Business Associations

By Robert Park Bryant*

This survey article deals with recent Georgia cases and statutory developments in the areas of partnerships, corporations, and securities regulation.

I. Partnerships

A. *Existence of a Partnership*

Jackson v. Jackson[1] involved a business operated by two brothers. Plaintiff, N. Jackson, contended that he and his brother operated the business as a partnership, although without benefit of a written agreement, and that they had agreed to share the financial results of the business equally. R. Jackson denied that there was a partnership arrangement and contended that only he had contributed funds toward the operation of the business. After N. Jackson left the business, R. Jackson continued its operation for some time but then sold out. N. Jackson sued to obtain a share of the profits from operations conducted after he left and from the sale. The jury found that a partnership did exist, but awarded plaintiff substantially less than half of the sale proceeds and none of the proceeds from operations conducted after plaintiff left the business. On appeal, plaintiff apparently contended that if a partnership were found it could only be on the "fifty-fifty" basis that he had asserted.

First, the court of appeals reaffirmed the principles that in Georgia a partnership may be formed through either a written or an oral agreement and that the intention of the parties controls whether the terms of the partnership agreement vary the characteristics normally inferred from a partnership arrangement.[2] The court then concluded that the jury was entitled to find both that a partnership existed and that the arrangement

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1. 150 Ga. App. 87, 256 S.E.2d 631 (1979).
2. *Id.* at 88, 256 S.E.2d at 632.

was not for equal sharing of the partnership's gains and profits.[3] The primary significance of *Jackson* may be merely to suggest that conducting a business jointly without clearly fitting it into some recognized form will raise the implication that a partnership was intended.

B. Liability of Partners

In *Westwood Place, Ltd. v. Green*,[4] the trustees of a trust sued to collect two notes executed to the trust by a limited partnership. The significant issue of partnership law raised by the case concerned the liability on the notes of one of the partners, who became a limited partner about the time the notes were signed and became a general partner after the litigation began.[5] Plaintiffs asserted that this partner was liable both as a general partner and as a limited partner.[6]

In determining that the partner was not liable as a general partner, the court of appeals applied the statute[7] that limits the liability of an incoming partner for then-existing partnership debts to those debts that are expressly assumed for a sufficient consideration.[8] The court found that the agreement admitting this partner to the partnership did not contain the requisite express assumption of liability.[9] Unfortunately for the defendant partner, the partnership agreement provided that each limited partner should " 'assume the liability for his proportionate share . . . of any mortgage or like financing on the partnership property assumed by the partnership. . . .' "[10] Rejecting defendant's claim that the quoted provision only established his liability to the partnership, the court held that the defendant partner was liable on the notes to the extent of his thirty percent interest in the partnership's profit and loss.[11]

Together with reaffirming the extent of an incoming partner's liability, *Westwood* suggests that those drafting partnership agreements can control by careful wording whether anyone other than the partnership may hold a partner liable on the basis of his required capital contributions.

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3. *Id.* at 89, 256 S.E.2d at 632.
4. 153 Ga. App. 595, 266 S.E.2d 242 (1980).
5. *Id.* at 595, 266 S.E.2d at 243.
6. *Id.* at 597, 266 S.E.2d at 244.
7. GA. CODE ANN. § 75-205 (1979).
8. 153 Ga. App. at 597, 266 S.E.2d at 244.
9. *Id.* at 598, 266 S.E.2d at 244.
10. *Id.*
11. *Id.* at 599, 266 S.E.2d at 245.

II. CORPORATIONS

A. *Derivative Actions*

Two recent decisions considered aspects of shareholder derivative actions. The plaintiffs in *C&S Land, Transportation & Development Corp. v. Yarbrough*[12] initially brought a shareholders' derivative action against their corporation and certain of its officers and agents alleging waste of corporate assets. More than two years later, plaintiffs added to their complaint a personal action against certain of the corporate officers and agents alleging securities law violations in connection with plaintiff's initial investment in the corporation.[13] The relevant issues arose from defendants' contentions that, first, by adding a personal claim to a derivative suit in which they in effect represented the corporation, plaintiffs were suing themselves[14] and, second, when plaintiffs added the personal claim to their complaint they had added a new party without the trial court's consent.[15]

In rejecting the first claim, the court of appeals analyzed the nature of a derivative claim:

> As minority stockholders, the cross appellants have a derivative interest in any recovery accruing to the corporation. Thus a recovery by the corporation from its agents or officers, though directly benefiting the corporation, also ultimately benefits the stockholders. However, this issue has no effect on whether the corporation through its officers or agents misrepresented the corporation so as to work an injustice or fraud on its stockholders in a sale of its certificates of ownership. The recovery or failure of recovery by the corporation of its assets based upon the malfeasance of its corporate officers and agents is not inextricably related to and does not terminally infect the right of minority stockholders to sue the corporation for return of their investment because of the malfeasance of the same officers and agents, though it might affect the amount of any eventual recovery.[16]

In addition, the court concluded that a new party had not been added to the suit. Rather, "what [was] involved [was] a change in the capacity of the parties plaintiff."[17]

In *Hasty v. Randall*,[18] the court of appeals applied the statutory provision requiring the plaintiff in a derivative action to "allege with particu-

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12. 153 Ga. App. 644, 266 S.E.2d 508 (1980).
13. *Id.* at 644, 266 S.E.2d at 509.
14. *Id.* at 647, 266 S.E.2d at 511.
15. *Id.* at 648, 266 S.E.2d at 511.
16. *Id.*
17. *Id.* at 649, 266 S.E.2d at 512.
18. 152 Ga. App. 365, 262 S.E.2d 626 (1979).

larity the efforts of the plaintiff to secure the initiation of such action by the board of directors . . . or the reasons for not making such effort."[19] Since plaintiff had done neither, his complaint failed to state a claim. The court left unaddressed the issue of which circumstances excuse a derivative plaintiff from seeking action from the board of directors.

B. Access to Corporate Books and Records

Section 22-613(b) of the Business Corporation Code[20] grants to shareholders who meet certain ownership requirements the "right to examine . . . at any reasonable time or times, for any proper purpose, its [the corporation's] books and records of account, minutes and record of shareholders."[21] In *Riser v. Genuine Parts Co.*,[22] the court of appeals applied this provision to a demand for access to corporate books and records made by a shareholder of a large, publicly traded company with over 6,000 shareholders.[23] Although the corporation had supplied a substantial quantity of the requested material, it refused access to much of what plaintiff requested.[24]

Conceding that the shareholder's stated goal in seeking the disputed information "to determine whether proper records are being kept, the performance of management and the condition of the company"[25] met the statute's requirement of a "proper purpose," the court of appeals focused its inquiry on the scope of the term "books and records of account."[26] Although the court appeared to suggest that "work sheets" and income tax returns would normally not be subject to a shareholder's demand

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19. GA. CODE ANN. § 22-615(b) (1977).
20. GA. CODE ANN. § 22-613(b) (1977).
21. *Id.*
22. 150 Ga. App. 502, 258 S.E.2d 184 (1979).
23. *Id.* at 503, 258 S.E.2d at 186.
24. The court summarized the records in dispute as follows:

> Refused were profit and loss statements for the past five years of the defendants' 286 company-owned jobbing stores . . .; earnings projections for all divisions and subsidiaries . . .; the attorneys' work papers and other files relating to the investigation of Genuine Parts Co. by the Federal Trade Commission; records of investments of pension and retirement funds of the defendant, its divisions and its subsidiaries; all data relating to a merger between Motion Industries and defendant, including the statements and opinions of the attorneys; all corporate tax returns, all reports submitted to the board of directors of [sic] management by the auditors . . ., and all records relating to aircraft purchase, maintenance, and flight logs. . . .

Id. at 502-03, 258 S.E.2d at 185-86.
25. *Id.* at 503, 258 S.E.2d at 186.
26. *Id.* at 504, 258 S.E.2d at 186. The court concluded at the outset that records of the manner in which the amounts the corporation contributed to its employee pension plan were invested should be disclosed.

under Georgia Code Ann. section 22-613(b),[27] the court in general deferred to the discretion of the trial court for a determination of what corporate books and records must be disclosed. The court suggested that the following factors would inform the exercise of the trial court's discretion:

> Whether the purpose named is a proper one, whether the request is vexatious or arising from idle curiosity, whether the documents called for are relevant, material and not over burdensome, whether granting the requests would violate principles of confidentiality, lead to legal difficulties with federal agencies, or give an unfair advantage to petitioning stockholders. . . .[28]

Moreover, the court approved the conclusion of the trial judge in *Riser* that the plaintiff had the burden of showing a proper purpose for each requested type of information and that the burden should be greater as " 'the information sought becomes increasingly remote from the statutory objects of "books and records of account, minutes and record of shareholders." ' "[29]

Although the court's suggestion of factors to be considered in determining the propriety of a shareholder's demand is well taken, more difficult issues remain to be resolved. In particular, the court did not consider whether the statute's requirement of selective disclosure of otherwise non-public information to certain shareholders can ever be consistent with the obligations of corporations under the federal securities laws.

C. *Repurchase of Stock by Issuing Corporation*

Although Georgia corporations generally have considerable flexibility in repurchasing their own shares, the Business Corporation Code restricts their power to do so in several ways, one of the more fundamental of which is that no purchases may be made "for any purpose at a time when the corporation is insolvent."[30] The plaintiff in *Hullender v. Acts II*[31] sought to except from this rule repurchases made by an insolvent corporation when no corporate creditors would be prejudiced.[32] Plaintiff, as part of a divorce settlement, transferred all of her stock in a corporation owned solely by her and her former husband to the corporation in exchange for a note. Pointing out that it was insolvent at the time it agreed to repurchase plaintiff's stock, the corporation asserted that under Geor-

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27. *Id.*
28. *Id.* at 505, 258 S.E.2d at 187.
29. *Id., quoting* from the trial court's opinion.
30. GA. CODE ANN. § 22-513(e) (1977).
31. 153 Ga. App. 119, 264 S.E.2d 486 (1980).
32. *Id.* at 120, 264 S.E.2d at 487.

gia Code Ann. section 22-513(e)[33] the contract to repurchase was void. Plaintiff argued that the corporation "should not be permitted to take advantage of its own insolvency to avoid liability for its obligations where, as here, no creditor is involved."[34] The court acknowledged that there existed authority from other jurisdictions supporting plaintiff's argument but concluded that the statute "contains an absolute prohibition and does not provide exceptions for its application."[35] Although the court had no occasion to address the issue, it may be that, had plaintiff obtained from the corporation in the repurchase agreement a warranty that the corporation was solvent, a cause of action for a breach of that warranty would have been sustained.

D. Stock Transfer Restrictions

In a case discussed in last year's survey,[36] the supreme court held that a bylaw containing a stock transfer restriction was invalid because it was adopted by the corporation's incorporator rather than its directors. That holding validated a pledge of stock that might otherwise have been prohibited by the transfer restriction. Subsequent to that ruling, the corporation's directors adopted bylaws containing the same transfer restriction, in an apparent attempt to prevent the pledgee from foreclosing upon and selling the shares held by it.

Seeking to block enforcement of the pledgee's security interest, the corporation's shareholders, in *Bloodworth v. Sandersville Production Credit Association*,[37] contended first that the pledged stock was issued before the adoption of the initial bylaws and therefore was void.[38] The court did not decide directly that such a contention could not be made. Rather, it held that plaintiffs were estopped to make the argument because if they prevailed on that basis "the appellant stockholders would not be stockholders and the corporation would have no right to keep the paid-in capital which authorized it to commence business seven years ago."[39] Second, responding to plaintiff's contention that the restriction in the newly adopted bylaws prohibited the pledgee's proposed sale, the court concluded that it need not decide the general question of whether a stock transfer restriction adopted after stock had been issued could be enforced against protesting shareholders, since the equities here were clearly in

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33. *See* note 30 *supra*.
34. 153 Ga. App. at 120, 264 S.E.2d at 487.
35. *Id.*
36. Avant v. Sandersville Prod. Credit Ass'n, 243 Ga. 173, 253 S.E.2d 176 (1979). *See* Ribstein, *Annual Survey of Georgia Law: Corporations*, 31 MERCER L. REV. 43, 55 (1979).
37. 245 Ga. 40, 262 S.E.2d 804 (1980).
38. *Id.* at 42, 262 S.E.2d at 805.
39. *Id.* at 42, 262 S.E.2d at 806.

favor of the pledgee, who had been prevented from enforcing his security interest prior to the adoption of the new restrictions only by the plaintiff's litigation.[40]

E. Service of Process on Foreign Corporations

Plaintiff in *Spiegel, Inc. v. Odum*[41] conceded that the defendant foreign corporation did not transact business in Georgia and therefore was not required to qualify to do business in Georgia as a foreign corporation.[42] Nonetheless, plaintiff asserted that under Georgia Code Ann. section 22-1410(b)[43] service could be perfected on the defendant by service on the Secretary of State.[44] The court rejected plaintiff's argument, concluding that the applicable Business Corporation Code section dealt only with foreign corporations that had qualified to do business or that should have qualified.[45] Accordingly, service could not be perfected on defendant through service on the Secretary of State.

F. Powers of a Liquidating Receiver

Plaintiffs in *Nesmith v. J&G Shoes, Inc.*[46] invoked the provisions of the Business Corporation Code that grant to the superior courts the power to liquidate a corporation when, among other reasons, the directors are deadlocked.[47] The court appointed a receiver to liquidate the corporation's assets. The receiver found that certain shareholders had received overpayments of salary in their capacity as corporate officers and set off the excess amounts against the distribution made to these shareholders in the liquidation of the corporation. In rejecting the shareholders' claim that the setoffs were improper, the court first concluded that "a liquidating receiver directed to marshall and sell the assets of a corporation has the power to investigate and record the debts owed to the corporation. He has this power notwithstanding the fact that those debts were incurred prior to his appointment."[48] Since the salary overpayments constituted a

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40. *Id.* at 43, 262 S.E.2d at 806.
41. 153 Ga. App. 380, 265 S.E.2d 297 (1980).
42. *See* GA. CODE ANN. § 22-1401 (1977).
43. GA. CODE ANN. § 22-1410(b) (1977).
44. 153 Ga. App. at 381, 265 S.E.2d at 299. The statute relied upon provides in relevant part as follows: "Whenever a foreign corporation doing business or having done business in this State shall fail to appoint or maintain a registered agent in this State . . . then the Secretary of State shall be an agent of such corporation upon whom any such process, notice, or demand may be served." GA. CODE ANN. § 22-1410(b) (1977).
45. 153 Ga. App. at 382, 265 S.E.2d at 299.
46. 244 Ga. 244, 260 S.E.2d 3 (1979).
47. *Id.* at 244, 260 S.E.2d at 4. *See* GA. CODE ANN. § 22-1317(a)(1)(A) (1977).
48. 244 Ga. at 246, 260 S.E.2d at 5.

debt owed the corporation, the receiver had the power to proceed to collect it. Second, the court invoked the principle that a debtor cannot insist that his creditor pursue a particular method of collecting the debt. Since setoff "is a traditional means of satisfying mutual debts,"[49] the receiver's action was appropriate.

III. SECURITIES REGULATION

A. *Sale of Limited Partnership Interests*

In *Hirsch v. Equilateral Associates*,[50] the court considered claims by purchasers of limited partnership interests in a partnership involved in real estate investment that the interests had been sold without the required registration of the sellers as "dealers" or "salesmen" and without registration of the limited partnership interests themselves. The court first concluded that no registration of the individual defendants as "dealers" or "salesmen" was required since the statute excepts from the applicable definitions "any general partner, or executive officer of any general partner of an issuer or executive officer of an issuer."[51] Next the court considered whether the exemption from securities registration provided by section 9(m) of the Georgia Securities Act[52] for transactions that are in effect private placements had been met. Conceding that three of the four requirements had been satisfied, the court focused on the necessity to "legend" securities issued in reliance on the section 9(m) exemption.[53] The court found that the only document involved in the issuance of the limited partnership interests was the Certificate and Agreement of Limited Partnership recorded with the superior court and that the certificate did not "represent" fractional shares of the entity but rather was "an instrument for the formation of a legal entity, defining the rights and limitations of the entity."[54] Since there was no "certificate" to which a legend could be affixed, that requirement was meaningless in determining

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49. *Id.*

50. 245 Ga. 373, 264 S.E.2d 885 (1980).

51. *Id.* at 376, 264 S.E.2d at 888. *See* GA. CODE ANN. §§ 97-102(a)(5) and 102(a)(15) (1976).

52. GA. CODE ANN. § 97-109(m) (1976).

53. The statute provides in pertinent part as follows:

> (3) any certificate or certificates representing such securities [shall be] marked for a period of one year from the date of such issuance or sale to indicate clearly that they were issued or sold in reliance on this exemption and that they cannot be sold or transferred except in a transaction which is exempt under this Act or pursuant to an effective registration statement under this Act or in a transaction which is otherwise in compliance with this Act.

Id. § 97-109(m)(3).

54. 245 Ga. at 377, 264 S.E.2d at 889.

whether the private placement exemption was available. Consequently, the sale of the limited partnership interests did not violate the securities registration provisions of the Georgia Securities Act.[55]

IV. LEGISLATION

The 1980 session of the Georgia General Assembly made a substantial number of changes to the statutes dealing with Georgia corporate law, some of which are of considerable significance.

Georgia Code Ann. section 22-501(b)(1)[56] has been amended to add flexibility to the characteristics that a corporation may confer on shares of its preferred stock. Prior to the amendment, only the corporate issuer of preferred stock could compel its redemption.[57] As modified, the section provides that preferred stock may be made redeemable at the option of the holder, pursuant to the conditions fixed by the articles of incorporation.

The legislature added new subsection (k) to Georgia Code Ann. section 22-1314.[58] The new section provides an expedited involuntary dissolution procedure for a corporation that has failed to file any of the annual reports required by Georgia Code Ann. section 22-1502[59] for the years 1969 through 1978. Under the new provision, the Secretary of State need only publish one notice of involuntary dissolution thirty days prior to the issuance of the certificate of involuntary dissolution and need not mail a copy of the certificate of involuntary dissolution to the corporation's registered office or last known address.

Georgia Code Ann. section 22-1417[60] grants to the Secretary of State the power to revoke the certificate of authority of a foreign corporation under certain circumstances. The legislature now has added section 22-1417.1[61] to the Business Corporation Code to establish a reinstatement procedure for a foreign corporation whose certificate of authority has been so revoked. The certificate of reinstatement may be issued within five years after the date of the certificate of revocation. The corporation must correct the cause of the revocation and remit to the Secretary of State all taxes, penalties, and fees due prior to the revocation and that would have been due during the period between revocation and reinstatement.

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55. *Id.*
56. GA. CODE ANN. § 22-501(b)(1) (Supp. 1980).
57. GA. CODE ANN. § 22-501(b)(1) (1977).
58. GA. CODE ANN. § 22-1314(k) (Supp. 1980).
59. GA. CODE ANN. § 22-1502 (1977).
60. GA. CODE ANN. § 22-1417 (1977).
61. GA. CODE ANN. § 22-1417.1 (Supp. 1980).

The legislature amended Georgia Code Ann. section 22-502[62] to increase the flexibility available to the board of directors with respect to series of preferred stock. Section 22-502, prior to its amendment, authorized the board generally to fix the rights and preferences of a series of preferred stock, if that power had been granted to the board by the articles of incorporation.[63] The amendment adds flexibility by permitting the directors, if authorized by the articles of incorporation, both to establish the number of shares issuable in a particular series at the time of the initial establishment of the series and to increase and decrease the number of shares in the series at their discretion, so long as the number is not decreased below the number of shares of such series then outstanding.

The more minor amendments to the Business Corporation Code include the following: Georgia Code Ann. section 22-803(c)(6)[64] now requires an incorporator or his attorney to deliver to the Secretary of State, at the time the articles of incorporation are filed, the written consent of the proposed registered agent to serve as registered agent of the corporation. Georgia Code Ann. sections 22-1408(c)[65] and 22-1405(a)(12)[66] now require, respectively, that a registered agent of a foreign corporation cannot be appointed without its prior written consent and that the consent of the registered agent must be filed with the Secretary of State when the foreign corporation applies for a certificate to transact business in Georgia. The option previously provided by Georgia Code Ann. section 22-402[67] whereby a corporation could change its registered office or registered agent by indicating the change on the annual report filed by the Secretary of State has been eliminated by the legislature.

62. GA. CODE ANN. § 22-502 (Supp. 1980).
63. GA. CODE ANN. § 22-502 (1977).
64. GA. CODE ANN. § 22-803(c)(6) (Supp. 1980).
65. GA. CODE ANN. § 22-1408(c) (Supp. 1980).
66. GA. CODE ANN. § 22-1405(a)(12) (Supp. 1980).
67. GA. CODE ANN. § 22-402 (1977).