly, the Georgia Securities Act explicitly provides for a private cause of action only to purchasers or sellers of a security.[134] As a result, shareholders who purchased their shares prior to the fraud and held those shares throughout the relevant time period are without a remedy under the federal and blue sky laws.

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[129] *Childs v. RIC Grp., Inc.*, 331 F. Supp. 1078, 1082 (N.D. Ga. 1970) (discussing Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, prohibiting material misstatements or omissions in connection with the purchase or sale of securities; "[w]here the director obtains the information by virtue of his official position, he holds the information in trust for the benefit of those who placed him where this knowledge was obtained") (quoting *Oliver v. Oliver*, 118 Ga. 362, 368, 45 S.E. 232 (1903)) (internal punctuation and emphasis deleted).

[130] *Childs v. RIC Grp., Inc.*, 331 F. Supp. 1078, 1082 (N.D. Ga. 1970).

[131] *See Greenwald v. Odom*, 314 Ga. App. 46, 723 S.E.2d 305 (2012). *See also* Chapter 4 (Securities Litigation) and Chapter 8, § 8-3 (specifically addressing negligent misrepresentation claims).

[132] *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006); *see* Chapter 4 (Securities Litigation).

[133] *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 464 (2d Cir. 1952).

[134] O.C.G.A. § 10-5-58.

However, such shareholders may have a remedy under Georgia common law. Georgia has recognized the viability of "holder claims," in which the shareholder's forbearance from selling stock may form the basis for a claim, provided that the other elements are present.[135] The Georgia Supreme Court has ruled that holder claims can be brought for both fraud and negligent misrepresentation.[136] To prevail on such a claim, a plaintiff must establish (1) that the communication that induced the plaintiff to refrain from selling the security was directly communicated to them, and (2) that the plaintiff specifically relied on the communication when deciding not to sell.[137]

While the question of what constitutes a "direct communication" is not entirely settled, courts appear to equate direct communications with personal, one-on-one communications specifically directed to the plaintiff.[138] The reliance element requires that the plaintiff "must allege actions, as distinguished from unspoken and unrecorded thoughts and decisions, that would indicate that the plaintiff actually relied on the misrepresentations."[139] While there is little current guidance as to how a plaintiff can satisfy the requirement of specific reliance, it is clear that at a minimum, the plaintiff should be able to demonstrate how many shares would have been sold, the timing of the sale, and other salient facts that would indicate that reliance on the alleged fraud actually caused the plaintiff's forbearance.[140] These limitations might, as a practical matter, foreclose many potential holder claims against directors and officers, including those brought as class actions.[141]

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135. *Holmes v. Grubman*, 286 Ga. 636, 639, 691 S.E.2d 196, 199 (2010).

136. *Holmes v. Grubman*, 286 Ga. 636, 641, 691 S.E.2d 196, 200 (2010).

137. *Holmes v. Grubman*, 286 Ga. 636, 640, 691 S.E.2d 196, 199 (2010).

138. *Holmes v. Grubman*, 286 Ga. 636, 639, 691 S.E.2d 196, 199 (2010) (citing *Gutman v. Howard Savings Bank*, 748 F. Supp. 254, 265 (D.N.J. 1990)); *Anderson v. Daniel*, 314 Ga. App. 394, 396, 724 S.E.2d 401, 403 (2012) (holding that *Holmes*' "direct communication" requirement barred claims based on communications made to the shareholders at large, including annual reports and audited financial statements).

139. *Holmes v. Grubman*, 286 Ga. 636, 640, 691 S.E.2d 196, 199 (2010).

140. *Holmes v. Grubman*, 286 Ga. 636, 640, 691 S.E.2d 196, 199 (2010) (citing *Small v. Fritz Cos.*, 65 P.3d 1255, 1265 (Cal. 2003)); *Anderson v. Daniel*, 314 Ga. App. 394, 724 S.E.2d 401 (2012).

141. *See* § 1-7:7.

1-7 ACTIONS AGAINST DIRECTORS AND OFFICERS

1-7:1 Types of Claims

A director or officer who commits a breach of fiduciary duty generally may be held accountable to the corporation itself or to shareholders injured by the breach.[142] Where the injury is to the corporation, the claim usually must be brought in the right of the corporation as a derivative action,[143] as the claim "belongs to the corporation and not to its shareholders."[144] Any recovery is paid to the corporation.[145] Shareholder derivative suits include several unique features that exist to safeguard the interests of the corporation, particularly against the pursuit of dubious claims or other claims that are not in the corporation's best interests. These features include the requirement of a demand on the board of directors,[146] the standing requirements of contemporaneous and continuous ownership of shares,[147] and the corporation's right to move the court to stay or dismiss the action.[148]

The typical justifications for requiring shareholder derivative suits are (1) to prevent multiple and duplicative suits by shareholders or groups of shareholders; (2) to protect creditors of the corporation, by ensuring that any recovery is paid to the corporation; (3) to protect absent shareholders, by ensuring that any recovery is paid to the corporation rather than to one or a small group of shareholders; and (4) to compensate all injured shareholders by restoring all or a portion of their lost share value.[149]

Where the director or officer's misconduct injures a particular shareholder or group of shareholders rather than the body of

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142. *Sewell v. Cancel*, 331 Ga. App. 687, 689, 771 S.E.2d 388, 391 (2015) (describing elements of breach of fiduciary duty as the existence of a fiduciary duty, breach of that duty, and damage proximately caused by the breach).

143. O.C.G.A. §§ 14-2-740(1) (2012); 14-2-831 (2012).

144. *Pickett v. Paine*, 230 Ga. 786, 790, 199 S.E.2d 223, 227 (1973); *Stephens v. McGarrity*, 290 Ga. App. 755, 763, 660 S.E.2d 770, 776 (2008).

145. *Barnett v. Fullard*, 306 Ga. App. 148, 151, 701 S.E.2d 608, 612 (2010); *Callicott v. Scott*, 357 Ga. App. 780, 788, 849 S.E.2d 547, 553 (2020).

146. *See* § 1-7:3.

147. *See* § 1-7:5.

148. *See* § 1-7:4.

149. *Rosenfeld v. Rosenfeld*, 286 Ga. App. 61, 65, 648 S.E.2d 399, 404 (2007); *Southwest Health & Wellness v. Work*, 282 Ga. App. 619, 625, 639 S.E.2d 570, 576 (2006).

shareholders as a whole, the injured shareholders may assert the claim directly.[150] In close corporations, injured shareholders may sometimes be able to pursue their claims without satisfying the requirements of a derivative suit where the normal justifications for requiring a derivative suit as stated above are not present, such as non-party shareholders or creditors whose interests are not adequately represented.[151]

1-7:2 Direct Versus Derivative Actions

The general rule in Georgia is that a suit brought to enforce a right of action belonging to the corporation or to obtain redress for wrongful conduct that injures the corporation's shareholders must be brought derivatively in the name of the corporation.[152] Accordingly, most actions for the misappropriation of corporate funds,[153] claims alleging corporate waste,[154] claims alleging corporate mismanagement,[155] and claims alleging the usurpation of corporate opportunities[156] are held to be derivative in character.[157] Likewise, claims based on disclosures that were made generally to all shareholders have been held to be derivative.[158]

There are two well-known exceptions to the general rule requiring a derivative suit. The first exception occurs where the plaintiff alleges a special injury separate and distinct from that suffered by the body of shareholders as a whole, or alleges the impairment of a shareholder contractual right specific to the plaintiff.[159] In

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150. *See* § 1-7:2 for a discussion of the distinction between derivative and direct claims.

151. *See* § 1-7:6; *see also* Chapter 3, § 3-2:2.

152. *See Phoenix Airline Servs., Inc. v. Metro Airlines, Inc.*, 260 Ga. 584, 585, 397 S.E.2d 699, 701 (1990).

153. *Rosenfeld v. Rosenfeld*, 286 Ga. App. 61, 64, 648 S.E.2d 399, 403 (2007).

154. *Bogle v. Bragg*, 248 Ga. App. 632, 638, 548 S.E.2d 396, 402 (2001).

155. *Medlin v. Carpenter*, 174 Ga. App. 50, 55, 329 S.E.2d 159, 165-66 (1985).

156. *Phoenix Airline Servs., Inc. v. Metro Airlines, Inc.*, 260 Ga. 584, 586, 397 S.E.2d 699, 702 (1990).

157. *See also* O.C.G.A. § 14-2-831(a) (enumerating claims that are derivative in character, which can be brought by the corporation or by a shareholder, derivatively, on its behalf).

158. *Next Century Comms. Corp. v. Ellis*, 171 F. Supp. 2d 1374, 1382 (2001).

159. *Rosenfeld v. Rosenfeld*, 286 Ga. App. 61, 64, 648 S.E.2d 399, 403 (2007); *Stoker v. Bellemeade, LLC*, 272 Ga. App. 817, 822, 615 S.E.2d 1, 7 (2005), *rev'd in part on other grounds*, 280 Ga. 635, 631 S.E.2d 662 (2006); *Grace Bros., Ltd. v. Farley Indus.*, 264 Ga. 817, 819-20, 450 S.E.2d 814, 816-17 (1994); *Holland v. Holland Heating & Air Conditioning, Inc.*, 208 Ga. App. 794, 432 S.E.2d 238 (1993) ("For a plaintiff to have standing to bring an individual action, he must be injured directly or independently of the corporation.");

such cases, the injured shareholders will be permitted to bring their claims directly against the defendants. Whether a claim is direct or derivative is generally addressed at the pleadings stage, and depends on the substance of the allegations.[160] The court looks to the nature of the injury alleged, not to any particular labels used by the plaintiff.[161] Where the injury alleged relates to the value of the corporation's stock in general, as opposed to the value of the plaintiff's shares only, the claim is considered to be derivative.[162] Likewise, allegations regarding an officer or director's performance of official duties owed to the corporation are likely to be construed as derivative claims.[163] On the other hand, claims that a particular shareholder or class of shareholders were treated differently from the body of shareholders as a whole are held to be direct.[164] Likewise, if a plaintiff claims an individual right to a specific asset or sum of money, like an unpaid distribution, the claim will be considered direct.[165]

The second exception to the general rule requiring a derivative suit permits direct actions in certain cases involving close corporations "where the circumstances show that the reasons for the general rule requiring a derivative suit do not apply."[166] This exception applies only to close corporations, generally when all potentially affected parties are already before the court.[167] The requirement that all affected parties be before the court has been applied strictly. Even if there is only one absent shareholder who may bring claims based

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Crittenton v. Southland Owners Ass'n, Inc., 312 Ga. App. 521, 524, 718 S.E.2d 839, 842 (2011) (expressing a similar rule applicable to homeowners' association).

160. *See, e.g., Next Century Comms. Corp. v. Ellis*, 171 F. Supp. 2d 1374, 1381 (N.D. Ga. 2001); *Holland v. Holland Heating & Air Conditioning, Inc.*, 208 Ga. App. 794, 797, 432 S.E.2d 238, 242 (1993).

161. *Phoenix Airline Servs., Inc. v. Metro Airlines, Inc.*, 260 Ga. 584, 585, 397 S.E.2d 699, 701 (1990); *Holland v. Holland Heating & Air Conditioning, Inc.*, 208 Ga. App. 794, 797, 432 S.E.2d 238, 242 (1993).

162. *Haskins v. Haskins*, 278 Ga. App. 514, 519-20, 629 S.E.2d 504, 508-09 (2006).

163. *Zhejiang Hailide New Material Co., Ltd. v. Hamilton*, 2020 WL 6931063, at *8 (N.D. Ga. Sept. 18, 2020).

164. *Grace Bros., Ltd. v. Farley Indus., Inc.*, 264 Ga. 817, 819, 450 S.E.2d 814, 816 (1994).

165. *Barnett v. Fullard*, 306 Ga. App. 148, 154, 701 S.E.2d 608, 613-14 (2010).

166. *Thomas v. Dickson*, 250 Ga. 772, 774, 301 S.E.2d 49, 51 (1983); *see* § 1-7:6.

167. *Patel v. 2602 Deerfield, LLC,* 347 Ga. App. 880, 887, 819 S.E.2d 527, 534 (2018).

on the same alleged injury asserted by the plaintiff, that will be sufficient to defeat the close corporation exception.[168]

While the derivative plaintiff must adequately represent the interests of the corporation, there is no per se rule prohibiting a court from hearing derivative and direct claims in the same action.[169]

A corporation is a proper and indispensable party to a derivative suit brought on its behalf.[170] The corporation should be identified as a party in the pleadings. A question often arises in derivative litigation whether the corporation is properly named as a plaintiff or defendant. In the Eleventh Circuit, this depends on whether the corporation is "antagonistic" to the bringing of the lawsuit. If the corporation claims to have interests that are antagonistic to those of the plaintiff bringing the derivative claim, the corporation is properly named as a defendant.[171] Likewise, if the complaint alleges that the controlling shareholders or dominant officials of the corporation are guilty of fraud or malfeasance, the corporation is deemed to be antagonistic and therefore a defendant.[172] If, however, the plaintiff is the majority shareholder or a controlling officer, the corporation cannot be deemed antagonistic and should be named as a plaintiff.[173] This can have implications on federal court jurisdiction over derivative lawsuits. The corporation's status as an indispensable party, and its alignment as either a plaintiff or defendant, can destroy diversity and require dismissal of federal court claims based solely on diversity jurisdiction.[174]

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168. *Rollins v. LOR, Inc.*, 345 Ga. App. 832, 855, 815 S.E.2d 169, 187 (2018).

169. O.C.G.A. § 14-2-741(2); *Thomas v. Dickson*, 250 Ga. 772, 774, 301 S.E.2d 49, 51 (1983); *Williams v. Serv. Corp. Intern.*, 218 Ga. App. 10, 11, 459 S.E.2d 621, 622-23 (1995); *Medlin v. Carpenter*, 174 Ga. App. 50, 53, 329 S.E.2d 159, 164 (1985); *Zhejiang Hailide New Material Co., Ltd. v. Hamilton*, 2020 WL 6931063, at *8 (N.D. Ga. Sept. 18, 2020).

170. *Callicott v. Scott*, 357 Ga. App. 780, 786, 849 S.E.2d 547, 552 (2020); *Zhejiang Hallide New Material Co., Ltd. v. Hamilton*, 2020 WL 6931063, at *11 (N.D. Ga. Sept. 18, 2020).

171. *Liddy v. Urbanek*, 707 F.2d 1222, 1224 (11th Cir. 1983); *Zhejiang Hailide New Material Co. Ltd. v. Hamilton*, 2020 WL 6931063, at *10 (N.D. Ga. Sept. 18, 2020).

172. *Liddy v. Urbanek*, 707 F.2d 1222, 1224 (11th Cir. 1983); *Zhejiang Hailide New Material Co. Ltd. v. Hamilton*, 2020 WL 6931063, at *10 (N.D. Ga. Sept. 18, 2020).

173. *Liddy v. Urbanek*, 707 F.2d 1222, 1224-25 (11th Cir. 1983); *Zhejiang Hailide New Material Co. Ltd. v. Hamilton*, 2020 WL 6931063, at *10 (N.D. Ga. Sept. 18, 2020).

174. *Zhejiang Hailide New Material Co. Ltd. v. Hamilton*, 2020 WL 6931063, at *12 (N.D. Ga. Sept. 18, 2020) (holding that corporation was a necessary plaintiff to a derivative suit brought on its behalf, and dismissing action because this destroyed diversity of citizenship).

1-7:3 The Demand Requirement

No derivative proceeding may be commenced until a written demand has been made upon the corporation.[175] The shareholder then may not bring the suit until 90 days have expired, unless the demand is rejected in less than 90 days or the plaintiff can show irreparable injury to the corporation would result by waiting 90 days.[176]

The statute's only explicit requirements of the demand are that it be in writing and that it call upon the corporation "to take suitable action." The commentary to O.C.G.A. § 14-2-742 provides that the demand should "set forth the facts concerning share ownership and be sufficiently specific to apprise the corporation of the action so that the demand can be investigated."[177] The commentary also suggests that the demand be addressed to the board of directors, chief executive officer or corporate secretary of the corporation at its principal office, though no statute or rule requires this.[178]

The demand requirement is rooted in the notion that the corporation's board of directors—and not the courts or individual shareholders—is charged with directing the affairs of the corporation.[179] This authority extends to the critical business decision whether to sue.

The GBCC's demand requirement contains no futility exception. Prior Georgia law permitted a shareholder to be excused from the demand requirement by alleging what efforts were made to secure curative action from the board of directors or the reasons why such efforts were not made.[180] The Georgia Court of

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175. O.C.G.A. § 14-2-742. As the commentary to § 14-2-742 indicates, the person eventually bringing the derivative proceeding need not be the same person who made the demand. *See* O.C.G.A. § 14-2-742 cmt. 3.

176. O.C.G.A. § 14-2-742; *McKoon v. Jones*, 214 Ga. App. 40, 41, 447 S.E.2d 50, 51 (1994); *Ebon Foundation v. Oatman*, 269 Ga. 340, 342, 498 S.E.2d 728, 731 (1998) (holding that the trial court could grant an exception to the 90-day rule upon a showing that the sale of corporate property was "imminent" and that the defendant would misappropriate proceeds).

177. O.C.G.A. § 14-2-742 cmt. 1.

178. O.C.G.A. § 14-2-742 cmt. 2.

179. *See Staehr v. Alm*, 269 Fed. Appx. 888, 891 (11th Cir. 2008) (stating that a similar Delaware demand requirement exists because derivative suits may intrude upon the managerial authority of directors).

180. *Dunn v. Ceccarelli*, 227 Ga. App. 505, 509, 489 S.E.2d 563, 567 (1997) (physical precedent only); *Pinnacle Benning, LLC v. Clark Realty Capital, LLC*, 314 Ga. App. 609, 615, 724 S.E.2d 894, 900 (2012).

Appeals has twice held that the absence of any reference to a futility exception in the current version of the GBCC means that no such exception exists.[181]

If the corporation, having received the demand, decides to pursue the lawsuit or to take control of a lawsuit that has already commenced, the plaintiff's right to bring or maintain the suit generally ceases.[182] If the corporation does not adequately pursue the matter, however, the shareholder may retain the right to bring or take control over the proceeding. For instance, in a case in which a shareholder demanded the corporation take action against officers and directors of a bank and its holding company who she alleged committed corporate waste and violated RICO and the corporation responded, instead, merely by filing suit against its surety to recover on a fidelity bond, the Georgia Court of Appeals held that the shareholder could pursue her own suit against the officers and directors, as it was "apparent that the corporation [had] yet to adequately pursue the claims."[183]

1-7:4 Stay or Dismissal; Special Litigation Committees

A derivative action may be dismissed on the motion of the corporation, upon a finding that the independent directors or an outside individual or panel has made a good faith determination following reasonable investigation that the maintenance of the suit is not in the corporation's best interests.[184] This determination can be made by one of the following: (1) a majority vote of the corporation's independent directors present at a meeting of the board of directors, if the independent directors constitute a quorum; (2) a majority vote of a committee comprised of two or

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181. *Dunn v. Ceccarelli*, 227 Ga. App. 505, 509, 489 S.E.2d 563, 567 (1997); *Pinnacle Benning, LLC v. Clark Realty Capital, LLC*, 314 Ga. App. 609, 615, 724 S.E.2d 894, 900 (2012). It should be noted that *Dunn* stands as physical precedent only and that *Pinnacle Benning* involved the demand requirement for limited liability companies, not corporations. There appears to be no contrary authority since the 1988 revision of the GBCC which adopted the current demand requirement.

182. O.C.G.A. § 14-2-742 cmt. 4; *McKoon v. Jones*, 214 Ga. App. 40, 41, 447 S.E.2d 50, 51-52 (1994).

183. *McKoon v. Jones*, 214 Ga. App. 40, 41, 447 S.E.2d 50, 52 (1994).

184. O.C.G.A. § 14-2-744.

more independent directors appointed by the board; or (3) a panel of one or more independent persons appointed by the court.[185]

The statute expressly authorizes the use of special litigation committees and provides that courts may (but are not required to) dismiss derivative suits upon a determination made by a duly authorized special litigation committee that pursuit of the litigation is not in the corporation's best interest.[186] A special litigation committee must consist of two or more independent directors.[187] It must also be appointed by a majority vote of the independent directors at a meeting of the board of directors.[188] The corporation may vest a special litigation committee with powers to make binding determinations and also to act for the board of directors and make decisions on behalf of the corporation regarding any derivative suit.[189]

In evaluating a motion to dismiss by the corporation, the court must examine the independence of the person or persons making the determination upon which the motion is based, and the good faith and reasonableness of their investigation.[190] The burden is on the corporation to show independence, good faith, and reasonableness.[191] The court may permit the plaintiff to conduct discovery into these areas in order to oppose a motion to dismiss.[192]

While independence is not specifically defined in the statute, it provides that a director does not lose independence per se by being nominated or elected by directors who are not independent, by being named as a defendant in the derivative proceeding itself, or by having approved the action being challenged (so long as the director did not receive a personal benefit as a result).[193] Courts have looked to whether the persons making the recommendation

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185. O.C.G.A. § 14-2-744; *Benfield v. Wells*, 324 Ga. App. 85, 88, 749 S.E.2d 384, 387 (2013); *Stephens v. McGarrity*, 290 Ga. App. 755, 760, 660 S.E.2d 770, 774 (2008).

186. O.C.G.A. § 14-2-744(b)(2); *Millsap v. Am. Family Corp.*, 208 Ga. App. 230, 232, 430 S.E.2d 385, 387 (1993).

187. O.C.G.A. § 14-2-744(b)(2).

188. O.C.G.A. § 14-2-744(b)(2).

189. *Millsap v. Am. Family Corp.*, 208 Ga. App. 230, 232, 430 S.E.2d 385, 387-88 (1993).

190. O.C.G.A. § 14-2-744, *Benfield v. Wells*, 324 Ga. App. 85, 87, 749 S.E.2d 384, 387 (2013).

191. O.C.G.A. § 14-2-744(a). A motion brought under O.C.G.A § 14-2-744(a) has been described as a "hybrid" summary judgment motion because of its evidentiary character. *Benfield v. Wells*, 324 Ga. App. 85, 85, 749 S.E.2d 384, 385 (2013).

192. *Thompson v. Scientific Atlanta, Inc.*, 275 Ga. App. 680, 683, 621 S.E.2d 796, 798-99 (2005).

193. *Millsap v. Am. Family Corp.*, 208 Ga. App. 230, 430 S.E.2d 385 (1993).

have a personal interest in the underlying transaction(s) involved in the claim and whether they have any personal or other relationship with the defendants that might influence their judgment.[194]

The statute also does not define what constitutes a good faith and reasonable investigation. The trial court has discretion to determine whether the investigation is sufficiently thorough. For example, the Georgia Court of Appeals found sufficiently detailed a special litigation committee's investigation notwithstanding the plaintiff's claim that the committee interviewed only eight of the 22 named defendants,[195] following the Delaware Supreme Court's approach of giving significant deference to the trial court's findings.[196]

Note that dismissal is not mandated even if the requirements of independence, good faith, and reasonableness are satisfied. A court, therefore, could make its own determination that the suit should continue, presumably based on its own business judgment. The GBCC places the burden of proof on the corporation[197] and permits the court to independently examine the bases for the committee's conclusions, thereby applying its own business judgment. This is discretionary and the court need not do so, however.

In addition to its power to seek dismissal, a corporation that commences an inquiry into the allegations raised in the demand is entitled to petition the court to stay a derivative action arising from those allegations.[198] The court is permitted to stay the action "for such period as the court deems appropriate."[199]

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194. *Millsap v. Am. Family Corp.*, 208 Ga. App. 230, 430 S.E.2d 385 (1993) (finding that special litigation committee members were independent; complaint did not allege that anyone other than defendant benefited from the challenged action); *Benfield v. Wells*, 324 Ga. App. 85, 89, 749 S.E.2d 384, 388 (2013) (holding that tangential outside business relationships between special litigation committee members and defendants did not destroy independence under the circumstances).

195. *Millsap v. Am. Family Corp.*, 208 Ga. App. 230, 232, 430 S.E.2d 385, 387 (1993).

196. *Kaplan v. Wyatt*, 499 A.2d 1184 (Del. 1985).

197. O.C.G.A. § 14-2-744.

198. O.C.G.A. § 14-2-743.

199. O.C.G.A. § 14-2-743.

1-7:5 Standing and Procedural Requirements for Derivative Actions

To have standing to commence and maintain a derivative action in Georgia courts, the plaintiff shareholder must demonstrate contemporaneous ownership and continuous ownership of shares of the corporation.[200] The "contemporaneous ownership" rule requires the plaintiff to have been a shareholder at the time of the act or omission complained of, or to have received such shares by operation of law from someone who was a shareholder at that time.[201] This is consistent with longstanding practice in many jurisdictions and is designed to ensure that shareholder derivative litigation cannot be purchased.[202]

Under the "continuous ownership" rule, the shareholder must "fairly and adequately represent[ ] the interests of the corporation in enforcing the right of the corporation" at all relevant times[203] and may not "commence or maintain a derivative proceeding unless the shareholder [has the requisite ownership interest and fairly and adequately represents the interests of the corporation]."[204] As the language suggests, a shareholder must do more than continuously hold stock; the shareholder must at all times be a fair and adequate representative of the corporation.[205] When the plaintiff's adequacy is challenged, the "most important" question is whether the plaintiff's interests conflict with or are antagonistic to those of the corporation.[206] If the plaintiff ceases to be a fair and adequate representative, that plaintiff loses standing, and the suit becomes subject to dismissal.[207] A plaintiff's failure to represent

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200. O.C.G.A. §§ 14-2-741, 14-2-831.

201. O.C.G.A. § 14-2-741(1).

202. O.C.G.A. § 14-2-741 cmt.

203. O.C.G.A. § 14-2-741(2); *Grace Bros. Ltd. v. Farley Indus., Inc.*, 264 Ga. 817, 818, 450 S.E.2d 814, 816 (1994) ("The law is well settled that a former shareholder in a merged corporation has no standing to maintain a shareholder's derivative action.").

204. O.C.G.A. § 14-2-741; *Grace Bros. Ltd. v. Farley Indus., Inc.*, 264 Ga. 817, 818, 450 S.E.2d 814, 815 (1994); *Haskins v. Haskins*, 278 Ga. App. 514, 520, 629 S.E.2d 504, 509 (2006).

205. *Williams v. Serv. Corp. Intern.*, 218 Ga. App. 10, 11, 459 S.E.2d 621, 623 (1995).

206. *Williams v. Serv. Corp. Intern.*, 218 Ga. App. 10, 11, 459 S.E.2d 621, 622 (1995).

207. *See Rothenberg v. Sec. Mgmt. Co., Inc.*, 667 F.2d 958 (11th Cir. 1982) (holding that trial court acted within its discretion to dismiss a case where named plaintiff was unaware of the facts and issues involved in the suit and "displayed an obvious unwillingness to learn about the suit").

the class fairly and adequately may also entitle other shareholders to intervene where their interests are jeopardized.[208]

Federal Rule of Civil Procedure 23.1, which governs derivative actions in federal courts, is substantially similar to O.C.G.A. § 14-2-741 with respect to contemporaneous and continuous ownership.[209] The principal difference is that the federal rule requires the plaintiff to fairly and adequately represent "shareholders or members who are similarly situated," rather than the corporation itself, as provided in O.C.G.A. § 14-2-741. Federal Rule of Civil Procedure 23.1 also contains unique pleading requirements for shareholder derivative suits. The complaint must be verified, must allege contemporaneous ownership, must allege that the action is not collusive in character, and must state either the plaintiff's efforts to make a demand on the board of directors (or other comparable authority) or the reasons for not doing so.[210]

A derivative action in Georgia courts may not be voluntarily discontinued or settled without the court's approval.[211] Notice to affected shareholders is required if the court determines that the proposed discontinuance or settlement will substantially affect their interests.[212] Similarly, in federal court, a derivative action may not be voluntarily dismissed or settled without the court's approval. The parties must give notice of the proposed dismissal or settlement as directed by the court.[213]

1-7:6 Limited Exception for Direct Actions in Closely Held Corporations

In certain circumstances, Georgia courts permit shareholders to bring directly what would otherwise be derivative claims, without

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208. *See Stephens v. McGarrity*, 290 Ga. App. 755, 758, 660 S.E.2d 770, 773 (2008) (holding that it was error to deny a shareholder's motion to intervene for the purpose of obtaining a determination of whether a named plaintiff had adequately represented the corporation's interests in reaching a derivative settlement).

209. *Haldi v. Continental Inv. Corp.*, 50 F.R.D. 275, 277 (N.D. Ga. 1970).

210. *Haldi v. Continental Inv. Corp.*, 50 F.R.D. 275, 277 (N.D. Ga. 1970). As discussed above, the GBCC's universal demand requirement eliminates the plaintiff's ability to excuse their failure to make a demand . *See* § 1-7:3.

211. O.C.G.A. § 14-2-745; *Stephens v. McGarrity*, 290 Ga. App. 755, 759-60, 660 S.E.2d 770, 774 (2008).

212. O.C.G.A. § 14-2-745; *Stephens v. McGarrity*, 290 Ga. App. 755, 759-60, 660 S.E.2d 770, 774 (2008).

213. Fed. R. Civ. P. 23.1(c).

the need for compliance with any of the rules and procedures associated with derivative suits. Specifically, shareholders may be able bring a direct action under an exception first expressed in *Thomas v. Dickson* (*Thomas* exception) where "the reasons requiring derivative suits do not exist."[214] The generally accepted justifications for requiring derivative suits are:

> (1) it prevents a multiplicity of lawsuits by shareholders; (2) it protects corporate creditors by putting the proceeds of the recovery back in the corporation; (3) it protects the interests of all shareholders by increasing the value of their shares, instead of allowing a recovery by one shareholder to prejudice the rights of others not a party to the suit; and (4) it adequately compensates the injured shareholder by increasing the value of his shares.[215]

Courts applying the *Thomas* exception have generally done so narrowly. It has been applied only where there are very few shareholders,[216] where the corporation is solvent and there is no present threat of insolvency,[217] and where there is no ready market for shares of the corporation.[218] As the *Thomas* Court warned, "[i]f there exists the possibility of prejudice to other interested parties, such as creditors or other shareholders, a direct recovery should

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[214] *Thomas v. Dickson*, 250 Ga. 772, 775, 301 S.E.2d 49, 51 (1983) (holding that claims to recover misappropriated funds from a close corporation could be brought as a direct action where (1) they were brought by a deceased shareholder's widow-executrix based on allegations that the remaining two shareholders, who served as officers with her late husband, conspired to divert profits to themselves and reduce the value of her shares, (2) there were no other potentially injured shareholders, (3) the corporation had no outstanding debts, and (4) there was no ready market for the plaintiff's shares; the Georgia Supreme Court found that the circumstances justified deviation from the general rule barring direct actions, particularly since a derivative action yielding a corporate recovery would have benefited the two alleged wrongdoers). *See* § 1-7:2 for a discussion of the generally accepted justifications for requiring derivative suits.

[215] *Thomas v. Dickson*, 250 Ga. 772, 775, 301 S.E.2d 49, 51 (1983).

[216] *Rosenfeld v. Rosenfeld*, 286 Ga. App. 61, 65, 648 S.E.2d 399, 404 (2007) (corporation had two shareholders); *Caswell v. Jordan*, 184 Ga. App. 755, 758, 362 S.E.2d 769, 773 (1987) (three shareholders); *Parks v. Multimedia Techs., Inc.*, 239 Ga. App. 282, 287, 520 S.E.2d 517, 523 (1999) (only shareholders were plaintiff and defendant's family members, who had not complained about his actions); *In re Pervis*, 497 B.R. 612, 625 (N.D. Ga. Jul. 24, 2013) (two shareholder corporation).

[217] *Rosenfeld v. Rosenfeld*, 286 Ga. App. 61, 65, 648 S.E.2d 399, 404 (2007); *Caswell v. Jordan*, 184 Ga. App. 755, 758, 362 S.E.2d 769, 773 (1987).

[218] *Rosenfeld v. Rosenfeld*, 286 Ga. App. 61, 65, 648 S.E.2d 399, 404 (2007); *Caswell v. Jordan*, 184 Ga. App. 755, 758, 362 S.E.2d 769, 773 (1987).

not be allowed."[219] Thus, the exception has not been extended where there is evidence of outstanding corporate indebtedness,[220] or when there is the possibility that other shareholders would be injured if the plaintiff's claims were true.[221] Evidence of the existence of multiple related lawsuits is strong evidence that the reasons for requiring a derivative lawsuit are present,[222] but the lack of such lawsuits is not dispositive. Even if there is only one absent shareholder who may assert claims based on the same alleged injury as the plaintiff, that will be sufficient to defeat the close corporation exception.[223]

The exception is available to closely held corporations whether or not they have opted for statutory close corporation status under O.C.G.A. § 14-2-901 et seq.[224]

1-7:7 State Law Shareholder Class Actions

Derivative actions are distinct from class actions, even though they are similar insofar as the named plaintiff (or lead plaintiff) acts in a representative capacity. In a derivative action, the injured party and the holder of the claim is the corporation, and the plaintiff must adequately represent the interests of the corporation. In a shareholder class action, the plaintiff claims to represent a class of similarly situated shareholders, each of whom have been directly injured by the alleged wrongful acts.

Georgia permits an action to be brought on behalf of a class where (1) the class is so numerous that it is impracticable to bring

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219. *Medlin v. Carpenter*, 174 Ga. App. 50, 53, 329 S.E.2d 159, 164 (1985) (citing *Thomas v. Dickson*, 250 Ga. 772, 775, 301 S.E.2d 49, 51 (1983)); *Parks v. Multimedia Techs., Inc.*, 239 Ga. App. 282, 288, 520 S.E.2d 517, 524 (1999) (finding possibility of harm to creditors "remote and speculative").

220. *Medlin v. Carpenter*, 174 Ga. App. 50, 53, 329 S.E.2d 159, 164 (1985); *Callicott v. Scott*, 357 Ga. App. 780, 789, 849 S.E.2d 547, 554 (2020) (recognizing need to protect creditors as a reason to require a shareholder's lawsuit to be brought derivatively).

221. *Patel v. 2602 Deerfield, LLC,* 347 Ga. App. 880, 887, 819 S.E.2d 572, 534 (2018); *Barnett v. Fullard*, 306 Ga. App. 148, 153, 701 S.E.2d 608, 613 (2010); *Levy v. Reiner*, 290 Ga. App. 471, 474, 659 S.E.2d 848, 851 (2008); *Stricker v. Epstein*, 213 Ga. App. 226, 230, 444 S.E.2d 91, 95 (1994).

222. *Zhejiang Hailide New Material Co., Ltd. v. Hamilton*, 2020 WL 6931063, at *10 (N.D. Ga. Sept. 18, 2020).

223. *Rollins v. LOR, Inc.*, 345 Ga. App. 832, 855, 815 S.E.2d 169, 187 (2018).

224. *Stoker v. Bellemeade, LLC*, 272 Ga. App. 817, 823, 615 S.E.2d 1, 8 (2005), *rev'd in part on other grounds*, 280 Ga. 635, 631 S.E.2d 662 (2006); *Haskins v. Haskins*, 278 Ga. App. 514, 518, 629 S.E.2d 504, 507 (2006).

all members before the court, (2) there exist questions of law and fact common to the class members which predominate over individualized questions, (3) the named plaintiff's claim is typical of those of the class members, (4) the named plaintiff will adequately represent the interests of the class, and (5) a class action is deemed to be superior to other potential vehicles as a means of resolving the dispute.[225] The case may be maintained as a class action if those prerequisites are satisfied, and in addition, the case must also fit one of the three requirements set forth in O.C.G.A. § 9-11-23(b).

Most actions involving claims for monetary relief against corporate fiduciaries are analyzed under O.C.G.A. § 9-11-23(b)(3), in which the court must

> find[ ] that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.[226]

Claims involving fraud and misrepresentation have been held to be maintainable as class actions.[227]

It is theoretically possible, in light of the Georgia Supreme Court's recognition of "holder claims,"[228] that a class of non-purchasing, non-selling shareholders who suffered direct injuries could maintain a class action for fraud or negligent misrepresentation. The elements necessary to prove such claims, however, may effectively foreclose the use of the class action device. One Georgia Court of Appeals opinion, for instance, has already held that *Holmes v. Grubman*'s "direct communication" requirement bars claims based on communications made to the shareholders at large, such as annual reports and audited financial statements.[229] The requirement of specific reliance may also lend

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225. *Brenntag Mid South, Inc. v. Smart*, 308 Ga. App. 899, 905-06, 710 S.E.2d 569, 576 (2011); *Lewis v. Knology, Inc.*, 341 Ga. App. 86, 799 S.E.2d 247 (2017).

226. O.C.G.A. § 9-11-23(b)(3).

227. *See, e.g., Sta-Power Indus. v. Avant*, 134 Ga. App. 952, 216 S.E.2d 897 (1975) (holding that a group of purchasers of securities alleging fraud against the issuing corporations and their officers could bring Georgia Securities Act claims as a class action).

228. *Holmes v. Grubman*, 286 Ga. 636, 691 S.E.2d 196 (2010); *see* § 1-6.

229. *Anderson v. Daniel*, 314 Ga. App. 394, 396, 724 S.E.2d 401, 403 (2012).

support to a defendant's claim that individualized issues of proof concerning reliance will predominate over common questions of law and fact.

1-7:8 Jurisdictional Considerations

Georgia's long-arm statute authorizes Georgia courts to exercise jurisdiction over nonresidents who transact business in Georgia.[230] The statute has been interpreted to grant the Georgia courts "unlimited authority" to exercise personal jurisdiction over those who transact business in the state, to the full extent allowed by due process.[231]

Georgia has rejected the "fiduciary shield" doctrine, which provides that nonresident individuals cannot be subject to personal jurisdiction in Georgia courts based solely upon official acts taken in their capacities as corporate officers.[232] This does not necessarily mean that a corporate fiduciary will always be subject to personal jurisdiction in cases where the corporation itself is subject to personal jurisdiction. Instead, the corporate director's or officer's contacts with the forum are subject to the same analysis used in the case of any other individual, without reference to whether the director's or officer's activities in the forum state were conducted in an official capacity or not. If the director or officer is a "primary participant" in the activities that form the basis of the court's jurisdiction over the corporation, then the court will have personal jurisdiction over the individual with respect to matters relating to those activities.[233]

The general venue provision for corporations under the GBCC is O.C.G.A. § 14-2-510, which provides that corporations are generally deemed to reside and are subject to venue in the county where the registered office is located. O.C.G.A. § 14-2-510 also confers venue for contract and tort actions in counties where the corporation "has an office and transacts business" if the contract was made or was to be performed or the tort cause of action "originated"

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230. O.C.G.A. § 9-10-91(1).

231. *Innovative Clinical & Consulting Servs., LLC v. First Nat'l Bank of Ames, Iowa*, 279 Ga. 672, 675-76, 620 S.E.2d 352, 355-56 (2005).

232. *Amerireach.com v. Walker*, 290 Ga. 261, 268, 719 S.E.2d 489, 495 (2011).

233. *Amerireach.com v. Walker*, 290 Ga. 261, 267, 719 S.E.2d 489, 494 (2011); *Gregory v. Preferred Fin. Solutions*, No. 5:11-CV-422(MTT), 2013 WL 5725991, at *5 (M.D. Ga. Oct. 21, 2013).

there.[234] Where venue against a corporate defendant in a tort action is premised solely on the location where the cause of action originated, the corporation has the right to remove the action to the county where it maintains its principal place of business.[235] The Georgia courts interpret "principal place of business" as referring to the corporation's "nerve center," similar to the test used by the federal courts to determine corporate citizenship for diversity jurisdiction purposes. This means that a corporation that maintains an office in Georgia, but has its corporate headquarters somewhere outside the state, cannot avail itself of the removal remedy under O.C.G.A. § 14-2-510.[236] Some statutory proceedings, such as those for appraisal of shares belonging to dissenting shareholders and judicial dissolution, contain separate venue provisions.[237]

1-7:9 Shareholder Inspection Rights

Every Georgia corporation is required to maintain copies of certain records and to make them available to the corporation's shareholders for inspection and copying.[238] The following categories of records are subject to this requirement: (1) the corporation's articles or restated articles of incorporation and all amendments thereto currently in effect; (2) its bylaws or restated bylaws and all amendments thereto currently in effect; (3) board or shareholder resolutions increasing or decreasing the number of directors, the classification of directors, and the names and residential addresses of all directors; (4) board resolutions creating classes of shares and fixing their relative rights, preferences and limitations, or affecting

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234. *See WMW, Inc. v. American Honda Motor Co., Inc.*, 291 Ga. 683, 733 S.E.2d 269 (2012) (describing and explaining various provisions of O.C.G.A. § 14-2-510(b)).

235. *Pandora Franchising, LLC v. Kingdom Retail Grp., LLLP*, 299 Ga. 723, 728, 791 S.E.2d 786, 790 (2016). The corporate defendant seeking removal must file a notice of removal within 45 days of service of the summons. *See* O.C.G.A. § 14-2-510(b)(4); *Burchfield v. West Metro Glass Co., Inc.*, 340 Ga. App. 324, 325, 797 S.E.2d 225, 226 (2017).

236. *Pandora Franchising, LLC v. Kingdom Retail Grp., LLLP*, 299 Ga. 723, 728, 791 S.E.2d 786, 790 (2016).

237. O.C.G.A. § 14-2-1330 (statutory appraisal for dissenting shareholders); O.C.G.A. § 14-2-1431 (judicial dissolution). Shareholder actions under O.C.G.A. § 14-2-940 involving statutory close corporations, must be brought in the Superior Court of the County of the corporation's principal office, but the Court's "exclusive" jurisdiction over such a proceeding does not override the application of O.C.G.A. § 14-2-510 to a parallel proceeding to enforce inspection rights. *Advanced Automation, Inc. v. Fitzgerald*, 312 Ga. App. 406, 718 S.E.2d 607 (2011).

238. O.C.G.A. § 14-2-1602.

the size of the board of directors; (5) minutes of shareholders' meetings, executed waivers of notice of meetings, and executed consents evidencing shareholder actions taken without meetings for the past three years; (6) all written and electronic communications made to the shareholders generally within the past three years; (7) a list of the names and business addresses of all current directors and officers; and (8) the corporation's most recent annual registration with the Secretary of State.[239] A shareholder seeking to inspect and copy the above records is entitled to do so upon giving five business days' written notice.[240] A shareholder need not make any showing of purpose or meet any other requirements in order to obtain the aforementioned records.[241]

Shareholders may also have the right to inspect certain additional records of the corporation if the request is made in good faith and for a proper purpose that is "reasonably relevant to his legitimate interest as a shareholder."[242] The commentary to O.C.G.A. § 14-2-1602 explains that the requirement of a legitimate interest is intended to exclude "interests related to personal interests, such as those of a competitor, which are not addressed directly to his interests as an investor."[243] The additional records that may be subject to inspection include relevant excerpts from board of directors meetings, committee meetings and shareholder meetings, accounting records, and the record of shareholders.[244] Shareholders desiring to inspect these records must give the same five business days' written notice and must describe with reasonable particularity the purpose and the records they desire to inspect.[245] The records must be directly connected to the stated purpose, and they may only be used for that stated purpose.[246] A corporation may, through its articles of incorporation or bylaws, limit the inspection rights described in this paragraph for shareholders

239. O.C.G.A. § 14-2-1602.
240. O.C.G.A. § 14-2-1602.
241. *Regal Nissan, Inc. v. Scott*, 348 Ga. App. 91, 96, 821 S.E.2d 561, 565 (2018).
242. O.C.G.A. § 14-2-1602(d).
243. O.C.G.A. § 14-2-1602 cmt.
244. O.C.G.A. § 14-2-1602(c).
245. O.C.G.A. § 14-2-1602(d).
246. O.C.G.A. § 14-2-1602(d).

owning 2 percent or less of the shares outstanding.[247] Shareholders who are subject to the 2 percent limitation cannot circumvent this limitation by invoking a common law right of inspection.[248]

If a corporation denies the shareholder's request to inspect and copy records, the shareholder may apply to the superior court of the county where the corporation's registered office is located for an order directing that the records be made available.[249] The application is supposed to receive expedited treatment.[250] If the court enters such an order, it also shall order the corporation to pay the shareholder's costs, including reasonable attorneys' fees, unless it finds that the corporation refused inspection in good faith due to a reasonable basis for doubting the shareholder's right to inspect the records.[251] The proceeding must be brought against the corporation, not the officers or directors who refused to make the requested records available.[252]

1-7:10 Corporate and Shareholder Remedies

1-7:10.1 Statutory Remedies

O.C.G.A. § 14-2-831 authorizes the corporation directly and a shareholder derivatively to bring an action (1) to compel the defendant "to account for official conduct or to decree any other relief called for" in cases involving failure to perform duties, waste of corporate assets, or misappropriation of corporate opportunities (or similar cases); (2) to enjoin a proposed unlawful conveyance, assignment, or transfer of corporate assets; or (3) to set aside an unlawful conveyance, assignment, or transfer of corporate assets. It is not clear whether O.C.G.A. § 14-2-831

247. O.C.G.A. § 14-2-1602(e).

248. *Mannato v. SunTrust Banks, Inc.*, 308 Ga. App. 691, 708 S.E.2d 611 (2011) (holding that O.C.G.A. § 14-2-1602(e) abrogates any common law right of inspection provided to shareholders owning 2 percent or less of a corporation's outstanding shares).

249. O.C.G.A. § 14-2-1604; *Advanced Automation, Inc. v. Fitzgerald*, 312 Ga. App. 406, 718 S.E.2d 607 (2011).

250. O.C.G.A. § 14-2-1604(b) ("The court shall dispose of the application on an expedited basis.").

251. O.C.G.A. § 14-2-1604; *Parker v. Clary Lakes Recreation Ass'n, Inc.*, 243 Ga. App. 681, 683, 534 S.E.2d 154, 156 (2000); *Grapefields, Inc. v. Kosby*, 309 Ga. App. 588, 710 S.E.2d 816 (2011).

252. *Barnett v. Fullard*, 306 Ga. App. 148, 151, 701 S.E.2d 608, 611 (2010); *In re Kwang Cha Yi*, 2011 WL 1364229 (N.D. Ga. Apr. 11, 2011).

authorizes only equitable relief. However, by its terms, the statute does not limit liability of directors and officers otherwise imposed by law.[253] Other injunctive relief may be available where the standards for obtaining an injunction under Georgia law are present. O.C.G.A. § 14-2-832 authorizes suits against directors for wrongful distributions.[254] O.C.G.A. § 14-2-940 authorizes actions by statutory close corporation shareholders for oppressive conduct, deadlock, or dissolution.

1-7:10.2 Apportionment of Liability Among Multiple Defendants

Corporate directors regularly make decisions and take actions collectively as a board or committee, and many lawsuits name the entire board or a subset of the board (such as a committee) as defendants. This raises the important question of how liability is to be apportioned among multiple defendants when a board or committee decision or action is found to have breached the duties set forth in this chapter.

Georgia's apportionment statute, O.C.G.A. § 51-12-33, generally requires the trier of fact to apportion damages among multiple defendants who are found liable according to the percentage of fault of each person. In 2019, the Georgia Supreme Court held, in response to certified questions from the Eleventh Circuit, that the apportionment statute applies to tort claims for purely pecuniary losses against bank directors and officers, but also that the apportionment statute does not abrogate the common law rule of joint and several liability as it applies to "concerted action" as that term was understood at the common law.[255] The Supreme Court's rationale was that fault is not divisible under such circumstances.[256] Applying the Georgia Supreme Court's answers to its certified questions, the Eleventh Circuit held that the apportionment statute could not be applied to negligence and gross negligence claims stemming from a bank board's decision to approve a loan, in part because any one of the directors could have unilaterally

253. O.C.G.A. § 14-2-831(c).
254. *See* § 1-11:2.
255. *FDIC v. Loudermilk*, 305 Ga. 558, 576, 826 S.E.2d 116, 129 (2019).
256. *See FDIC v. Loudermilk*, 305 Ga. 558, 576, 826 S.E.2d 116, 129 (2019).

defeated the proposal by vetoing it, and none did.[257] These decisions indicate that the applicability of O.C.G.A. § 51-12-33 to future cases involving board action will depend heavily on the particular facts and circumstances of each case.[258]

1-7:10.3 Attorneys' Fees

Under the GBCC, both plaintiffs and defendants can recover attorneys' fees and litigation expenses in shareholder derivative proceedings depending on the outcome. If the proceeding results in a "substantial benefit to the corporation," the court may order the corporation to pay reasonable expenses, including attorneys' fees, to the plaintiff.[259] If the court finds that the proceeding was "commenced or maintained without reasonable cause or for an improper purpose," it may order the plaintiff to pay the defendants' reasonable expenses, including attorneys' fees.[260]

1-7:10.4 Dissenters' Rights[261]

Shareholders are granted appraisal rights under certain circumstances and, where applicable, that remedy is largely exclusive. The GBCC's dissenters' rights procedure thus represents a major limitation on their ability to impose personal liability on directors and officers of Georgia corporations.

Under the GBCC, the following corporate actions give rise to dissenters' rights for a corporation's record shareholders: (1) a merger in which the shareholder is entitled to vote (subject to certain exceptions); (2) a share exchange in which the shareholder is entitled to vote; (3) the sale or exchange of all or substantially all of the corporation's property if a shareholder vote is required; (4) a reverse stock split or similar transaction reducing the shareholder's holding to a fractional share to be exchanged for cash; or (5) any corporate action taken pursuant to a shareholder

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257. *FDIC v. Loudermilk*, No. 16-17315, 2019 WL 3282609, at *8 (11th Cir. July 22, 2019).

258. *FDIC v. Loudermilk*, No. 16-17315, 2019 WL 3282609, at *7 (11th Cir. July 22, 2019) (noting that the Georgia Supreme Court "strongly suggested that concerted action is a jury question").

259. O.C.G.A. § 14-2-746(1).

260. O.C.G.A. § 14-2-746(2); *Rothenberg v. Security Mgmt. Co., Inc.*, 736 F.2d 1470 (11th Cir. 1984).

261. *See also* Chapter 3, § 3-3:4.

vote in which Article 9 of the GBCC, the corporation's articles of incorporation or bylaws, or a board resolution provides for dissenters' rights.[262]

Shareholders who dissent from the transaction and satisfy the GBCC's conditions are entitled to a judicial determination of the fair value of their shares and payment for their shares.[263] In determining the fair value of stock in a dissenters' rights proceeding, the court should not reduce the value of the dissenters' shares by applying "minority" or "lack of marketability" discounts.[264]

The requirements for both the corporation and the dissenting shareholder are exacting, with pitfalls for non-compliance. Shareholders with dissenters' rights must be given proper notice of the right to dissent.[265] If the transaction or corporate action in question is submitted to a shareholder vote, the dissenting shareholder must deliver a notice of intent to demand payment prior to the vote and may not vote in favor of the proposed action.[266] The corporation must then deliver a notice to all dissenting shareholders, stating where and by when the payment demand must be sent.[267] The dissenting shareholders must timely demand payment and deposit their certificates in accordance with the notice.[268]

Within 10 days of receipt of a payment demand, or within 10 days after the action in question is taken if that date is later, the corporation must make an offer to pay the dissenting shareholder "an amount the corporation estimates to be the fair value of his or her shares, plus accrued interest."[269] The offer must be accompanied by certain financial and other information in order to allow the

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262. O.C.G.A. § 14-2-1302.

263. O.C.G.A. § 14-2-1330. An action to enforce dissenters' rights must be brought no more than three years after the corporate action was taken, regardless of whether notice of the corporate action and of the right to dissent was given by the corporation in compliance with the provisions of the GBCC. O.C.G.A. § 14-2-1332.

264. *See Blitch v. Peoples Bank*, 246 Ga. App. 453, 457, 540 S.E.2d 667, 670 (2000) (holding that court erred in discounting stock due to shareholder's minority status and the lack of an open market for the shares).

265. O.C.G.A. § 14-2-1320.

266. O.C.G.A. § 14-2-1321 (a shareholder who fails to make this initial demand loses the right to dissent).

267. O.C.G.A. § 14-2-1322 (dissenters must provide notice no later than ten days after the action to which it relates was taken and said notice must be accompanied by a copy of the GBCC statutory provisions).

268. O.C.G.A. § 14-2-1323.

269. O.C.G.A. § 14-2-1325.

shareholder to understand the basis for the corporation's estimate.[270] A shareholder who is dissatisfied with the offer of payment must within 30 days notify the corporation of the shareholder's own estimate, and must demand payment on the basis of that estimate.[271] If the demand remains unsettled, the corporation is required to commence a proceeding, in the county of its registered office, within 60 days after receiving the payment demand, making all of the dissenting shareholders parties to the proceeding and petitioning the court to determine the fair value of their shares.[272]

Under Georgia law, the appraisal remedy is the dissenting shareholder's exclusive relief under these circumstances. Its availability bars any other type of claim, including claims against the corporation or its officers and directors for breach of fiduciary duty based on the unfairness of the transaction or the insufficiency of the price, unless either (1) the corporate action failed to comply with procedural requirements or the corporation's articles of incorporation or bylaws, or (2) the vote required to obtain approval of the corporate action "was obtained by fraudulent and deceptive means."[273] The fraud exception requires "actual fraud" to circumvent exclusivity and to support a collateral attack on the transaction,[274] thus reducing the risk that a Georgia merger will be successfully challenged through a shareholder class action asserting state law non-disclosure claims against the corporation, the board, and management.[275]

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270. O.C.G.A. § 14-2-1325; *Rakusin v. Radiology Assocs. of Atlanta, P.C.*, 305 Ga. App. 175, 699 S.E.2d 384 (2010) (holding that an offer of payment under § 14-2-1325 is invalid if not contemporaneously accompanied by the information specified in § 14-2-1325(b)).

271. O.C.G.A. § 14-2-1327. A shareholder who fails to make the second demand for payment is deemed to have accepted the corporation's offer.

272. O.C.G.A. § 14-2-1330. The proceeding is quasi in rem as to the dissenters' shares. O.C.G.A. § 14-2-1330(c). The court has plenary and exclusive jurisdiction over the case and may appoint appraisers to hear the evidence and recommend a decision on the fair value of the shares. O.C.G.A. § 14-2-1330(d).

273. O.C.G.A. § 14-2-1302(b); *Grace Bros. Ltd. v. Farley Indus., Inc.*, 264 Ga. 817, 820, 450 S.E.2d 814, 817 (1994); *Lewis v. Turner Broadcasting Sys., Inc.*, 232 Ga. App. 831, 833, 503 S.E.2d 81, 84 (1998).

274. *Grace Bros. Ltd. v. Farley Indus., Inc.*, 264 Ga. 817, 820 n.11, 450 S.E.2d 814, 817 n.11 (1994).

275. During 2011, the Fulton Superior Court Business Court, relying on *Grace Bros.* and § 14-2-1302(b), handed down several decisions denying expedited discovery and injunctive relief for claims of alleged disclosure violations, based on the exclusivity of dissenters' rights. *See, e.g., In re Radiant Sys., Inc. Shareholder Litigation*, No. 2011-CV-203228 (Fulton

1-7:11 Shareholder Ratification; Estoppel

Shareholders of a corporation who participate in the performance of an act or who ratify the act are estopped from complaining of the act either in a derivative or a direct action.[276] Questions of estoppel are typically decided by a jury.[277] A shareholder may ratify a corporate act by voting in favor of it,[278] or by knowingly acquiescing to the act and accepting the benefits thereof.[279] Abstention from voting does not equate to ratification, particularly where information material to the shareholder's vote is not provided to the shareholder.[280]

1-7:12 Statutes of Limitations

In Georgia, there is no single, well-settled statute of limitations applicable to all claims against corporate directors and officers. The governing limitations period appears to be four years on most theories of liability, but there are common law and statutory exceptions and uncertainty in some areas. The statute of limitations for a claim based on breach of fiduciary duty is the statute that most closely applies to the conduct that caused the breach.[281] For actions involving injuries to personalty, the statute of limitations is four years.[282] That same statute generally governs claims involving

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Sup. Ct. Aug. 10, 2011); *Shaev v. EMS Technologies, Inc.*, No. 2011-CV-203036 (Fulton Sup. Ct. Aug. 25, 2011). These decisions are available at http://digitalarchive.gsu.edu/col_businesscourt. None of these rulings were appealed.

276. *Pickett v. Paine*, 230 Ga. 786, 792, 199 S.E.2d 223, 228 (1973); *Marshall v. W.E. Marshall Co.*, 189 Ga. App. 510, 511-12, 376 S.E.2d 393, 395 (1988); *Claire v. Rue de Paris, Inc.*, 239 Ga. 191, 194, 236 S.E.2d 272, 275 (1977).

277. *Dunaway v. Parker*, 215 Ga. App. 841, 849, 453 S.E.2d 43, 51 (1994).

278. *See, e.g., Medlin v. Carpenter*, 174 Ga. App. 50, 52, 329 S.E.2d 159, 163 (1985); *Mathews v. Tele-Systems, Inc.*, 240 Ga. App. 871, 873, 525 S.E.2d 413, 415 (1999).

279. *See In re Reliable Air, Inc.*, No. 05-85627, 2007 WL 7136475, at *4 (Bankr. N.D. Ga. Mar. 9, 2007).

280. *See Dunaway v. Parker*, 215 Ga. App. 841, 849, 453 S.E.2d 43, 51 (1994).

281. *Peery v. CSB Behavioral Health Sys.*, No. CV106-172, 2008 WL 4425364 (S.D. Ga. Sept. 30, 2008); *see Resolution Trust Corp. v. Artley*, 28 F.3d 1099 (11th Cir. 1994) (four-year statute applied to bank receiver's claims for negligence against directors); *In re Pac One, Inc.*, No. 01-85027 MGD, 2007 WL 2083817 (N.D. Ga. July 17, 2007); *but see Tindall v. H&S Homes, LLC*, No. 5:10-CV-044(CAR), 2011 WL 5827227 (M.D. Ga. Nov. 18, 2011) (recognizing a Georgia common law preference claim against corporate insiders for preferring their interests to those of other creditors of an insolvent corporation and holding that such claims are governed by a six-year statute of limitations for breaches of trust).

282. O.C.G.A. § 9-3-31.

fraud and negligent misrepresentation, among others.[283] If the breach of fiduciary duty arises out of a written contract, the statute of limitations is six years.[284]

Where actual fraud is the gravamen of the action, the statute of limitations is tolled "until the fraud is discovered or by reasonable diligence should have been discovered."[285] The Eleventh Circuit has held that Georgia would not recognize the "adverse domination" doctrine of tolling, pursuant to which the statute of limitations is tolled so long as the defendants have control of the corporation.[286] The state appellate courts have not spoken on the point.

The GBCC does not contain a single statute of limitations governing all statutory director and officer liability claims and remedies. Claims brought under O.C.G.A. § 14-2-831 "for the relief provided" under that Code section are subject to a four-year statute of limitations.[287] The courts have not yet clarified whether this limitation period applies to claims for damages as well as for equitable relief. Claims under O.C.G.A. § 14-2-832 for wrongful distributions are subject to a two-year limitations period.[288]

1-8 SECONDARY LIABILITY

1-8:1 Corporate Liability for Acts of Its Agents

While a corporation is a separate legal entity from its directors and officers, it often may be subject to liability for torts committed by its agents under principles of vicarious liability, also known as respondeat superior liability. An agent's conduct is imputed to the corporation when such conduct is committed in the prosecution

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283. *Paul v. Destito*, 250 Ga. App. 631, 636, 550 S.E.2d 739, 745 (2001) (assuming, without deciding, that § 9-3-31 applies to conspiracy to breach fiduciary duty and negligent breach of fiduciary duty claims).

284. *Crosby v. Kendall*, 247 Ga. App. 843, 849, 545 S.E.2d 385, 390-91 (2001) ("The trial court properly held that the applicable statute of limitation for the appellees' claims of breach of fiduciary duty, which arise out of a breach of the escrow agent agreements, was six years pursuant to O.C.G.A. § 9-3-24.").

285. *Paul v. Destito*, 250 Ga. App. 631, 637, 550 S.E.2d 739, 746 (2001).

286. *Resolution Trust Corp. v. Artley*, 28 F.3d 1099 (11th Cir. 1994).

287. O.C.G.A. § 14-2-831 ("No action shall be brought for the relief provided in subsection (a) of this Code section more than four years from the time the cause of action accrued.").

288. O.C.G.A. § 14-2-832(c) (generally measured from the date of distribution).

of and within the scope of its business.[289] A party damaged by the agent's conduct may sue either the agent, the corporation, or both.[290] This rule applies to statements made by a corporate agent as well.[291]

Where knowledge is relevant to a claim or defense, the knowledge of officers may be imputed to the corporation, and the corporation is bound by that knowledge. For instance, an officer's knowledge and fraudulent intent in transferring funds to a corporation is imputed to the corporation for purposes of defeating a good faith defense to a fraudulent transfer claim.[292] However, an officer's knowledge will not be imputed to the corporation when the officer's interests are significantly adverse to those of the corporation.[293]

A corporation may only be vicariously liable where its agent has actual or "apparent authority"[294] to act on the principal's behalf. Under Georgia law, the doctrine of apparent agency applies only where,

> a person of ordinary prudence conversant with business usages and the nature of the particular business is justified in assuming that such agent had authority to perform a particular act and deals with the agent upon that assumption.[295]

The principal's manifestations determine whether apparent authority exists, not the agent's representations, which are irrelevant.[296] The principal must do something to lead a person

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289. *Smith v. Hawks*, 182 Ga. App. 379, 384, 355 S.E.2d 669, 675 (1987); O.C.G.A. § 51-2-2 ("Every person shall be liable for torts committed by . . . his servant by his command or in the prosecution and within the scope of his business, whether the same are committed by negligence or voluntarily.").

290. *Smith v. Hawks*, 182 Ga. App. 379, 384, 355 S.E.2d 669 (1987).

291. *APA Excelsior III, LP v. Windley*, 329 F. Supp. 2d 1328, 1353-54 (N.D. Ga. 2004) ("[A] corporation may be held liable co-extensively with the officer or employee actually responsible for the fraudulent conduct engaged in while in the course of the employment and while transacting corporate business.") (internal quotations omitted); *Black v. New Holland Baptist Church*, 122 Ga. App. 606, 609, 178 S.E.2d 571, 573 (1970) ("A corporation is not bound by a declaration of an agent made outside the scope of his agency.").

292. *Miller v. Lomax*, 266 Ga. App. 93, 99, 596 S.E.2d 232, 239-40 (2004).

293. *In re Friedman's, Inc.*, 394 B.R. 623, 632 (S.D. Ga. 2008); *Clarence L. Martin, P.C. v. Chatham Co. Tax Com'r*, 258 Ga. App. 349, 351, 574 S.E.2d 407, 410 (2002); *People's Bank of Glennville v. Burkhalter*, 179 Ga. 863, 177 S.E. 708 (1934).

294. Restatement (Third) of Agency, § 2.03 (defining "apparent authority" as "the power held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations").

295. *Turnipseed v. Jaje*, 267 Ga. 320, 323, 477 S.E.2d 101, 103 (1996).

296. *Trust Co. of Georgia v. Nationwide Moving Co.*, 235 Ga. 229, 232, 219 S.E.2d 162, 165 (1975).

of ordinary prudence to believe that the agent is acting on the principal's behalf.[297]

1-8:2 Personal Liability for Corporate Acts and Debts

Corporate officers are not personally liable for corporate torts in which they do not participate or direct the particular act to be done.[298] Thus, the mere fact that an injury occurred while a defendant served as an officer of the corporation, even as its chief executive officer, is not sufficient to support an action against the officer.[299] The corollary principle is that an officer who personally participates in a tort can be held personally liable for those actions, without regard to piercing the corporate veil.[300]

1-8:3 Control Person Liability Under Various Statutes

Some statutes directly impose individual liability on directors, officers, and/or "control persons" who have the power to control primary violators of the statute. Prominent examples are the federal and Georgia securities laws,[301] Georgia's tax laws,[302] consumer protection and unfair competition laws,[303] laws

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297. *Turnipseed v. Jaje*, 267 Ga. 320, 323, 477 S.E.2d 101, 103 (1996).

298. *Dempsey v. Se. Indus. Contracting Co.*, 309 Ga. App. 140, 709 S.E.2d 320 (2011); *Hamilton Bank & Tr. Co. v. Holliday*, 469 F. Supp. 1229, 1239 (N.D. Ga. 1979) (citing *Lincoln Land Co. v. Palfery*, 130 Ga. App. 407, 203 S.E.2d 597 (1973)).

299. *Dempsey v. Se. Indus. Contracting Co.*, 309 Ga. App. 140, 709 S.E.2d 320 (2011).

300. *Delong Equipment Co. v. Washington Mills Abrasive Co.*, 840 F.2d 843, 851 (11th Cir. 1988); *Brown v. Rentz*, 212 Ga. App. 275, 441 S.E.2d 876 (1994) ("[I]t is well established that '[a]n officer of a corporation who takes part in the commission of a tort by the corporation is personally liable therefore."), *appeal after remand*, 219 Ga. App. 187, 464 S.E.2d 617 (1995). *See* § 1-8:5 for situations where individual liability is determined under piercing the corporate veil principles.

301. *See* 15 U.S.C. § 78t(a) (imposing joint and several liability on persons who control primary violators of the Securities Exchange Act of 1934); O.C.G.A. § 10-5-58(g) (imposing joint and several liability upon executive officers and directors of primary violators of O.C.G.A. § 10-5-58, as well as other persons who directly or indirectly control the primary violator).

302. *See* O.C.G.A. § 48-2-52 (officers and others having "control or supervision" of a corporation's tax collection responsibilities who willfully evade or fail to observe tax obligations under the Code may become personally responsible for an amount equal to the taxes not collected and/or not paid over to the state).

303. *See, e.g.*, O.C.G.A. § 10-5B-4(b) (imposing individual liability on control persons of companies that engage in illegal telemarketing activities); O.C.G.A. § 10-1-405(c) (imposing individual liability on control persons of Fair Business Practices Act violators, provided that the control person had "actual knowledge" of the acts constituting the violation and

governing multilevel distribution companies,[304] and the Georgia Land Sales Act.[305]

A critical question in cases involving control person liability, particularly in the securities litigation context, is what it means to control the primary violator. Section 20(a) of the Securities Exchange Act of 1934 does not explicitly target officers, directors, or other principals of a corporation that violate the securities laws. Instead, it states rather broadly that "[e]very person who, directly or indirectly, controls any person liable under any provision of this title" may be subject to joint and several liability.[306] In the Eleventh Circuit, the test is whether the defendant (1) had the power to control the general affairs of the person or entity that committed the primary violation, and (2) had the requisite power to directly control or influence the specific act or corporate policy that resulted in the violation.[307] A control person under Section 20(a) is entitled to a complete affirmative defense if that person "acted in good faith and did not directly or indirectly induce the acts constituting the violation or cause of action."[308]

The Georgia Securities Act explicitly provides that "[a]n individual who is a managing partner, executive officer, or director"

"directly authorized, supervised, ordered, or did any of the acts constituting in whole or in part the violations").

304. *See* O.C.G.A. § 10-1-417(d) (providing penalties for officers and directors of a corporation that violate the laws governing sales of business opportunities and multilevel distribution companies); *Amerireach.com LLC v. Walker*, 290 Ga. 261, 271, 719 S.E.2d 489, 497 (2011) (holding that company's founding members, who at the relevant time were its CEO, operating chairman, and general counsel, respectively, were subject to individual liability under O.C.G.A. § 10-1-417).

305. *See* O.C.G.A. § 44-3-8 (imposing individual liability on control persons of primary violators of the Georgia Land Sales Act).

306. 15 U.S.C. § 78t(a).

307. *See Brown v. Enstar Grp., Inc.*, 84 F.3d 393, 396 (11th Cir. 1996). Other circuits have adopted tests that vary from the Eleventh Circuit's test. *See, e.g., S.E.C. v. J.W. Barclay & Co., Inc.*, 442 F.3d 834, 841 n.8 (3d Cir. 2006) (holding that "control person" must be a "culpable participant" in the acts constituting the violation in order to be jointly and severally liable); *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000) (rejecting "culpable participation" requirement and describing control as "an intensely factual question, involving scrutiny of the defendant's participation in the day-to-day affairs of the corporation and the defendant's power to control corporate actions.").

308. 15 U.S.C. § 78t(a); *Laperriere v. Vesta Ins. Grp., Inc.*, 526 F.3d 715, 721-22 (11th Cir. 2008).

of the primary violator may be jointly and severally liable.[309] Such persons may avoid liability by proving that they did not know, and in the exercise of reasonable care could not have known, of the existence of the conduct giving rise to the primary violation.[310]

Under Georgia's tax laws, the test for individual liability of an officer or director is whether that person is (1) a responsible person, (2) who willfully fails to collect and remit state taxes.[311] Courts have looked to federal tax laws to determine when an officer is a "responsible person" for purposes of tax liability.[312] Mere status as an officer is not necessarily enough; the court also must consider "whether the person performed the duties of an officer and exercised authority within the company."[313] To satisfy the willfulness requirement, it must be shown that the defendant knew either "that the required taxes [were] not being paid or recklessly ignor[ed] a known risk that the taxes [would] not be paid."[314]

1-8:4 Aiding and Abetting Breaches of Fiduciary Duty

Georgia recognizes a separate cause of action akin to claims of aiding and abetting a breach of fiduciary duty,[315] which have become more prominent in multi-party corporate litigation in recent years. Aiding and abetting claims have surfaced in the context of mergers and acquisitions. Shareholders of the target corporation may, for example, contend that the target corporation's board breached its fiduciary duties in connection with the transaction, and that the acquiring company and/or its officers and directors were complicit in that breach and rendered assistance to the breaching parties. In an arms-length transaction, an acquiring company and its officers and directors do not owe fiduciary duties to target company

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309. O.C.G.A. § 10-5-58(g)(2). A parallel clause in O.C.G.A. § 10-5-58(g) tracks the language of Section 20(a) of the federal Securities Exchange Act of 1934. *See* O.C.G.A. § 10-5-58(g)(1).

310. O.C.G.A. § 10-5-58(g)(2).

311. *See* O.C.G.A. § 48-5-52; *In re Haysman*, 432 B.R. 336, 338-39 (Bankr. N.D. Ga. 2010); *GDOR v. Moore*, 328 Ga. App. 350, 352, 762 S.E.2d 184, 186 (2014).

312. *See In re Haysman*, 432 B.R. 336, 338-39 (Bankr. N.D. Ga. 2010); *GDOR v. Moore*, 328 Ga. App. 350, 352, 762 S.E.2d 184, 186 (2014).

313. *See In re Haysman*, 432 B.R. 336, 339 (Bankr. N.D. Ga. 2010).

314. *See In re Haysman*, 432 B.R. 336, 338-39 (Bankr. N.D. Ga. 2010).

315. *See also* Chapter 8, § 8-4:4, discussing tortious interference with fiduciary duties.

shareholders; they can thus only be sued on a theory of secondary liability such as aiding and abetting.[316]

The Georgia courts have recognized a version of this theory based on the Georgia statutes concerning maliciously procuring injury to another under O.C.G.A. § 51-12-30. To state such a cause of action in Georgia, the plaintiff must plead the following elements: (1) through improper action or wrongful conduct and without privilege, the defendant acted to procure a breach of the primary wrongdoer's fiduciary duty to the plaintiff; (2) with knowledge that the primary wrongdoer owed the plaintiff a fiduciary duty, the defendant acted purposely and with malice and the intent to injure; (3) the defendant's wrongful conduct actually procured a breach of the primary wrongdoer's fiduciary duty; and (4) the defendant's tortious conduct proximately caused damage to the plaintiff.[317] Although the term "procure" is interpreted broadly, the Georgia version of the tort consists more of instigation than merely knowing assistance.

As the third element indicates, an aiding and abetting claim is derivative of the claim for breach of fiduciary duty itself. Without an underlying breach, there cannot be an aiding and abetting claim.[318] There also must be conduct that is independently wrongful on the part of the aider and abettor. Examples include "predatory tactics such as physical violence, fraud or misrepresentation, defamation, use of confidential information, abusive civil suits, and unwarranted criminal prosecutions."[319]

1-8:5 Piercing the Corporate Veil

The courts have historically respected the separateness of a corporation and its owners or shareholders and have shown considerable restraint in permitting third parties to pierce the

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316. This example is given for illustrative purposes; there is no Georgia appellate decision to date addressing whether an aiding and abetting claim is viable under these circumstances.

317. *Insight Tech., Inc. v. FreightCheck, LLC*, 280 Ga. App. 19, 25-26, 633 S.E.2d 373, 378-79 (2006) (citing O.C.G.A. § 51-12-30).

318. *Insight Tech., Inc. v. FreightCheck, LLC*, 280 Ga. App. 19, 25-26, 633 S.E.2d 373, 378-79 (2006).

319. *White v. Shamrock Bldg. Sys., Inc.*, 294 Ga. App. 340, 343-44, 669 S.E.2d 168, 172-73 (2008).

corporate veil.[320] However, courts disregard the separateness of the corporate entity "where the corporation has overextended its privileges in the use of the corporate entity to defeat justice, to perpetuate fraud, or to evade statutory, contractual or tort responsibility."[321] In order to pierce the corporate veil, a plaintiff must show that "the shareholders disregarded the corporate entity" and used it as "a mere instrumentality for the transaction of their own affairs," creating "such a unity of interest and ownership that separate personalities of the corporation and the owners no longer exist."[322]

The critical question is whether there has been abuse of the corporate form. This inquiry is fact intensive, and ordinarily the issue should be decided by the trier of fact.[323] Courts typically look for signs that the corporation has failed to observe corporate formalities, such as the filing of annual registrations, issuance of stock certificates, keeping of minutes and other records, maintenance of a physical office or place of business, and maintenance of accounts separate from those of its owners.[324]

Another critical factor is whether the corporation is undercapitalized, though this fact alone is not dispositive. Instead, for undercapitalization to justify piercing the corporate veil, "it must be coupled with evidence of an intent at the time of the capitalization to improperly avoid future debts of the corporation."[325] The fact that a corporation is capitalized largely through loans from its owners, without further evidence of actual abuse of the corporate form, does not support piercing the corporate veil.[326] There is now substantial authority that the veil will not be pierced unless the corporation can be shown to be insolvent, since solvency implies that the plaintiff has an

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320. *Hickman v. Hyzer*, 261 Ga. 38, 39, 401 S.E.2d 738, 739 (1991) ("We have long recognized that great caution should be exercised by the court in disregarding the corporate entity.") (internal punctuation omitted).

321. *Hickman v. Hyzer*, 261 Ga. 38, 39, 401 S.E.2d 738, 739 (1991).

322. *Baillie Lumber Co. v. Thompson*, 279 Ga. 288, 289-90, 612 S.E.2d 296, 299 (2005).

323. *Soerries v. Dancause*, 248 Ga. App. 374, 375, 546 S.E.2d 356, 358 (2001).

324. *See, e.g., Christopher v. Sinyard*, 313 Ga. App. 866, 868, 723 S.E.2d 78, 81 (2012).

325. *Hickman v. Hyzer*, 261 Ga. 38, 39-40, 401 S.E.2d 738, 739-40 (1991).

326. *Pazur v. Belcher*, 290 Ga. App. 703, 708, 659 S.E.2d 804, 808 (2008).

adequate remedy at law in the form of a money judgment against the corporation.[327]

The ability to pierce the corporate veil is not necessarily confined to third parties. Under some circumstances, a director, officer, or shareholder of the corporation may be permitted to pierce the veil.[328] A corporation can also pierce its own veil under very limited circumstances.[329] In these unusual situations, the Georgia courts adhere to the principle that piercing the veil is appropriate in circumstances in which it 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, perpetrate fraud or evade contractual or tort responsibility."[330] The Georgia courts have not recognized "reverse piercing" of the veil by outside third parties seeking to impose liabilities of shareholders on the corporations they own.[331]

1-9 EXCULPATION: LIMITATIONS ON LIABILITY OF DIRECTORS IN ARTICLES OF INCORPORATION

Georgia law permits a corporation, in its articles of incorporation, to limit or eliminate the personal liability of its directors to the corporation or its shareholders, except for liability arising from (1) misappropriation of corporate opportunities; (2) intentional misconduct and knowing violations of law; (3) unlawful distributions as defined in O.C.G.A. § 14-2-832; or (4) transactions in which the director received an improper personal benefit.[332] In proscribing "intentional misconduct and knowing violations of law,"[333] the Georgia exculpation provision deleted a "not in good faith" exception from the Model Act's version

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327. *See, e.g., The B&F Sys., Inc. v. LeBlanc*, No. 7:07-CV-192 (HL), 2011 WL 4103576, at *34 (M.D. Ga. Sept. 14, 2011); *Great Dane Ltd. P'ship v. Rockwood Serv. Corp.*, No. CV410-265, 2011 WL 2312533, at *3 (S.D. Ga. June 8, 2011).

328. *Paul v. Destito*, 250 Ga. App. 631, 639, 550 S.E.2d 739, 747 (2001).

329. *Baillie Lumber Co. v. Thompson*, 279 Ga. 288, 291-92, 612 S.E.2d 296, 300 (2005).

330. *Baillie Lumber Co. v. Thompson*, 279 Ga. 288, 291, 612 S.E.2d 296, 299 (2005).

331. *Acree v. McMahon*, 276 Ga. 880, 881, 585 S.E.2d 873, 874 (2003); *Holiday Hospitality Franchise, Inc. v. Noons*, 324 Ga. App. 70, 70, 749 S.E.2d 380, 380 (2013); *Corrugated Replacements, Inc. v. Johnson*, 340 Ga. App. 364, 369, 797 S.E.2d 238, 242 (2017).

332. O.C.G.A. § 14-2-202(b)(4).

333. O.C.G.A. § 14-2-202(b)(4)(B).

and also differentiates itself from Delaware in that respect.[334] The statute has not been tested or interpreted by the Georgia appellate courts.

Note that there is no corresponding power under the GBCC to exculpate corporate officers. The implication from this is that there are public policy reasons for not allowing exculpation of non-director officers. Yet there is a seeming inconsistency between this and O.C.G.A. § 14-2-857(a)(2), which, as discussed in Section 1-10, permits a corporation to indemnify officers to the same extent that O.C.G.A. § 14-2-202(b)(4) permits exculpation for directors, though O.C.G.A. § 14-2-857(a)(2) does not expressly mention O.C.G.A. § 14-2-202.[335] This discrepancy has not been addressed by the courts, but based on the statutory language alone, corporations arguably may be able to accomplish for officers through indemnification what they are not permitted to accomplish through exculpation.

1-10 INDEMNIFICATION AND INSURANCE

1-10:1 Indemnification of Directors, Officers, and Employees; Advancement of Defense Expenses

There are three related but distinct principles that govern the indemnification of directors and officers under the GBCC. First, directors who succeed in litigation brought against them in their official capacities are entitled by statute to mandatory indemnification of their defense expenses under O.C.G.A. § 14-2-852. Second, a corporation is permitted (though not required) under O.C.G.A. §§ 14-2-851 and 14-2-857 to indemnify its directors and officers against certain liabilities in connection with certain types of proceedings without shareholder approval. If no shareholder approval has been given, the corporation must follow certain statutory procedures laid out in O.C.G.A. § 14-2-855 in order to determine the entitlement to indemnification.

Finally, a corporation that has obtained shareholder approval is permitted broad authority under O.C.G.A. § 14-2-856 to indemnify

334. *Compare* O.C.G.A. § 14-2-202(b)(4)(B) *with* 8 Del. C. § 102(b)(7).
335. O.C.G.A. § 14-2-857(a)(2).

its directors without the need for compliance with the statutory safeguards, with the sole limitation being that no indemnification may be given for the same conduct for which exculpation is also prohibited (intentional misconduct, knowing violations of law, misappropriation of corporate opportunities, wrongful distributions, and receipt of improper benefits). In addition to these principles, the corporation can choose to address indemnification on an ad hoc basis or, under O.C.G.A. § 14-2-859(a), to obligate itself in advance by its articles, bylaws, or by resolution or contract and thereby confer on directors and officers rights to mandatory indemnification beyond the statutory rights under O.C.G.A. § 14-2-852.

1-10:1.1 Mandatory Indemnification

Where a director or officer defends a proceeding and is "wholly successful, on the merits or otherwise," indemnification is mandatory.[336] The director is said to have a statutory right of indemnification to defense costs in such situations,[337] and may enforce this right in the pending proceeding or in another court of competent jurisdiction.[338] This right accrues both in litigation brought by or in the right of the corporation and litigation brought by third parties.

1-10:1.2 Permitted Indemnification Without Shareholder Approval

Under O.C.G.A. § 14-2-851, a corporation is authorized to indemnify its directors who are parties to a proceeding against liability for defense costs, judgments and settlements incurred in the proceeding if the director acted in good faith and reasonably believed that the conduct or decision at issue was in the best interests of the corporation (or, if the action concerns conduct not performed in the director's official capacity, that the conduct was not opposed to the interests of the corporation).[339] In a criminal proceeding, the corporation is authorized to indemnify

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336. O.C.G.A. §§ 14-2-852; 14-2-857(c); *Georgia Dermatologic Surgery Centers, P.C. v. Pharis*, 341 Ga. App. 305, 308, 800 S.E.2d 376, 379 (2017).

337. O.C.G.A. § 14-2-852 cmt.

338. O.C.G.A. § 14-2-854.

339. O.C.G.A. § 14-2-851.

the director so long as the director had no reasonable cause to believe the alleged conduct was unlawful.[340] Under no circumstances may a corporation indemnify a director under O.C.G.A. § 14-2-851 in connection with any proceeding in which the director was adjudged liable on the basis that the director received an improper personal benefit.[341]

O.C.G.A. § 14-2-855 requires the corporation to make a determination that indemnification of the director is permissible because the director has met the relevant standard of conduct.[342] That determination must be made by a majority vote of disinterested directors or a duly appointed committee of disinterested directors, or alternatively, can be made by special legal counsel appointed in accordance with O.C.G.A. § 14-2-855(b)(2), or by the shareholders, excluding shares owned or controlled by non-disinterested directors.

1-10:1.3 Permitted Indemnification With Shareholder Approval

A corporation may, with the approval of its shareholders, undertake broader indemnification obligations to directors that are free of the limitations placed on indemnification under O.C.G.A. § 14-2-851 and § 14-2-855. The GBCC contains a second and entirely separate grant of corporate authority to indemnify directors in O.C.G.A. § 14-2-856. A corporation that chooses to indemnify its directors under this section, and that obtains the necessary shareholder approval to do so, may fully indemnify directors for all costs and expenses, including settlements, judgments and fines, and may obligate itself to indemnify directors for proceedings brought by the corporation and derivative actions, as well as actions by third parties.[343]

The limitations on this authority mirror the limitations on a corporation's authority to exculpate directors in its articles of incorporation.[344] Namely, the corporation cannot indemnify

340. O.C.G.A. § 14-2-851.
341. O.C.G.A. § 14-2-851(d)(2).
342. O.C.G.A. § 14-2-855.
343. O.C.G.A. § 14-2-856 cmt.
344. *See* § 1-10; O.C.G.A. § 14-2-202.

directors and officers who are directors for any liability incurred in a proceeding in which the director is adjudged liable to the corporation for (1) misappropriation of corporate opportunities; (2) intentional misconduct and knowing violations of law; (3) unlawful distributions as defined in O.C.G.A. § 14-2-832; or (4) transactions in which the director received an improper personal benefit.[345] Under O.C.G.A. § 14-2-857(a)(2), officers who are not directors may be indemnified—without the need for shareholder approval—for conduct not involving those four exclusions.

1-10:1.4 Advancement of Defense Expenses

A corporation also may advance to directors and officers funds to pay for "reasonable expenses" of litigation where the director is a party to the proceeding if the director delivers a written affirmation of the director's good faith belief that the conduct in question meets the relevant standard of conduct under O.C.G.A. § 14-2-851 or that the conduct will be exculpated under O.C.G.A. § 14-2-202. The director or officer must also undertake in writing to repay any funds advanced in the event that the director or officer ultimately is not entitled to indemnification.[346]

The procedures for authorizing the advancement of litigation expenses on an ad hoc basis are similar to those found under O.C.G.A. § 14-2-855 for determining that indemnification is permissible, except that there is no provision allowing the determination to be made by special legal counsel. However, as with indemnification, the corporation may impose on itself a standing obligation of mandatory advancement of expenses, in which case the corporation then must advance expenses upon receipt of the affirmation and undertaking described above.

1-10:2 Director and Officer Liability Insurance

Georgia law broadly permits a corporation to purchase and maintain insurance on behalf of directors, officers, and others who serve on its behalf (D&O liability insurance).[347] The right to

345. O.C.G.A. § 14-2-856.
346. O.C.G.A. §§ 14-2-853, 14-2-856(c), 14-2-857(c).
347. O.C.G.A. § 14-2-858.

purchase insurance is independent of the corporation's rights and obligations with respect to indemnification. A corporation may undertake obligations to indemnify its directors and officers and, at the same time, purchase D&O liability insurance. In fact, that is what is done by most publicly held corporations and an increasing number of privately held corporations. Typical D&O policies will insure the company's indemnification obligations, and then will provide further coverage for claims and matters that are not or cannot be indemnified by the corporation.

Depending on a corporation's circumstances, D&O liability insurance is generally able to cover a broader range of costs and circumstances in which indemnification is prohibited.[348] D&O insurance is subject to certain limitations not applicable to indemnification, however. For instance, D&O policies are "claims made" policies, where coverage is triggered by the assertion of a "claim" as defined in the policy documents.[349] Indemnification is not subject to the same limitation, and as a result, indemnification may be available to cover costs relating to threatened litigation, investigations, and other matters that have not matured to the point of being considered claims.

Though the text of O.C.G.A. § 14-2-858 does not expressly limit a corporation's authority to purchase and maintain insurance, as a practical matter, a typical D&O policy is likely to exclude coverage for claims involving fraudulent conduct, bad faith, self-dealing and the like. Many policies also exclude matters that are "uninsurable" as a matter of law or public policy.[350] To date, the Georgia courts have not passed on the enforceability of any such exclusion clauses.

Perhaps the most significant and most heavily litigated exclusion contained in most D&O policies is the "insured vs. insured" exclusion, which generally excludes coverage for suits by the

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348. For instance, insurance may cover derivative action settlements and judgments, which are beyond the scope of permitted indemnification in the absence of shareholder approval.

349. A typical definition of "claim" in a D&O policy may include any or all of the following: written demands for payment, the initiation of civil litigation, an administrative proceeding or a criminal proceeding, receipt of a formal order of investigation from a regulatory body, or the like.

350. For instance, a typical definition of "loss" in a D&O policy may provide that it excludes any matters "uninsurable under the law" of the state whose laws govern the policy.

insured company against its officers and directors.[351] This exclusion can itself have exceptions, or "carvebacks," that allow coverage for shareholder derivative actions, claims brought by bankruptcy trustees, and claims brought by receivers. The scope of insured vs. insured exclusions has seen increased attention in litigation in recent decisions, with varying and sometimes inconsistent results including decisions finding such exclusions to be ambiguous and declining to enforce them in the context of FDIC bank receiverships.[352]

Another significant limitation on the availability of D&O insurance coverage relates to whether the claims arise from acts committed in an "insured capacity." D&O policies typically specify, either through definitions of covered activity or through exclusionary clauses, that coverage is afforded only in claims arising from acts committed by the individual insureds in their capacities as directors and officers of the insured entities. Some policies may specify other capacities in which coverage is available (or not excluded), such as service as a director or officer of a private equity firm's portfolio companies. The question of whether there is coverage arises where the insured acts simultaneously in more than one capacity. Take, for example, a scenario in which a director or officer serves as a shareholder or a lender—a situation not uncommon in close corporations. It has been held in such a situation that when the policy contains an exclusion expressly barring coverage for acts or

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351. *See, e.g., Cox Communications Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 708 F. Supp. 2d 1322 (N.D. Ga. 2010), *on motion for reconsideration*, No. 1:09-CV-410-TWT, 2010 WL 5092282 (N.D. Ga. Dec. 8, 2010); *Greenwich Ins. Co. v. Lecstar Corp.*, No. 1:05-CV-3275-RLV, 2006 WL 2052375 (N.D. Ga. July 20, 2006). *Davis v. Bancinsure, Inc.*, No. 1:05-CV-3275-RLV, 2013 WL 1223696, at *8 (N.D. Ga. Mar. 20, 2013) (holding that exclusion applied to the FDIC's claims because the exclusionary language used the word "receiver"); *St. Paul Mercury Ins. Co. v. FDIC*, 774 F.3d 702, 710 (11th Cir. 2014) (holding that exclusion for claims brought "by or on behalf of" a bank was ambiguous when applied to the FDIC serving as receiver for the bank, citing that the FDIC represents not only the bank's interests but those of the insurance fund it oversees).

352. *Compare Progressive Casualty Ins. Co. v. FDIC*, 926 F. Supp. 2d 1337 (N.D. Ga. 2013) (holding insured vs. insured exclusion for claims brought "by or on behalf of, or at the behest of the Company" to be "ambiguous" when applied to claims brought by the FDIC as receiver for a failed bank, given the FDIC's multiple interests) *with St. Paul Mercury Ins. Co. v. Miller*, 968 F. Supp. 2d 1236 (N.D. Ga. 2013) (holding that exclusion containing similar "by or on behalf of" language was not ambiguous and could be applied to bar a suit brought by the FDIC). These decisions involved policies in which the insured vs. insured clauses did not contain a carveback for bankruptcy trustees and receivers. The *St. Paul* decision was reversed by the Eleventh Circuit, in large part because the court found that the conflicting interpretations of nearly identical language by different district courts strongly supported a finding that the language was ambiguous. *See St. Paul Mercury Ins. Co. v. FDIC*, 774 F.3d 702, 710 (11th Cir. 2014).

omissions committed in an uninsured capacity, the exclusion will be enforced if the claims would not have arisen but for the existence of alleged wrongful acts undertaken in the uninsured capacity.[353]

1-11 INSOLVENT AND FINANCIALLY TROUBLED CORPORATIONS

1-11:1 Fiduciary Duties Owed to Creditors

When a corporation becomes insolvent, its directors and officers no longer simply represent the corporation and its shareholders. Under Georgia common law principles, the directors and officers of an insolvent corporation become "quasi-trustees" who are "bound to manage the remaining assets for the benefits of its creditors."[354] As such, they have a fiduciary duty not to use their position for the purpose of preferring themselves over any creditor.[355] Their duty requires them to apply the remaining assets to the payment of debts of the corporation, and they may not use corporate assets to pay debts that the corporation owes to themselves.[356] If the directors breach this duty by making preferential payments to themselves, creditors will have an action to recover sums improperly paid.[357]

This duty and concomitant right of action are considered to be independent from whatever other rights creditors may have under the bankruptcy laws, the Uniform Fraudulent Transfers Act, and other provisions of the GBCC, such as the prohibition against unlawful distributions under O.C.G.A. § 14-2-832.[358] Accordingly, a creditor of an insolvent or financially troubled corporation may have a valid breach of fiduciary claim without regard to whether

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353. *Langdale Co. v. National Union Fire Ins. Co. of Pittsburgh*, 609 Fed. Appx. 578, 590 (11th Cir. 2015) (enforcing insured capacity exclusion against directors and officers of close corporation who simultaneously served as trustees of family trusts holding an interest in the corporation; finding that the allegations in the underlying litigation were premised on alleged acts committed as trustees of the family trusts).

354. *Hickman v. Hyzer*, 261 Ga. 38, 40, 401 S.E.2d 738, 740 (1991); *Ware v. Rankin*, 97 Ga. App. 837, 104 S.E.2d 555 (1958).

355. *Ware v. Rankin*, 97 Ga. App. 837, 839, 104 S.E.2d 555, 559 (1958).

356. *Ware v. Rankin*, 97 Ga. App. 837, 839, 104 S.E.2d 555, 559 (1958).

357. *Hickman v. Hyzer*, 261 Ga. 38, 40, 401 S.E.2d 738, 740 (1991).

358. *Tindall v. H&S Homes, LLC*, 2011 WL 5327227 (M.D. Ga. Nov. 18, 2011).

any other claims may be viable under the circumstances.[359] This can be of particular importance if other potential claims are not viable due to the expiration of statutes of limitation.[360]

1-11:2 Liability for Wrongful Distributions to Shareholders

In addition to their broad fiduciary duty not to prefer themselves over creditors when the corporation is insolvent, directors are subject to a statutory prohibition against making or authorizing distributions that would render the corporation insolvent.[361] As a general matter, corporations may authorize and make distributions to their shareholders under O.C.G.A. § 14-2-640. This authority is subject to restrictions set forth in the corporation's articles, and also must comply with O.C.G.A. § 14-2-640(c), which prohibits distributions (1) that would render the corporation unable to pay its debts as they become due in the usual course of business, or (2) that would cause the corporation's assets to be less than the sum of its total liabilities plus the amount that would be needed to satisfy preferential rights at the time of dissolution.[362]

A director who votes for or assents to a distribution made in violation of O.C.G.A. § 14-2-640(c) or the corporation's articles of incorporation may become personally liable to the corporation for the amount of the distribution that exceeds what could have been distributed without violating O.C.G.A. § 14-2-640 or the articles of incorporation.[363] Directors whose conduct is challenged under O.C.G.A. § 14-2-832 are entitled to the protection of the O.C.G.A. § 14-2-830 safe harbor provisions, the business judgment rule, and any other defenses that would ordinarily be available under the circumstances.[364] A director also may be entitled to contribution from every other director

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359. *Tindall v. H&S Homes, LLC*, 2011 WL 5327227 (M.D. Ga. Nov. 18, 2011).

360. *See, e.g., Tindall v. H&S Homes, LLC*, 2011 WL 5327227 (M.D. Ga. Nov. 18, 2011) (holding that a creditor's breach of fiduciary duty claims were subject to the six-year statute of limitations for breaches of trust, and therefore were viable even if claims under the Uniform Fraudulent Transfers Act and O.C.G.A. § 14-2-832 were time-barred).

361. O.C.G.A. § 14-2-832.

362. O.C.G.A. § 14-2-640(c).

363. O.C.G.A. § 14-2-832.

364. O.C.G.A. § 14-2-832(a) and cmt. *See* § 1-3 for discussion of the business judgment rule.

who could have been held liable for the unlawful distribution.[365] Directors' liabilities under O.C.G.A. § 14-2-832 may not be exculpated or indemnified.[366] Such claims are subject to a two-year statute of limitations.[367]

1-11:3 Receiverships and Custodianships

Under the GBCC, a Georgia court in a judicial dissolution proceeding brought by a shareholder may appoint a receiver for the corporation to wind up its affairs and liquidate the corporation's assets.[368] The court can also appoint a custodian to manage the corporation's business and affairs.[369]

Under Georgia's general receivership statutes (which are not part of the GBCC), creditors as well as shareholders can seek appointment of an equity receiver (1) when any fund or property—including a corporation and its assets—is in litigation and the rights of parties to the litigation cannot otherwise be fully protected; (2) when there is a fund or property having no one to manage it; (3) when there is a risk of destruction or loss to trust or joint property; and (4) when assets are charged with the payment of debts and there is "manifest danger" of loss, destruction, or injury to interested parties.[370] In the corporate context, an equity receiver can be appointed where the corporation's management or board is deadlocked.[371]

The grant or refusal of a receivership or custodianship is left to the sound discretion of the trial court.[372] The general receivership statute provides that the power to appoint a receiver "should be prudently and cautiously exercised" and that a receiver should not be appointed "except in clear and urgent cases."[373]

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365. O.C.G.A. § 14-2-832(b) and cmt.

366. O.C.G.A. §§ 14-2-202(b)(4)(C) and 14-2-857(b)(3). *See* §§ 1-9 and 1-10:1:3.

367. O.C.G.A. § 14-2-832(c). *See* § 1-7:11.

368. O.C.G.A. § 14-2-1432(a).

369. O.C.G.A. § 14-2-1432(a).

370. O.C.G.A. §§ 9-8-1 to -3; *Considine v. Murphy*, 327 Ga. App. 110, 112, 755 S.E.2d 556, 559 (2014).

371. *Black v. Graham*, 266 Ga. 154, 464 S.E.2d 814 (1996); *Farrar v. Pesterfeld*, 216 Ga. 311, 116 S.E.2d 229 (1960).

372. *Georgia Rehab. Center v. Newnan Hosp.*, 284 Ga. 68, 69, 663 S.E.2d 204, 205 (2008); *Treu v. Humanism Inv., Inc.*, 284 Ga. 657, 670 S.E.2d 409 (2008).

373. O.C.G.A. § 9-8-4.

The courts have considerable authority to define the powers and duties of the receiver or custodian. Under the GBCC's judicial dissolution statute, courts may confer on the receiver or custodian "all of the powers of the corporation," in which case the receiver or custodian may essentially replace the company's board or management.[374] These powers typically include the power to take possession of the corporation's assets, records and accounts, to preserve, liquidate and distribute corporate property, to settle claims and debts, and to investigate potential claims belonging to the corporation. A receiver may be empowered to bring claims on behalf of the corporation, including suits against directors and officers for mismanagement.[375]

1-11:4 Removal of Directors and Officers

Shareholders may remove directors without the need for court action under O.C.G.A. § 14-2-808, but this action must comply with the statute, which outlines when directors may be removed without cause,[376] who may vote for removal,[377] how the vote must be conducted,[378] and (where appropriate) how the votes should be counted.[379] A director may be removed by the shareholders only at a meeting called for that purpose, and the notice of that meeting must state the purpose.[380] The right of shareholders by majority vote to remove directors is absolute and cannot be questioned for improper motive.[381]

While the Model Business Corporation Act provides for judicial removal of directors,[382] the GBCC contains no such

374. O.C.G.A. § 14-2-1432(c)(2).

375. O.C.G.A. § 14-2-1432(c)(1); *Woodward v. Stewart*, 149 Ga. 620, 101 S.E. 749 (1919).

376. *See* O.C.G.A. § 14-2-808(a) (providing that removal may be with or without cause unless the corporation's articles or a bylaw adopted by shareholders limits removal to *for cause*); O.C.G.A. § 14-2-808(d) (providing that where directors have staggered terms, removal can only be for cause unless the articles or a bylaw adopted by the shareholders provides otherwise).

377. *See* O.C.G.A. § 14-2-808(b) (providing that only shareholders of a voting group that elected the director may vote on removal of that director).

378. *See* O.C.G.A. § 14-2-808(e) (requiring that removal occur at a meeting called for the purpose of removal and directing form of notice of that meeting).

379. *See* O.C.G.A. § 14-2-808(c) (setting rules for counting votes where cumulative voting is authorized).

380. O.C.G.A. § 14-2-808(e).

381. *Matthews v. Tele-Systems, Inc.*, 240 Ga. App. 871, 874, 525 S.E.2d 413, 415-16 (1974).

382. *See* Model Bus. Corp. Act § 8.09.

provision outside of the context of statutory close corporations.[383] A shareholder of a statutory close corporation may petition the superior court of the county where the corporation's principal office is located (or registered office, if no principal office exists) for removal of a director (among other forms of relief, including appointment of a replacement director) if (1) the directors have acted, are acting, or will act in an "illegal, oppressive, fraudulent, or unfairly prejudicial manner" towards the petitioning shareholder, or (2) circumstances constituting deadlock exist.[384]

The remedy of removal may be sought concurrently with other remedies. However, a shareholder who has agreed in writing to pursue a nonjudicial remedy must exhaust that remedy first,[385] and a shareholder who has dissenters' rights with respect to a corporate action must commence a removal proceeding before giving notice of intent to demand payment under the dissenters' rights statute.[386]

1-11:5 Liabilities Involving Nonexistent Corporations

O.C.G.A. § 14-2-204 imposes personal liability on a person who purports to act on behalf of a corporation, knowing that the corporation has not been incorporated. The statute explicitly imposes joint and several liability on multiple persons who purport to act as or on behalf of an unincorporated corporation.[387] The statute applies only when the persons acting on behalf of the corporation know that the corporation does not exist.[388] A corporation is considered to exist, for purposes of O.C.G.A. § 14-2-204, so long as it has been issued a certificate of incorporation by the Secretary of State certifying that articles of incorporation have been duly filed pursuant to the Code.[389] Liability under this statute,

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383. The statutory close corporation under the GBCC is a special elective status achieved by a declaration to that effect in the corporation's articles of incorporation. *See* O.C.G.A. § 14-2-902. *See also* Chapter 3, § 3-2:4.

384. O.C.G.A. §§ 14-2-940, 14-2-941; *Gallagher v. McKinnon*, 273 Ga. App. 727, 732, 615 S.E.2d 746, 750 (2005); *VanRan Comms. Svcs. v. Vanderford*, 313 Ga. App. 497, 722 S.E.2d 110 (2012).

385. O.C.G.A. § 14-2-940(c).

386. O.C.G.A. § 14-2-940(d).

387. O.C.G.A. § 14-2-204.

388. *G&E Constr. LLC v. Rubicon Constr. Inc.*, 357 Ga. App. 55, 57, 849 S.E.2d 785, 787-88 (2020).

389. *G&E Constr. LLC v. Rubicon Constr. Inc.*, 357 Ga. App. 55, 57, 849 S.E.2d 785, 787-88 (2020).

therefore, is distinct from alter ego liability. If the corporation has been incorporated and therefore exists, evidence that a person failed to observe corporate formalities or abused the corporate form is irrelevant to liability under O.C.G.A. § 14-2-204, even though such evidence might give rise to alter ego liability.[390]

1-12 CRIMINAL LIABILITY

1-12:1 Criminal Liability of Corporations

There are two ways in which criminal liability may attach to a corporation under Georgia law.[391] First, where the criminal statute clearly indicates an intent to impose liability on corporations, liability may attach whenever an agent of the corporation engages in the prohibited conduct while acting on behalf of the corporation in the scope of his or her employment.[392] As specifically outlined in O.C.G.A. § 16-2-22, "agent" is defined broadly as "any director, officer, servant, employee, or other person who is authorized to act in behalf of the corporation."[393] Thus, the test for corporate criminal liability in this situation closely resembles principles of respondeat superior in the civil context. To illustrate, a court has found clear statutory intent to hold corporations liable under Georgia's parental notification requirement for abortions.[394] On the other hand, it has been held that the Georgia RICO statute[395] and Georgia's deceptive business practices statute[396] were not clearly intended to apply to corporations.

Where no clear statutory intent to impose corporate criminal liability is found, the corporation can only be prosecuted if the crime is "authorized, commanded, performed, or recklessly tolerated" by the board of directors or by a "managerial official"

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390. *G&E Constr. LLC v. Rubicon Constr. Inc.*, 357 Ga. App. 55, 57, 849 S.E.2d 785, 787-88 (2020).

391. O.C.G.A. § 16-2-22; *Cobb Cty. v. Jones Grp. P.L.C.*, 218 Ga. App. 149, 153, 460 S.E.2d 516, 521 (1995); *See* Chapter 7 for a discussion of the RICO laws.

392. O.C.G.A. § 16-2-22(a).

393. O.C.G.A. § 16-2-22(b)(1).

394. O.C.G.A. § 15-11-118; *see Planned Parenthood Ass'n of Atlanta Area, Inc. v. Harris*, 670 F. Supp. 971 (N.D. Ga. 1987).

395. *Cobb Cty. v. Jones Grp. P.L.C.*, 218 Ga. App. 149, 153, 460 S.E.2d 516, 521 (1995); *Byrne v. Nezhat*, 261 F.3d 1075, 1105 (11th Cir. 2001).

396. O.C.G.A. § 16-9-50; *see Military Circle Pet Center No. 94, Inc. v. State*, 181 Ga. App. 657, 660, 353 S.E.2d 555, 559 (1987).

within the scope of that person's employment.[397] "Managerial official" is another specially defined term: it refers to an officer of the corporation or an agent with comparable policymaking or supervisory duties.[398] One decision has interpreted this to refer exclusively to "top management."[399]

While corporations obviously cannot be imprisoned for criminal violations, this does not mean that a court cannot impose a sentence. If necessary to effectuate the underlying legislative intent, a court may impose a sentence of confinement, then suspend that sentence and impose a fine.[400] This procedure has been used to defeat the argument that a corporation cannot be prosecuted and fined because the criminal statute in question provided only for incarceration.[401]

1-12:2 Criminal Liability of Persons Acting on or Under a Duty to Act on the Corporation's Behalf

Courts will recognize the separateness of a corporation and its principals and owners in the context of criminal proceedings, just as they do in civil cases.[402] The mere fact that evidence is sufficient to show that the corporation committed a crime does not, without more, support a finding of guilt on the part of the officer. Rather, evidence must still be shown indicating that the defendant was personally involved in or directed the criminal activity, or that the defendant is the alter ego of the corporation.[403] However, an officer cannot disclaim liability for criminal acts carried out through the instrumentality of a corporation that the officer "controlled and

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397. O.C.G.A. § 16-2-22(a)(2); *Davis v. State*, 225 Ga. App. 564, 565, 484 S.E.2d 284, 287 (1997) (discussing sufficiency of evidence to support conviction for theft by taking under O.C.G.A. § 16-2-22(a)(2)).

398. O.C.G.A. § 16-2-22(b)(2).

399. *Military Circle Pet Center No. 94, Inc. v. State*, 181 Ga. App. 657, 353 S.E.2d 555 (1987).

400. *State v. Shepherd Const. Co., Inc.*, 248 Ga. 1, 5, 281 S.E.2d 151, 157 (1981).

401. *State v. Shepherd Const. Co., Inc.*, 248 Ga. 1, 5, 281 S.E.2d 151, 156-57 (1981).

402. *See Fishman v. State*, 128 Ga. App. 505, 513, 197 S.E.2d 467, 473 (1973) ("[W]e have no evidence at all that [the defendant] and the corporation are a single entity. It must be presumed that they are entirely separate and distinct.").

403. *Fishman v. State*, 128 Ga. App. 505, 512-13, 197 S.E.2d 467, 472-73 (1973) (where State presented no evidence of corporate president's involvement in or knowledge of the alleged criminal activity (offering obscene magazines), and no evidence supporting the alter ego theory, the evidence was insufficient for conviction).

dominated in all respects."[404] Moreover, corporate agents who participate in and are responsible for criminal activity do not cease to be subject to prosecution simply because the corporation itself cannot be prosecuted.[405]

Under the federal "responsible corporate officer" doctrine, an officer or other person who stands in a "responsible relationship" within the corporation may face individual criminal liability for violations of laws and regulations that would create a "public danger."[406] At least one Georgia appellate court decision has discussed the doctrine without determining whether it applies in Georgia.[407] The court found the doctrine useful in construing the meaning of "person in charge" as used in a county fire ordinance, but ultimately held that the defendants (an apartment manager and maintenance supervisor) did not have sufficient responsibility within the company to face criminal prosecution.[408]

404. *Parish v. State*, 178 Ga. App. 177, 178, 342 S.E.2d 360, 362 (1986) (holding that officer could be prosecuted for writing bad checks drawn on the corporation's account); *Bailey v. State*, 84 Ga. App. 839, 842, 67 S.E.2d 830, 833 (1951) (upholding conviction of individual who embezzled funds through his solely owned corporation).

405. *See Byrne v. Nezhat*, 261 F.3d 1075, 1105 (11th Cir. 2001) (holding that fact that corporation could not be prosecuted for Georgia RICO violation did not prevent prosecution of responsible agents).

406. *See generally U.S. v. Dotterweich*, 320 U.S. 277, 64 S. Ct. 134, 88 L. Ed. 48 (1943).

407. *See O'Brien v. DeKalb Cnty.*, 256 Ga. 757, 353 S.E.2d 31 (1987).

408. *See O'Brien v. DeKalb Cnty.*, 256 Ga. 757, 353 S.E.2d 31 (1987).