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Order on Motion for Declaratory Judgment (BRUCE E. BOWERS)

Alice D. Bonner
Superior Court of Fulton County

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IN THE SUPERIOR COURT OF FULTON COUNTY
STATE OF GEORGIA

BRUCE E. BOWERS **Plaintiff,** **v.** **E. WADE SHEALY, JR., HAMPTON ISLAND PRESERVATION PROPERTIES, INC.** **Defendant.**	)))))))))))	Civil Action File No. 2008CV149904

FILED IN OFFICE
MAR 27 2009
DEPUTY CLERK SUPERIOR COURT
FULTON COUNTY, GA

ORDER ON MOTION FOR DECLARATORY JUDGMENT

The parties and their counsel appeared before this Court on September 24, 2008, to present oral argument on Plaintiff's Motion for Declaratory Judgment. After the Court granted the Motion to Intervene by Hampton Island Preservation Properties Inc. ("HIPP") in open court, the Court held open the record in this matter for thirty (30) days in order for HIPP to file an answer. On October 24, 2008, the Court entered the parties' stipulated stay of the case through December 31, 2008, pending a global settlement. On February 26, 2009, counsel for the parties appeared in chambers to inform the Court that a settlement was not reached and to request the Court's ruling on Plaintiffs' Motion for Declaratory Judgment. Thereafter, on March 6, 2009, Defendant HIPP filed its answer and counterclaim for reformation of the Articles of Incorporation.

After reviewing the record of the case, the briefs submitted on the motion, and the arguments of counsel, the Court hereby finds as follows:

Plaintiff requests that the Court determine the voting rights of certain common stock held by Plaintiff and other shareholders herein designated as "non-voting common" shareholders. Defendants, on the other hand, petition the Court to find that the omission of a

non-voting class or series of stock in the Articles of Incorporation was a mutual mistake that warrants reformation by the Court. This case presents a question of first impression under Georgia law and therefore the Court will look to the controlling statutes and to other jurisdictions for guidance. See e.g., Hammette v. Eickemeyer, 203 Ga. App. 243, 243 (1992) ("The reasoning of the trial court finds support in both the statutory scheme and in decisions of other jurisdictions."); see also, Dudley v. Wachovia Bank N.A., 290 Ga. App. 220, 223 (2008) (looking to other jurisdictions for guidance on a question of first impression); Glisson Coker, Inc. v. Coker, 260 Ga. App. 270, 271 (2003) (upholding a trial court's reasoning on a question of first impression after reviewing the "record in this case, of Georgia law, and of persuasive authority from other jurisdictions").

FACTUAL SUMMARY:

In November 2004, Daniel Landis, an attorney acting for Defendant Shealy, incorporated HIPP. To effectuate the purpose of HIPP, several supporting documents were created including the Articles of Incorporation and the Bylaws, as well as subscription agreements and certain purchase and sale agreements (hereinafter referred to as the "Sale Documents").

The HIPP Articles of Incorporation, a mere two page document, states in Section 4 that HIPP is authorized to issue 1 million shares of "no par value common stock." The Articles of Incorporation contain no other language either designating a separate class of non-voting stock, designating a separate non-voting series of common stock, or otherwise restricting the voting rights of the common stock.

Pursuant to O.C.G.A. § 14-2-72, each outstanding share of stock is entitled to one vote unless the articles of incorporation provide otherwise. Additionally, O.C.G.A. § 14-2-601

requires that the articles of incorporation set forth the classes and number of shares authorized to be issued. Section 601 also states that, unless a class is divided into separate series, all shares of the same class are entitled to the same rights, privileges, and duties.

Section 2.12 of the HIPP Bylaws, states that each outstanding share of common stock authorized under the Articles of Incorporation "to have voting power shall be entitled to vote upon each matter submitted to a vote at a meeting of the shareholders." The provision continues, in contradiction of the first sentence, that only Wade Shealy and William Cole Jr., are the initial voting shareholders and that all other shareholders "hold non-voting shares." Section 2.12 concludes by stating that "[t]he voting rights, if any, of classes of shares other than voting common stock shall be as set forth in the Corporation's Articles of Incorporation or by appropriate legal action of the Board of Directors."

The corporation's Subscription Agreements (both the one dated November 9, 2004, and the one dated February 24, 2006) list as "non-voting" those shares held by Plaintiff and the shareholders whom he purported to represent in proxy. Additionally, the Purchase and Sale Agreement, as well as the Addendum to the Closing Statements on Club Membership, entered into between Plaintiff and HIPP/Defendant Shealy state that Plaintiff's interest in HIPP is "3% non-voting."

LEGAL ARGUMENTS:

Articles of incorporation "trump" or supersede the by-laws of a corporation. Any conflict between those two documents is resolved in favor of the articles of incorporation. O.C.G.A. § 14-2-206(b) ("The bylaws of a corporation may contain any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with law or the articles of incorporation."). A simplistic reading of the law and policy behind

Georgia's corporate code and contract law could end the Court's inquiry here with a declaration that the shares in question hold voting rights pursuant to the language of the Articles of Incorporation and O.C.G.A. § 14-2-721.

The Court, however, determines that as a court of equity presented with a petition for a declaratory judgment and a request for reformation, it must look at the totality of the facts, including the intent of the parties, before making a determination as to the rights affixed to the shares held by Plaintiff.[1] The Court declines to find, as urged to by Plaintiff, that the non-voting restrictions are illegal or ultra vires, and therefore void. Instead, the Court finds no dispute in the record that HIPP intended to, and did in fact, offer voting and non-voting shares. The failure to memorialize that intent in the proper manner under the Articles of Incorporation is a mutual mistake appropriate for reformation.

To support their petition before the Court, Plaintiff cites to John P. King Manufacturing Co. v. Clay, 218 Ga. 382 (1962), a case where the Georgia Supreme Court read into the articles of incorporation certain statutory default rules regarding charter amendments. In John P. King the question before the Court was what percentage of shareholders must approve a charter amendment where the charter stated that majority vote shall always govern, except in the matter of winding up the affairs of the corporation, but where the corporate code set the default standard for approving charter amendments at a two-thirds majority. Finding that the charter was silent as to approval for amendments, the Court held that the default statutory requirement of two-thirds approval was applicable to the

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[1] See e.g., Ind. Dist. Group, Inc. v. Waite, 222 Ga. App. 233, 235 (1996) *rev'd on other grounds* 268 Ga. 115 (1997) ("The *remedy* fashioned by the trial court was not a mere injunction but a dramatic reformation of the by-laws. In our view, this equitable relief was more beneficial to the corporation as an entity and to all of the shareholders than if the requested receiver had been appointed.").

amendments in question. Id. at 386. Plaintiff urges the Court to follow John P. King and find that where HIPP's charter is silent as to the creation of a second class of stock or any voting restrictions, the Court must then apply O.C.G.A. § 14-2-721 and recognize the voting rights of all HIPP shareholders.

The legal reasoning in John P. King, however, provides the Court with additional guidance by stating that the charter of a corporation is a ***contract*** between the State and the corporation as well as between the corporation and its stockholders which is subject to the same rules of construction. Id. at 386. In John P. King, the Court held that there was no "clear manifestation" of intent for amendment approvals to be obtained by a simple majority. Id. at 386. In this case, in sharp contrast with the facts in John P. King, voting rights are addressed in the Bylaws and in each of the Supporting Sale Documents, providing ample evidence of the intent of all parties for Plaintiff's stock to be non-voting. When viewing the Articles of Incorporation as a contract, subject to rules of contract construction, intent then becomes not only an appropriate, but a necessary, component of the Court's review.

Defendants cite to Millspaugh v. Cassedy, 191 A.D. 221 (Sup. Ct. NY 1920), for the proposition that a court may utilize its equity powers to reform articles of incorporation containing a mutual mistake. In Millspaugh, the articles of incorporation in question created two classes of stock—common and preferred—but did not restrict the voting powers of preferred shareholders. There was no dispute that at the time of creation, the "intention and purpose of the incorporations [was] that the preferred stock should have no voting power, that the sole voting power should be vested in the common stock of the company..." Id. at 222. The by-laws unanimously adopted by the corporate board of directors at their first meeting stated that "preferred stock shall not be entitled to any vote." Id. For twenty years there was

no challenge by the preferred shareholders to exercise a right to vote, until, in 1918, the trustee holding the preferred shares realized that articles of incorporation did not contain the requisite non-voting restriction.[2] Id. at 225.

In Millspaugh, both the trial and appellate courts evaluated the power of a court of equity to reform the certificate of incorporation; both courts determined that reformation was an available and appropriate remedy under the facts of the case. Id. at 224. The court in Millspaugh found that the intent of the parties when creating the company whose stock was at issue in that case was to create two classes of stock: non-voting preferred and voting common. The court also found that the failure to include the voting restriction on the preferred stock was a mutual mistake, basing its finding on evidence such as the language of the by-laws and the parties' twenty years of acquiescence. Id. at 226. Finding that the articles of incorporation are essentially a contract, especially with regard to voting rights among shareholders, the court in Millspaugh held that it was appropriate to reform the contract with a finding of mutual mistake. Id. at 227-228. "The very principle of this Court in correcting instruments is that the parties are to be placed in the same situation as they would have stood in if the error to be corrected had not been committed..." Id. at 227. In rejecting the appellants' arguments that there can be no contract right arising from an illegal (ulta vires) by-law, the court reasoned that :

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[2] From the time when the articles of incorporation of Higginson Corporation, the company whose stock was at issue in Millspaugh, were filed in 1898 and when the suit was brought in 1918, the New York corporate code was codified and amended to disallow voting restrictions in the bylaws alone and requiring that such restrictions be stated in the articles of incorporation. Id. at 224. At the time that Higginson was incorporated, restrictions on voting powers were recognized, however the corporate code was amended in 1901 to provide a default rule similar to what is in effect in Georgia today that unless otherwise provided in the certificate of incorporation each share was entitled to one vote. Id. at 225.

> [t]he parties here put a record of their undoubted agreement into the wrong place, and the very fact of its having been misplaced is a sufficient ground to ask a court of equity to put it in the right place, where it can be validated through an amended certificate of incorporation.

Id. at 228-229. Accordingly, the appellate court in Millspaugh upheld the trial court's reformation of the articles of incorporation based upon a finding of mutual mistake after ascertaining the intent of the parties. See also, Molina v. Largosa, 465 P.2d 293, 296 (Haw. 1970) (where both the majority and the dissent looked to the intent of the parties to determine whether or not stock issued had voting or non-voting rights).

While Millspaugh is not controlling precedent upon the decision of this Court, in the absence of a clear directive in Georgia case law, this Court finds the reasoning instructive. As in Millspaugh, the instant case presents clear facts that at the time of incorporation and with each shareholder's investment, the intent of the parties[3] was that all shares not held by Defendant Shealy or William Cole,[4] were to be non-voting shares. To support this conclusion, the Court relies upon the inclusion of the "non-voting" restriction in the Bylaws, the Subscription Agreements, the Purchase and Sale Agreements, and the Closing Addendum. See e.g., Friedman v. Friedman, 259 Ga. 530 (1989), *overruled on other*

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[3] In the construction of a contract, the cardinal rule is to ascertain the intention of the parties, and to effectuate that intent, the court should consider the whole instrument and surrounding circumstances. Brooke v. Phillips Petroleum Co., 113 Ga. App. 742 (1966); O.C.G.A. § 13-2-3. "The fundamental rule, the rule which swallows up almost all others in construing a paper, is to give it that meaning which will best carry into effect the intent of the parties. This is the object of the rules of interpretation, to discover the true intent of the parties, and in doing this we are to take the whole of (the instrument) together, and to consider this with the surrounding circumstances." Paul v. Paul, 235 Ga. 382, 382 (1975).

[4] William Cole is a non-party to the suit and a shareholder in HIPP. He, along with Defendant Wade Shealy, were "initial voting" shareholders under the terms of the Bylaws. In addition, Mr. Cole has served on the board of directors since HIPP's inception. Mr. Cole was allegedly elected to replace Defendant Shealy as president of HIPP at the March 30th shareholder meeting where Plaintiff Bowers attempted to vote his shares and those shares for which he held proxies.

grounds, 268 Ga. 566 (1997) (looking to the whole agreement and interpreting each provision in harmony with the others to determine the true intent of the parties).

In addition to the documentary evidence persuasive to the Court, the incorporating attorney, Daniel A. Landis, submitted an affidavit stating that it was the intent of the parties to create two classes of stock, one voting and one non-voting, but that he failed to incorporate HIPP properly. Similarly, the record contains several deposition transcripts of HIPP shareholders who state that from the time they purchased their shares in HIPP, they believed that they owned non-voting stock.[5] Finally, Plaintiff waited over one year after purchasing his shares to attempt to exercise his voting rights and many of the shareholders for whom Plaintiff served as proxy waited over two years before attempting to vote. See e.g., Askhouti v. Widener, 231 Ga. App. 539 (1998) (holding that conduct may also provide evidence of intent); Millspaugh, 191 A.D. 221, 225 (finding that the plaintiff's twenty year delay in attempting to exercise its voting rights was evidence of intent to hold non-voting stock).

Defendants contend that the parties' mutual mistake provides the Court with sufficient grounds to reform HIPP's Articles of Incorporation to create a second class or series of non-voting stock. "A mutual mistake as an action for reformation means one in which both parties had agreed on the terms of the contract, but by mistake of the scrivener the true terms of the agreement were not set forth." First Nat'l Bank of Polk County v. Carr, 260 Ga. App. 439 (2003).[6] In Layfield v. Sanford, 247 Ga. 92 (1981), the Georgia Supreme Court refused to

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[5] See e.g., Deposition testimony of shareholders Flautt, Clausel, Becker, Roy, and Howard, attached as exhibits B- F to Defendant Wade Shealy Jr., Supplemental Response.

[6] In First Nat'l Bank of Polk County v. Carr, the Georgia Court of Appeals refused to find a mutual mistake and reform a deed as petitioned to by the Bank because the Court found that the Bank "failed to exercise ordinary diligent to protect itself and to prevent itself from obtaining the wrong two lots as collateral." 260 Ga. App. at 441-442. Plaintiff similarly argues that Defendants had the means to verify the original intent and determine that the sale

reform a boundary line contained in a deed where there was evidence in the deed that the boundary line was beyond the fence in question and where defendants made no representations to plaintiffs regarding the fence and the boundary lines. Id. at 451. As a result, the Court determined that the mistake was a unilateral one that did not warrant reformation. In the instant case, however, the sale documents and the testimony of investors warrant the opposite finding. In this case, the language in the Bylaws regarding voting rights, as well as, the clearly marked non-voting restrictions on the supporting Sale Documents demonstrate that representations were made regarding the voting rights of the stock, and that both Plaintiff and Defendants understood that the shares held by Plaintiff and his proxies were intended to be non-voting.

The Court finds that neither Plaintiff nor his proxies will be prejudiced by this finding for they will still receive exactly what they were promised and what they believed they were purchasing. See, DeGolyer v. Green Tree Servicing, LLC, 291 Ga. App. 444, 447 (2008) (finding a mutual mistake where the parties failed to convey a tract of land or include a description of the property to the security deed and finding no prejudice where the parties still received the benefit of their original bargain).

The Court acknowledges the sacrosanct nature of articles of incorporation, which sit as a hybrid between legislated statute and private-party contracts. See, e.g., John P. King

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documents and Articles of Incorporation did not accurately reflect that intent. Instead, Defendants made no effort to correct the sale documents through reformation until Plaintiffs brought this declaratory judgment action. In Carr, the defect related to lots numbered 1 & 4 listed as collateral where defendant Carr knew that the house/septic tank were on lots 3 and 4, which negated a finding of mutual mistake. Id at 440-441. Additionally, the bank had the plats related to the lots in question on file, but did not review it, and therefore, failed to demonstrate due diligence on its part. Id. at 441. Here, the parties failed to include the voting restrictions/creation of a second class of stock in the appropriate documents, but nonetheless, documented their intent to create such restrictions.

Manufacturing Co., v. Clay, 218 Ga. 382, 385, 387 ("The charter of a corporation is in effects its constitution....Its grants of power and exemptions must be strictly constructed whether they be due to the state or individuals....The charter of the defendant corporation is a contract between the state and the corporation and also between the corporation and its stockholders."). The powers of any party to contract in articles of incorporation is necessarily limited by the restrictions and requirements imposed upon them in the Georgia Corporate Code. For example, O.C.G.A. §§ 14-2-601 and 14-2-721 require that the articles of incorporation enumerate voting rights of stock in separate classes or series of stock. The intent of the parties to create voting and non-voting stock is not barred by these statutes, although the manner in which the parties effectuated this agreement is. Because articles of incorporation contain both contract and statutory powers, the Court cannot disregard the intent of the parties in entering into their agreement without disregarding the contractual elements within articles of incorporation. For the reason that articles of incorporation are contracts existing within a statutory framework, this Court declines to ignore the intent of the parties where the intended terms are not barred by the governing statutes. Additionally, this Court notes the uniquely persuasive evidence in the undisputed record of intent by Plaintiff, and the shareholders for whom he held proxies, to purchase non-voting shares.

Accordingly, the Court finds that the parties intended to create voting and non-voting shares. In order to effectuate that intent, the Court orders the reformation of the Articles of Incorporation to create two classes of common stock: one to represent the initial voting stock, and second to represent the non-voting stock. In addition, all supporting documents shall be similarly reformed to reflect the two classes of stock.

SO ORDERED this 27 day of March, 2009.

ALICE D. BONNER, SENIOR JUDGE
Superior Court of Fulton County
Atlanta Judicial Circuit

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