UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

In re:

Northlake Foods, Inc.,	Case No. 8:08-bk-14131-CED
Debtor.	Chapter 11

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David H. Crumpton, in his capacity as Distribution Trustee for the Distribution Trust of Northlake Foods, Inc.,

Plaintiff,

v.	Adv. Pro. No. 8:10-ap-953-CED

A. Douglas McGarrity,

Defendant.
_____/

ORDER GRANTING MOTION TO DISMISS AMENDED COMPLAINT

THIS PROCEEDING came on for hearing on April 20, 2011, of the Defendant's *Motion to Dismiss Amended Complaint and Incorporated Memorandum in Support* (Doc. No. 30) (the "Motion to Dismiss"). For the reasons stated below, the Court will grant the Motion to Dismiss.

The Plaintiff, David Crumpton, is the Distribution Trustee for the Distribution Trust of Northlake Foods, Inc., the Debtor herein. The Defendant, A. Douglas McGarrity, is a former shareholder of the Debtor. The Plaintiff's original complaint (Doc. No. 1) asserted fraudulent transfer claims under 11 U.S.C. §§ 544, 548, 550, and 551, and the Georgia Uniform Fraudulent Transfer Act, O.C.G.A. § 18-2-70 *et seq.* The Plaintiff alleged that a payment made in 2006 by the Debtor to the Defendant pursuant to a shareholders' agreement (the "2006 Transfer") constituted an improper dividend under Georgia law, and was therefore subject to avoidance by the Plaintiff as a fraudulent transfer.

The Defendant filed a Motion for Judgment on the Pleadings (Doc. No. 19). After a hearing, the Court granted the motion and dismissed the complaint without prejudice. *See* Doc. No. 25 (the "Order"). In the Order, the Court stated:

> 2. Defendant is entitled to judgment on the pleadings with respect to all Counts of the Complaint because the Complaint reflects that the Debtor received reasonably equivalent value for the 2006 Transfer. O.C.G.A. § 18-2-73(a) and 11 U.S.C. § 548(d)(2)(A) each define value within the context of fraudulent transfer law to include satisfaction of an antecedent debt, and the 2006 Transfer satisfied an antecedent debt owed to Defendant pursuant to the Shareholders Agreement.

Thereafter, the Plaintiff filed an amended complaint (Doc. No. 29) seeking, in Count I, the avoidance and recovery of the 2006 Transfer from the Defendant because the 2006 Transfer was an illegal dividend under O.C.G.A. § 14-2-640(c), and in Count II, the disallowance or equitable subordination of the Defendant's claim filed in this bankruptcy case (Claim No. 121) because the 2006 Transfer resulted in injury to the Debtor's non-insider/non-shareholder creditors, and conferred an unfair advantage on the Defendant.

Georgia law prohibits distributions to shareholders when a corporation is insolvent. O.C.G.A. § 14-2-640(c) provides that no distribution may be made to shareholders if, after giving the distribution effect, the corporation would not be able to pay its debts as they become due or the corporation's total assets would be less than its total liabilities. O.C.G.A § 14-2-832 imposes personal liability upon directors who vote for or assent to a distribution that violates O.C.G.A. § 14-2-640(c) to the extent a distribution exceeds what could have been distributed without violating Code Section 14-2-640. Directors held personally liable under O.C.G.A. § 14-2-832(a) are then entitled to contribution from other directors who could be held liable under O.C.G.A. § 14-2-832(a), and from each shareholder for the amount of the distribution that such shareholder accepted while knowing that it was made in violation of O.C.G.A §14-2-640.

In this case, the Plaintiff, standing in the Debtor's shoes, seeks to recover the allegedly improper distribution directly from a shareholder, the Defendant. In support of the proposition that a corporation may seek recovery of improper distributions made while the corporation was insolvent directly from a shareholder, the Plaintiff relies on a case decided long before the Georgia Corporate Code was enacted in 1968. Plaintiff quotes the court in *Reid v. Eatonton Mfg. Co.*, 40 Ga. 98 (Ga. 1869), as stating:

> Nor do we question the right of the creditors, in a Court of Equity, to compel

> stockholders to refund dividends made to them *out of the capital stock itself*. The whole capital stock is a trust fund for the payment of the debts contracted upon the faith of it, which the stockholders cannot divert from that object, by distributing it as dividends, or otherwise dividing it among themselves.

Id. at 104 (emphasis supplied).

But, the Plaintiff neglected to recite the preceding sentence:

> *We do not think dividends already paid out are a trust fund for the payment of debts which may be followed by creditors in a Court of Chancery and recovered for that purpose*. But we will not say that in a proper case, where the corporation is insolvent, and the capital stock, upon the faith of which the credit was given, has become insufficient for the payment of the debts of the company, a case might not be made where a Court of Equity would enjoin the payment of future dividends to the stockholders, till the debts are paid.

Id. at 104 (emphasis supplied).

The holding in *Reid* is not applicable to the facts presented herein because the *Reid* case involved distributions from a corporation's "capital stock," a concept that was not adopted in the Georgia Corporate Code. *Reid* has not been cited by another court since 1937; no party has cited, nor has the Court been able to locate, a Georgia decision rendered after the enactment of the Georgia Corporate Code that recognizes the right of an insolvent corporation or its creditors to directly pursue shareholders for improper distributions.

The Plaintiff's remedy for an allegedly improper distribution is proscribed by the Georgia statutes. That is, to pursue the directors who voted or assented to the distribution in violation of O.C.G.A. §14-2-640, who in turn may seek contribution from the sources specified in O.C.G.A. § 14-2-832(b). In this case, it appears that the two-year statute of limitations for an action by the Plaintiff against the directors has expired. *See* O.C.G.A. § 14-2-832.

For the foregoing reasons, the Court will grant the Motion to Dismiss Count I. Inasmuch as Count II, which seeks disallowance or equitable subordination of the claim filed by the Defendant in this bankruptcy case, is wholly dependent on Count I, it shall also be dismissed. Accordingly, it is

ORDERED

1. The Motion to Dismiss is GRANTED.

2. This adversary proceeding is DISMISSED.

DONE and **ORDERED** in Chambers at Tampa, Florida, on September 9, 2011.

/s/ Caryl E. Delano

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Caryl E. Delano
United States Bankruptcy Judge