BUSINESS ASSOCIATIONS

By JOE R. YOUNG, JR.*

The Georgia law of business associations continued its normal growth, expanding slightly by legislation and being modified by litigation. The cases during this period present a more interesting selection than those of earlier periods.

Probably the most interesting case decided during the past year established that in a proper case a receiver may be appointed to manage a corporation when there is a deadlock on the board of directors.[1] Plaintiff brought an action in equity seeking an injunction and appointment of a receiver. Plaintiff alleged that he and defendant each owned 50% of the capital stock of the corporation, that each was a director, that plaintiff was president and defendant was secretary-treasurer, that the bylaws provided that the entire general charge of corporate affairs was to be managed by a three-man board of directors, a majority of whom constituted a quorum, and that upon a vacancy the other two directors would elect a successor until the next election. It appeared that one of the directors had resigned, leaving plaintiff and defendant as the sole remaining directors and that they could not agree upon a succeeding director, nor could they agree on the operation of the business. Plaintiff further alleged that defendant refused to attend directors' meetings called by plaintiff, thereby preventing a quorum. Plaintiff also alleged that the business was losing money, and that the defendant was threatening to dispose of the business. The Supreme Court held that GA. CODE §55-301[2] provides that the judge of the superior court may appoint a receiver of a fund or of property having no one to manage it. Mere physical management by an unfriendly or irresponsible person might conceivably be worse than no management at all because it may amount to mismanagement and waste if not destruction and total loss. The defendant, while acting as general manager of the corporation under authority from the board of directors prior to their becoming deadlocked, was an agent of the corporation. Without authority from a majority of the board of directors, no single director of the corporation, or any agent or other person, may act for the corporation, and is without authority

* Associate in the firm of Hitch, Miller and Beckmann, Savannah, Georgia. B.A., Vanderbilt University, 1951; LL.B., Mercer University, 1956. Member of the Georgia Bar.

1. Farrar v. Pesterfield, 216 Ga. 311, 116 S.E. 2d 229 (1960).
2. GA. CODE ANN. § 55-301 (1961 Rev.).

to control and manage the business of the corporation. Although it appeared that there were two directors who together constituted a majority of the board of directors, they disagreed on the operation and management of the business of the corporation and were completely deadlocked. Therefore, the court concluded, the corporation was in fact left without anyone in legal control of its business operation or property. The court quoted with approval from the case of *Saltz v. Saltz Brothers, Inc.*,[3] as follows:

> Where stock of a corporation is owned in equal shares by two contending parties, which condition threatens to result in destruction of business, and it appears that the parties cannot agree upon management of business, and under existing circumstances neither one is authorized to impose its views upon the other, a court of equity may appoint a receiver to preserve the property of the corporation, administer it, and, if necessary, dispose thereof for the protection of creditors and owners.

The court therefore concluded that the petition did allege such a situation authorizing the appointment of a receiver.

Following the Supreme Court decision the trial judge entered an order appointing a receiver and from this order the defendant again appealed.[4] The defendant contended that the evidence showed that the corporation was publishing a newspaper at great financial loss and therefore the trial court had erred in ordering the receiver to preserve the status quo, thus compelling the corporation to operate at a loss to stockholders. The Supreme Court rejected this argument, pointing out that if it became apparent that the business was operating at a loss under the receivership it would be the duty of the receiver or of any interested party to bring that to the trial court's attention and seek further directions in the matter.

In another decision, the Supreme Court held, that while a director in buying stock from another stockholder has a duty of full disclosure when the sources of information are not equally accessible, there is no such corresponding duty to the corporation or other directors. Stock in a corporation owned by an individual is his property and the corporation is not concerned with the disposition of his stock. Nor is it any concern of the corporation as to who purchases the stock, even if it be for the purpose of gaining control of a majority of the outstanding stock.[5]

Primarily the right of action for a wrong suffered by the corporate interests is in the corporation, and even where the stockholder may bring

3. 84 F. 2d 246 (1936).
4. Tri-State Broadcasting Company, Inc. v. Pesterfield, 216 Ga. 381, 116 S.E. 2d 556 (1960).
5. King Manufacturing Company v. Clay, 216 Ga. 581, 118 S.E. 2d 581 (1961).

suit in accordance with GA. CODE § 22-711 (1933), the corporation must be made either a party plaintiff or party defendant.[6] Thus, where a minority stockholder suit was against the individual directors without making the corporation a party plaintiff or party defendant the suit was subject to general demurrer.

The bylaws of a corporation constitute permanent rules governing its management, and as such are binding upon the stockholders, who, as a rule, are presumed to have knowledge of the bylaws and cannot avoid their operation or escape liability on a plea of ignorance. This also applies to directors and other officers of the corporation. Further, the bylaws of a corporation are binding on the parties who enact them as contracts and must be construed according to the principles of the law of contracts. Thus a party is bound by the terms of the bylaws which he has executed without reading, if he can read, and was not prevented from reading by any artifice, or any device of the other contracting party, or by any emergency.[7]

Before a restriction on the transfer of stock is valid a notice of the restriction must appear on the certificate, therefore, a restriction appearing only on the minutes of a corporation is without effect.[8] The words "conditionally transferable" written across the top of each stock certificate, were not sufficient to comply with the requirements of GA. CODE § 22-1915 (1933), requiring that any restriction, to be valid, must be stated on the certificate itself. However, in the particular case the court held that such was sufficient to put one on notice to make inquiry to determine the restriction.[9]

A petition alleging that the plaintiff was elected vice-president of the defendant corporation for one year and until his successor was elected and qualified, and that he had been discharged without cause, stated a cause of action to recover the salary for the remainder of the year, against the contention that such position was terminable at will.[10]

In a suit on an open account, where one of the defendants denied being a partner, but the evidence showed the defendant to be a co-owner of the partnership property, the court held that such constituted a partnership as to third persons. Further, even though defendant was a silent partner, she would still be liable to everyone dealing with the partnership

6. Smyly v. Smith, 216 Ga. 529, 118 S.E. 2d 188 (1961).
7. Gwin v. Thunderbird Motor Motels, Inc., 216 Ga. 652, 119 S.E.2d 14 (1961).
8. Drennon Food Products Company v. Drennon, 101 Ga. App. 606, 114 S.E. 2d 799 (1960).
9. Floyd Construction Company v. Stanley, 101 Ga. App. 696, 115 S.E. 2d 231 (1960).
10. Drennon Food Products Company v. Drennon, 101 Ga. App. 606, 114 S.E. 2d 799 (1960).

for the contracts of the partnership so long as she remained a member thereof.[11]

When a third party corporation intervenes in an action and claims ownership of property levied on, the right of the claimant corporation to own the property may not be disputed by the plaintiff in *fi. fa.* as an ultra vires act.[12]

If a plea of *nul tiel* corporation is filed in an action by a foreign corporation, plaintiff must prove its act of incorporation and operation under its charter.[13]

Repairs on a company vehicle performed on the strength of the credit of an individual corporate officer who had agreed to pay the repair bill before the work was done, obligates the individual and not the corporation.[14] In an action to recover the balance due for the purchase of corporate stock, defendant could not set off a debt due the corporation from the plaintiff, since the defendant and the corporation were separate entities.[15]

The equitable doctrine, permitting a resident defendant to set off a tort claim in a contract action brought by a non-resident does not apply where the non-resident plaintiff is a corporation which has designated an agent within the state for the service of process, and is doing business in the county.[16]

STATUTES

The single legislative change of any distinction in this particular field is the creation of a hybrid business vehicle which might be classified as a "quasi-corporation". The Georgia Professional Association Act[17] was enacted apparently for the purpose of permitting professional men to enjoy the benefits of a corporation, yet retain some of the features of a partnership. The act is somewhat ambiguous, and to the writer at least, appears to have limited value. However, a professional association might well fill the gap now existing because of the prohibition against a corporation practicing certain professions. Such association might hire duly licensed professional men to render the professional service. In substance, the act provides for the formation of an unincorporated entity having more corporate than partnership characteristics. The association is formed

11. Wynn v. Charles S. Martin Distributing Company, 103 Ga. App. 81, 118 S.E. 2d 384 (1961).
12. United States Fidelity and Guaranty Company v. Coastal Service, Inc., 103 Ga. App. 133, 118 S.E. 2d 710 (1961).
13. Baker v. Metallizing Company of America, 103 Ga. App. 174, 118 S.E. 2d 843 (1961).
14. Summerour v. Burt, 102 Ga. App. 687, 117 S.E. 2d 542 (1960).
15. McLendon v. Galloway, 216 Ga. 261, 116 S.E. 2d 208 (1960).
16. Gordy Tire Company v. Dayton Rubber Company, 216 Ga. 83, 114 S.E. 2d 529 (1960).
17. Ga. Laws 1961, pp. 404-13.

by the recording of "articles of association" with the clerk of the superior court in the county of the association's principal office. Such recording constitutes notice to the world. The association must be limited to one profession, however, it may invest and own other properties. The association can render professional services only through licensed or legally authorized officers, agents and employees. The Act however is ambiguous as to whether non-licensed or non-qualified persons might serve under the direct supervision of licensed persons who in turn would render professional services to the public. The Act provides that it does not modify the law relating to liability or the relationship between such professional people and the public, however, it does provide that the members would not be individually liable for the association's debts unless such member personally participated in the transaction out of which the debt arose. The association is to be governed by a board of governors which would in turn elect the officers. The Act provides for the adoption of bylaws. The association is to constitute a separate entity for such time as is provided in the articles or until the association is dissolved by a two-thirds vote of its members. The association would have a continuity of existence unknown to a partnership and, except as above stated, would continue indefinitely, regardless of the death of members or any similar act or occurrence sufficient to dissolve a partnership. The Act provides for ownership and sale of stock or, in the alternative, for undivided interest in the association's property. An estate of a deceased member may retain stock for a reasonable administrative period. Whenever a member becomes disqualified to practice such member must sever all interest and connection with the association, or subject the association to a possible forfeiture of its right to practice as an association. The method for determining the value of a former member's interest is set forth in the Act where it is not otherwise specifically provided for in the articles or bylaws. The association is required to render a report to the Secretary of State upon organization, and annually thereafter. Ownership is restricted to persons authorized to practice the particular profession. On dissolution assets must be used first to pay the debts of the association with the balance being distributed to the stockholders or members. The association is a separate entity with general powers to contract, own property, sue and be sued, etc. The association's assets are not subject to attachment for debts of the individual members. The association is to be governed by the law of corporations and not the law of partnerships where corporate law is in conflict with the Act itself. The law entitled, Actions By or Against Unincorporated Organizations or Associations,[18] was adopted

18. Ga. Laws 1959, pp. 44-46, GA. CODE ANN. §§ 3-117 through 121 (1960 Supp.).

by reference and is to apply to professional associations. [See the discussion of this Act, 11 Mercer L. Rev. 32-33 (1959).]

Another Act passed during the survey period[19] slightly changes the procedure for obtaining an exemption for the sale of securities by requiring that in certain instances the issuer of such securities request an exemption from the commissioner, and furnish the required information.

Persons may now reside farther away from the city in which a bank is located and still qualify as directors. The former limit of twenty-five miles has been extended to forty miles.[20]

Apparently corporations can now contract usurious loans and the stockholders will be unable to complain.[21]

19. Ga. Laws 1961, p. 457.
20. Ga. Laws 1961, p. 196 (Act 193).
21. Ga. Laws 1961, p. 300.