The Development of the Shareholder's Direct Action Damage Remedy

by Wade H. Watson, III and J. Bertram Levy

Over the past decade Georgia courts have recognized a new cause of action for shareholders known as the direct action.[1] Under certain circumstances, a shareholder who contends that he has been damaged as a result of a breach of corporate fiduciary duties may now recover compensatory damages, punitive damages, and attorney's fees directly against the majority or controlling shareholders, officers, or directors of a corporation and is not required to bring a derivative action for the benefit of the corporation.[2] Georgia's recognition of this new damages remedy is consistent with the development of the law in a number of other states,[3] and has significant implications for corporate and tort practitioners. This article traces the origin of the direct action, discusses the cases that demonstrate its application, and identifies some of the unresolved issues facing the litigants in a direct action.

I. Origin of the Shareholder's Direct Action

A. *The Close Corporation Environment*

The shareholder's direct action damage remedy was created to respond to the unique problems of the close corporation.[4] In their treatise on close corporations, Professors O'Neal and Thompson define the close corporation as having the following attributes:

> (1) the shareholders are few in number, often only two or three; (2) they usually live in the same geographical area, know each other, and are well acquainted with each other's business skills; (3) all or most of the shareholders are active in the business, usually serving as directors or officers or as key participants in some managerial capacity; and (4) there is no established market for the corporate stock, the shares not being listed on a stock exchange or actively dealt in by brokers; little or no trading takes place in the shares.[5]

As the Georgia Supreme Court has noted, the formalities of corporate governance are frequently not observed:

> [T]he participants very often fail to hold shareholders' and directors' meetings and to distinguish between the two, they neglect to keep books and records or to keep them properly, they fail to maintain a separate bank account for the corporation, and they often do business by resolution and do not go through the procedure of authorizing expenditures such as salaries.[6]

Frequently, the close corporation is formed by a small group of entrepreneurs who derive their principal employment and income from the corporate enterprise and who view themselves essentially as partners.[7] A second common occurrence is the corporation formed by a single dominating entrepreneur who then distributes corporate stock among members of his family.[8]

The most important characteristic of the close corporation for the purposes of a direct action claim is the absence of a ready market for the corporation's stock. In the absence of such a market, when a dispute among the owners of a close corporation arises, the minority shareholder cannot liquidate his investment and protect himself from abusive policies or unfair practices of the controlling shareholders. In *Comolli v. Comolli*,[9] the Georgia Supreme Court explained the vulnerability of the minority shareholder this way:

> In close corporations, minority stockholders may easily be reduced to relative insignificance and their investment rendered captive, because ordinarily there is no market for minority stock in a close corporation and a minority stockholder cannot easily liquidate his investment for its true value. We recognize that these circumstances may arise in close corporations at any time through combinations of stockholders, sales of stock between stockholders or to third parties and are inherent in the organization of corporations.[10]

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Because of these attributes of the close corporation, the minority shareholder is particularly at risk for unfair treatment.[11] As the Court of Appeals has observed, "[m]inority shareholders in close corporations in particular are susceptible to freeze-out by the majority shareholder."[12] This recurring pattern of abuse is also referred to as a "squeeze-out." The purpose of a typical squeeze-out is to deny the minority shareholder a fair return on his ownership interest in the corporation or to force the minority shareholder to sell his stock to the controlling shareholder for less than its true value, or both.[13]

Squeeze-out techniques include: withholding dividends; siphoning off earnings by high compensation to majority shareholders; withholding information; diverting corporate earnings by making leases and loans favorable to majority shareholders, by having other enterprises controlled by the majority shareholder perform services for the corporation, or by making other fraudulent or unfair contracts; appropriating corporate assets; obtaining contracts or credit for personal use; usurping corporate opportunities; arranging unfair transactions between a parent corporation and partly owned subsidiaries; donating to pet charities; and diluting a minority shareholder's interests through the issuance of stock.[14] The consequences of being the target of a squeeze-out campaign can be devastating to the minority shareholder's economic interests.[15]

B. Limitations of the Traditional Derivative Action

Georgia has traditionally provided a number of remedies to redress unfair treatment of minority shareholders by those in control of a corporation. These remedies include the shareholder's derivative action,[16] judicial dissolution,[17] and judicial appointment of a receiver to either wind up and liquidate or to act as a custodian to manage the affairs of the corporation.[18] Despite the apparent scope of these remedies, Georgia courts have recognized that there are circumstances, particularly in the close corporation environment, in which these remedies are inadequate.

For example, consider these remedies in the context of a squeeze-out in the hypothetical *XYZ* corporation, which is owned entirely by shareholders *A* and *B*. *A* owns 51% of the stock and *B* owns 49%. *A* and *B* participate jointly in the management of the corporation and receive periodic distributions of the profits of the corporation in the form of salary, bonuses, perquisites, and other arrangements, none of which are treated as declared dividends. *A* and *B* have a bitter dispute over the management of the corporation. *A* uses his controlling position to terminate *B's* participation in management and also ceases distribution of any of the corporation's profits to *B*. *A* distributes all of the profits to himself or siphons them

off into other enterprises which *A* alone controls. *A* then offers to buy *B's* stock for a fraction of what *B* believes it to be worth.

The traditional derivative action fails to provide a damage remedy which would enable the minority shareholder *B* to participate in the distribution of corporate profits and thereby defeat the squeeze-out effort initiated by *A*. In a derivative action, the minority shareholder sues "for the benefit of the corporation" and alleges that the conduct of the majority has caused an injury to the corporation.[19] The shareholder who brings a derivative action must fairly and adequately represent the interests of the corporation in enforcing the rights of the corporation.[20] The minority shareholder may not participate directly in any recovery that may be made by the corporation as a result of the action.[21]

The inadequacy of the derivative action remedy under the facts of the hypothetical described above is apparent. *B* would bring a derivative action and allege that A's conduct caused damage to the *XYZ* corporation by causing it to pay excessive salaries or by usurping corporate opportunities. If *B* prevailed, the *XYZ* corporation would obtain a judgment against *A*. While *B* may recover his attorney's fees and expenses of litigation,[22] *A* will retain effective control over the profits of the *XYZ* corporation which he has withheld from *B* because *A* continues to control the corporation. *A* may use corporate funds to defend the suit,[23] and if he loses, the recovery simply enhances the value of the *XYZ* corporation and provides a source of funds for future distributions to *A*. If *B* wins, *B* will receive no actual damages and in the absence of the grant of extraordinary equitable relief such as dissolution or a buyout,[24] *B* will never obtain a return on his equity interest in *XYZ* corporation. This result advances *A's* squeeze-out effort. Thus, in a squeeze-out situation, it has been observed that the derivative action benefits the parties who were guilty of the misconduct which gave rise to the action, not the parties who were aggrieved by it.[25]

C. Creation of the Direct Action

The response of the Georgia courts to this situation has been to permit a minority shareholder in a closely held corporation to bring an action directly against the majority shareholder to recover damages resulting from the misappropriation of corporate funds or assets.[26] The existence of such a damage remedy was first recognized as being available "in various rare circumstances" in the 1973 decision of *Pickett v. Paine*,[27] but was not applied under the facts of that case. In *Paine*, the minority shareholder complained of misappropriation and waste of corporate assets by the majority shareholder. The minority shareholder asserted a derivative claim on behalf of the corporation and also sought damages as compensation for undeclared dividends and a division of corporate profits.[28] The Georgia Supreme Court began its analysis by restating the general rule that shareholders, except in various rare circumstances, may not recover directly.[29] The Court observed that under the general rule, the minority shareholder could only realize his interest "indirectly through the declaration of dividends or other corporate agreement by which such minority shareholder would be allowed a portion of the profits as perhaps related to his percentage interests in the corporations."[30] The Georgia Supreme Court refused to allow the shareholder to recover directly, concluding that the minority shareholder could gain complete relief through the traditional derivative action or through liquidation of the corporation and its assets.[31]

Four years later, in *Davis v. Ben O'Callaghan Co.*,[32] the Georgia Supreme Court permitted a judgment creditor of a corporation to bring a direct action against a corporate officer based upon the officer's waste of corporate assets. In reaching that holding, the Court characterized *Paine* as authorizing a shareholder to bring a direct action under the proper circumstances.[33] While recognizing that the exceptions to the derivative action requirement were not clearly defined, the Court suggested that direct actions are authorized:

> [W]hen to allow the corporation to retain the proceeds of the judgment would actually benefit the parties who were guilty of the very misconduct which gave rise to the action . . . [or] where there is some relationship between the shareholder and the wrongdoer, arising out of a special fiduciary or contractual relationship, independent of the usual shareholder and director relationship.[34]

The Georgia Court of Appeals echoed this theme in the 1981 case of *Pelletier v. Schultz*.[35] In that case, a minority shareholder obtained a default judgment based upon a complaint which included a direct action claim for breach of fiduciary duties against the defendant shareholders. The defendants did not contest the plaintiff's right to sue directly, but appealed on the grounds that the plaintiff had failed to introduce evidence to establish the amount of his damages as required by Rule 55(a) of the Civil Practice Act. The Court agreed, finding that the plaintiff's direct action claim against the defendant shareholders sounded in tort for breach of fiduciary duties, was properly classified as *ex delicto,* and required that the amount of damages be proven.[36] Although the availability of the direct action was not at issue

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"Under certain circumstances, a shareholder who contends that he has been damaged as a result of a breach of corporate fiduciary duties may now recover compensatory damages, punitive damages, and attorney's fees directly against the majority or controlling shareholders, officers, or directors of a corporation and is not required to bring a derivative action for the benefit of the corporation."

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in the appeal, the Court discussed the plaintiff's theory of recovery in some detail and quoted the language from *Davis v. Ben O'Callahan Co.* describing the circumstances in which a shareholder's direct action is appropriate.[37]

Ten years after the Georgia Supreme Court first recognized the availability of the direct action "in various circumstances," the Court finally gave definition and scope to this damage remedy in the 1983 decision of *Thomas v. Dickson*.[38] In that case, Messrs. Dickson, Thomas, and Akin owned and operated a closely held corporation. Each shareholder owned one-third of the stock and each received $1000 per month in salary plus one-third of any profits of the corporation as additional compensation.[39] When Dickson died, Thomas and Akin attempted to acquire his stock from his estate by paying his widow a $5000 death benefit.[40] When she refused to sell, the other shareholders continued to pay the corporate profits to themselves in the form of compensation and denied Mrs. Dickson right to participate in any of these distributions.[41] In effect, she was the victim of a squeeze-out technique intended to force her to sell her shares at less than their true value.[42] Mrs. Dickson brought a direct action against the other shareholders to recover one-third of the profits which they had paid to themselves as compensation. The defendants responded by contending that she was required to bring a derivative action.

The trial court permitted the direct action to proceed and the jury awarded damages to Mrs. Dickson equal to what they found to be her husband's share of the profits which had been paid to the controlling shareholders.[43] The jury also awarded punitive damages and attorneys' fees.[44] Citing *Davis* and *Pelletier*, the Court of Appeals approved the direct action because it found it unfair to allow the corporation to retain the proceeds of the judgment when this result would actually benefit the parties who were guilty of the misconduct which gave rise to the action.[45]

On certiorari, the Georgia Supreme Court affirmed the ruling of the Court of Appeals. The Supreme Court declared that "[a]lthough Georgia follows the general rule [requiring derivative actions], we believe that in exceptional situations this Court and our other state courts should look at the 'realistic objectives' of a given case to determine if a direct action is proper."[46] The Supreme Court cited with approval authorities which supported the Court of Appeals' rationale.[47] However, the Supreme Court rejected what it described as the "blanket rule" for permitting direct actions adopted by the Court of Appeals because that rule focused solely on the benefit to the alleged wrongdoer and failed to consider the "possibility of prejudice" to other interested parties, such as creditors and other shareholders.[48] Instead the Supreme Court found that the availability of the direct action depends upon the realistic objectives of the suit and a four part analysis of whether the reasons for requiring derivative actions apply.[49]

The *Thomas* court observed that the reasons for the general rule requiring derivative actions are that:

> 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.[50]

The Court then looked at the facts of the *Thomas* case to determine if the reasons for the derivative action applied. Looking to the "realistic objectives" of the suit, the Court found that these reasons did not exist. Since the other shareholders had assented to and participated in the misappropriation of corporate profits, Mrs. Dickson was the only injured shareholder.[51] Thus, there was no concern about the possibility of a multiplicity of suits (factor no. 1) or prejudice to the rights of other shareholders (factor no. 3).[52] The defendants also presented no evidence of any creditor "in need of protection" (factor no. 2).[53] While the corporation had creditors, the *Thomas* court observed that the financial records of the corporation indicated the corporation was solvent and had been paying its debts.[54] Perhaps most importantly, the Court found that a corporate recovery would not adequately compensate Mrs. Dickson (factor no. 4). The Court determined that since the corporation was closely held, there was no ready market for her shares. Consequently, Mrs. Dickson had no ability to sell her shares and thereby benefit from the theoretical increase in the value of her shares which might result from a corporate recovery.[55]

The *Thomas* case establishes a four part analysis to determine if a direct action may be maintained. This analysis poses the following questions, the responses to which should be based upon the realistic objectives of the particular suit: (1) Will the direct action result in a multiplicity of actions? (2) Are there creditors in need of protection? (3) Will the rights of other shareholders be prejudiced by a direct recovery by the minority shareholder? and (4) Would the plaintiff be adequately compensated by a corporate recovery?[56] This analysis necessarily requires a case by case approach with the outcome depending upon a court's factual findings on these issues.[57]

Two justices concurred specially and one justice dissented in the *Thomas* decision. In his concurrence, Justice Smith advocated a broader scope for the remedy than the majority opinion outlined. Instead of limiting the remedy to cases brought by the sole injured shareholder or confining its application to close corporations, Justice Smith stated that the courts should allow the direct action "where justice requires, based on a careful evaluation of the facts of each case."[58] By contrast, Justice Weltner, the other concurring justice, agreed that the remedy was available for Mrs. Dickson, but only because she was the sole injured shareholder and because he viewed her complaint "stripped of the technicalities of pleadings" as being "in the nature of a stockholder's derivative action combined with an application to require distribution of improperly withheld dividends."[59] Justice Clarke, the lone

dissent, stated that the direct action represented an infringement on the integrity of the corporation as a legal entity that would "impede the free rotation of the wheels of commerce."[60]

There is an inherent tension in the application of the majority's four part analysis because of the Court's admonitions that the availability of the direct action depends upon the "realistic objectives" of the suit and that a direct action should not be allowed where there is "the possibility of prejudice to other interested parties, such as creditors or other shareholders."[61] In many close corporation settings, there may be facts from which one could argue that the "possibility of prejudice" to third parties exists, but is that sufficient to defeat the direct action when the realistic objectives of the suit make that possibility remote? The interplay among the majority opinion, the concurrences and the dissent further indicates that the full scope of the direct action has yet to be decided.

Additionally, the *Thomas* court reserved the question of the direct action's availability where the injury is primarily a direct injury to the shareholder, rather than primarily for misappropriation of corporate funds.[62] The Court found this reservation possible since the case could be decided on the basis of the nonexistence of the reasons for requiring derivative actions.[63] However the Court indicated that in "an appropriate case this issue might have to be reached."[64] Thus the Court may have signalled its willingness to expand the direct action beyond the factors listed in the *Thomas* case itself. The authorities cited in the *Thomas* case would certainly support such a result.[65] Thus, the Court may have provided future litigants with another way of avoiding the derivative action's limitations.

II. Application of the Direct Action Subsequent to its Formulation in *Thomas v. Dickson*

Following *Thomas v. Dickson*, the Georgia Supreme Court itself has addressed the availability of a shareholder direct damage claim under Georgia law in only one reported case.[66] In *BBMS, Inc. v. Brown*,[67] the Supreme Court held that a minority shareholder was entitled to bring a direct action for damages against the majority shareholder as a counterclaim to the majority shareholder's suit against her, rather than being required to bring a separate derivative action on behalf of the corporation in a different forum. The Court, without ruling on the merits of the direct action, found that it was available since the minority shareholder was the sole injured shareholder. The court observed that the reasons requiring derivative actions did not exist because "[t]here will not be a multiplicity of lawsuits, and there is no concern that a recovery by [Brown] will prejudice the rights of other shareholders."[68] Justice Weltner again concurred specially on the same grounds as his concurrence in *Thomas v. Dickson*.[69] Because of the brevity of the decision, *BBMS* adds little to the direct action landscape.

The Court of Appeals, however, has applied *Thomas* in three reported cases.[70] In *Medlin v. Carpenter*,[71] the plaintiff Medlin was a former president and minority shareholder of the Globe Continental Corporation. In a previous action, the corporation had sued Medlin to recover corporate assets and money allegedly diverted for his personal use.[72] Medlin counterclaimed to establish his right to a bonus which another officer had received.[73] The trial court granted partial summary judgment to the corporation on its complaint and granted summary judgment against Medlin on his counterclaim.[74] The Court of Appeals reversed, in part, the trial court's grant of summary judgment on the counterclaim. In the subsequent action, Medlin attempted to relitigate his entitlement to the bonus and asserted a direct action for damages against the majority shareholder for the misappropriation of corporate funds.

The Court of Appeals affirmed the trial court's grant of summary judgment on Medlin's claims for dividends and bonuses.[75] In addressing the direct action issue, the Court of Appeals found that Medlin could not sue directly due to the possibility of prejudice to creditors and referred to affidavits in the record indicating the existence of corporate indebtedness.[76] However, the *Medlin* court indicated that it was unsure if the indebtedness alone was sufficient to defeat the direct action and gave two alternative reasons for rejecting the claim: (1) the lack of any disputed issues of material fact that would permit plaintiff to recover on the direct claim and (2) the fact that the direct claim was barred by res judicata because it was not asserted in the prior action as an additional counterclaim.[77]

In *Caswell v. Jordan*,[78] the Court of Appeals relied on *Thomas* in permitting a minority shareholder in a closely held corporation to bring a direct action against the corporation's president and his wife to set aside a conveyance and to recover monies allegedly transferred from the corporation.[79] The dispute centered around the defendants' use of the proceeds of a $60,000 loan which the defendants had obtained by pledging corporate property as collateral. The defendants contended

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that the action did not present one of the "exceptional situations" in which direct actions were permitted.[80] The Court of Appeals disagreed, finding that when the "realistic objectives" of the suit were considered, a direct action was authorized under the standards announced in *Thomas v. Dickson*.[81] In reaching this conclusion, the *Caswell* court observed that the plaintiff was the only injured shareholder, there was no evidence of a creditor in need of protection, and since the corporation was closely held, a corporate recovery would not have adequately compensated the plaintiff.[82]

The most recent decision applying the rule of *Thomas* is *Marshall v. W.E. Marshall Co.*[83] In that case, Steven Marshall sued his father, W.E. Marshall, Jr., in a direct action to recover damages for his father's breach of fiduciary duties, corporate waste and mismanagement of the W.E. Marshall Co., a closely held family corporation.[84] The son also sought the appointment of a receiver and other equitable relief. The father was the majority shareholder, chairman of the board and president of the corporation. He had fired the son from his employment with the corporation and had allegedly permitted other family members, who were corporate officers and directors, to engage in acts of mismanagement, waste, and breaches of fiduciary duty. The trial court dismissed the son's direct claims on the ground that a derivative action was required.[85] The Court of Appeals reversed, finding that the facts fell within the exception recognized in *Thomas v. Dickson* and *Caswell v. Jordan*.[86] The *Marshall* court also made it clear that the duty of good faith and loyalty which officers and directors owe to minority shareholders applies equally to majority shareholders.[87]

The opinions in *Caswell* and *Marshall* give little insight into how the Court of Appeals analyzed the competing claims of the "realistic objectives" of the respective suits against the "possibility of prejudice" to creditors and other shareholders. Instead, they simply conclude that the *Thomas* test has been satisfied. Yet the record in both cases indicates that there was evidence of corporate creditors and other shareholders arguably in need of protection. In *Caswell*, the defendants showed the appellate court that there were other shareholders of the corporation at the time the suit was filed and that the corporation had $60,000 to $90,000 in debts in the form of "bond forfeiture Fi Fas."[88] In *Marshall*, the defendants established by affidavit the presence of both general creditors and "trade" creditors.[89] This point was argued to the *Marshall* trial court which concluded that there were creditors in need of protection and granted summary judgment on the direct action claim.[90] Although the defendants presented this evidence in their brief to the Court of Appeals, the appellate court nevertheless found that the direct action was authorized under *Thomas* and *Caswell*.[91]

"Attorneys representing parties in shareholder disputes should be aware of this relatively new and potentially powerful remedy and the corresponding risk it presents to majority shareholders, officers, and directors in closely held corporations."

When the records of these cases are considered with the opinions, it is apparent that in applying the *Thomas* test, the Court of Appeals required the party seeking to defeat a direct action claim to demonstrate more than the mere presence of creditors or other shareholders. In applying the *Thomas* exception, the real concern of the Court of Appeals appears to be whether the direct action presents genuine prejudice to third parties. In the absence of evidence of such prejudice, the Court of Appeals allowed direct actions to be maintained even though corporate creditors or other shareholders existed. This approach to the application of the *Thomas* test is certainly consistent with the underlying remedial purpose of the direct action remedy. An overly technical or restrictive application of the test would be inconsistent with that purpose.

III. Other Issues Facing the Litigants in a Direct Action

A. *The Measure of Damages*

One area which is somewhat undeveloped in the law of direct actions is the measurement of the injured shareholder's damages. The *Thomas* opinion does not address this issue directly, but the measure which was approved may be inferred from the facts of the opinion. In *Thomas*, the plaintiff's "realistic objective" was to recover a pro rata distribution of the profits of the corporation being received by the majority shareholders. It appears that the Supreme Court treated the corporate profits received by the majority in the form of "bonuses" as constructive dividends and approved an award which provided the plaintiff with a pro rata share of those dividends based upon her stock ownership.[92]

This analysis is consistent with the remedial purpose of the direct action remedy and with the underlying tort which gives rise to the cause of action. The shareholder's direct action remedy arises from the breach of the heightened fiduciary duty which Georgia law places on the majority shareholder to exercise "utmost good faith and loyalty" toward minority shareholders.[93] Obviously, whenever the majority shareholder engages in squeeze-out techniques or other unfair practices to the detriment of the minority shareholder's economic interests, this heightened fiduciary duty of utmost good faith and loyalty is violated. Consequently, squeeze-out techniques can be said to proximately cause damages by preventing the minority shareholder from receiving a fair share of the profits of the corporate enterprise which are being received by other shareholders.

In the *Caswell* case, the Court of Appeals demonstrated that it would be guided by tort law principles in

reviewing direct action damages.[94] For reasons which are not fully explained, the plaintiff in *Caswell* withdrew his claim for actual damages at trial, submitting instead only a claim for nominal damages.[95] The Court of Appeals held that nominal damages could be awarded in direct action cases where the actual damages were relatively small or where the plaintiff failed to demonstrate the value of the actual damages by a preponderance of the evidence.[96] The *Caswell* court upheld the award of nominal damages and attorney's fees and then turned to the issue of punitive damages. In approving the assessment of punitive damages, the Court of Appeals commented:

> Punitive damages may be awarded in a suit based in tort. OCGA § 51-12-5. 'The relationship of a corporate officer or director to the corporation and its stockholders is fiduciary or quasi-fiduciary, which requires that they act in utmost good faith . . . . Directors and officers in the management and use of corporate property in which they act as fiduciaries and are trustees are charged with serving the interests of the corporation as well as those of all the stockholders . . . . For a violation of these duties resulting in waste of the corporate assets or injury to such property, the directors and managers of a corporation are liable to account to the stockholders . . . . A breach of these fiduciary duties is sufficient to support an award of punitive damages arising out of such tortious misconduct.'[97]

From these cases, it is apparent that the right to assert a direct action against a corporate officer, director, or controlling shareholder arises from the defendant's breach of a fiduciary duty owed to the minority shareholder. This breach of duty sounds in tort because the duty exists independent of a contractual relationship and is implied by law.[98] Thus, the damages awarded, if they are to meet the realistic objectives of the suit, should be calculated to compensate the minority shareholder for the damages proximately caused by that breach. The exact formulation of damages will necessarily vary with each factual record.

Returning to the hypothetical discussed above in which shareholder *A* attempts to squeeze shareholder *B* out of the *XYZ* corporation,[99] once *B* demonstrates that he should be allowed to sue *A* directly, he must next establish the amount of his damages. Applying tort law principles to this scenario, *B* should recover from *A* the amount he would have received in distributions or benefits from the *XYZ* corporation if *A* had treated him fairly and had not breached his fiduciary duties. Extrapolating from the *Thomas* case, this amount could be measured by treating the profits which *A* siphoned off to himself as undeclared dividends of the *XYZ* corporation and awarding *B* a pro rata share of those dividends based upon his stock ownership. Shareholder *B* should also seek an award of attorney's fees and punitive damages which are sufficiently large enough

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to deter *A* from further wrongdoing. Damages awarded in this fashion would meet the realistic objectives of the case.

B. The Direct Action's Availability in the Statutory Close Corporation Setting

Georgia's new corporate code authorizes the creation of an entity known as the statutory close corporation.[100] The Code essentially allows the shareholders to treat the corporation as a partnership while still preserving the corporate fiction.[101] The Code authorizes the aggrieved shareholder to petition the superior court for relief if *inter alia*, "[t]he directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner, whether in his capacity as shareholder, director, or officer of the corporation."[102]

Should a court find that grounds for relief exist, the Code provides that the court can order the payment of dividends[103] and award damages to any aggrieved party[104] as well as order a complete restructuring of the corporation.[105] Attorneys' fees and expenses of experts are allowed if the opposing party acted arbitrarily, vexatiously, or otherwise not in good faith.[106] Other provisions authorize the court to force a buy out[107] or to order the dissolution of the corporation.[108]

There have been no reported decisions addressing the direct action's availability in the statutory close corporation setting since the statute's enactment in 1989. However, since the statutory scheme authorizes the award of damages to the shareholder, the corporate code would appear to have codified the shareholder's direct action in the statutory close corporation setting. Even if the Code's language does not independently authorize the direct action, it states that the shareholder's right to commence an action under the statutory close corporation provisions are "in addition to any other right or remedy he may have."[109] Thus, the direct action damage remedy should be available in statutory close corporations on the same basis as in other close corporations.

IV. Conclusion

The shareholder's direct action represents the creation of a new tort remedy in the close corporation setting. Unlike the traditional derivative action, the direct action places the assets of the individual majority shareholder, officer, or director at risk to a recovery by the minority shareholder. Moreover, because the direct action sounds in tort and is premised on a breach of fiduciary duty, it is often an appropriate case for the award of punitive damages.[110] Attorneys' fees and expenses of litigation may also be recovered.[111] Attorneys representing parties in shareholder disputes should be aware of this relatively new and potentially powerful remedy and the corresponding risk it presents to majority shareholders, officers, and directors in closely held corporations.

The goals of compensation for injured shareholders and of preservation of corporate law structures and prerogatives sometimes conflict. Yet Georgia courts have demonstrated their understanding of the special problems inherent in the close corporation and the need for a judicial response to insure that minority stockholders are treated fairly and that their investments are protected.[112] The direct action furthers this policy by providing a minority shareholder in a closely held corporation with an effective damage remedy. Nevertheless, the future of the direct action will depend on how the courts balance the sometimes conflicting policies of tort and corporate law. Much will depend on the quality and dynamics of the factual records with which these courts are presented as they further define the direct action based upon "the realistic objectives of a given case."[113]

Footnotes

1. Thomas v. Dickson, 250 Ga. 772, 301 S.E.2d 49 (1983); Marshall v. W.E. Marshall Co., 189 Ga. App. 510, 376 S.E.2d 393 (1988), cert. denied, (Feb. 23, 1989); Caswell v. Jordan, 184 Ga. App. 755, 362 S.E.2d 769 (1987). *Accord* BBMS Inc. v. Brown, 251 Ga. 409, 306 S.E.2d 288 (1983).
2. *Id.*
3. *See, e.g.*, McDonald v. U.S. Die Casting & Dev. Co., 541 So.2d 1064 (Ala. 1989)(Sole injured shareholder entitled to bring direct action seeking to recover proportionate share of constructive dividends); Shumacher v. Shumacher, 469 N.W.2d 793 (N.D. 1991)(Direct action allowed where shareholder alleges harm distinct from that suffered by other shareholders or breach of special duty owed by defendant to corporation); Crosby v. Bream, 548 N.E.2d 217(Ohio 1989)(Minority shareholder in close corporation allowed to bring direct action for majority shareholder's breach of fiduciary duty); IVERY D. FOREMAN, RE-DEFINING CLOSE CORPORATIONS, A.B.A.J., March 1992, at 76.
4. *See* cases cited *supra*, note 1.
5. 1 FOREST H. O'NEAL & ROBERT. B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 1.07 (3d ed. 1990)(Footnotes omitted).
6. Pickett v. Paine, 230 Ga. 786, 791, 199 S.E.2d 223, 228 (1973), citing O'NEAL, CLOSE CORPORATIONS § § 1.07 and 8.02 (1971 ed.).
7. 1 FOREST H. O'NEAL & ROBERT. B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 1.02 (3d ed. 1990).
8. *See, e.g.,* Comolli v. Comolli, 241 Ga. 471, 246 S.E.2d 278 (1978); Marshall v. W.E. Marshall Co., 189 Ga. App. 510, 376 S.E.2d 893.
9. Comolli, 241 Ga. 471, 246 S.E.2d 278.
10. *Id.* at 474, 246 S.E.2d at 280.
11. *Id.*
12. Marshall, 189 Ga. App. at 512, 376 S.E.2d at 396. *See also* Comolli, 241 Ga. at 474-475, 246 S.E.2d at 280.
13. 1 FOREST H. O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 3.02 (2d ed. 1985); *See generally* 2 FOREST H. O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 8.07 (3d ed. 1990).
14. *Id.*
15. 1 FOREST H. O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 1.03 (2d ed. 1985). Of course, not all minority shareholders are virtuous and there may be circumstances in which the majority's desire to terminate a minority shareholder's interest in a close corporation is justified and appropriate. *See, e.g.*, Medlin v. Carpenter, 174 Ga.App. 50, 359 S.E.2d 159 (1985). The factual predicate for the direct action, however, is that the majority shareholder's actions injure the economic interests of the minority shareholder in breach of the majority shareholder's duty of good faith and loyalty. *See, e.g.,* Comolli, 241 Ga. 471, 246 S.E.2d 278.
16. O.C.G.A. §§ 14-2-740 through 747 (1989).
17. O.C.G.A. §§ 14-2-1430 through 1431 (1989).
18. O.C.G.A. § 14-2-1432 (1989).
19. O.C.G.A. § 14-2-831(a) (1989).
20. O.C.G.A. § 14-2-741(2) (1989).
21. Pickett, 230 Ga. at 790, 199 S.E.2d at 227.
22. O.C.G.A. § 14-2-746(1) (1989).
23. O.C.G.A. § 14-2-746(2) (1989); O.C.G.A. § 14-2-853 (1989).
24. O.C.G.A. § 14-2-1430 (1989); Comolli, 241 Ga. 471, 246 S.E.2d 278; Pickett, 230 Ga. 786, 199 S.E.2d 223.
25. Davis v. Ben O'Callaghan Co., 238 Ga. 218, 222, 232 S.E.2d 53, 56 (1977); Pelletier v. Schultz, 157 Ga. App. 64, 66, 276 S.E.2d 118, 120 (1981).
26. *See* cases cited *supra* note 1. *Accord*, Quinn v. Cardiovascular Physicians, P.C., 254 Ga. 216, 326 S.E.2d 460 (1985).
27. Pickett, 230 Ga. 786, 790, 199 S.E.2d 223, 227.
28. *Id.* at 789, 199 S.E.2d at 227.
29. *Id.* at 790, 199 S.E.2d at 227.

30. *Id.*
31. *Id.* at 790-791, 199 S.E.2d at 228.
32. Ben O'Callaghan Co., 238 Ga. 218, 232 S.E.2d 53.
33. *Id.* at 222, 232 S.E.2d at 56.
34. *Id.*
35. Pelletier, 157 Ga. App. at 66-67, 276 S.E.2d at 120.
36. *Id.* at 66-67, 276 S.E.2d at 120-21.
37. *Id.* at 66-67, 276 S.E.2d at 120, quoting Ben O'Callaghan, 238 Ga. at 222, 232 S.E.2d at 56.
38. Thomas, 250 Ga. at 774, 301 S.E.2d at 51.
39. *Id.* at 774, 301 S.E.2d at 49.
40. *Id.* at 772-73, 301 S.E.2d at 50.
41. *Id.* at 773, 301 S.E.2d at 50.
42. *See* 1 FOREST H. O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 3:07.
43. Thomas, 162 Ga. App. 569, 570, 291 S.E.2d 747, 749 (1982), *aff'd* 250 Ga. 772, 301 S.E.2d 49.
44. *Id.*
45. *Id.* at 571, 291 S.E.2d at 749, *citing* Davis, 238 Ga. 218, 232 S.E.2d at 56; Pelletier, 157 Ga. App. at 67, 276 S.E.2d at 121.
46. Thomas, 250 Ga. at 774, 301 S.E.2d at 51.
47. *Id. See generally* JEROME L. KAPLAN, NADLER'S GEORGIA CORPORATION LAW § 11-16 (1971), Comment, CORPORATIONS-SHAREHOLDERS' DERIVATIVE AND DIRECT ACTIONS-INDIVIDUAL RECOVERY, 35 N.C.L. Rev. 279 (1957); *See also* Watson v. Button, 235 F.2d 235 (9th Cir. 1956).
48. Thomas, 250 Ga. at 775, 301 S.E.2d at 51.
49. *Id.* at 774, 301 S.E.2d at 51.
50. *Id.*
51. *Id.*
52. *Id.* at 774-75, 301 S.E.2d at 51.
53. *Id.* at 775, 301 S.E.2d at 51.
54. *Id.*
55. *Id.*
56. *Id.* at 774, 301 S.E.2d at 51.
57. *Compare* Thomas, 250 Ga. 772, 301 S.E.2d 49 (Sole injured shareholder seeking pro rata share of distributed profits) *and* Caswell, 184 Ga. App. 755, 362 S.E.2d 769 (Realistic objectives served by forcing corporate officers to pay damages to shareholder despite existence of other creditors) *with* Medlin, 174 Ga.App. 50, 359 S.E.2d 159 (Existence of creditors in need of protection prevented minority shareholder's direct claim for damages for misappropriation of corporate funds).
58. Thomas, 250 Ga. at 776, 301 S.E.2d at 52 (Smith, J. concurring specially).
59. *Id.* (Weltner, J. concurring specially).
60. *Id.* (Clarke, J. dissenting).
61. *Id.* at 774, 301 S.E.2d at 51.
62. *Id.* at 774 n.1, 301 S.E.2d at 50 n.1. *Cf.* Phoenix Airline Services, Inc. v. Metro Airlines, Inc., 260 Ga. 584, 397 S.E.2d 699 (1990).
63. Thomas, 250 Ga. at 774 n.1, 301 S.E.2d at 50 n.1.
64. *Id.*
65. *Id.*, at 774-75, 301 S.E.2d at 51, *citing inter alia Note, Distinguishing Between Direct and Derivative Shareholder Suits,* 110 U. PA. L. REV. 1147 (1962); Eisenberg v. Flying Tiger Line, Inc., 451 F.2d 267 (2d Cir. 1971).
66. BBMS, Inc. v. Brown, 251 Ga. 409, 306 S.E.2d 288, 290 (1983). *Cf.* Phoenix Airline Servs., Inc. v. Metro Airlines, Inc., 194 Ga.App. 120, 390 S.E.2d 219 (1989), *rev'd,* 260 Ga. 584, 397 S.E.2d 699 (1990) (Rejecting a shareholder's attempt to bring a direct action for usurpation of a corporate opportunity under Delaware law).
67. BBMS, Inc., 251 Ga. 409, 306 S.E.2d 288, 290.
68. *Id.* at 411, 306 S.E.2d at 290 (citations omitted).
69. *Id.* at 412, 306 S.E.2d at 290 (Weltner, J., concurring specially).
70. Marshall, 189 Ga. App. 510, 376 S.E.2d 393; Caswell, 184 Ga. App. 755, 362 S.E.2d 769; Medlin,174 Ga. App. 50, 359 S.E.2d 159.
71. Medlin, 174 Ga.App. 50, 359 S.E.2d 159.
72. Medlin v. Globe Continental Corp., 171 Ga. App. 103, 318 S.E.2d 807 (1984).
73. Medlin, 174 Ga. App. at 51, 359 S.E.2d at 162 *citing* Medlin v. Globe Continental Corp., 171 Ga. App. 103, 318 S.E.2d 807 (1984).
74. *Id.*
75. *Id.* at 51-52, 359 S.E.2d at 162-163.
76. *Id.* at 53, 359 S.E.2d at 164.
77. *Id.*
78. Caswell, 184 Ga. App. 755, 362 S.E.2d 769.
79. *Id.* at 755-757, 362 S.E.2d at 770-71.
80. *Id.* at 758, 362 S.E.2d at 773. *See generally* PAUL A. QUIROS & DONNA R. JONES, BUSINESS ASSOCIATIONS, ANNUAL SURVEY OF GEORGIA LAW: JUNE 1, 1987 - MAY 31, 1988, 40 Mercer L. Rev. 61 (1988).
81. Caswell, 184 Ga. App. 758, 362 S.E.2d at 773.
82. *Id.*
83. Marshall, 189 Ga. App. 510, 376 S.E.2d 393.
84. *Id.* at 511, 376 S.E.2d at 394-395.
85. *Id.* at 511, 376 S.E.2d at 395.
86. *Id.*
87. *Id.* at 512, 376 S.E.2d. at 396.
88. Brief of Appellants at 13, Caswell v. Jordan, 184 Ga.App. 755, 362 S.E.2d 769 (1987) (No. 75528).
89. Affidavit of W.E. Marshall, Jr., at ¶ 4, Marshall v. W. E. Marshall Co., 189 Ga.App. 510, 376 S.E.2d 393 (1988) (No. 77359), *cert. denied* (Feb. 23, 1989).
90. Superior Court's Order on Motions, at 3, Marshall v. W. E. Marshall Co., 189 Ga.App. 510, 376 S.E.2d 393 (1988) (No. 77359), *cert. denied* (Feb. 23, 1989).
91. Brief of Appellees at 5, Marshall v. W. E. Marshall Co., 189 Ga.App. 510, 376 S.E.2d 393 (1988) (No. 77359), *cert. denied* (Feb. 23, 1989).
92. The Supreme Court's opinion characterized the payments made to the other shareholders as representing "excess profits." Thomas, 250 Ga. at 773, 301 S.E.2d at 50. The Court of Appeals decision indicates that the jury awarded damages against the other shareholders proportionate to the shares of stock owned by each. Id. at 570, 291 S.E.2d at 749.
93. Quinn v. Cardiovascular Physicians, P.C., 254 Ga. 216, 217, 326 S.E.2d 460, 463 (1985), *citing* King Mfg. Co. v. Clay, 216 Ga. 581, 118 S.E.2d 581 (1961); Comolli, 241 Ga. 471, 246 S.E.2d 278; Marshall, 189 Ga. App. at 512, 376 S.E.2d at 396.
94. Caswell, 184 Ga. App. at 759, 362 S.E.2d at 774.
95. *Id.* at 758, 362 S.E.2d at 772-773.
96. *Id.* at 759, 362 S.E.2d at 774.
97. *Id.* at 760, 362 S.E.2d at 774 *quoting* Pelletier, 157 Ga. App. at 66, 276 S.E.2d at 120 (citations omitted).
98. *Id.*
99. See Section I B of this article.
100. O.C.G.A. §§ 14-2-901 through 950 (1989 and Supp. 1991). *See generally* WILLIAM J. CARNEY, CHANGES IN CORPORATE PRACTICE UNDER GEORGIA'S NEW BUSINESS CORPORATION CODE, 40 Mercer L. Rev. 655, 698 (1989).
101. *Id.*
102. O.C.G.A. § 14-2-940 (1989).
103. O.C.G.A. § 14-2-941(a)(8) (1989).
104. O.C.G.A. § 14-2-941(a)(9) (Supp. 1991).
105. O.C.G.A. § 14-2-941(a)(1)-(7) (Supp. 1991).
106. O.C.G.A. § 14-2-941(b) (Supp. 1991).
107. O.C.G.A. § 14-2-942 (1989).
108. O.C.G.A. § 14-2-943 (1989).
109. O.C.G.A. § 14-2-940(e) (1989).
110. Thomas, 162 Ga. App. 570, 291 S.E.2d 748, *aff'd,* 250 Ga. 772, 301 S.E.2d 49; Caswell, 184 Ga. App. at 758, 362 S.E.2d at 774.
111. *Id.*
112. Comolli, 241 Ga. at 474-475, 246 S.E.2d at 280.
113. Thomas, 250 Ga. at 774, 301 S.E.2d at 51.

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