The Michigan Business Law

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To fulfill this mission, the Section (a) provides a forum to facilitate service and commitment and to promote ethical conduct and collegiality within the practice; (b) expands the resources of business lawyers by providing educational, networking, and mentoring opportunities; and (c) reviews and promotes improvements to business legislation and regulations.
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**DID YOU KNOW?**

By G. Ann Baker

**Viewing Entity Documents**

Corporation, limited partnership, and limited liability company documents, annual statements, and reports filed with the Corporation Division, Bureau of Commercial Services, Michigan Department of Labor and Economic Growth (DLEG), are now available online. This information can be accessed 24 hours a day, 7 days a week.

A silent launch of the new feature occurred in mid-August and a formal announcement was made by DLEG on September 14, 2004. Customers no longer have to call, mail, fax, or request in person uncertified copies. There is no charge for viewing or printing the documents, statements, or reports.

On the Corporation Division’s website, www.michigan.gov/corporations, click on “Business Entity Search” under “Quick Links” or go directly to the business entity search at http://www.cis.state.mi.us/bs_corp/sr_corp.asp

To view documents, enter a corporation name in the business entity search engine and click on “Search Database by Name” and “Search.” Click on the name of the business. Click on “Images Available” in the box at the bottom of the screen to view a list by date of all documents on file pertaining to that business. Click on the camera icon, which will open an image viewer to view a document. Anyone experiencing trouble with the viewer can click on the help menu icon at the top.

Records may also be searched using a key word or the six-digit file number assigned by the Corporation Division. To search for records using one of these features, click on the “Search Database by Key Word” or “Search Database by File Number” and enter the appropriate information in the search field. The data and images are updated daily and anything added to the data base or image system by 5 p.m. should be available online by the next day.

To obtain certified copies, certificates of good standing, or other certificates, contact Corporation Division Customer Service at (517) 241-6470; fax requests to (517) 241-0537; mail requests to P.O. Box 30054, Lansing, MI 48909; or visit the office located at 2501 Woodlake Circle, Okemos, MI. The minimum charge for a certified copy is $16 and for a certificate is $10.

Certified copies may be delivered to customers by fax. Section 131(2) of the Business Corporation Act, MCL 450.1131(2) and section 104(5) of the Michigan Limited Liability Company Act, MCL 450.4104(5), provide that a certified copy may be sent by the administrator by facsimile or other electronic transmission and “shall be considered an original for all purposes and is admissible in evidence in like manner as an original.”

**Customers no longer have to call, mail, fax, or request in person uncertified copies. There is no charge for viewing or printing the documents, statements, or reports.**

**Educational Corporations**

All educational corporations must obtain the requisite approvals required by section 171 of the General Corporation Act, MCL 450.171, before the articles of incorporation can be filed. Elementary and secondary schools obtain their letter of approval from the Department of Education. To further information regarding this determination, contact Carol Eastlick, Department Specialist with the Bureau of School Finance and School Law at the Department of Education.

**Chiropractor and Professional Service Corporations**

Section 4 of the Professional Service Corporation Act provides that one or more licensed persons may organize and become a shareholder in a professional service corporation. However, if the corporation renders a professional service that is within the Public Health Code, the act requires all of the shareholders to be licensed or legally authorized to render the same professional services. Section
904 of the Michigan Limited Liability Company Act contains a similar provision.\footnote{Section 904 of the Michigan Limited Liability Company Act, MCL 450.4904, provides that if a PLLC renders professional services included in the Public Health Code “all members and managers . . . shall have and possess all the general powers and privileges and be subject to all of the liabilities of a municipal corporation and become the local governing body.”} Public Act 335 of 2000 added to section 4(3) of the Professional Service Corporation Act a provision to clarify that one or more physicians and surgeons licensed under the Public Health Code may organize a professional corporation with one or more physicians and surgeons licensed under different provisions of the Public Health Code.

In Opinion No. 7151 issued March 9, 2004, the Attorney General opined that “a chiropractor may not organize a professional service corporation with an allopathic or osteopathic physician for the purpose of providing medical and chiropractic services.” The opinion reviewed whether chiropractors are “licensed . . . to render the same professional service” as allopathic and osteopathic physicians and whether chiropractors are “physicians and surgeons” as that term is used in section 4(3) of the Professional Service Corporation Act.\footnote{MCL 450.224(3).}

The opinion states “While there is some overlap between the practice of chiropractic and the practice of medicine or osteopathic medicine, the services offered by chiropractors are not the same as those offered by allopathic or osteopathic physicians.” The opinion concludes that “chiropractors are not licensed to render the same professional services as allopathic or osteopathic physicians.”

The opinion refers to several earlier opinions that found that chiropractors are not physicians in the context of certain statutes. The term “physician and surgeon” is not defined in the Professional Service Corporation Act, and the use of the phrase in the act “indicates a physician who can perform surgery. While many allopathic and osteopathic physicians do not perform surgery, the general categories of the licensed health professionals to which they belong are legally authorized to do so.” The opinion states that chiropractors are prohibited from performing surgery and concludes that they are not “physicians and surgeons.”

**Summer Resort Associations**

The act for the incorporation of summer resort owners, MCL 455.201 et seq., permits the formation of a summer resort owners corporation and provides they “shall have and possess all the general powers and privileges and be subject to all of the liabilities of a municipal corporation and become the local governing body.”\footnote{MCL 455.219.} Section 19 of the act specifically provides that “The corporation may assess annual dues and special assessments against its members, by a vote of a majority thereof.”\footnote{MCL 455.204.}

Attorney General Opinion No. 7164, issued October 7, 2004, reviews the act for the formation of a summer resort owners corporation regarding the vote required for the assessment of dues. The opinion concludes that the act permits the board of trustees to adopt bylaws but a bylaw authorizing the assessment of annual dues by a vote of fewer than a majority of its members is unenforceable. The opinion distinguished the vote required to elect trustees “by a majority of all votes cast” from “a vote of the majority thereof” and found that a “vote of the majority thereof” means a vote of a majority of the members of the corporation.

The opinion states that a bylaw authorizing assessment of annual dues by a vote of fewer than a majority of all its members is inconsistent with section 19 of the act and unenforceable.

**NOTES**

1. MCL 450.224.
2. MCL 333.1101 et seq.
3. Section 904 of the Michigan Limited Liability Company, MCL 450.4904, provides that if a PLLC renders professional services included in the Public Health Code “all members and managers . . . shall be licensed or legally authorized in this state to render the same professional service.”
4. MCL 450.224(3).
5. MCL 455.204.
6. MCL 455.219.
This column will briefly address two practical problems for business law practitioners that also are concerns for tax lawyers. The first is the unfortunately routine loss of attorney-client privilege. The second is the client who, like Martha Stewart, believes that she or he can talk her, or his, way out of difficulty.

Losing Privilege

The scope of the historical privilege of clients to communicate with their counsel in confidence has been generally under assault by the federal judiciary in recent years. This includes several highly publicized cases in the tax shelter area. The most common reason for loss of the attorney-client privilege is inadvertent waiver. This applies to both tax and business law practitioners.

A Bad Example. Your long-time friend, also an attorney, has a chilling scenario. He or she penned an exceedingly confidential letter summarizing information of great importance and imparting most sensitive information that the other side in negotiations was never, ever to read. The correspondence has now been furnished to that party in follow-up litigation. How did this happen? Unfortunately, the usual answer is that “cc:” copies were sent to non-privileged parties. For example, during negotiations or later if there is litigation. A simple answer is probably two letters. The first is a simple transmittal letter where accountants, investment bankers, and representatives of other parties generally on your side of the transaction, etc., are copied. The second is a confidential letter to your client. It certainly helps to garner your client’s attention if you mark it “Confidential – Subject to Attorney-Client Privilege and Work Product Doctrine.” That heading alone, as case law demonstrates, will not insulate it from disclosure. However, it is a start.

Client Education (or Martha As a Bad Example)

It is also helpful at times to remind the client in a letter, as well as orally, that confidential information should not be discussed or otherwise shared with other parties. This may sound like common sense advice. However, the attorney-client privilege is inadvertently waived in every major city in the country on a daily basis by even sophisticated counsel and parties.

It is also helpful to periodically remind existing clients and inform a new client at the beginning of the transaction, about confidentiality and whom they speak to so that the conversation would not be repeated in a deposition. While my practice is confined to tax, colleagues in the business transaction area have yet to represent a client who got in trouble for what he or she did not say. We have all observed numerous clients who encountered legal difficulty for what they did say or write. This is a result of the natural human tendency that “I can explain this and make the problem go away.” Clients inevitably think that while others may have encountered problems, they know what they are talking about and can do it. I would cite but two examples to the contrary, Martha Stewart’s explanations to federal investigators and former President Clinton’s testimony in the Paula Jones civil rights litigation.

My purpose is not to tell you not to communicate with your clients. It is quite the opposite. It is simply to ensure that your confidential communications, in writing or orally, are not inadvertently waived by either you or by a client.
Despite the dot-com bust at the turn of the century, the use of the Internet for business continues, and it has become an accepted tool for information, marketing, communication, and transactions. Are we finally at the point where the legal infrastructure has caught up with technology and we all know how to advise our clients?

Far from it. If anything, the legal landscape has become more confusing. The statute books are becoming littered with politically driven and opportunistic legislation that does not affect business but can cause difficulty. A great example is the CAN-Spam legislation (Pub L No 108-187, 117 Stat 2699 (2003); 15 USC 7701 et seq.) from Congress last year. Even local governments seek to regulate many aspects of commerce in cyberspace. Nevertheless, we have yet to address any of the genuinely difficult issues facing business. For example, we know that mass e-mail advertisements must use the letters “ADV” at the beginning of the subject line, but businesses still have trouble with the minefields of state and local taxes.

Let’s revisit some of the basic concepts that are often overlooked. Is electronic commerce subject to any laws? Of course. Just because the transactions may be facilitated electronically, the law of contract still applies. If an agreement is for the sale of goods, look no further than Article 2 of the Uniform Commercial Code. Finance and secured transactions? The Uniform Commercial Code still applies across the board for such transactions. What has really changed?

**Writings.** The modernization of the term “writing” in the Uniform Commercial Code is now the term “record.” A record can include a writing, but can also be an electronic file, a facsimile, or any other evidence of an agreement that can be stored and retrieved.

**Signatures.** More significantly, the need for a “signature” in the traditional use of that term is no longer necessary. The Electronic Signatures in Global and National Commerce Act (commonly known as “E-Sign,” Pub L No 106-229, 114 Stat 464; 15 USC 7001 et seq.) provides the legal infrastructure for agreements to be recognized as valid without physical signatures. This has enabled everything from the electronic signature pad at the local store, to the use of alphanumeric representations in place of a signature (such as used by the U.S. Patent and Trademark Office), to the ubiquitous clicking of the “I Agree” button on a website. A revolutionary change occurred and the world hardly noticed.

**E-Commerce Law.** Luckily for those merchants that consider the entire world to be their marketplace, the spread of electronic commerce legislation has been relatively consistent. The adoption of a legal infrastructure supporting electronic commerce (or at least a tacit agreement by not blocking it) in most of the industrialized world has encouraged growth. In October 2004, the United Nations Commission on International Trade Law (UNCITRAL) convened another session of the Working Group on Electronic Commerce in Vienna that is moving forward efforts for a draft international convention that has the ability to support electronic commerce on a worldwide basis.

**Jurisdiction.** Often ignored by companies doing business around the world is the issue of jurisdiction. After all, the Web site selling homemade fudge from a location in Mackinac City doesn’t have to worry about being dragged into court across the globe when a walnut shell in the fudge causes an injury. Right? Well, not really.

In the United States, a line of cases applying the traditional minimum contacts and constitutional due process standards seems to be reaching a consensus about this issue. In a recent case from the 7th Circuit Court of Appeals, *Jennings v AC Hydraulic A/S*, 383 F3d 546 (7th Cir 2004), decided on September 2, 2004, the court followed a consensus among other circuits that the mere establishment of an informational Web site does not subject the owner of the site to jurisdiction in another location just because people in that location can access the Web site. This is distinguished, however, from an “interactive” site, such as a transactional Web site where consumers can purchase goods. In those cases, the vendor may have submitted itself to jurisdiction wherever its goods are purchased.

In the European Union (EU), efforts are underway to require that disputes be resolved in the venue and under the laws of the member state where the *customer* is located. That would subject anyone doing business with a consumer in the EU to jurisdiction in any member state. Developments in the Hague II Convention on the international recognition of foreign judgments could make this binding on U.S. companies as well.

Stay tuned for more developments.

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Succession Planning for Agribusinesses

By George F. Bearup & Scott D. Harvey

Introduction

Business succession planning, “the process of creating and implementing a strategic plan for the family business that is designed to mesh the emotional and financial needs of the owner, family and key employees with the needs of the business as a viable ongoing entity,” can be a daunting task for a business owner. Planning for the ongoing viability of the business when they are no longer at the helm is often a topic that business owners would rather not consider. This is especially true for owners of family agribusinesses (including farms, orchards, vineyards, etc.), some of whom have spent their lives living on, working on, and tending to their business, which may have been in their family for generations. This can lead the family agribusiness owner to have extremely strong emotional ties to his or her business, viewing it in some respects not just as a job, but as his or her “life.” Thus, just as many persons are hesitant to contemplate and plan for their death, so too family agribusiness owners are hesitant to contemplate and plan for life after the “farm.” Indeed, while 78 percent of agribusiness owners intend to pass the business on to their children, only 34 percent create a succession plan, and for 25 percent of these owners, a will is the only element of that plan. Failing to plan for the transfer of the business, however, can lead to financial insecurity, personal and family dissatisfaction, and unanticipated capital losses. Through the creation of a detailed and comprehensive business succession plan, however, agribusiness owners can ensure that the family business remains viable and will continue to provide for the family after his or her death or departure.

This article discusses business succession planning for the family agribusiness owner and the role that an attorney can play in this process, along with the tools and mechanisms that an attorney can provide to an agribusiness owner to enable a successful transition of his or her business, whether that transition is through its sale, lease, or transfer.

Succession Planning in General

Succession planning seeks to integrate current tax, business, and liquidity considerations with family relationship issues to achieve an overall plan that is workable for current operational needs and for the long-range estate planning goals of the client and the financial success of the business. Therefore, the attorney’s role in assisting in the preparation of a succession plan is not limited to the giving of technical legal advice and the preparation of legal documents. The attorney plays a vital role as a trusted advisor, counselor, and, to some extent, family psychologist (especially considering the emotions surrounding a family agribusiness), all the while paying attention to ethical considerations that are beyond the scope of this article. Business succession planning is complex and is not limited to estate planning. It involves more, and different, techniques that are fraught with more tax risks. It requires a good estate plan to complement a good business succession plan, as is examined in greater detail later in this article.

Each business and family situation is unique and the goals and objectives that each business owner has for his or her business will vary considerably. Accordingly, a business succession plan must be custom-tailored to fit each client’s goals and objectives. That said, the basic steps and processes involved to create a business succession plan will apply to most if not all businesses, including family agribusinesses. In addition, there are some planning opportunities and challenges particular to family agribusinesses that the succession planner should be aware of, and which will be examined in greater detail below.

The planner must first ensure that the agribusiness clients have employed trusted, competent, and varied professional planners (including certified public accountants (CPAs), investment planners, life underwriters, appraisers, etc.) to assist in the creation and implementation of the plan. This is crucial because of the complex and varied nature of business succession planning,
including the tax risks involved. The planner should insist on the owner employing these professionals as part of the creation of the succession plan, and should work closely with these other professionals to develop a comprehensive plan.

In addition, the planner must make clear to the agribusiness owner what business succession planning is, and what it is not. This will help the owners understand the issues that he or she must address in this process and to give the owner and the planner a framework to create the plan.

Succession planning is:

- a process;
- about family, people, and relationships;
- about ownership, management, and the estate;
- about what is fair; and
- driven by the family’s values, wants, and concerns.

Succession planning is not:

- an event;
- just the owner’s problem;
- about minimizing taxes;
- about equity; or
- driven by technical issues.

At this stage, the planner must make it clear to the owner that planning for business succession is unlike “traditional” estate planning in that it is an ongoing process that should involve all members of the owner’s family. Unlike traditional estate planning, business succession planning is not personal to the owner; rather, it requires the views of the family, or at least those that are or will be involved in the business. Business succession planning is ongoing; it is a series of steps that enables the owner and his or her family to reach their goals both during and after the owner’s life. It is not a one-time event that disposes of the owner’s assets.

Also unlike traditional estate planning, a business succession plan cannot be motivated by a desire to ensure that all members of the owner’s family are treated equally. Especially in the context of an agribusiness, where different family members may have varied skills and varied levels of interest or involvement in the agribusiness, planners must caution owners who insist on treating each member of the family equally. Instead, the owner’s focus should be on treating each member of the family fairly so that the agribusiness is not sacrificed at the expense of the family, and vice versa.

The driving force behind the succession plan should be the goals and objectives that the owner and his or her family have for the agribusiness. Establishing the goals and objectives that the owner and the family have for their agribusiness will determine the type of succession plan that should be created. The tax savings and technical legal aspects of the plan should work with, not against, these identified goals and objectives. Only after these factors have been examined can an owner and his or her family determine their goals and objectives for the agribusiness and only then can a succession plan be created and begin to be implemented.

The goals and objectives of agribusiness succession planning will vary with each situation. However, the goals and objectives of any business succession plan will likely contain at least some of the following aspects:

- to determine the successor(s) who will operate the business, as well as the other key employees
- to provide a method to transfer control of the business
- to determine how to mesh family and business priorities together
- to determine how (and whether) to create a family legacy
- to develop a plan and mechanism to ensure succession that is viewed as unbiased and fair and, to the extent possible, based upon family consensus.
- to achieve family harmony, while maintaining family values and lifestyles
- to provide for the owner’s financial and retirement requirements
- to clarify career paths for family members with the appropriate training, mentoring, and experience
- to ensure viability of the business by minimizing liquidity demands and ensuring competent leadership
- to provide for contingencies and revision of the plan

Family Agribusinesses

In the case of a family agribusiness, the goals and objectives can be quite varied and will contain a combination of those listed above. In the end, however, the owner, along with his or her family, must choose between four basic options for their business: (1) sell the
assets of the business, (2) lease the assets to another producer, (3) hire a professional farm-property manager, or (4) involve family members in managing the agribusiness and transfer the business during the owner’s lifetime or on the owner’s death.\(^8\)

The choice the family makes for the business is, to a large extent, driven by their goals and objectives for the business. The overriding goal and objective for most owners (and their families) is to maintain the agribusiness after the owner’s departure. This holds such importance in the context of the family agribusiness because of the emotional ties that an owner often has with the agribusiness. Often, the agribusiness owner will view it not just as a business, but as his or her (and his or her family’s) life, built on generations of hard work and sacrifice. It is often viewed by the agribusiness owner not simply as just a business, but as a place where generations have been born, lived, worked, and died. This emotion and passion for the business, while commendable, can cloud an agribusiness owner’s judgment when it comes to succession planning, leading him or her to believe that the business must be continued at all costs. Therefore, it is the planner’s responsibility to make the owner appreciate the objective “big picture” for the agribusiness and take into consideration certain factors when determining the appropriate goals and objectives for the business after his or her departure.

Two of these principal factors are whether there exist identifiable successors to assume control of the business and the owner’s need for liquidity to provide for his or her financial security and retirement, which is often critically important in the context of an agribusiness, where there may not be a sufficient (or any) retirement plan in place for the owner.

Identifying a Successor

In agribusinesses it is often the case that the business has been in the family for generations. Consequently, there exists a strong desire to maintain the business in the family. Determining whether this objective is possible will require an attempt to identify the owner’s successor within the family. If the owner is unable to identify a successor within his or her family, he or she may be able to identify one outside of the family, perhaps allowing the business to be continued, though outside of the family’s control.

The first step to identify a potential successor is to assess the agribusiness’ current position. This involves analyzing the work conducted on the farm, orchard, or vineyard; the maturity of the farm; its productivity; and the management structure of the business. In short, the planner must help the owner assess how much work the owner currently performs for the business, how long he or she can maintain that current work load, how much work is currently being done by other individuals, if any, and how the owner could reduce his or her work load by transferring some or all of it to these other individuals. The planner must then help the owner to assess the level of the major decision making by the owner and other individuals, if any, and what, if any, business decisions (e.g., production, harvesting, crop recycling, marketing, personnel, etc.) might the owner be willing to begin to transfer to these identified individuals. Often, this phase-in of the transfer of decisions to others is accomplished over several years.

Analyzing these factors will help the owner to identify who might be willing and able to take over some of this work and share responsibility. While the owner’s intent might be to treat everyone in the family equally, the owner must make an honest evaluation of the contribution and abilities of the other family members to determine which persons are most likely to continue the agribusiness successfully. If the owner identifies multiple successors to the agribusiness, such as his or her two sons, the owner and the family must determine whether those family members will cooperate to run the business profitably or whether they will inevitably resort to familial warfare.\(^9\)

Other questions that may need to be addressed at this preliminary stage are:

- Are there key employees who need to be kept involved for the long-range success of the agribusiness?
- If familial rivalries exist, how is one family member to be protected from the other?
- Has the designated successor(s) been given the opportunity to succeed in some aspect of the agribusiness, or outside of the agribusiness?\(^10\)

In many instances in an agribusiness, the family has been involved in the production...
of aspects of the business (the “working of the fields”), but may not have been involved in the business side (the financing, marketing, accounting, distribution, etc.). Accordingly, the owner must ensure that not only is the successor willing to take over the agribusiness, but that the successor will have sufficient experience and possess the capability to maintain the agribusiness as a viable, profitable entity.

In evaluating potential successors, the agribusiness owner should take into account the following skills and abilities: crop and livestock management, marketing, purchasing, mechanical ability, financial management, building construction skills, communication skills, tolerance for risk, and personnel management. Only after the agribusiness owner assesses these skills and abilities in potential successors can he or she accurately determine whether a potential successor may be trusted with the ownership of the business.

The agribusiness owner’s identification of a successor within the family will be the overriding factor in determining whether the business will be continued within the family or whether it will be sold to or managed by a third party. Certainly the owner’s goals for the business will come into play at this point as well, because it may be the case that the owner’s retirement security and financial wellbeing may be achieved only through a sale of the business. The owner may also be determined to retain the business in the family at any cost. Nevertheless, if an owner is unable to identify a successor for the business within his or her family, he or she may be forced to dispose of the business to a third party.

If after assessing the owner’s goals and objectives for the business and the owner’s conclusion there are no suitable successors within his or her family it is determined that a sale of the business makes sense, there are certain factors that must be considered in the context of a family agribusiness.

Sale or Lease of the Agribusiness to Unrelated Parties

In the case of an agribusiness, there are two factors that must be considered when a sale of the business to an unrelated party is contemplated. First, the land that comprises the farm, orchard, or vineyard will likely account for most of the value of the assets of the business. Second, the market for the business as an agribusiness may be significantly less than would be the market for the land that it comprises, assuming that it could be used for another use, such as residential or commercial development.

These factors may force the owner to make a difficult decision. Would he or she rather see the agribusiness continued as an agribusiness, even though the demand for it may be relatively small, and as such, he or she is unable to obtain adequate value for the business? Or would the owners rather terminate the business, sell off its assets, including the land, and likely realize a significant increase in its value?

These are questions that can only be answered by the owner, after assessing his or her goals and objectives for the business. If the owner wants the business to continue at all costs, he or she might insist on a complete sale of the business, even though this may cause him or her to realize a significant reduction in profit, thus impacting retirement and financial security. If, on the other hand, the owner’s main goal is to provide for retirement and to ensure financial security (including that of the owner’s family), it may make sense to sell the assets of the business, including the land, so long as it has a more valuable use.

One option available to an agribusiness owner who would like to preserve the land, but where the business will not continue after the owner’s departure, is to sell the development rights of the property to a land conservancy organization. This allows the owner to ensure the land that he or she has worked for decades is preserved from development, while allowing the owner to realize a profit to provide for financial security and retirement. The sale of development rights also affords the owner the ability to continue residing on the land. Further, it may afford the owner’s estate with the ability to exclude up to 40 percent of the value of the land for estate tax purposes, up to $500,000.

In addition, conservancy organizations will purchase “key” pieces of land from agribusiness owners to ensure that they are protected from future development. Either way, the transfer of development rights allows the agribusiness owner whose business will not continue to realize some profit from his or her land without having to for-sake its character.

Whether the sale of the agribusiness
occurs during the owner’s lifetime or at his or her death will in large part depend on the financial needs of the owner. If the owner requires liquidity for retirement, a sale during the owner’s lifetime may be in order. If this is the case, then the requirement for a sale, its terms, and the identity of the parties should be reduced to writing in a buy/sell agreement, which is detailed later. However, agricultural land enjoys certain estate tax advantages that might make it worthwhile to sell the business only after the death of the owner, which decision again depends on the owner’s liquidity needs during his or her lifetime.13

There is a final option available to the agribusiness owner who is unable to identify a successor, but whose primary goal is to maintain the business after his or her departure from the business. This option involves a lease of the assets of the business to a professional farm-manager, or to another competent individual, who provides the owner and his or her family with periodic lease payments and maintains the business in return for the right to sell the crops, etc. This option allows the agribusiness to continue, while providing a stream of income to the owner and his or her family, and will likely allow the owner and his or her family to remain in their home, again assuming they live on the land.14

Transfer of Business to Family Successors

Assuming the family agribusiness owner desires to maintain the business in the family after his or her departure and is able to identify a competent successor within the family, the question becomes one of transferring the business to the next generation effectively and efficiently, while minimizing the tax burden on the successors. It is at this point that the planner must make it clear to the owner that involvement of the entire family is crucial, because the transition cannot be successfully accomplished without the involvement in and acceptance of the plan by the owner’s family.15

The business succession plan needs to be specifically directed to the goals and objectives of the family and should provide for the efficient and effective transfer of ownership and assets, while anticipating any events that may disrupt the transition. Although every plan is different, each plan should generally include, at a minimum, the following:16

- an appropriate ownership structure to provide the desired roles for the owner, his or her spouse, and their children and in-laws, allocating control and voting rights among the family and to permit sales of ownership interests under prescribed procedures.
- a method for communication and resolution of family disputes
- provisions for the training of younger family members and their compensation, if any
- provisions that address liquidity needs, including providing sufficiently for the retirement or disability of the senior generation

“On-Farm” vs “Off-Farm” Children

Although it is rarely possible for an agribusiness succession plan to treat everyone in the next generation equally, it should be one of the objectives for the plan to treat “on-farm” and “off-farm” children fairly. The planner must make this clear distinction to the owner, who will likely be concerned with treating all of his or her children fairly.

“Off-farm” children often want to see the farm stay in the family, but they need to realize that the “on-farm” children, as successors of the business, will need some help to become established, and may therefore receive more under the owner’s plan. Although the plan may therefore not treat everyone in the next generation as equal, it may need to be explained to “off-farm” children that they have received some benefits over the years that their “on-farm” siblings have not, such as a college education, etc. By the same token, “on-farm” children’s labor and management time must be considered as “sweat equity.” All of this needs to be communicated and explained to the entire family early on to avoid any surprises and to help minimize any conflicts within the family that may work to destroy an otherwise carefully crafted succession plan.

Often, however, there may not be sufficient assets outside of the farm assets to provide for the “off-farm” children who will not be involved in the agribusiness. This situation calls for creativity on the part of the planner, possibly through structuring the business in a way that will keep “off-farm”
children involved in the business by afford-
ing to them the opportunity to invest in the
business. At a minimum, it may be necessary
to acquire additional assets in the form of life
insurance to balance the equities between all
of the children, which the owner will likely
desire.17

The Succession Plan for the
Agribusiness

The mechanisms to transfer the business can
be as varied as the owners themselves, but
there are some general principles that the
planner should follow when preparing the
succession plan.

A prudent initial step is to conduct a val-
uation of the agribusiness. This is where
employing an appraiser as part of the suc-
cession planning team is so essential. An
expert valuation of the business will help
facilitate the transfer of the business and
help to fend off any challenges from the IRS
regarding the value of the transfer.

In this regard, when conducting a val-
uation of the business in preparation for its
transfer, the planner should take note of the
special valuation of agricultural land under
the Internal Revenue Code (IRC). Under IRC
2032A, subject to certain requirements, on
the death of the owner, the owner’s family
may be able to reduce the fair market value
of the “qualified agricultural property” by
up to $750,000 for estate tax purposes.18 If
the real property is jointly owned by a cou-
ples and both intend to pass on the land to
the next generation, each spouse can take the
deduction, which allows up to an additional
$1.5 million exemption from estate tax liabil-
ity.19 In addition, subject to certain require-
ments, the placing of a conservation easement
on the land transferred to the succes-
sors can allow the successors to exclude up
to 40 percent of the value of the land, up to
$500,000, for estate tax valuation purposes.20

The second step in the succession plan is
to ensure that the business has an ownership
structure in place that will facilitate the suc-
cession plan and allow for the effective and
efficient transfer of management and assets.
The structure should also be designed to
attempt to minimize tax concerns, including,
in particular, the valuation of the agribusi-
ness for transfer tax purposes and to ease
any eventual liquidity problems that may
arise as a result.21

The structure or legal entity used by a
majority of family agribusinesses is the sole
proprietorship. However, it is likely the case
that another structure for the business, such
as an S-corporation, family limited partners-
ship, or limited liability company (LLC) may
better facilitate the succession plan, especial-
ly where there is concern about distinguish-
ing between ownership and control of the
business.22

Structuring the business as an S-corpora-
tion, family limited partnership, or LLC will
likely be more efficient and provide the plan-
er with greater flexibility to prepare and
implement the plan. Using a new operating
entity may reduce the investment needed by
“on-farm” heirs to gain control of the operat-
ing entity, as well as make it easier to deal
equitably with “on-farm” and “off-farm”
heirs by providing “off-farm” heirs with the
opportunity to be involved in the business as
investors.

Additionally, there are obvious advan-
tages to structuring the agribusiness as an S-
corporation, family limited partnership, or
LLC outside of succession planning such as
limited liability, the ability to raise capital,
and, perhaps, certain tax advantages. These
benefits must be weighed against any ad-
verse tax consequences that result from a
change in the structure of the business and
must complement the estate tax goals of the
owner’s estate plan.23 This demonstrates
both the need to coordinate the succession
plan with the owner’s estate plan and the
need to employ other competent, trusted
advisors, such as CPAs, when creating the
plan.

Finally, it should be noted that agribusi-
nesses are often structured so that the owner
owns at least part of his or her land with one
or more unrelated individuals or entities as
tenants in common. Such a situation could
present problems for the transfer of owner-
ship of this land if the landowners treat this
land as a type of joint venture, acting as busi-
ness or investment partners regarding the
land. Depending on whether the parties
intend to act as partners, this may cause this
property to be classified as “partnership
property,” subject to the requirements of the
Uniform Partnership Act, MCL 449.1 et seq.,
even in the absence of a formal partnership
agreement.24

Such a classification would likely pre-
clude the owner from partitioning the prop-
erty by transferring it to his or her succe-
sor(s), which could therefore cause a severe
disruption in the succession plan, especially if this parcel of land is essential to the operation of the agribusiness. If the parcel is essential to the operation of the agribusiness, the planner should explore with the owner his or her options for the effective transfer of this land, including buying out the “partner’s” share of the property.

In sum, the planner must take care to thoroughly analyze the structure and assets of the business to avoid potential pitfalls when creating the succession plan, including the transfer of land that may not be owned outright by the agribusiness. Only after this analysis has taken place can an effective agribusiness succession plan be created and implemented.

Succession Plan Documents

No matter the structure of the agribusiness, the planner must ensure that the basic principles of the plan outlined above are captured in the planning documents.

A major component of these planning documents will likely be a buy-sell agreement, which will incorporate many of the provisions outlined above. Such an agreement will provide the plan with the identity of the ownership, the liquidity of the business interest, an estate tax valuation, and operating guidelines for the business.

Furthermore, although generally beyond the scope of this article, planners should be cognizant that any such agreement complies with relevant tax laws, including the “anti-freeze” regulations contained in IRC 2701–2704, which pertain to the valuation of stock subject to an option or a contract to purchase. Being aware of these regulations and structuring the agreement properly can provide the agribusiness owner with the capability to shift excess earnings and growth estate and gift tax free to the next generation.

To afford the owner this capability, however, the planner must take care that the buy-sell agreement complies with the requirements of IRC 2703. Accordingly, the buy-sell agreement must (1) represent a bona fide business arrangement, (2) not be used as a device to transfer property for less than adequate and full consideration, and (3) be comparable at the time of drafting to similar arrangements entered into in arms-length transactions. Ensuring that the buy-sell agreement meets this three-pronged requirement is essential to utilizing this potential estate tax savings mechanism and demonstrates the need to coordinate the succession plan with the owner’s estate plan.

The plan should also contain written procedures, either in the buy-sell agreement or otherwise, detailing the method for communication and resolution of family disputes; provisions for the training of younger family members and their compensation, if any; and provisions addressing liquidity needs, including providing sufficiently for the retirement or disability of the senior generation. Ensuring that the plan provides sufficient liquidity for the owner is especially important in the context of agribusiness succession planning, since, unlike “traditional” businesses, it is often the case that the agribusiness owner will not have a retirement plan in place sufficient to support his and his spouse’s retirement. Liquidity needs for the owner and his spouse can be provided through the funds acquired by the transfer of the business, as well as through consulting agreements between the owner and the successor(s).

Finally, it is often wise to include a provision in the applicable succession plan documents requiring facilitative mediation of all disputes that may arise. Including such a requirement will afford the parties, who are often related, the ability to settle their disputes much more efficiently and inexpensively than via the courts and with lessening of the relational strains on the family, which can become exacerbated with litigation.

In sum, to a large extent, the structure of the business will drive the succession plan and the particular mechanisms by which the business is transferred. It may be a good idea to structure the agribusiness as an S-corporation, family limited partnership, or LLC, if it is not already, for a variety of reasons related and unrelated to succession planning. Whatever structure and mechanism for transfer the planner employs, however, the plan should adhere to the basic principles outlined above.

Review and Update Plan Periodically

The planner and the owner must ensure that they periodically review the progress of the succession plan and any changes in family members or others that are integral parts of the plan, especially where the transfer of ownership is to take place over a number of years. If there have been changes that affect
the plan, the planner needs to keep abreast of these to ensure that updates and revisions to the plan are timely made, and thus are effective to meet the change in circumstances.

Coordination of Estate Plan

The planner must also ensure that any business succession plan is coordinated with the owner's estate plan. For example, the valuation deductions for agricultural property discussed earlier can be used by planners within the context of the owner’s estate plan to help ease the estate tax burden on the successors. If even part of the succession plan does not mesh with the owner’s estate plan, there is a good chance that the plan will fail or, at the very least, will create difficulties with the continued implementation of the plan. Further, it will force the next generation to deal with the headaches of attempting to correct the plan and may even leave them saddled with an unnecessary estate tax bill.

Conclusion

The family agribusiness owner is tied to his or her business like no other business owner. The owner and his or her family have likely worked, lived on, and tended to this business for their entire lives, and perhaps for generations. Therefore, there is likely to be a strong desire to maintain the business in the family. Nevertheless, there are several options available to an owner of an agribusiness who desires to depart from the business. The planner, along with the owner and his or her family, must determine the goals and objectives the owner and his or her family have for the business and put together a succession plan or other disposition of the business that meets these goals and objectives effectively.

NOTES

4. See MRPC 1.7.
5. Koren at §1203.
6. Koren at §1203.
7. Koren at §1201.2.
9. Koren at §1205.2.
10. Koren at §1205.3.
11. “Succession Planning: How Do I Train the Next General Manager?,” Strategic Business Planning for Commercial Producers, Purdue University.
12. See IRC 2031.
13. See IRC 2031.
14. See IRC 2032A.
15. Koren at §1207.1.
17. Koren at §1207.3.
18. See IRC 2032A.
19. See id.
20. See IRC 2031.
22. Id.
23. Planners should be cautioned that the use of a family limited partnership or a family LLC to transfer “sliver interests” in non–income producing vacant land to the next generation may not qualify for the annual gift tax exclusion when this asset is not a “substantial present economic benefit.” See Hadd v Commissioner of Internal Revenue, 118 TC 279 (2002), aff’d by Hadd v Commissioner of Internal Revenue, 335 F3d 664 (7th Cir. 2003).
26. IRC 2703.

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Fiduciary Duties and Standards of Conduct of Members of a Michigan Limited Liability Company

By James R. Cambridge

Introduction

A limited liability company (LLC) often looks like a corporation. At other times, an LLC resembles a partnership. Should members of an LLC then be compared to shareholders and officers of a corporation when it comes to defining their fiduciary duties and standards of conduct or should they be treated as partners in a partnership? There is no provision in the Michigan Limited Liability Company Act (Michigan LLCA) requiring members to adhere to prescribed fiduciary duties or standards of conduct. However, it seems unreasonable to conclude that members have no duties at all. In time, Michigan courts can be expected to determine that members of a Michigan LLC have certain fiduciary duties and must adhere to certain standards of conduct. But what will these duties and standards of conduct be? This article discusses how Michigan courts, like courts in other parts of the country, might define the fiduciary duties and standards of conduct of members of a Michigan LLC. The article specifically discusses how courts balance two very important (and sometimes conflicting) principles—the freedom of contract on one side and the need to restrict opportunistic and abusive conduct on the other.

The “Contractarian” Theory—Delaware’s Approach

An LLC is largely a creature of contract. An LLC is an unincorporated membership organization whose business and affairs are generally governed by a written contract (commonly known as an operating agreement) between the members of the LLC. Each state has its own limited liability company act and, although the various statutes are similar in some respects, they differ in many ways. For example, it is the express policy of the Delaware LLCA to adhere to the principle of freedom of contract to the greatest extent possible. Delaware follows what some have called the “contractarian theory” of defining the duties and standards of conduct of members of an LLC. Under a strict interpretation of the Delaware LLCA, it would be possible to contractually limit, if not outright eliminate, a member’s duties. Professor Sandra K. Miller discusses the contractarian theory and the need for mandatory constraints on opportunistic and abusive conduct in an article published recently in the University of Pennsylvania Law Review. Professor Miller argues that whether or not LLC statutes contain express fiduciary duties, courts are compelled to address the issue of the duties of members. She points out that although LLC statutes are relatively new, abusive conduct is not. Professor Miller finds that, in response to these abuses, courts are beginning to formulate a mandatory set of core duties and standards of conduct that cannot be varied by contract. It remains to be seen whether this will occur in Michigan.

Historically, Delaware courts have given great deference to the freedom of members to limit or even eliminate their fiduciary duties. In Walker v Resource Dev Co, LLC, the Delaware Chancery Court stated that the basic approach of the Delaware LLCA is to provide members with broad discretion in drafting their operating agreements and to provide default rules only when the agreement is silent. The Delaware court stated that “LLC members’ rights begin with and typically end with the Operating Agreement” and that “[o]nce members exercise their contractual freedom in their limited liability company agreement, they can be virtually certain that the agreement will be enforced in accordance with its terms.” However, this deference to contractual freedom is not without its limits. In Gotham Partners, LP v Hallwood Realty Partners, LP, when considering the duties of partners in a partnership, the Delaware Supreme Court...
held that while a partner’s fiduciary duties may be restricted, they cannot be eliminated. In Omnicare, Inc v NCS Healthcare, Inc, the Delaware Supreme Court held that corporate directors can only go so far in attempting to limit their fiduciary duties in private contracts such as, in this case, a merger agreement. Finally, in Solar Cells, Inc v True North Partners, LLC, the Delaware Chancery Court, in enjoining a planned merger of an LLC, focused on specific waiver-of-duty language in an operating agreement and concluded that the language did not eliminate the members’ duty to act in good faith.

Will Michigan courts adopt a similar contractarian approach? Although the Michigan LLCA provides a great deal of contractual freedom, unlike the Delaware LLC, the Michigan LLCA includes a few statutory requirements that cannot be varied by contract. So, to that extent, the Michigan LLC is not quite as generous as the Delaware LLC. The Michigan LLCA also does not expressly state, as the Delaware LLC does, that it is the statute’s policy to give effect to the principle of freedom of contract to the greatest extent possible and to strictly enforce operating agreements whenever possible. However, the absence of this express statutory language should not mean that this should not be Michigan’s policy. Most will argue that, with some exception, it should be possible for members of a Michigan LLC to limit, if not altogether eliminate by contract, their duties and standards of conduct. The same individuals will argue that members should have limited duties and standards of conduct. But what should these duties and standards be? Michigan courts will have to answer this question and, in so doing, may look at more established corporate and partnership principles for guidance. An examination of Michigan corporate and partnership law seems to suggest that, in time, Michigan courts might impose on members of a Michigan LLC some of the duties and standards of conduct required of shareholders or partners.

The Corporate Approach

Michigan courts may first look at corporate law for guidance since, as it turns out, most LLCs look and function like corporations. The Michigan Business Corporation Act (Michigan BCA) does not impose any specific fiduciary duties or standards of conduct on corporate shareholders except for the reference in Section 489 to “illegal, fraudulent, or willfully unfair and oppressive” conduct by persons in control of the corporation, which presumably includes controlling shareholders. In Estes v Idea Eng’g & Fabricating, Inc, the Michigan Court of Appeals held that Section 489 creates a separate, independent cause of action for minority shareholder oppression in closely-held corporations. As used in Section 489, willfully unfair and oppressive conduct means a “continuing course of conduct or a significant action or series of actions that substantially interferes with the interests of the shareholder as a shareholder. The term does not include conduct or actions that are permitted by an agreement, the articles of incorporation, the bylaws, or a consistently applied written corporate policy or procedure.”

The language of Section 515 of the Michigan LLCA is virtually identical. Applying the reasoning of Estes, Michigan courts should conclude that Section 515 of the Michigan LLCA gives aggrieved minority members of an LLC a direct cause of action against members in control of the LLC for the illegal, fraudulent, or willfully unfair and oppressive conduct of controlling members. In making such conduct actionable, Section 515 imposes on members in control of a Michigan LLC a prescribed standard of conduct or duty not to engage in illegal, fraudulent, or willfully unfair and oppressive conduct toward the LLC or another member. Section 515 of the Michigan LLC (and Section 489 of the Michigan BCA) comes as close as it gets in Michigan to imposing a duty on members in control of a Michigan LLC (and shareholders in control of a Michigan corporation) to abstain from illegal, fraudulent, or willfully unfair and oppressive conduct toward the company or the other members (or shareholders).

Although the Michigan LLC does not expressly prescribe duties and standards of conduct for members of a Michigan LLC, it does make some provision for members who are also managers. If management is vested in the members, under Section 401 of the Michigan LLC, the members are considered managers for purposes of applying the LLC. This means that members who are also managers are subject to all the duties and liabilities of managers and to all the lim-
Michigan courts may also turn to partnership law when considering whether members of a Michigan LLC, perhaps like partners in a Michigan partnership, must adhere to certain fiduciary duties and standards of conduct. Michigan has adopted the Uniform Partnership Act (Michigan UPA). The Partnership Approach

Michigan courts may also turn to partnership law when considering whether members of a Michigan LLC, perhaps like partners in a Michigan partnership, must adhere to certain fiduciary duties and standards of conduct. Michigan has adopted the Uniform Partnership Act (Michigan UPA). Under Section 20 of the Michigan UPA, every partner must also account to the partnership for any profits, derived by the partner without the consent of the other partners in any transaction connected with the partnership or from any use of partnership property. Section 21 establishes the duty of loyalty of a partner. Courts universally recognize the fiduciary relationship of partners and impose on them obligations of the utmost good faith and integrity in their dealings with one another in partnership affairs. Partners are held to a standard stricter than that of the marketplace and their fiduciary duties should be broadly construed, “connoting not mere honesty but the punctilio of honor most sensitive.” The fiduciary duty among partners is generally one of full and frank disclosure of all relevant information. Each partner has the right to know all that the others know and each is required to make full disclosure of all material facts within his or her knowledge in any way relating to the partnership affairs. Partners owe to one another, while the enterprise continues, the duty of the finest loyalty. Thus, partners have both a duty to disclose and a duty of loyalty. However, there is no statutory duty of care imposed on partners under the Michigan UPA and no Michigan courts have specifically recognized a common-law duty of care.

The Michigan UPA, like the partnership laws of most of the states, has changed very little since it was adopted. Given the popu-

Consequently, a manager may rely on information and opinions provided by other managers, members, or employees of the LLC, as well as professionals. However, this reliance must be reasonable. A manager is not entitled to rely on the information and opinions of others if the manager has knowledge of the matter in question that makes reliance unwarranted. A manager is not liable for an action taken as a manager or the failure to take an action if the manager performs the duties of the manager’s office in compliance with Section 404 of the Michigan LLC. And, except as otherwise provided in an operating agreement or by vote of the members pursuant to Sections 502(4) and (7), a manager must account to the LLC for, and hold as its trustee, any profit or benefit derived by the manager from any transaction connected with the LLC or from any personal use by the manager of LLC property. This provision of the Michigan LLC is based largely on Section 21 of the Michigan Uniform Partnership Act (Michigan UPA).

Managers of an LLC that has adopted the centralized form of management in its articles of organization function the same as directors and officers of a corporation. In closely-held corporations, most shareholders are also the directors and officers. Thus, it stands to reason that the courts would look to the duties and standards of conduct of directors and officers (who are often also shareholders) in determining what duties and standards member-managers of an LLC might be expected to follow. For a discussion of the duties and standards of conduct of corporate directors and officers, see Stephen H. Shulman et al., Michigan Corporation Law and Practice.

The Partnership Approach

Michigan courts may also turn to partnership law when considering whether members of a Michigan LLC, perhaps like partners in a Michigan partnership, must adhere to certain fiduciary duties and standards of conduct. Michigan has adopted the Uniform Partnership Act (Michigan UPA). Under Section 20 of the Michigan UPA, every partner must also account to the partnership for any benefits derived by the partner without the consent of the other partners in any transaction connected with the partnership or from any use of partnership property. Section 21 establishes the duty of loyalty of a partner. Courts universally recognize the fiduciary relationship of partners and impose on them obligations of the utmost good faith and integrity in their dealings with one another in partnership affairs. Partners are held to a standard stricter than that of the marketplace and their fiduciary duties should be broadly construed, “connoting not mere honesty but the punctilio of honor most sensitive.” The fiduciary duty among partners is generally one of full and frank disclosure of all relevant information. Each partner has the right to know all that the others know and each is required to make full disclosure of all material facts within his or her knowledge in any way relating to the partnership affairs. Partners owe to one another, while the enterprise continues, the duty of the finest loyalty. Thus, partners have both a duty to disclose and a duty of loyalty. However, there is no statutory duty of care imposed on partners under the Michigan UPA and no Michigan courts have specifically recognized a common-law duty of care.

The Michigan UPA, like the partnership laws of most of the states, has changed very little since it was adopted. Given the popu-
larity of LLCs, there may be no reason ever to change the Michigan UPA again. However, the National Conference of Commissioners on Uniform State Laws adopted a Revised Uniform Partnership Act (Revised UPA) in 1997, which Michigan has not yet adopted. Section 404 of the Revised UPA reflects a current view of what fiduciary duties a partner owes the partnership and other partners. Section 404 states that the only fiduciary duties a partner owes are the duties of loyalty and care set forth in Section 404. Those duties may not be waived or eliminated in the partnership agreement but the agreement may identify activities and determine standards for measuring performance of the duties, if not manifestly unreasonable. Section 404(b) of the Revised UPA finds that there are three specific rules that comprise a partner’s duty of loyalty. Subsection (b)(1) is based on Section 21(1) of the Uniform Partnership Act and restates the general rule of law that partnership property usurped by a partner, including the misappropriation of a partnership opportunity, is to be held in trust for the partnership. This rule is reflected in Section 21(1) of the Michigan UPA. Subsection (b)(2) provides that a partner must refrain from being adverse to the partnership. There is no similar provision in the Michigan UPA. And Section 404(b)(3) provides that a partner must refrain from competing with the partnership in the conduct of its business. Again, there is no similar provision in the Michigan UPA.

Prototype and Uniform LLC Acts

The Michigan LLCA is based largely on a draft of the American Bar Association’s Prototype Limited Liability Company Act (Prototype LLCA). Section 402 of the Prototype LLCA and Section 404 of the Michigan LLC are similar in the general sense that both sections provide that members of an LLC who are also managers have certain fiduciary duties as member-managers. However, the sections are different in some important ways. Section 402(A) of the Prototype LLCA expressly sets forth a gross negligence or willful misconduct standard of care for member-managers. Section 402(B) expressly sets forth the additional duty of loyalty for member-managers. Nevertheless, Section 402(C) states that a member who is not also a manager has no duties to the LLC or to the other members solely by reason of acting in the capacity of a member. The comments to Section 402 of the Prototype LLCA confirm that these stated duties of care and loyalty are default rules that can be limited or even eliminated by contract. Section 404 of the Michigan LLCA describes the duties of member-managers in a different way.

Under Section 404(1) of the Michigan LLCA, a manager (including also a member-manager) must “discharge his or her duties as a manager in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner he or she reasonably believes to be in the best interests of the [LLC].” This is the only expression in the Michigan LLCA of the duties of members and thus, this standard applies to members only by virtue of their position as managers as well. Unlike the Prototype LLCA, the Michigan LLCA does not expressly state that a member who is not also a manager does not have any duties to the LLC or to the other members solely be reason of acting in the capacity of a member.

Section 404 of the Prototype LLCA provides that an operating agreement may eliminate or limit the personal liability of the member or manager for monetary damages for breach of any duty provided for in Section 402 of the Prototype LLCA. The Michigan LLCA includes a clear indication that members can agree in their operating agreement to limit, if not eliminate, their liability for a breach of duty. Section 407 of the Michigan LLCA provides that either the articles of organization or an operating agreement may eliminate or limit the monetary liability of a manager to the LLC or its members for a breach of prescribed duties except in four instances—(1) for the receipt of a financial benefit to which the manager is not entitled, (2) for improper distributions, (3) for a knowing violation of law, and (4) for an act or omission occurring before the date when such provision in the articles or operating agreement became effective.

Since the Prototype LLCA was published, a Uniform Limited Liability Company Act (Uniform LLCA) was written. Although Michigan has not adopted the Uniform LLCA, the uniform act is illustrative of yet another view of what duties and standards of conduct might apply to members. The Uniform LLCA expressly imposes on members the duties of loyalty and care.
and the obligation of good faith and fair dealing. Under Section 409(b) of the Uniform LLC Act, a member’s duty of loyalty to a member-managed company and its other members consists of the duty to account to the LLC for any property, profit, or benefit derived from the company’s business or the company’s property. This duty of loyalty also requires a member-manager to refrain from dealing with the LLC as a party having an interest adverse to the company and to refrain from competing with the company.

Under Section 409(c) of the Uniform LLC Act, a member’s duty of care to a member-managed company and its other members requires the member to refrain from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law. Subsection (d) requires a member in a member-managed LLC to act in good faith and to deal fairly with the LLC and its other members. The comments to Section 409 indicate that a member’s duties of loyalty and care may not be eliminated or waived by contract. However, the contract of the operating agreement may identify activities and determine standards for managing the performance of such duties, if not manifestly unreasonable. Members who are not also managers owe no duties at all. Under Section 409(h)(1) of the Uniform LLC Act (like the Prototype LLC Act), a member who is not also a manager owes no duties to the LLC or to the other members solely by reason of being a member.

The Possible Evolution of Michigan Case Law

The only reported case involving fiduciary duties of a Michigan LLC was decided, interestingly enough, by the Delaware Chancery Court. In In re Bigmar, Inc., the Delaware Chancery Court considered the fiduciary duties of members of a Michigan LLC. The Michigan LLC in question was a member-managed LLC. The chancery court addressed the fiduciary duties of member-managers in a Michigan LLC in considering the validity of one of the members voting the LLC’s shares of stock in a Delaware corporation. Citing Section 404(1) of the Michigan LLC Act, the Delaware court concluded that members of a Michigan LLC (who, in this case, were both members and managers) owed fiduciary duties to the other members.

The Delaware decision is, perhaps, a little misplaced and hopefully will not have an impact on the development of Michigan law concerning the duties of members of a Michigan LLC. First, it is not literally true, as the Delaware Chancery Court stated, that every member of a Michigan LLC has fiduciary duties. Section 404(1) of the Michigan LLC Act, which the Chancery Court cites, sets forth the duties of managers (not members) of a Michigan LLC. These duties would only extend to a member of a Michigan LLC if the member were also a manager. Second, it has not yet been decided by a Michigan court that the Section 404(1) duties are fiduciary duties. Third, the Section 404(1) standards are not, as the Delaware Chancery Court noted, duties of full candor and disclosure. Instead, a literal reading of Section 404(1) imposes an obligation on a member-manager to discharge his or her duties in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner the manager reasonably believes to be in the best interest of the LLC. Fourth, the Section 404(1) duties are probably duties that are owed to the LLC and not to other members.

In McGee v Best, the Tennessee Court of Appeals considered a provision of the Tennessee Limited Liability Company Act that is virtually identical to Section 404(1) of the Michigan LLC Act. Although taking different statutory approaches, both statutes stand for the proposition that a member of a member-managed LLC must discharge such member’s duties in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner the member believes to be in the best interest of the LLC. Both statutes also provide that every member of a member-managed LLC must account to the LLC for any benefit, and hold as trustee any profits derived by the member from any transaction connected with the LLC or from its property. The Tennessee court determined that the Tennessee statute
defines the fiduciary duty of members of a member-managed LLC as one owing to the LLC, not to individual members.\(^5^4\)

The Virginia Limited Liability Company Act is also similar to the Michigan LLCA in that the pertinent Virginia statute sets forth the duties of managers as opposed to mere members. However, like the Michigan LLCA, the Virginia statute states that a member who is also a manager of the LLC will be considered a manager for the purposes of these duties. In KMK Factoring, LLC v McKnew (In re McKnew),\(^5^5\) the United States Bankruptcy Court for the Eastern District of Virginia considered the effect of this provision. The Bankruptcy Court concluded that under the Virginia Limited Liability Company Act, only a manager is required to discharge his or her duties in accordance with the judgment of what is in the interest of the LLC.\(^5^6\) The Bankruptcy Court noted that there is no such provision concerning members of an LLC and, therefore, unlike partnerships, there are no fiduciary obligations among members who are not also managers.\(^5^7\)

In McConnell v Hunt Sports Enters,\(^5^8\) the Appellate Court for the Tenth District of Ohio sided with Delaware and other states when it found that members of an Ohio LLC could, by contract, limit or define the scope of fiduciary duties imposed on members.\(^5^9\) In McConnell, the Ohio court stated that an LLC, like a partnership, involves a fiduciary relationship. Normally, the court stated, the presence of such a relationship would preclude direct competition between the members of the LLC.\(^6^0\) However, in McConnell, the LLC had an operating agreement that, by its very terms, allowed members to compete with the business of the LLC. The Ohio court concluded that an LLC operating agreement may limit or define the scope of the fiduciary duties imposed on its members.\(^6^1\)

If the reasoning of McGee and McKnew is followed in Michigan, a Michigan court might conclude that the duties of member-managers imposed by Section 404(1) of the Michigan LLCA are owed to the LLC and not the other members and that, unlike partnerships, there are no fiduciary obligations among members who are not also managers. If the strict “contractarian” reasoning of McConnell is followed, a Michigan operating agreement may limit or even eliminate the fiduciary duties of members.

Will Michigan courts find, as they have in other settings, that there is a duty of good faith and fair dealing for members under the contract of an operating agreement? Perhaps. However, Michigan law does not recognize a general cause of action for breach of an implied covenant of good faith and fair dealing when a party acts according to the express terms of a contract.

**Suminski v Sick, Inc\(^6^2\)** held, in the context of a distributor agreement, that Michigan law does not recognize a cause of action for an implied covenant of good faith and fair dealing: “[T]his Court has declined to recognize a cause of action for breach of an implied covenant of good faith and fair dealing ‘because such a radical departure from the common law and Michigan precedent should come only from the Supreme Court.’ ” \(^6^3\)

Only discretionary aspects of a contract imply a duty of good faith on termination of the contract. In Maida v Retirement & Health Servs Corp,\(^6^4\) where a contract for the sale of land expressly provided that either party could cancel the agreement in its sole discretion within a certain time period, a court would not imply a duty of good faith that contradicted the contract’s express terms.\(^6^5\) The developer argued that it should have been permitted to try the issues of whether the seller violated a duty of good faith when it terminated the contract. The court found that the seller did not act in bad faith when it gave notice of the termination because there was no evidence that the action taken was arbitrary, reckless, indifferent, or in intentional disregard of the interest of a person owed a duty.\(^6^6\) The court agreed with plaintiff that there was a duty of good faith where a contract provided for a discretionary manner of performance. In cases where there was no discretionary aspect, no good faith duty was to be implied.\(^6^7\)

A good faith obligation also exists at the outset of contract formation. In General Aviation, Inc v Cessna Aircraft Co,\(^6^8\) cited as authority by the court in Maida v Retirement & Health Servs Corp, General Aviation argued that Cessna breached its implied duty of good faith by terminating a one-year distributorship agreement that had previously been renewed several times.\(^6^9\) The contract was renewable at the parties’ option, but if neither party took affirmative action to renew the contract, it would automatically terminate.\(^7^0\) Cessna intentionally allowed time for renewal to pass, thereby terminat-
Given that the Michigan LLCA does not expressly prescribe duties and standards of conduct for members, courts should take great care in considering whether they should prescribe duties and standards of conduct as a matter of law.
36. MCL 449.21.
38. 59A Am Jur 2d, Partnership §420; see also Van Steev Ransford, 346 Mich 116, 77 NW2d 346 (1956).
41. Comments to Section 404, Uniform Partnership Act (1997).
43. MCL 450.4404.
44. MCL 450.4404(1).
45. MCL 450.4407.
47. 2002 Del Ch LEXIS 45 (Del Ch Apr 5, 2002).
48. Id. at *10.
49. Id. at *58-*59.
50. Id. at *80.
51. MCL 450.4404(1).
52. 106 SW3d 48 (2002).
53. Id. at 63-64.
54. Id. at 64.
55. 270 BR 593 (Bankr ED Va 2001).
56. Id. at 629.
57. Id.
59. Id. at 688-689.
60. Id. at 687.
63. Id. at *7 (quoting Dahlman v Oakland University, 172 Mich App 502, 507, 432 NW2d 304 (1988).
65. Id. at *10-*17.
66. Id. at *16.
67. Id. at *10-*12.
68. 915 F2d 1038 (6th Cir 1990) [LX].
69. Id. at 1040.
70. Id.
71. Id. at 1039-1040.
72. Id. at 1041-1042.

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By Todd M. Rowe

Introduction

More than ever, intellectual property is an asset that can give a business a competitive edge. As with any other asset, the insurance market has stepped up to cover the new risks resulting from the emergence of intellectual property in the business world. Consequently, there has been a dramatic increase in the number of lawsuits involving allegations of intellectual property infringement being tendered to insurance companies for defense and indemnification. While the development and protection of intellectual property creates an advantage over the competition, the cost of defending a complex lawsuit and the potential liability for a judgment or settlement of a competitor’s claims of infringement can be financially devastating to a business. It has become increasingly important that any attorney representing a commercial entity be familiar with the fundamental concepts of intellectual property and the types of insurance coverage available for infringement by a competitor. The advertising injury clause, available in commercial general liability (CGL) insurance policies, is where intellectual property and insurance coverage intersect.

The Development of the Advertising Injury Clause

Coverage under the advertising injury clause is typically triggered by an offense committed by the insured, whereas an occurrence is generally the event triggering coverage under most other types of insurance. Therefore, rather than merely acting negligently, the insured may set out with the intent to steal a competitor’s ideas and the resulting damages from the theft will be covered under the policy. The advertising injury clause, due in part to its coverage for the questionable acts of the insured, the complexities of intellectual property itself, and the fact that it is a relatively new form of insurance coverage, has been subjected to a number of different interpretations by state and federal courts.

The latest generation of the advertising injury clause typically contains the following standard language that reads in pertinent part:

We will pay those sums that the insured becomes legally obligated to pay as damages because of personal injury or advertising injury....This insurance applies to: ...[a]dvertising injury caused by an offense committed in the course of advertising your goods, products or services.

Advertising injury means injury arising out of one of the following or more offenses:

a. oral or written publication of material that slanders or libels a person or organization or disparages a person’s or organization’s goods, products or services
b. oral or written publication of material that violates a person’s right of privacy
c. misappropriation of advertising ideas or style of doing business
d. infringement of trademark, copyright, title or slogan

For coverage of intellectual property claims, only subpart “d. infringement of trademark, copyright, title or slogan,” is important. At first glance, the language seems somewhat straightforward. A plaintiff’s allegation that the insured had stolen a competitor’s ideas or infringed the plain-
tiff’s trademark or copyright (the offense) should give rise to coverage. However, it is important to remember that this is only half of the analysis: this is only the offense. The policy language also requires that the alleged injury be caused by an offense committed in the course of advertising. There must be a causal nexus between the offense and the insured’s advertising. It is important to keep in mind that the policy language does not state that merely copyright infringement is covered. Rather, coverage arises only when the underlying complaint contains allegations that the copyright infringement (offense) was used in the insured’s advertising activities, which then directly lead to the plaintiff’s injury. It is the analysis of this causal nexus—that is, the strength of the causal nexus—that has caused a division among courts.

Making matters worse, under Michigan’s system of notice pleading, a complaint in the underlying action will not necessarily need to use the words “copyright” or “trademark” and it still could be interpreted as having a trademark, trade dress, or copyright infringement claim. Under Michigan law, questions concerning insurance coverage are resolved by using principles similar to those used in interpreting an ordinary contract. This analysis for insurance coverage calls on courts to compare the complaint against the insurance policy to make a determination whether, if the allegations can be proven, the underlying judgment would have to be paid by the insurer. The Michigan Supreme Court has opined that an insurance company has a duty to defend when “the allegations against the insured even arguably come within the policy.” The terms in the policy are to be given their “plain and easily understood sense.” While ambiguity in the policy terms should be construed in a light most favorable to establishing coverage, courts should “not torture ordinary words until they confess to ambiguity.”

For example, an offense as defined by the policy language is clearly identifiable in a situation where the underlying complaint has the words “copyright infringement” and then lays out the elements of that claim. However, this is not always the case. The allegations in the underlying complaint may not clearly designate the direct link between the advertising and the injury caused by that advertising. The underlying complaint may not, and is not required to, boldly state that it is a copyright or trademark infringement claim. The ambiguity that results from notice pleading can make analysis of the underlying complaint in a coverage dispute a nightmare. Counsel for your client’s (or your client’s insured’s) competitor drafted the underlying complaint at a time when they most likely would have no reason to care whether there would be a subsequent declaratory action for coverage. Therefore, there is no reason to expect to find the telltale marks to conclusively establish or preclude coverage under the advertising injury clause. The material subject to copyright and trademark protection is often closely related to one’s advertising activities, but it does not have to be intertwined. It is important to keep in mind that an underlying complaint may have allegations of advertising, intellectual property infringement, and an alleged injury. However, there must be a causal nexus between these components for coverage to exist under the advertising injury clause. Therefore, it is necessary to be familiar with fundamental intellectual property concepts before making any determination about whether insurance coverage may exist.

A Basic Review of the “Offenses” of the Advertising Injury Clause, Copyright, and Trademark Infringement.

Introduction
The advertising injury clause will cover the cost of defense and indemnification and hinges on copyright and trademark infringement allegations in the underlying complaint. Accordingly, it is important to at least be aware of the basic principles of copyright and trademark law because these terms may not appear anywhere within the four corners of the underlying complaint.

Copyright Law
Copyright infringement is designated as an offense, which, if committed in the course of advertising may trigger coverage under the advertising injury clause. In a nutshell, copyright law protects the following: literary works; musical works; dramatic works; pantomimes and choreographic works; pictorial, graphic, and sculptural works; motion picture and other audiovisual works; sound
It is necessary to be familiar with fundamental intellectual property concepts before making any determination about whether insurance coverage may exist.

recordings; and architectural works.8 The main thrust of copyright law is to award a limited monopoly to an individual who authors one of the above-mentioned items. This is accomplished by protecting works “fixed in a tangible medium of expression.”9 At present, “authors” of a copyright can expect this protection to last the life of the author plus 70 years after the author’s death.10 While registration is not essential, one advantage to registering a copyright versus owning an unregistered copyright is that registration will strengthen any subsequent copyright infringement case.

Trademark Law
While copyright protection is gained through registration, trademark protection requires use before it can be registered for ownership. The Commerce Clause of the U.S. Constitution gives Congress the authority to protect trademarks in the United States. At present, Congress has created federal protection of trademarks through the Lanham Act.11 The Lanham Act, which codifies common law, defines trademarks as a “word, name, symbol, or device, or any combination thereof—(1) used by a person, or (2) which a person has a bona fide intention to use in commerce...to identify or distinguish his or her goods....”12 Based on these requirements it is difficult to imagine a situation how one could “distinguish his or her goods” without engaging in an advertising activity.13

Trade dress protection is another form of a trademark and causes significantly more confusion in a coverage dispute. Rather than using a symbol or mark to designate a certain manufacturer of a product, trade dress will use the total look of the product or packaging, e.g., classic shape of a Coca-Cola bottle.14 However, the one underlying principle is that the subject matter will not be protected if it serves any function that is essential to the product. Any device that is functional will be subject to patent protection rather than trade dress protection. Because a specific portion of a device or the overall construction of a device is called into play, the allegations comprising trade dress infringement and patent infringement may be similar, although the latter is not covered under the advertising injury clause. Therefore, it is important to differentiate between allegations of patent and trade dress infringement in an underlying complaint in a coverage dispute. If the allegations are not grouped under the heading “Trade Dress Infringement” and the alleged infringed product may be functional rather than ornamental, it may be a patent infringement claim and therefore the insured is not covered.

Unlike copyright infringement, there may be significant merit to an argument that you cannot infringe a trademark without advertising and, therefore, there will be coverage under the advertising injury clause with any allegations that are arguably a trademark infringement claim. However, it is possible to infringe a trademark and never engage in advertising. Trademark infringement is based on causing consumer confusion about the source of a product, and advertising the infringing product is one method of causing the confusion.15 Allegations may assert that the trademark was infringed “in connection with the sale [or] distribution...of any goods or services” rather than advertising.16 Without getting into an analysis of the complexities of intellectual property law, it is easy to see how courts have come to a variety of conclusions concerning insurance coverage for intellectual property infringement.

Judicial Treatment of the Advertising Injury Clause: Michigan’s Creation of the Minority Rule Requiring a Stronger Causal Nexus Between the Offense and the Advertising Activity
The seminal decision in the Sixth Circuit concerning the strength of this causal nexus between the offense and the advertising has spurred great debate among state and federal courts across the country. The Sixth Circuit in Advance Watch Co v Kemper Nat’l Ins Co17 found the advertising injury clause to be triggered only if there exists “some nexus between the ground of asserted liability and the insured’s advertising activities....” The Sixth Circuit required a sufficiently strong causal nexus to preclude the advertising injury clause from being trotted out “when ever an advertised product or service is alleged to have caused harm, rendering the coverage applicable with respect to most claims against an insured business.”18 A number of courts in other jurisdictions had
adopted the Sixth Circuit reasoning in Advance Watch and have held that the “insured’s advertising must have been the cause of whatever injury is alleged in the underlying suit.”20 However, other jurisdictions have flatly rejected the reasoning in Advance Watch and have found the causal connection to be satisfied as long as the insured’s advertising could be found to have played a role in the injury.21

In Michigan’s state courts this issue has not been completely resolved. However, courts seem to be leaning toward requiring a stronger connection. For example, the Michigan Court of Appeals in GAF Sales & Serv v Hastig Mut Ins Co,21 opined that “[t]he policy coverage for “advertising injury” thus requires three elements: an “advertising injury” as defined in the policy; a “course of advertising” (not defined in the policy); and proof of a causal relationship between the first two elements.” Applying this three-step test the court of appeals found allegations of an “offense” in the subject complaint—there was an allegation of copyright infringement when the plaintiffs claimed that the insured copied software. Second, the court found an allegation of advertising in a national magazine. The third element required proof of a causal connection between the copyright infringement (injury) being used in the advertising (in the trade magazine). Here, the court found there was not coverage under the advertising injury clause because “the underlying complaint does not allege any injuries that resulted from the plaintiffs’ advertising.”22 Simply, coverage under the advertising injury clause was never triggered because the stolen software was never used in the national advertising campaign.

The interpretation of the advertising injury clause can have a significant impact on Michigan businesses and insurance companies. For instance, a claim commonly seen is that a builder infringes another’s copyright claim by building from architectural plans without compensating the copyright owner.23 In this instance there is undoubtedly a claim of copyright infringement—an “offense” under the advertising injury clause. And, for the sake of argument, assume that in addition to the copyright claim, the complaint mentions in its factual assertions that the builder also distributes brochures to prospective buyers. There can be dramatically different outcomes from jurisdiction to jurisdiction if the builder gets into a dispute with its insurance company over whether there is coverage for the copyright owner’s claims. In the subsequent declaratory action, the underlying complaint will be compared to the builder’s CGL policy. A court that requires a weaker causal connection may find insurance coverage under the advertising injury claim because the complaint mentions both advertising activities and copyright infringement, albeit in completely different allegations. In a jurisdiction that requires a stronger causal connection, the court may not find coverage because the allegations concerning the brochure are completely unrelated to the infringement of the copyrighted architectural designs. This latter court would require that the advertising activity actually caused the copyright owner’s injury, which it did not in this hypothetical situation. Rather, if the builder had infringed the copyright owner’s brochure and used it in advertising, this would be a scenario in the true spirit of the advertising injury clause.

Conclusion

There is a lot at stake for businesses as well as business insurers in cases implicating the advertising injury clause. If the insurance company denies coverage and is unsuccessful in a declaration action, a policyholder could eventually be entitled to defense of the underlying suit, indemnification for any adverse judgment or settlement, and legal fees for both the underlying lawsuit and the lawsuit to establish insurance coverage. Consequently, the advertising injury clause will continue to be subject to the unpredictability of judicial interpretation unless the policy language directly addresses the strength of the causal nexus in the advertising injury clause.

In an effort to avoid the uncertainty of leaving the question of insurance coverage to a court, it is in the best interests of both insurers and insureds to stipulate contractually to the strength of the causal connection of the advertising injury clause in the policy itself. For example, the policy language could reflect that coverage is only triggered in instances where the insured’s advertising must have been the direct cause of whatever injury is alleged in the underlying suit. Alternatively, the policy language may give rise to coverage whenever “the allegations against the insured even arguably come
within the policy.” Either way, it is in the best interests of the parties to the insurance policy to determine when coverage is triggered under the advertising injury clause before a complaint is filed by the insured’s competitor.

NOTES

1. Coverage for advertising injury did not appear until approximately 1973 “as part of a Broad Form Endorsement” and did not become standard in CGL policies until 1986. Francis J. Mootz III, Coverage for Unfair Competition Torts Under General Liability Policies Will the “Intellectual Property Tail Wag The Coverage Dog?” 8 Conn Ins L J 37, 43 (2002). Advertising injury coverage was once again revised in 1998 when it ceased being separate coverage and instead became part of the “combined ‘Personal and Advertising Injury’ coverage.” Id. at 52.

2. Subpart “d.” Trademark infringement is not included in all policy language. In fact, trademark infringement was not included in the majority of the policies where Michigan state and federal courts analyzed the advertising injury clause under Michigan law.

3. In Michigan, an allegation must only “reasonably . . . inform the adverse party of the nature of the claims the adverse party is called on to defend.” MCR 2.111(B)(1), see also Nationsbank Mortgage Corp v Luptuk, 243 Mich App 560, 566, 625 NW2d 385 (2000). Therefore, an allegation based on a violation of the false designations provision of the Lanham Act (15 USC 1125) can be interpreted as trademark infringement or federal unfair competition.


7. Western States Ins Co v Wisconsin Wholesale Tire, Inc, 184 F.3d 699, 702 (7th Cir 1999); and See also Fresard v MillersMut Ins Co, 414 Mich 686, 327 N.W.2d at 289.

8. 17 USC 102.
9. 17 USC 102(a).
10. 17 USC 302(a).
11. 15 USC 1051 et seq.
12. 15 USC 1127.
13. Id.
14. See Badger Meter Inc v Grinnell Corp, 13 F 3d 1145 (7th Cir 1994).
15. 15 USC 1114 identifies infringement as follows:
   (1) Any person who shall, without the consent of the registrant:
      a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale . . . distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake or to deceive;
      b) reproduce, counterfeit, copy, or colorably imitate a registered mark and apply such reproduction, counterfeit, copy, or colorable imitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used in . . . advertising of goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive, shall be liable in a civil action by the registrant for the remedies hereinafter provided.
16. Id.
18. See AdvanceWatch, 99 F 3d at 806.
22. Id. at 269.

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Michigan’s Judgment Lien Statute: A New Collection Tool for Creditors

By Richard E. Kruger*

Introduction

Michigan’s judgment lien statute became effective on September 1, 2004, and identifies the method for the placement of a judgment lien on real estate. More than 40 states previously enacted judgment lien statutes of one type or another. From a creditor’s perspective, the statute is overdue. From a debtor’s perspective, the statute is unwelcome, but not unyielding.

As detailed below, the statute provides an easy way for a judgment creditor to place a lien on the debtor’s real estate. The creditor has no right to foreclose the lien but may receive a distribution from the sale or refinance of the property, depending on the debtor’s equity. For the protection of the debtor, the statute allows for certain other subsequently recorded interests to obtain priority over the judgment lien. The lien may also be extinguished through the debtor’s bankruptcy case. Finally, the statute also provides protections for the innocent who has the same name as the judgment debtor. Overall, the statute provides benefits to judgment creditors while protecting the debtor’s interests.

Creation and Attachment

The creation and attachment process consists of four steps. The first step, and the hardest, is to obtain a final judgment from a Michigan state or federal court or to certify a final foreign judgment with a Michigan court. The next step is to obtain a certified judgment lien notice from the clerk of the court that issued the final judgment. The notice must contain the following information:

- the case caption and docket number
- the current name and address of the judgment creditor and attorney, if any
- the name, last known address, and last four digits of the social security or tax identification number of the judgment debtor
- the current balance due on the judgment
- the date the judgment was entered, the expiration date of the judgment, and the expiration date of the judgment lien
- the signature of the judgment creditor or judgment creditor’s attorney

The notice does not need to contain a legal description.

After certification by the clerk that the foregoing information is complete and accurate, the creditor must then serve a copy of the certified notice on the judgment debtor by certified mail at the debtor’s last known address and file a proof of service with the court. If the judgment amount exceeds $25,000, a copy of the certified notice must be personally served on the debtor.

The final step is to record the certified notice with the register of deeds. The judgment lien attaches to all real estate owned by the judgment debtor in the county on the date the certified notice is recorded with that county’s register of deeds. The judgment lien also attaches to all after-acquired property when the debtor acquires an interest. However, the lien will not attach to “property owned as tenants by the entirety unless the underlying judgment is entered against the husband and wife.”

Priority of Lien; No Right of Foreclosure

Even after attachment, the judgment lien is subject to priority liens of other subsequently perfected interests. Those interests include, but are not limited to the following:

- a purchase money mortgage
- a mortgage used to refinance or pay off a purchase money mortgage

*Mr. Kruger thanks his partner, Michael S. Khoury, for his assistance with the preparation of this article.
liens that have or acquire priority by operation of law
construction liens
condominium and other home or property owners’ association fees
federal or state tax liens

In addition, proceeds that would otherwise be paid to a judgment lien creditor from the sale or refinance of real estate are “limited to the judgment debtor’s equity in the property at the time of the sale or refinancing after all liens senior to the judgment lien, property taxes, and costs and fees necessary to close the sale or refinancing are paid or extinguished.”

Finally, the judgment creditor has no right of foreclosure. Therefore, the only means of converting the judgment lien into cash is upon the judgment debtor’s sale or refinance of the real estate. Fortunately for the creditor, it may still pursue collection, since the judgment lien is expressly an additional and separate remedy from any of the creditor’s other judgment rights.

Expiration
The judgment lien expires on the earlier of the expiration of the judgment or five years. A second certified notice of judgment may be obtained and recorded once within 120 days of expiration of the first five-year term to extend the judgment lien another five years; however, the judgment lien will expire earlier if the judgment itself expires. An intervening bankruptcy case does not toll the passage of time or otherwise extend the expiration dates.

Extinguishment and Discharge
The judgment lien is extinguished when one of the following is recorded with the register of deeds:

- a discharge of lien signed by the judgment creditor or judgment creditor’s attorney
- a certified copy of a satisfaction of judgment that was filed with the issuing court
- a certified copy of a court order that discharges the judgment lien
- a copy of the judgment debtor’s discharge in bankruptcy issued by a United States bankruptcy court and a copy of the bankruptcy schedule listing the judgment debt; provided that the judgment creditor does not obtain an order determining that the judgment debt was excepted from discharge

The judgment creditor must record a full or partial discharge of the judgment lien within 28 days of full payment of the judgment amount or on partial payment after sale of the attached real estate. The debtor may obtain damages if the judgment creditor fails to record a discharge within 28 days, the debtor sends a written discharge request via certified mail, and the judgment creditor fails to record a discharge within 14 days of the request. If the foregoing fails to result in the recording of a discharge and the debtor is unable to locate the judgment creditor, the debtor may record an affidavit that indicates full or partial payment, a copy of the written request for discharge, and a copy of the certified mailing of the discharge request.

Protection of the Innocent
Because the notice does not require a legal description, the recorded notice of judgment lien may adversely impact innocent individuals with names similar to the judgment debtor. However, there are protections for the innocent. The first is the requirement that the notice contain the last four digits of the judgment debtor’s social security number. Additionally, a person with the same or similar name as the judgment debtor may demand in writing that the judgment lien creditor deliver a recordable document that discharges any judgment lien that may have attached to the innocent individual’s property. The judgment lien creditor must comply with the demand or be subject to damages. Moreover, the innocent person may seek an order from the court discharging the lien if the judgment lien creditor is uncooperative or unresponsive.

Comment
During the legislative stage, the proposed provisions of the statute were reviewed and comments proffered by authors Lawrence M. Dudek and Michael H. R. Buckles in this journal. Mr. Dudek’s article, entitled Advisability of Proposed Judgment Lien Legislation, 23 MI Bus LJ 2, 24 (2003), raised several issues that the legislature addressed in the final version of the judgment lien act. Specifically, Mr. Dudek raised concerns over the fact that, under the proposed version, a
judgment lien could take priority over a construction lien and property association fees. Now, the act specifically provides that those types of liens have priority over a judgment lien, even if they are recorded or perfected after the judgment lien is in place.\footnote{17}

Mr. Dudek also raised concerns that the proposed legislation allowed for the recording of a notice without a legal description because it would result in increased transaction costs. That provision remains intact. However, it is not clear that it will result in increased transaction costs. There may not be an increase in costs because the statute was designed to provide for the recording and indexing of the judgment lien notice in the same manner as a tax lien. The same search should cover both tax and judgment liens. Therefore, there should be no additional costs.

Mr. Buckles’ article entitled A Judgment Lien Statute Makes Good Sense for Michigan, 23 MI Bus LJ 2, 11 (2003), described the benefits of the proposed legislation for creditors. The decreased cost to judgment creditors in securing a lien on real property seemed to be the most important aspect of the proposed legislation. However, the proposed legislation was changed to include the requirement that the judgment creditor personally serve the judgment debtor with a copy of the certified notice if the judgment exceeds $25,000.\footnote{18}

Personal service is sometimes a difficult and expensive task, and it is not clear from the statute itself whether a creditor unable to find the debtor may seek authority to post the notice on the property. Nevertheless, the statute, as enacted, is still an easy way for a judgment creditor to secure an interest in the debtor’s real property without having to proceed with formal attachment and sale.

An important provision was added to the statute after Mr. Dudek and Mr. Buckles authored their articles. The act allows for a lien to be extinguished through bankruptcy. Normally, liens on real property survive a property owner’s bankruptcy discharge. However, the statute expressly provides that the discharge of the debtor results in the discharge of the lien, provided the judgment debt is scheduled in the bankruptcy case.\footnote{19}

The judgment lien holder has the right to challenge whether its debt should be excepted from discharge; however, the lien itself does not grant the holder any greater rights than it would have as an unsecured creditor in the debtor’s bankruptcy proceeding.

Undoubtedly, the statute is still new and untested. On balance, the statute is designed to enhance a judgment creditor’s rights without unduly prejudicing the debtor. It is too early to tell whether the statute will live up to its design.

NOTES

1. MCL 600.2801–600.2819.
2. MCL 600.2805(1).
3. MCL 600.2805(2).
4. MCL 600.2805(3) and (4).
5. MCL 600.2803.
6. MCL 600.2807(1).
7. MCL 600.2807(2).
8. MCL 600.2807(3).
9. MCL 600.2819.
10. MCL 600.2817.
11. MCL 600.2809(1)–(4).
12. MCL 600.2809(5).
13. MCL 600.2809(6).
14. MCL 600.2811.
15. MCL 600.2813.
16. MCL 600.2815.
17. MCL 600.2817(2)(e)-(f).
18. MCL 600.2805(4).
19. MCL 600.2809(6)(d).

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[T]he innocent person may seek an order from the court discharging the lien if the judgment lien creditor is uncooperative or unresponsive.
The Federal SAFETY Act and Antiterrorism Technology: Liability Protection and Other Considerations

By Donald L. Katz, Carla Machnik, & Stephen Ravas

Introduction

Congress passed the Homeland Security Act of 2002 (HSA) as part of the government’s effort to address terrorism aimed at U.S. soil and assets. Part of that act, Public Law 107-296, includes the aptly named SAFETY Act (Support Anti-Terrorism by Fostering Effective Technologies; the SAFETY Act). At its best, the SAFETY Act attempts to encourage the private sector, which might not ordinarily seek to develop such technology, to join the fight against terrorism by offering liability protections to the products that qualify for various designations. However, the SAFETY Act also gives a great deal of discretion to government officials, which could result in abuse or favoritism.

This article provides a brief overview of the SAFETY Act, its purpose, the application process, and a cursory analysis of its utility for both government and nongovernment contractors. This article is not intended to cover the act in detail, but rather to offer a high-level overview of some business and legal considerations associated with the process and the practical functionality of the SAFETY Act.

Background

Purpose

The SAFETY Act attempts to limit the exposure related to product liability lawsuits for “claims arising out of, relating to, or resulting from an act of terrorism” when qualified antiterrorism technologies (QATTs) have been deployed.

The SAFETY Act’s purpose is to stimulate the development and deployment of antiterrorism technologies by creating systems of “risk and litigation management” for certain qualified technologies. Congress intended to counteract the economic effects of the potential liability exposure and its effect on insurance coverage availability by providing differing levels of protection and possibly absolute defenses for certain technologies used for the intended purpose of protecting against domestic terrorist attacks.

Congress was primarily concerned that the tremendous liability exposure associated with antiterrorism technology in a post-September 11th world would chill the receptiveness of the insurance industry, making such products uninsurable and therefore not cost effective to develop or deploy. That is, the risk exposure of a terrorist attack could be so large that insurance companies might be unwilling to insure such products for fear that claims arising from a single attack would run the insurer out of business. “Because there are many technologies important to the fight against terrorism, the SAFETY Act grants Designation and Certification for effective technologies that will prevent, detect, identify, or deter acts of terrorism, or mitigate the harm that such acts might otherwise cause, and that satisfy additional statutory criteria.” However, companies should keep in mind that the resulting liability protection extends only to QATTs (defined below) employed and causing or failing to prevent injury during a terrorist attack.

Mechanics

The SAFETY Act extends some limited liability protections for sellers of QATTs. QATT status is obtained by meeting certain standards, specific to each technology, promulgated by the Department of Homeland Security (DHS) through the application process. More specifically, a QATT is any product, equipment, service (including support services), device, or technology (including information technology) designed, devel-
The application process can be complex, involving disclosure of confidential information, and may be subject to manipulation or worse. For example, to decide whether an antiterrorism technology should be considered qualified, the under secretary “may exercise discretion and judgment” when considering six specific sets of criteria.\(^9\) The under secretary should (but is not necessarily obligated to) consider:

1. prior use by the U.S. government or the utility and effectiveness of the technology against terrorism in past or current usage;
2. whether the technology can be immediately deployed;
3. the existence of an extraordinary liability to the seller of the technology;
4. the likelihood that the technology will not be deployed unless there are protections in place, such as a risk management system to limit liability;
5. the amount of risk to the public if such technology is not deployed; and
6. evaluation of all scientific studies and other factors deemed relevant by the under secretary.\(^1\)

“Technology” encompasses tangible products, software, services, and various forms of intellectual property. The types of products that might qualify are very broad; however, the number of actual applications that the DHS has received is surprisingly small: approximately 18 as of July 2004. We can only speculate about the lackluster interest in seeking the protections afforded qualifying technology, but it is possible that the amount of disclosure and the required detail associated with the application process might be to blame because it remains unclear whether such information would be made available to competitors through a Freedom of Information Act (FOIA) request.

**Purported Benefits of Certification and Designation**

Numerous advantages may be obtained through designation or certification, each of which differs in the benefits conferred depending on the status sought by the applicant under the SAFETY Act. “Designation” is an essential step to receive certification. Simply receiving designation provides a seller of QATTs exclusive jurisdiction in federal court for all product liability suits brought against it, provided that the cause of action arises from an injury where the proximate cause was the QATT and resulted from an act of terrorism on U.S. soil.\(^1\) Further, the cause of action can only be brought against the seller of the QATT for claims of injuries that were allegedly caused by the QATT or presumably the failure of the QATT.\(^1\) Therefore, if a seller’s technology is deployed overseas, the SAFETY Act does not necessarily offer any protection. The application of the SAFETY Act in relation to injuries sustained in terrorist attacks in a foreign jurisdiction but on a U.S. ship or a U.S. Embassy is unclear and remains to be tested.

If a seller of QATTs receives designation, its liability exposure is limited to the amount of liability insurance coverage specified for each individual technology. The sellers are not required to obtain more liability insurance coverage than is reasonably available “at prices and terms that will not unreasonably distort the sales price” of the technology.\(^1\) The under secretary appears to have broad discretion in determining the amount of liability insurance that may be required for each technology; the goal is to avoid situations in which the purchase of maximum liability insurance from private sources would result in an unreasonably distorted sales price of the seller’s technology.\(^1\)

The under secretary may examine all of the following factors in determining the amount of liability insurance required for each QATT: (1) the technology in question, (2) the amount of insurance that the seller was actually able to purchase, (3) the amount of insurance purchased by sellers of similar technologies, and (4) the designated use of the technology. The under secretary may also consider the liability insurance the world market offers, the history regarding casualty losses, and the effect the cost of insurance would have on the price, production, deployment, and consequences of the technology.\(^1\)

An additional benefit of designation as a QATT is the bar of joint and several liability for noneconomic damages.\(^1\) A seller’s exposure is limited to the percentage of noneconomic damages proportionate to its respon-
The application process can be complex, involves disclosure of confidential information, and may be subject to manipulation or worse.

**Application Process**

An applicant must complete four steps to receive designation and certification. The first step involves a registration process consisting of a short form, which requires general company information and a point of contact.

The second step is a pre-application. The pre-application form consists of five pages of general questions, and a brief description of the product is also required (20 lines maximum). This step is optional but highly recommended, since informative feedback is usually provided within 21 days of submission. The pre-application is mandatory if you apply for designation only or if you are applying for designation and certification simultaneously.

Step three results in designation status and requires significant additional attachments in support of the information already provided in the pre-application questionnaire. The applicant must disclose potentially confidential and highly sensitive information regarding the technology, as well as detailed financial information and historical costs. How this information is treated remains to be seen but we feel that such disclosures are worthy of consideration in the risk analysis of the application process.

Certification is obtained by completing step four, which includes answering three questions aimed at substantiating that the QATT (1) performs as intended, (2) conforms to the seller’s specifications as indicated, and (3) addresses all safety and hazard concerns.

The DHS SAFETY Act application kit provides a detailed step-by-step process for the application procedure, and most of the material can be submitted electronically. The process can be time consuming and should not be done without consideration of the sensitivity of the information being disclosed. Like any government document, it is what is missing in the information that is dangerous. For example, can the disclosures be used against an applicant in civil litigation that falls outside the subject matter jurisdiction of the SAFETY Act? It remains uncertain whether such statements, research, and other disclosures provided in the application may be used against an applicant; we see this risk as disturbing.

Given the concerns regarding the disclosure of confidential information, potentially privileged communications, trade secrets, and detailed financial information concerning an applicant and its technology, we cannot emphasize strongly enough the need to consult counsel regarding this process. We see such disclosure as a major uncertain risk in the process, which has very little history thus far. An applicant should weigh the risks and benefits of obtaining QATT designation and certification before initiating the process because disclosing confidential information may be tantamount to a waiver of privilege.

**Analysis and Commentary**

**What Are the Real Benefits?**

The primary benefit of the SAFETY Act is obtaining the GCD for products and services that would otherwise not be entitled to such a defense because the technology was not the product of a government contract. The U.S. Supreme Court, in the seminal case of *Yearsley v WA Ross Constr Co*, recognized that government contractors who properly perform their work according to the specification and pursuant to a government contract, should be permitted to avoid liability for injuries resulting from the completed work as would the government if it had performed the work itself. The general rule has been stated as follows: to the extent the work performed by the contractor was done under a contract with the government, and in conformity with the terms of said contract, no liability can be imposed on the con-
tractor for any damages claimed to have been suffered by third parties.\textsuperscript{29}

Similar to the SAFETY Act, one of the motivating factors behind the GCD is the control of government contract prices. It has been suggested that if a contractor were held liable under a government contract, “contract prices to the government would be increased to cover the contractor’s risk of loss from the possible harmful effects of complying with decisions of [governmental] officers authorized to make policy judgments.”\textsuperscript{30} As mentioned earlier, designation as a QATT may be of limited value in light of the possible disclosure of confidential and privileged information, which might actually be used against an applicant in unrelated law suits not falling within the subject matter jurisdiction of the SAFETY Act. An applicant’s disclosures could create further risk and diminution of value to the company and the technology if the application is denied and no litigation management benefit is conferred. That is, as mentioned earlier, it remains unclear whether the disclosures made during the application process are discoverable or admissible.

Contrasting the possible pitfalls under the SAFETY Act with the protections provided under the Government Contractor Defense, it appears that innovation is not necessarily encouraged under existing legislation due to the extensive disclosure required in the application process, which exposes a seller’s specifications to competitors and potential litigants.

On the other hand, certification, and the GCD that it confers, establishes the SAFETY Act’s appeal in certain situations. Exclusive federal jurisdiction provides a prohibition on joint and several liability, and the capping of certain insurance costs is surely helpful for sellers of certain antiterrorism technology; however, without the GCD, the SAFETY Act may not necessarily meet its objective. Arguably, the development of antiterrorism technology might not be sufficiently stimulated if significant exposure remains, which may far exceed the potential profits to be made with such technology.

Before the availability of certification under the SAFETY Act, a seller of antiterrorism technology could only be covered by the GCD if it was established that product specifications were provided by the government pursuant to a government contract, that the product was manufactured in accordance with those specifications, and that the government had knowledge of the hazards of the product.\textsuperscript{31} The SAFETY Act statutorily changes those requirements for those technologies acquiring certification.\textsuperscript{32} If certified, sellers of technology may circumvent the above requirements and gain the “rebuttable presumption” that the product met government specifications even though no such specifications were ever issued or followed.\textsuperscript{33}

The SAFETY Act replaces the need for government specifications with the certification application process. Instead of requiring government specifications, the government, through the granting of certification, implies that had the government known about the product, it would have required the same specifications as those that make up the technology. In short, certification through the SAFETY Act accepts the specifications of the seller’s technology as if the government itself required those exact specifications. Certification under the SAFETY Act allows the seller to acquire the protection of a rebuttable presumption without the need for meeting any government specifications.

It appears that some government contractors see this advantage as being worth the potential risks. There is no jurisdictional bar prohibiting government contractors to apply for certification, even though they would be permitted to use the GCD. Gaining the rebuttal presumption of compliance with the specifications would appear to be of benefit if a lawsuit is brought by third parties; however, it remains unclear whether such a presumption would bar a suit by the government for failure of the technology if it was purchased as a commercial item by a governmental agency or the Department of Defense.\textsuperscript{34}

Achievement of Intended Purpose

In early June 2004, 86 pre-applications and 18 applications had been submitted to the OHS and none had received a final decision.\textsuperscript{35} Since then and up to the time this article was written, protection has been granted to only four technologies.\textsuperscript{36} Thus, a year after the DHS began taking applications, it appears that it is either very difficult for technologies to gain approval or that companies are seeing similar risks to those mentioned in this article.

Those technologies that met the approval of the DHS are extremely diverse. One
approved technology is an automated, threat-based risk assessment platform created by Lockheed Martin. This platform is used for aviation screening and its purpose is to determine the potential threat of an individual through "public records and intelligence." Another approved technology is a two-way, high-speed video and audio system by Michael Stapleton Associates that lets bomb technicians notify clients (presumably, federal and state law enforcement) about suspicious items. Northrop Grumman owns the third approved technology, which is a system that accumulates air samples while mail is on a sorting machine. The air samples are then analyzed for biological agents, such as anthrax spores. The fourth approved technology was developed by Teledyne Brown Engineering and uses a pressurized water stream to cut through containers. The purpose of this device is to open containers from a safe distance limiting possible injuries to law enforcement. The granting of certification in only four out of 18 applications may suggest the problems associated with broad discretion granted to the under secretary or perhaps the limited utility of the SAFETY Act’s application.

Discretion of Under Secretary for Science and Technology

The future success of the SAFETY Act may be to some extent predicated on politics. Under federal regulations, the SAFETY Act leaves a large amount of discretion to the Under Secretary for Science and Technology of the DHS. The position of under secretary for each division of DHS is appointed by the President and confirmed by the U.S. Senate. As with any political appointee, he or she may, in the exercise of discretion, prefer one technology over another.

In 6 CFR 25.3, the under secretary is granted discretion four separate times. For example, when describing necessary qualifications of QATTs, the under secretary can “interpret and weigh” any of the stated criteria when evaluating whether to grant designation and may consider any other factor that may be “relevant to the determination or to the homeland security of the United States.”

The considerable amount of discretion granted to the under secretary could result in potential problems. The most obvious is that the under secretary ultimately has the discretion to award certification, providing protection for a technology that would not normally have the government contractor because of lack of specifications. How is a company to know if it was legitimately denied qualification, certification, or both? There appears to be no appeal process or rationale to challenge a finding, and the under secretary’s thought process appears to be unchecked.

Conclusion

While the interim rules grant abundant discretion to the under secretary, the SAFETY Act could more easily meet its intended purpose if the final rule gives more objective standards, because a seller of QATTs would be better able to determine whether it can meet the standards without subjecting itself to the potential pitfalls mentioned in this article. Further, a company considering submitting an application should be wary of the information it submits, because it remains unclear whether such disclosures may be used against it in future proceedings where the litigation management system does not offer protection, namely those outside the SAFETY Act’s grant of subject matter jurisdiction. Lastly, it also is not clear whether trade secrets and confidential information might be available to an applicant’s competitors.

NOTES

3. Id at 41,421.
4. See Statement of Representative Dan Burton, Chairman–Committee on Government Reform, 2002 WL 20319115.
5. Id.
7. SAFETY Act Regulations supra note 1, at 41,421.
8. “Seller(s)” as used in this article means the developer, supplier, or inventor of the QATT.
9. 6 CFR 25.9.
10. 6 CFR 25.3.
11. Id.; see also SAFETY Act Regulations, supra note 1, at 41,421.
13. 6 CFR 25.4.
14. Id.
15. Id.
16. Id.
17. 6 CFR 25.4(f)
18. Id.
19. Id.
20. SAFETY Act Regulations, supra note 1, at 41,427.
21. Id. at 41,421.
22. Id. at 41,422.
24. Id. at 29.
25. Id. at 30.
26. Id. at 35.
29. Myers v United States, 323 F2d 580, 583 (9th Cir. 1963).
32. See 6 CFR 25.6.
33. Id.
38. Id.
40. Id.
41. Id.
42. Id.
43. 6 CFR 25.3.

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Reduce Costs with a Foreign Trade Zone

By Andrew P. Doornaert

Introduction

Companies are continuously exploring methods to reduce the cost of doing business while increasing their ability to compete in a global market. Those importing goods, components, or materials from abroad could gain significant savings by setting up a Foreign Trade Zone (FTZ) as a means of reducing, avoiding, or deferring duties associated with imported merchandise.

An FTZ is a designation given to a physical location within the United States that is considered “outside commerce” for purposes of U.S. Customs and Border Protection (U.S. Customs). Existing or future manufacturing or distribution facilities can be granted this status—whether near a port or international border, or even landlocked. Once in an FTZ, merchandise may be stored, repackaged, assembled, labeled, repaired, destroyed, or combined with domestic goods.

FTZs may be underutilized as a business tool because companies are not aware of how much U.S. Customs duty they pay. Sometimes the cost of duty is hidden in transportation costs. In some cases, a domestic supplier who imports materials may pass on the cost of duty in the piece price. In this situation, an FTZ could allow the FTZ user to become the importer of record for materials and the domestic supplier could ask the supplier to reduce the purchase price of the imported materials accordingly.

Duty-saving opportunities can be found in numerous industries: automotive, pharmaceutical, plastic, chemical, industrial tool, robotic, furniture, food, and consumer goods.

Benefits

FTZs offer many financial and operational benefits, including:

- duties reduced or eliminated through manufacturing (inverted tariff relief);
- no duty on exports;
- transfer of duty liability to customer;
- reduced merchandise processing fee (MPF);
- duty deferral (cash flow savings);
- eliminated or reduced duty on scrap and waste;
- direct delivery; and
- weekly entry.

Inverted Tariff Benefit: Elimination or Reduction of Customs Duty

Companies in an FTZ can choose to pay the duty rate of the finished products manufactured in the zone instead of the duty rate of the imported materials used to make the manufactured products. The difference in duty rates between the imported materials and finished products can be substantial. In some cases, the duty rate of the imported materials may be around 10 percent while the duty rate of the finished goods is zero, so that U.S. Customs duty can be completely eliminated. Finished goods that may be imported duty free include pharmaceuticals, furniture, and some motor vehicle parts.

In the motor vehicle industry, the inverted tariff savings may only represent a reduction in U.S. Customs duty costs, such as the importation of plastic resins. The duty rate on plastic resins of 6.5 percent can be reduced to 2.5 percent, which is the duty for some plastic injected motor vehicle parts. Thus, the importer can reduce its import duties by 4 percent.

No Duty on Exports

Merchandise that enters an FTZ and is later exported will be exempt from U.S. Customs duty because it doesn’t enter the commerce of the United States.

Transferring Duty Liability to a Customer

If a company in an FTZ will be selling the merchandise to a customer located in another zone, the duty liability can be transferred to the customer in accordance with 19 CFR 146.66. Several motor vehicle assembly plants are operating in FTZs, including BMW and Mercedes. A parts supplier could import the parts, avoid paying U.S. Customs duties, and transfer the duty liability of parts to the vehicle assembly plant. In negotiating such an arrangement, a price adjustment
may be requested from the vehicle assembly plant since the plant becomes responsible for paying the original duty if the goods are entered into the commerce of the United States. If the vehicle is subsequently exported, duty on the part can be avoided completely.

**Merchandise Processing Fee**
The MPF is an ad valorem fee (.21 percent) assessed on the value of merchandise at the time of entry. Entries subject to MPF with over $231,000 worth of merchandise are assessed the maximum MPF rate of $485 per entry. To consider the potential savings, a company should consider the number of U.S. Customs entries it files per week because the FTZ privilege “weekly entry” could minimize its MPF to the maximum $485 per week. Distributors of imported merchandise, like retailers that don’t further process goods in the United States, have used FTZs solely for this reason to reduce the costs associated with MPF.

**Duty Deferral**
Companies that pay a significant amount of U.S. Customs duty may choose to defer payment until the goods are shipped from their facility to the customer. In a non-FTZ scenario, the importer would typically pay the duty soon after the goods arrived at the border. With an FTZ, the importer will realize a cash flow savings because the importer will not have to pay duty for merchandise that remains in a warehouse until the customer is prepared to take possession.

**Direct Delivery**
Direct delivery allows importers to clear U.S. Customs at their facilities instead of at the port of entry, which might be a busy port subject to delays. The goods would be shipped in-bond to the facility. Any inspections may take place at the importer’s facility rather than having the goods detained and stored at a warehouse near the port. This can reduce delays and the cost of demurrage and unloading for inspection purposes.

**Weekly Entry**
Weekly entry allows the importer to file one weekly estimate of merchandise to be removed from the zone at the beginning of the week and one weekly entry of the merchandise that actually left the zone at the end of the week. This avoids filing an entry for each shipment received, which can reduce MPF as discussed above.

**How to participate in the FTZ program**

**Application**
Authority for establishing FTZs is found in the Foreign Trade Zones Act of 1934 (FTZA). The purpose of FTZ as stated in the FTZA is to “expedite and encourage foreign commerce.”

The FTZA authorizes the FTZ Board to grant corporations the privilege of establishing, operating, and maintaining FTZs. Because granting an FTZ involves different national policy concerns, such as protection of domestic manufacturers, collection of U.S. Customs duty, international competitiveness, and border security, Foreign Trade Zones Board decisions require approval from the Departments of Commerce, Treasury, and Homeland Security.

A company may be able to work with an existing General Purpose Zone or may be required to establish its own FTZ Subzone. Each FTZ Subzone or FTZ boundary modification needs to be “sponsored” by a “grantee.” A grantee is usually a local government or quasi-government entity that administers the local General Purpose Zone as a tool for economic growth.

Once a subzone application is submitted, a notice of the formal filing of the application will be published in the Federal Register. Normally, there is a public comment period, which will close 60 days after the publication of the notice. This is when existing domestic suppliers or competitors may exercise their right to file an objection that may hinder or even prevent the application from being approved.

**Subzone Activation**
The local port director formally activates the site approved by the FTZ Board only after the company has ensured that all security, inventory control, and other regulatory requirements are met. In most cases, the FTZ operator will be the first party to break the seal of the container and inspect the contents to ensure the goods have not been tampered with or stolen. The local port director will need to be assured that the goods will arrive in a secure environment. The FTZ site will be expected to have security measures that are similar to those of participants in Customs-
Trade Partnership Against Terrorism (C-TPAT).\textsuperscript{8}

**Conclusion**

Although FTZs have existed since the 1930s, companies are still using the FTZ program as a tool to reduce the cost of doing business. Changes in duty rates and in a company’s sourcing and exporting activities can create the conditions that are right for an FTZ. An attorney experienced in customs and FTZs can assist a company to determine if an FTZ will make the company more competitive and set up an FTZ if evidence suggests that it is advisable or desirable.

**NOTES**

1. 19 USC 81c.
2. To realize the inverted tariff benefit, the company must be approved by the FTZ Board, which will be discussed further below.
3. The value of imported material is “frozen” at the amount when the goods are received into the zone, so if the finished good remains dutiable the duty liability is limited to the value “originally declared” when the imported materials were received.
5. 19 USC 81a–81u.
7. 19 USC 81b(a).
8. C-TPAT is a joint U.S. government-importer community initiative aimed at building cooperative relationships that strengthen overall supply chain and border security implemented after the events of 9/11.

Andrew P. Doornaert is an attorney at the law firm of Miller Canfield, where he is a member of the International Business Group and leader of the Export Control and International Trade and Customs practices. Mr. Doornaert is a licensed attorney and licensed U.S. Customs Broker. His experience includes managing the application and activation phases of a foreign trade zone for companies that manufacture products in the subzone. Mr. Doornaert has been engaged in all steps of this process including preparing the FTZ application, seeking political support for its expedited approval at the local and Congressional level, and assisting in activating the zone by preparing all necessary documentation for CBP, implementing a FIFO inventory layer FTZ system, and writing desk procedures. Mr. Doornaert can communicate with the CBP, FTZ Board, the grantee, foreign and domestic suppliers, and the customs broker. Mr. Doornaert’s Customs experience includes tariff classification, rates of duty and valuation of imported merchandise, NAFTA, country-of-origin marking and labeling requirements, customs compliance assessments, customs penalty cases, Maquiladoras, value-added taxes, and other customs considerations that arise in the shipment of goods between the United States and foreign markets.
**Case Digests**

*Prepared by Candace G. Hines*

**Corporations—Imputation/Wrongful Conduct Rule**

In *MCA Fin Corp v Thornton*, 263 Mich App 152, 687 NW2d 850 (2004), plaintiff mortgage bank filed an action against the officers of MCA, alleging that the officers should have discovered and disclosed accounting irregularities in the bank’s financial statements to the bank’s board of directors. The plaintiff bank argued that had the irregularities been exposed at an earlier time, the bank’s insolvency would have been identified earlier, thus reducing the magnitude of the bank’s financial loss and bankruptcy.

The trial court held and the court of appeals affirmed that the bank officers were protected by the wrongful conduct or imputation rule, which maintains that conduct of individual corporate officers may be imputed to corporations, thus precluding the corporations from maintaining an action against the auditors. The court of appeals affirmed the trial court’s grant of summary disposition in favor of defendants, as the plaintiffs presented no evidence to establish a genuine issue of material fact to support the application of the adverse interests exception to the imputation rule.

**Corporations—Minority Shareholder Oppression**

In *Franchino v Franchino*, 263 Mich App 172, 687 NW2d 620 (2004), a majority shareholder and a minority shareholder were the sole shareholders and the sole members of the board of directors in a closely held corporation when the majority shareholder discharged the minority shareholder. The minority shareholder subsequently brought an action for minority shareholder oppression under MCL 450.1489.

Reasoning that MCL 450.1489 applied to protect the interests of shareholders only in their capacity as shareholders, the court of appeals concluded that MCL 450.1489 did not create a cause of action for a shareholder in a close corporation when the shareholder is removed from the corporation’s board of directors and his employment with the close corporation is terminated. The court affirmed the trial court’s grant of summary disposition and affirmed the denial of the motion to amend the complaint.

**Single Business Tax Act—Officer-Employee Compensation**

In *Herald Wholesale, Inc v Dep’t of Treasury*, 262 Mich App 688, 687 NW2d 172 (2004), the corporate plaintiff sued the Department of Treasury, alleging that the Department of Treasury wrongfully included compensation in the corporation’s single business tax (SBT) tax base because the compensation was paid solely by the services company and was received by the officers in their capacities as employees of the services company, not as officers of the corporation. The court held that MCL 208.4(4), amended by 2002 Mich Pub Acts 603, made it clear that such compensation was not to be included in the tax base of the managed corporation, but should be included in the SBT tax base of the management services company.

**Michigan Consumer Protection Act (MCPA)—Document Preparation Fees**

In *Newton v Bank W*, 262 Mich App 434, 686 NW2d 491 (2004), plaintiff borrower alleged that defendant bank’s routine practice of charging document preparation fees in residential real estate mortgage loan transactions was in direct violation of the Michigan Consumer Protection Act, MCL 445.901 et seq. Because the MCPA exempts transactions or conduct specifically authorized under laws administered by a regulatory board or officer acting under state or federal statutory authority, the MCPA does not apply to residential mortgage loans with federal or state savings banks because such loans are specifically authorized under both state and federal statutes.

**Labor and Employment—Sexual Harassment**

In *Corley v Detroit Bd of Educ*, 470 Mich 274, 681 NW2d 342, 2004 Mich LEXIS 1184 (2004), a former employee was romantically involved with her supervisor. When the supervisor began another relationship with a coworker, the supervisor repeatedly threatened plaintiff with adverse employment action if she said or did anything that interfered with his relationship. The employee alleged that the harassment concluded when she was discharged, and subsequently sued the employer. The circuit court granted defendants’ motion for summary disposition, ruling that the employee failed to state a claim on which relief could be granted and that there was no genuine issue of material fact.

The supreme court held that the supervisor’s threats, because they were not sexual in nature, did not constitute sexual harassment. Therefore the employee was not able to meet the threshold requirement to establish either a quid pro quo sexual harassment claim or a hostile work environment sexual harassment claim. The circuit court’s order granting summary disposition for defendants was reinstated.

**Labor and Employment—Sexual Harassment and Constructive Discharge**

In *Pa State Police v Suders*, 124 S Ct 2342 (2004), a former employee sued her employer, alleging that she was con-

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structively discharged since her supervisor sexually harassed the employee until it led to her resignation. The employer contended that no tangible employment action occurred to hold the employer liable for the supervisor’s alleged harassment where the employee failed to take advantage of the employer’s process for dealing with workplace harassment claims. The employee argued that the constructive discharge was itself a tangible employment action, and thus the employer could be liable without exhaustion of the employer’s remedial process.

To establish a hostile work environment, plaintiffs must show harassing behavior “sufficiently severe or pervasive to alter the conditions of [their] employment.” To establish “constructive discharge,” the plaintiff must make a further showing: that the abusive working environment became so intolerable that her resignation qualified as a fitting response. An employer may defend against such a claim by showing both (1) that it had installed a readily accessible and effective policy for reporting and resolving complaints of sexual harassment, and (2) that the plaintiff unreasonably failed to avail herself of that employer-provided preventive or remedial apparatus. However, this affirmative defense is not available to the employer if the plaintiff quits in reasonable response to an employer-sanctioned adverse action officially changing her employment status or situation (e.g., a humiliating demotion, extreme cut in pay, or transfer to a position in which she would face unbearable working conditions). The judgment precluding the employer from asserting the affirmative exhaustion defense was vacated, and the case was remanded for further proceedings.

Labor and Employment—Reverse Discrimination

In *Lind v City of Battle Creek*, 470 Mich 230, 681 NW2d 334, 2004 Mich LEXIS 1151 (2004), the plaintiff, a white police officer, alleged that the defendant city violated the Michigan Civil Rights Act, MCL 37.2202(1)(a), when it promoted a black officer, rather than the plaintiff, to police sergeant. The court of appeals held that plaintiff had to present circumstantial evidence portraying defendant as an employer who discriminated against the majority. The issue before the Supreme Court of Michigan was whether a claim of reverse discrimination had to satisfy standards different from those required of other claims of discrimination.

The Supreme Court of Michigan reversed the judgment of the court of appeals, overruling *Allen v Comprehensive Health Services*, 222 Mich App 426, 564 NW2d 914 (1997), and holding that applying different standards to different racial groups in order to determine whether discrimination had been established violated the Michigan Civil Rights Act.

Labor and Employment—Michigan Civil Rights Act’s antiretaliation provision

In *Rymal v Baergen*, 262 Mich App 274, 686 NW2d 241 (2004), a female employee brought an action against her employer, supervisor, and second employer, alleging quid pro quo harassment, hostile environment, and retaliation under the Civil Rights Act (CRA).

The court of appeals found that the trial court erred in finding that there was no genuine issue of material fact regarding the sexual harassment claims and retaliation claim against defendant company. The court also found that that the trial court did not err in finding that an employee-supervisor could not be held individually liable for the sexual harassment claims, but that he could be held individually liable for retaliation.

Labor and Employment—Statute of Limitations

In *Jones v RR Donnelley & Sons Co*, 158 L Ed 2d 645, 2004 US LEXIS 3236, 124 S Ct 1836 (2004), involved consolidated suits in which current and former African-American employees sued their employer for race discrimination under 42 USC 1981. The U.S. District Court for the Northern District of Illinois determined that the four-year federal “catch-all” limitations period was applicable to the suit. The U.S. Court of Appeals for the Seventh Circuit reversed and held that this limitations provision did not apply.

The U.S. Supreme Court reversed the Seventh Circuit, ruling that the plaintiffs’ claims were governed by the federal “catch-all” four-year statute of limitations under 28 USC 1658, which applies to causes of action arising under an act of Congress enacted after December 1, 1990, and governed this case since the claims arose under the 1991 Civil Rights Act.
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