STATE BAR OF MICHIGAN
BLS
BUSINESS LAW SECTION

The Michigan Business Law JOURNAL

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Volume 34
Issue 3
Fall 2014

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STATE BAR OF MICHIGAN

Published by THE BUSINESS LAW SECTION, State Bar of Michigan

The editorial staff of the *Michigan Business Law Journal* welcomes suggested business law topics of general interest to the Section members, which may be the subject of future articles. Proposed business law topics may be submitted through the Publications Director, D. Richard McDonald, *The Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, Michigan 48304, (248) 203-0859, drmcdonald@dykema.com, or through Daniel D. Kopka, ICLE, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, (734) 936-3432, dan@icle.org. General guidelines for the preparation of articles for the Michigan Business Law Journal can be found on the Section's website at http://michbar.org/business/bizlawjournal.cfm.

Each issue of the *Michigan Business Law Journal* has a different primary, legal theme focused on articles related to one of the standing committees of the Business Law Section, although we welcome articles concerning any business law related topic for any issue. The primary theme of upcoming issues of the *Michigan Business Law Journal* and the related deadlines for submitting articles are as follows:

Issue	Primary Theme/Committee	Article Deadline
Summer 2015	Nonprofit Corporations Committee	March 31, 2015
Fall 2015	Uniform Commercial Code Committee	July 31, 2015
Spring 2016	Commercial Litigation Committee	November 30, 2015
Summer 2016	LLC & Partnership Committee	March 31, 2016

ADVERTISING

All advertising is on a pre-paid basis and is subject to editorial approval. The rates for camera-ready digital files are $400 for full-page, $200 for half-page, and $100 for quarter page. Requested positions are dependent upon space availability and cannot be guaranteed. All communications relating to advertising should be directed to Publications Director, D. Richard McDonald, the *Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, MI 48304, (248)203-0859.

MISSION STATEMENT

The mission of the Business Law Section is to foster the highest quality of professionalism and practice in business law and enhance the legislative and regulatory environment for conducting business in Michigan.

To fulfill this mission, the Section shall: (1) expand the resources of business lawyers by providing educational, networking, and mentoring opportunities; (2) review and promote improvements to Michigan's business legislation and regulations; and (3) provide a forum to facilitate service and commitment and to promote ethical conduct and collegiality within the practice.

The *Michigan Business Law Journal* (ISSN 0899-9651), is published three times per year by the Business Law Section, State Bar of Michigan, 306 Townsend St., Lansing, Michigan.

Volume XXII, Issue 1, and subsequent issues of the *Journal* are also available online by accessing http://www.michbar.org/business/bizlawjournal.cfm

From the Desk of the Chairperson

By James L. Carey

Transitions

One year ends, another begins. And so it is with your Business Law Section and Business Law Journal. Industries come and go—buggy whips anyone? Transitions can be great, horrible, tough, invigorating, scary, or mundane. Often a combination of some or all of those things. Tough to tell when you are in the middle of it. Chances are you are going through a lot of changes in any number of areas in your life. I hope your changes bring you success in the long-run even if they are tough in the short-run.

We are now well into a new year for the Business Law Section. Lots of changes. New Business Law Section website. New State Bar of Michigan Website. New Chairperson. New Officers. New Schulman Award Winner. New issues of our Business Law Journal.

Here in Michigan, we have certainly seen a lot of transitions—the auto industry, the city of Detroit, Business Courts, new tax policies, the Michigan Supreme Court looking at whether the State Bar should remain mandatory—no shortage of transitions around us. The practice of law is certainly not immune from changes, which is to say your practice of law is likely changing just as my practice has changed.

And I like to think that's where your Business Law Journal, and Business Law Section, can be so valuable. The Journal can help keep you current on changes that may affect your livelihood. And if you come across something worth sharing with your fellow attorneys, write an article to help update us all. The Business Law Section gives you a chance to meet and interact with business lawyers from many different sub-specialties, geographic areas, ages, and interests. From the newest sole practioner to the most senior of big-law partners, from the established, in-house counsel to the law student, we have a lot to learn from each other. Organizations like the Business Law Section and publications like the Business Law Journal give us that chance. I am humbled to be a small part of this tradition and a tiny cog in the transitions that continually must happen for us to grow.

Enjoy this issue of the Journal and think about how you might contribute to it in the future. Check out the Business Law Section webpage (www.michbar.org/business/) and consider how you might get involved. We have great committees in substantive areas, wonderful activities, and some of the best people I know. Do a little, or do a lot. But know that we are here. My transitions have always been better when I work with others rather than struggling alone.

And let's take just a minute to thank past Chair Jeff Van Winkle who finished a fantastic year as chair in September. And to congratulate Diane Akers who was chosen as the Outstanding Business Lawyer in Michigan. Diane is a wonderful person who has had an exemplary legal career. She was a natural choice to receive this year's Shulman Award from the Business Law Section.

As for our other Business Law Section officers, committee chairs, directors, and council members—thank you for your continued service to the Section and to our over 3,400 members. You provide an invaluable structure and support for our activities. You do the work that makes our section a productive and valuable resource for the business lawyers of Michigan. And good law makes for a good society. The needs of the people are great, and our role in making things better is critical. Because at our core, we lawyers are problem solvers. Our transitions often pale in comparison to the transitions we help our clients through. Whether we litigate, draft contracts, close deals, or negotiate resolutions, we are at our best when we are solving our clients' problems. Helping them through their transitions.

So thank you for being one of Michigan's business lawyers. Keep up the good work. And may your transitions lead you to joy and to peace.

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Regulatory Boards and Commissions Ethics Act

Public Act 96 of 2014 created the Regulatory Boards and Commissions Ethics Act.[1] The act was effective on July 1, 2014, and supplements existing standards of conduct and disclosure requirements for members of a board in the Department of Licensing and Regulatory Affairs that has authority in regulatory actions concerning private individuals or entities. Section 3 of the act requires a board member to disclose "any pecuniary, contractual, business, employment or personal interest that the board member may have in a contract, grant, loan, or a regulatory, enforcement, or disciplinary matter before the board. Disclosure is also required if a spouse, child, or stepchild of a board member is a director, officer, director or indirect shareholder, or employee of an entity under consideration for a contract, grant, or loan or is the subject of a regulatory, enforcement, or disciplinary action before the board."

If a member has an interest, the act requires the board member to refrain from discussions with other board members regarding matters before the board in which the member has an interest and to abstain from voting on any motion or resolution in a matter in which the member has an interest. The act also requires a board member to "use state resources, property, and funds under the board member's official care and control judiciously and solely in accordance with prescribed constitutional, statutory, and regulatory procedures and not for personal gain or benefit."[2]

A list of prohibited conduct in section 3(2) of the act[3] includes not divulging to an unauthorized person any confidential information acquired in the course of the member's service on the board; not representing the member's opinion as that of the board or department; not engaging in a business transaction in which the board member may profit from his or her official position or benefit financially from confidential information obtained as a board member; not rendering services for a private or public interest if that service is incompatible or in conflict with the discharge of the board member's official duties; and not participating in official capacity as a board member in negotiating or executing contracts, making loans, granting subsidies, fixing rates, issuing permits or certificates, or other regulation or supervision relating to a business entity in which the board member or an immediate family member has a pecuniary or personal interest, other than a 2 percent or smaller interest in a publicly traded company.

Section 4 of the act[4] provides that a contract, grant, or loan is voidable by the department unless the affected member complies with the provisions of the act. Section 5 of the act authorizes an investigation to be conducted by the director of the department or his designee and grants him discretion to refer the matter to the board of ethics.[5] The legislature makes clear in section 6 that it intends the act to supplement existing law. Section 6 specifically lists provisions that control if there is a conflict with 2014 PA 96.[6]

Deregulation

Some of the recommendations of the Office of Regulatory Reinvention have been implemented by recently passed legislation. Statutory provisions regarding the regulation of proprietary school solicitors, ocularists, and community planners were repealed effective June 11, 2014.[7] In addition, 2014 PA 163 abolished the Carnival-Amusement Board effective June 11, 2014.

Public Act 174 of 2014 amended 2004 PA 161 and repealed sections 4, 7, 9, and 15 of the Michigan Immigration Clerical Assistant Act[8] regarding creation and filing requirements for a list of immigration clerical assistants, effective June 17, 2014. Article 29 of the Occupational Code regarding auctioneers was repealed by 2014 PA 151, effective June 24, 2014. Public Acts 194 and 195 of 2014 amended other statutes to remove references to registered auctioneers. Public Act 193 of 2014 repealed section 601a of the Occupational Code regarding interior designers and is also effective on June 24, 2014.

State Registered Trademark and Entity Names

It is not uncommon for owners of a corporation or limited liability company to assume that they can acquire exclusive right to use a name by filing either a formation document or a Certificate of Assumed Name with the Corporations, Securities and Commercial Licensing Bureau (CS&CL). The Business Corporation Act and Michigan Limited Liability Company Act, however, provide that the fact that a name complies with the act does not create substantive rights to the use of that name.[9]

In *Travis v Preka Holdings, LLC*,[10] the Michigan Court of Appeals addressed the right to use a particular name in a trademark infringement case. Plaintiff and its predecessors have used the mark "Travis" since 1944 in connection with family owned restaurants. Plaintiff registered the mark with the CS&CL in 1996. Defendant bought a restaurant that had been licensed by plaintiff to use the Travis mark. Defendant only purchased the restaurant and did not obtain a license from plaintiff to use the mark. Defendant filed a certificate of assumed name with CS&CL in 2012 for the name "Travis Grill." Defendant used Travis Grill on its menus and in advertising and used "famous Travis burger" on its menu.

The plaintiff filed an action to enjoin defendant from use of "Travis" and related marks. The defendant argued that the plaintiff's mark had not acquired secondary meaning and was not a valid trademark under MCL 429.31, et seq. The trial court held that the "Travis" mark had acquired secondary meaning and granted the injunction. Defendant appealed to the Michigan Court of Appeals.

The opinion discusses the state trademark act and the right of an owner of a registered mark to seek an injunction against an infringer. The court concluded that under MCL

429.34(3), registration of the mark with the state "is prima facie evidence that plaintiff's mark is valid, and the burden of production shifts to defendant to demonstrate that the mark is not valid." Applying common law and the Michigan trademark and service mark act,[11] the court of appeals held that "defendant failed to show the plaintiff's "Travis" mark was invalid, and plaintiff showed that: (1) it had priority in the trademark; (2) defendant's marks confused consumers and suggested the defendant's business was associated with plaintiff; and (3) defendant used confusing mark in the sale or advertising of services rendered in Michigan. The court of appeals affirmed the lower court decision.

A person selecting a name for a business may search the list of registered marks, including their current status, at www.michigan.gov/corporations under Trademarks, Service Marks and Insignias. The list is in pdf format and updated monthly. Entity names and assumed names may be searched at www.michigan.gov/entitysearch.

10b-5 Reliance Requirement

In *Basic, Inc v Levinson,*[12] the United States Supreme Court adopted the "fraud on the market" presumption of reliance. An investor who buys or sells at market prices may be considered to have relied on all public material information, including misstatements, allowing investors to rely on the efficiency of the market to satisfy the reliance requirement.

In *Halliburton Co v Erica P John Fund Inc*,[13] Halliburton asked the supreme court to overturn its decision in *Basic v Levinson.* In its June 23, 2014 decision, the supreme court did not overturn *Basic* but it did hold that defendant could rebut the presumption at the class certification stage by introducing evidence to show a lack of price impact. Previously, a defendant could only introduce such evidence showing a lack of price impact during the merits stage of the proceeding.

NOTES

1. MCL 15.481-.486
2. MCL 15.483(1)(d).
3. MCL 15.483(3).
4. MCL 15.484.
5. Board of ethics was created under section 3 of 1973 PA 196, MCL 15. 343.
6. Section 10 of article IV of the state constitution of 1963; 1978 PA 566, MCL 15.181 to 15.185; 1968 PA 318, MCL 15.301 to 15.310; 1968 PA 317, MCL 15.321 to 15.330; 1973 PA 196, and MCL 15.341 to 15.348.
7. 2014 PA 157 repealed 1963 PA 40 regarding proprietary school solicitors; 2014 PA 156 and 2014 PA 153 repealed Articles 27 and 23 of the Occupational Code, respectively, regarding ocularists and community planners.
8. MCL 338.3451-338.3471.
9. MCL 450.1212(3), MCL 450.450.1217(1), MCL 450.4204(5), and MCL 450.4206(4).
10. No 315560, 2014 Mich App LEXIS 1432 (July 31, 2014).
11. 1969 PA 242, effective January 1, 1970.
12. 485 US 224 (1988).
13. 134 S Ct 2398 (2014).

G. Ann Baker is Deputy Director of the Corporations, Securities and Commercial Licensing Bureau, Department of Licensing and Regulatory Affairs. Ms. Baker routinely works with the department, legislature, and State Bar of Michigan's Business Law Section to review legislation. She is a past chair of the Business Law Section and is the 2008 recipient of the Stephen H. Schulman Outstanding Business Lawyer Award.

By Eric M. Nemeth

Tax Scams – Identity Theft, Phone Scams – We Are All Targets

The IRS released pursuant to IR-2014-1, its annual "Dirty Dozen" list of tax scams. As we head quickly into another tax season, we should all be vigilant for ourselves and our clients of the ever-expanding con artists using the tax system to prey on the unsuspecting.

Identify Theft

We all probably know someone who has had their identity stolen if, in fact, not ourselves. Identity theft can take many forms. The basic stolen credit card number (often caught by your credit card company very quickly) to much more pervasive identity theft, including cleaning out bank accounts, opening credit card accounts, and use of your identity for various transactions. The recent well-publicized data security breaches at major retailers have put consumers at risk as we become ever more "connected" and cashless. The 2013 Federal Reserve Payment Study issued by the Federal Reserve Bank of San Francisco found payments are increasingly card based and cash, while in volume is still dominant; in value cash only represents 14 percent of dollar volume.

Tax Return Filing

Imagine now that you or your client dutifully files a tax return electronically (again, paperless) only to get an e-mail back that the tax return was rejected because a tax return was already filed under that social security number. The panic sets in immediately. How do you file a tax return? Are you in trouble? What else have the thieves done? Indeed, one identity theft will prevent the filing of a joint income tax return leaving the other spouse in limbo. Does he/she file a separate tax return to avoid penalties; can you amend later? April 15 or October 15 are when many of these incidents will be uncovered.

Quick action is critical. First, call the IRS Identity Protection Specialization Unit, 800-908-4490. You need to establish a record. Next, complete IRS Form 14039—Identity Theft Affidavit and submit the form to the IRS. I recommend filing the "correct original" tax return by certified mail or overnight mail (including payment of any tax balance due) with a letter of explanation. You should also contact the Social Security Administration as the improper tax return can affect your credits and tax. Outside of the tax considerations, you should contact your credit card companies and banks to check for any suspicious activity and pull your credit report as well.

During the ensuing months following your report of identity theft to the IRS, watch for any correspondence from the IRS. The IRS computer may "match" the bogus tax return to your correct third-party records and generate deficiency notices. Do not ignore these notices as non-response could lead to procedural assessments and tax liens that are difficult to unwind, adding insult to injury.

Telephone Scam

Increasingly, I have heard from accountants and attorneys that their client received a telephone call from someone claiming to be from the IRS. The calls range from "phishing" in which there is an attempt to secure bank account information, social security numbers, and credit card numbers, to demands for money. The scam is often based upon an alleged refund of taxes—the caller needs to verify the identity of the taxpayer and an account to wire the refund. Of course, the wire will go in the other direction. Another scam involves a threat that the taxpayer owes money to the IRS (some scams seem to be searching public records for federal tax liens), thereby adding apparent credibility to the call. The caller threatens that the taxpayer will be jailed or have his driver's license revoked unless an immediate payment is made.

Note, these calls are frauds. Your client should hang-up immediately. If your client owes taxes, call the IRS or seek counsel to help set-up a payment arrangement or some other appropriate resolution. Your client can also call the Treasury Inspector General at 800-366-4484 to report the incident.

Recent reports indicate that scam artists are taking taxpayer information and contacting international financial institutions directly, posing as the IRS seeking information about specific U.S.-based clients. The alleged reasoning is compliance with the Foreign Account Tax Compliance Act (FATCA). FATCA was the topic of a previous article. The institutions are solicited for account balances and even passwords. The IRS does not solicit such information by telephone or e-mail but, like computer hackers, these scammers probe for weaknesses in the system, and even one unsuspecting clerk can provide a financial windfall. Both you and your clients should take steps to ensure their financial institutions have strong firewalls to protect their privacy from illegitimate inquiries.

Lastly, scam artists abound promoting all manner of grandiose special tax credits and deductions. These claims range from "one-time" IRS special deals and programs to special credits for reparation and mortgage forgiveness. The IRS website (*www.irs.gov*) can help identify such scams, or your client should contact a reputable tax professional. Your client should keep in mind that tax-return-preparer fraud is a major problem. Taxpayers must understand that even if they acted in good faith, they are ultimately responsible to pay any additional tax and interest, and possibly penalties, from the actions of their tax return preparer. IRS Fact Sheet 2014-5 offers IRS advice on choosing a tax preparer. However, referrals from trusted sources are usually best.

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TECHNOLOGY CORNER By Michael S. Khoury and Jeremy D. Bisdorf

What's in a (Business) Name?

As business lawyers, we often advise clients on how to set up their businesses, and one item that frequently arises is the company name. We counsel them to research whether a name is available for use in the state of organization. We also recommend that the company check to be sure that trademark rights of third parties will not be violated and that an Internet domain name that makes sense can be secured. We talk about the U.S. Patent and Trademark Office (USPTO), but rarely are the rights under state law given much credence. Also, if a person's name is involved, the analysis gets tricky.

Let's set the context. The registration of a trademark with the USPTO provides the owner with many rights. For example, a federal trademark registration through the USPTO allows whomever is first to register a mark to have priority over others in any territory in the United States in which the mark is not already being used. The owner also has access to the federal courts to enforce these rights and to the U.S. Customs and Border Protection to prevent the importation of goods that infringe registered marks. When one looks at the rights that are available under Michigan law for a state registered trademark, though, they seem very limited, even though the process is easier and the cost is lower.

In Michigan, a trademark or service mark can be registered with the Michigan Department of Licensing and Regulatory Affairs by filing an Application for Registration of Trademark/Service Mark (Form CSCL/CD-600). The filing fee for this application is $50. By making this filing, a registrant's trademark rights are recorded in the state of Michigan's List of Registered Marks, and the mark then becomes subject to the protections of Michigan's Trademark Act,[1] which provides a registrant with certain injunction rights and the potential to obtain monetary damages against infringers.[2]

In July 2014, the Michigan Court of Appeals issued a decision in a business name dispute between two restaurant owners. *Janet Travis, Inc v Preka Holdings, LLC, doing business as Travis Grill*.[3] This was a trademark case that summarizes and describes the application of Michigan trademark law. The dispute in *Travis* involved business names and marks used in connection with the promotion of the parties' respective restaurants. The plaintiff and its predecessors had been using the mark "TRAVIS" in connection with their restaurant since 1944 and had obtained a state of Michigan trademark registration for their mark in 1996. This registration remained in place during the litigation. In 2011, the defendant bought a restaurant that was previously licensed to use the plaintiff's "TRAVIS" mark, but the defendant purchased only the restaurant and did not retain a license to use the "TRAVIS" mark. However, the defendant did file a certificate of assumed name with the state of Michigan and changed the name of the purchased restaurant from "Travis of Chesterfield" to "Travis Grill." The defendant continued to market its restaurant services under the "TRAVIS" mark and also advertised a "famous Travis burger" on its menu. The plaintiff filed suit against the defendant to enjoin it from further use of "TRAVIS" related marks. The trial court ruled in favor of the plaintiff and granted the injunction.

In *Travis*, the court stated that there are three sources of trademark law in Michigan: common law, Michigan's Trademark Act, and the federal Lanham Act.[4] The court indicated that a plaintiff may bring separate trademark-related claims under each body of law.[5] Given that the mark "TRAVIS" was registered only with the state of Michigan, the court analyzed this case only in accordance with the state Trademark Act.[6] The court noted that owners of trademarks registered under the Trademark Act were entitled to seek relief to enjoin the manufacture, use, display, or sale of any counterfeits or imitations of its mark by a third-party infringer.[7]

The *Travis* court recognized that marks can be broken down into one of four categories: 1) generic, 2) descriptive, 3) suggestive, and 4) arbitrary or fanciful.[8] The court noted that only suggestive, arbitrary, and fanciful marks were inherently distinctive enough to qualify for trademark protection, that generic marks can never qualify for trademark protection, and that descriptive trademarks can only qualify for trademark protection if they become source identifiers for consumers by acquiring "secondary meaning."

The defendant in *Travis* argued that the "TRAVIS" mark was a surname and therefore was not entitled to trademark protection because the mark was "descriptive." The court noted that because the plaintiff registered its mark with the state of Michigan, the burden was then on the defendant to show that the mark lacked secondary meaning.[9] The court believed that the defendant failed to meet this burden with the trial court, and as such the trial court properly ruled in plaintiff's favor by granting the injunction. When finding for the plaintiff, the court took particular notice of 1) plaintiff's sixty years of prior use of the mark, 2) defendant's use of the phrase "famous Travis burger" on its own menu, and 3) multiple affidavits provided by the plaintiff showing evidence of actual confusion by consumers. After contrasting this evidence with defendant's mere assertion that there was no likelihood of confusion between the various uses of the marks, the court had no trouble ruling for the plaintiff.

The *Travis* case serves to remind us that certain intra-state related matters can raise important trademark related issues that will not qualify to be reviewed in federal court under Lanham Act standards. As such, it is important not to forget the potential benefits that can be obtained from properly filing trademark claims with

the state of Michigan in appropriate situations, including shifting the burden to the other party, and that by doing so we can successfully obtain certain valuable benefits and protections for our client similar to those provided under federal law.

NOTES

1. MCL 429.31 *et seq.*

2. See MCL 429.43.

3. No 315560, 2014 Mich App LEXIS 1432 (July 31, 2014).

4. 15 USC 1051 *et seq.*

5. *Travis* at *12.

6. The court recognized that there is much similarity between Michigan's Trademark Act and the Lanham Act. The court noted that it was unclear if Michigan intended the Trademark Act to be a direct copy of the Lanham Act, but it was enacted after the Lanham Act and its structure and language clearly parallel the initial version of the Lanham Act. The court also noted that Michigan's Trademark Act bears a striking resemblance to the Model State Trademark Bill, which is patterned after the Lanham Act and is used in all states except West Virginia, Hawaii, Wisconsin, and New York. See *Travis* at 11-12, citing 3 *McCarthy on Trademarks* §§ 22.5 and 22.7.

7. *Travis* at *13 citing MCL 429.43(1).

8. Id. at *16-17 citing a "now-classic test" formulated by Judge Friendly in *Abercrombie & Fitch Co v Hunting World, Inc,* 537 F2d 4 (2nd Cir 1976). Further, the court provided detailed descriptions of each category and examples of each.

9. Id. at *22.

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 By Janet Toronski

Transform Your Career: From the Legal Office to the Business Office

Whether you're a relatively new lawyer or have been practicing for years, you may think you'll continue to practice law for the rest of your career. After all, that's what all the work in law school was for, right? Maybe—maybe not. You might just have the perfect education and experience to launch a business career.

I was seven years into my legal career working as in-house counsel at an automotive finance company when I was approached to go on the business side. Senior management thought I could not only negotiate complex commercial transactions but also believed I could effectively communicate and sell to the company's customers. At first I was reluctant. I figured that I had made the decision to become a lawyer, and that's what I should stick to. After some more thought, I decided to give it a try. Realistically, I figured I would be back in the legal office inside of a year. Twelve years later, I was still on the business side of the automotive finance business (but at a different company) running the commercial loan department.

There are a many issues to consider before making a move from the legal side to the business side. Each person must make his or her own list of "pros" and "cons" when considering such a big switch. Whether issues end up in the pros or cons column are very personal choices. For example, as a lawyer, you are likely not making business decisions on a daily basis. While some of the legal issues surrounding any given industry may be black and white, lawyers often operate in the "gray" area of the law and must advise their clients accordingly. A good lawyer will help his or her business client weigh the benefits and risks of a business decision. Ultimately, however, that decision is up to the businessperson. Do you find yourself wishing you were in a position to be making decisions yourself, or do you thrive being the person providing clarity and advice surrounding business issues?

Consider the industry in which you practice. Is it highly regulated? Are you constantly giving your clients lessons on state or federal statutes because the processes and procedures of running the business are closely intertwined with the applicable law? In the automotive finance industry, areas of the law such as secured transactions, fair lending, and licensing are the foundation of its business. Practically all of the business people in that industry should have at least a general understanding of these laws. When you're a lawyer in a particular industry and move to the business side, you often have an easier time making decisions since you have a deeper understanding of the rules and risks. That, in turn, can lead to more thoughtful, better decision making.

One of the downsides of making a move to the business side is not having the background and experience of many of the businesspeople who came up through the ranks of the company. When I made the move, I entered the business side as a mid-level manager. Most of my peers had sat through the traditional chairs to earn their way to that level. Some of them were reluctant to welcome me with open arms, as they felt I hadn't earned my way. I quickly learned, as with everything else in life, that I had my strengths and weaknesses. I had a strong knowledge of the business already, albeit from a legal viewpoint, and I had strong relationships with many of the businesspeople, as I had served as their lawyer for seven years. However, I never held the more technical jobs that trained on the finer details of finance and credit analysis. But, I never pretended that I did. I asked countless questions—to anyone who would answer them. And, as I moved up through the ranks, I made sure I surrounded myself with people who were really good at the things I wasn't.

Do you like to manage people? Are you good at it? (By the way, these questions often have two different answers). Hard work often leads to promotions, and promotions often lead to management roles. So, typically the better a person is at his or her job, the more likely that person will ultimately manage people. Whether you're a lawyer or a businessperson, being good at your particular job does not, unfortunately, mean that you are a good manager. We've all seen really good, smart people progress to "department head" and fail miserably in that role. This is a real problem in many organizations, and one that won't be solved easily. The point for the purpose of this column is to ensure that you honestly consider whether or not you like to manage people—and as importantly, whether or not you're good at it. As your career progresses in the legal office, you likely will be managing a group of legal professionals. But, if you find yourself on the business side, you may find yourself managing a much larger department with people of diverse experiences and educations. So, before you make a move to a position with a high level of management responsibility, honestly evaluate your talents in that area before making the jump.

I found that the best advantage a lawyer has in finding success on the business side is advanced critical thinking skills. "Critical thinking" is defined very broadly. It includes, among other things, how one thinks, analyzes, and assesses issues and problems. Good critical thinkers thoughtfully consider all sides of an issue or problem—not just their own positions or views. Good critical thinkers thoughtfully and persuasively articulate their positions on issues, but they are equally prepared to speak to the arguments against their positions. I made critical thinking an important topic of conversation with my employees. I was surprised and disappointed that many of our otherwise good employees were not very good critical thinkers. They always knew their side of the story. They had their upbeat sales pitch mastered.

They could articulate all the reasons why we should approve a credit file. But, too often, they didn't consider "the other side." Their sales pitch was met with objections that they hadn't considered. They were asked about the weaknesses of the credit file that they hadn't addressed. Of course, this made them appear unprepared and made others wonder whether all pertinent issues were considered. Critical thinking is an essential tool that a lawyer can bring to the business side and help spread throughout the organization.

If you think you're interested in a business position, start talking about it. Whether it's to your boss, your clients, human resources, or your colleagues, talk to people that you trust who will give you honest advice and feedback. And if you do make the leap, submerse yourself, learn as much as you can, and enjoy the experience. Someday, you may decide to go back to the legal side, but if you do, you'll be be a better lawyer because of the experiences that you've had.

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Michigan v. Delaware – 2014

By Cyril Moscow and Richard D. Hoeg

Introduction

Michigan-based companies typically choose either Michigan or Delaware for their state of incorporation or organization. Delaware is the most popular jurisdiction for formation of out-of-state businesses. A 1996 article "Michigan or Delaware Incorporation," describes the background of the corporate statutes and considerations involved in deciding between the two states.[1] A 2002 article supplemented the 1996 article.[2] This article further updates the comparison and adds analysis of the similar considerations confronted when deciding where to form a limited liability company (LLC).

Although there are many differences in structure and detail between the Michigan and Delaware corporation statutes, both are flexible in recognizing business needs. In some areas, the Michigan Business Corporation Act (MBCA) borrows provisions from the Delaware General Corporation Law. Important Michigan provisions also come from the Model Business Corporation Act ("Model Act").

In most cases, Michigan is the better choice. The conclusion of the 1996 article stated:

> For the largest businesses headquartered in Michigan, the overwhelming choice for state of incorporation has been Delaware. This choice is understandable because of restrictions under the old law, the insignificance of the additional annual cost to such corporations, the assurance that the Delaware Legislature will be responsive to business needs in amendments to the statute, the sophisticated courts, and the familiarity of corporate advisors with Delaware law. For closely held Michigan businesses, it is almost always preferable to incorporate in Michigan to avoid the additional costs and litigation exposure of incorporating elsewhere. For medium-sized public corporations, the choice is less clear and the legal differences are not very significant. Overall, cost savings and the flexibility of the Michigan statute, antitakeover provisions, broader indemnification, and avoidance of Delaware jurisdiction over the corporation and its directors in litigation indicate that Michigan should be favorably considered as a state of incorporation by the management of Michigan-based businesses.[3]

These comments remain generally correct today. For most Michigan-based corporations, there have been no significant changes in the statutory or caselaw that make Delaware the better choice. On the other hand, for large public corporations, there still is little reason not to ultimately choose Delaware. The relative ease with which a Michigan- or Delaware-based entity can now change its jurisdiction of incorporation or organization make "staying close to home" more attractive for initial organization.

Delaware's Preeminence

Corporations

The national preference for Delaware as a state of incorporation is clear, particularly for the largest corporations. Of the Fortune 500 companies, 65 percent are incorporated in Delaware and only three (Stryker Corporation, DTE Energy Corporation, and CMS Energy Corporation) are incorporated in Michigan. As of June 30, 2014, of the 102 corporations headquartered in Michigan with a class of equity securities registered under the Securities Exchange Act of 1934, 34 were incorporated in Delaware and 45 in Michigan.[4] Many of the Michigan corporations were local banks and bank holding companies. The 1996 article stated that at December 31, 1995, there were 219 comparable corporations headquartered in Michigan of which 80 were incorporated in Delaware and 123 were incorporated in Michigan. The decline in the number of Michigan corporate headquarters is related to, but greater than, the national decline in the number of reporting companies since 1995.

The reasons for Delaware's preeminence are often summarized by three major characteristics. That state possesses:

1. A flexible corporation statute with frequent amendments to keep it current with business needs.

Delaware usually amends its statute every year, while Michigan amendments are adopted roughly every four years. There is efficient administration of the Delaware statute reflecting the importance of maintaining preeminence to the state government. Delaware statutory amendments reflect current issues. For example, a 2013 amendment that loosened the requirements for short-term mergers has itself already been clarified in a 2014 amendment.[5]

2. A sophisticated and responsive judicial system for resolving corporate disputes with a developed body of corporate caselaw.

There are hundreds of corporate cases in Delaware each year. The Delaware Court of Chancery has five respected judges, and appeals are made directly to a five-person supreme court, many of whom served on the chancery court.

In contrast, there are only about 25 corporate cases that reach the Michigan Court of Appeals each year, and almost all decisions that are issued by the court of appeals are unpublished. Further, most corporate cases in Michigan deal with routine close corporation matters concerning piercing the corporate veil, oppression of minority shareholders, or successor liability. The Michigan Supreme Court hears corporate cases only infrequently, and when it does, it decides them slowly. The arrival of business courts in Michigan may somewhat reduce the sophistication gap at the trial level.

Although there are many differences in structure and detail between the Michigan and Delaware corporation statutes, both are flexible in recognizing business needs.

3. Familiarity and satisfaction of lawyers, managers, and investors with Delaware incorporation over many years.

The two factors described above created a cultural acceptance of Delaware that made it the presumptive choice for large national businesses or corporations with out-of-state or professional investors. That acceptance, together with business' resultant comfort with various Delaware documents, administrative requirements, and precedents, serves to continually reinforce and strengthen Delaware's standing in this arena. For example, of the 71 venture-capital-firm-backed initial public offerings in 2013, 69 were by Delaware corporations.[6]

Despite these benefits, there are disadvantages in Delaware incorporation. First, since both domestic and foreign corporations must pay Michigan franchise fees to do business in Michigan, the costs imposed by Delaware are an extra burden on Michigan- based corporations. In addition to the initial fee paid on incorporation in Delaware, there is an annual franchise tax based on the authorized capital stock of a corporation that can be imposed by the state at a maximum value of $180,000 per year. Michigan corporations ordinarily avoid Delaware taxes for Michigan-based businesses.

Second, incorporation in Delaware creates greater risk of litigation in Delaware. As stated in 1996:

> An overriding disadvantage of the Delaware court system for businesses having no other contacts with Delaware is the amenability of Delaware corporations and their directors to suit in Delaware…. A more subtle disadvantage to the Delaware court system is the greater likelihood that shareholder litigation will be instituted against a Delaware corporation than against a Michigan corporation. The Delaware bar is sophisticated and active in bringing shareholder litigation; the Michigan bar has only a few lawyers who regularly appear on the plaintiff's side of shareholder litigation…. Although there is no empirical evidence to support the conclusion, it is probable that experienced plaintiffs' lawyers in Wilmington or New York would be more likely to institute a shareholder class or derivative action in Delaware against a Delaware corporation, or its directors, than to bring a suit in Michigan against a Michigan corporation or its directors.[7]

This danger was worsened when, effective January 1, 2004, non-resident officers, as well as directors of Delaware corporations, were made subject to suit in Delaware.[8] By comparison, a Michigan-based corporation doing business in Michigan will generally be litigated against in Michigan courts, and some lawyers feel that gives organization in Michigan an additional advantage: Michigan judges might be more likely to give a "hometown" decision to Michigan-based corporations.

Limited Liability Companies

Since 1996, there has been a rapid growth in the number of limited liability companies, making that form of entity the preferred form for closely held businesses (except where issuance of publicly-traded securities is contemplated). For the fiscal year ended September 30, 2013, 59,642 limited liability companies and 15,971 corporations were formed in Michigan. For the year ended December 31, 2013, 109,169 limited liability companies and 34,234 corporations were formed in Delaware.[9] The choice between Michigan and Delaware when forming limited liability companies has many of the same considerations as the choice for corporations. In particular, the preference of out-of-state investors and their advisors for Delaware, based largely on general acceptance and familiarity, is the same for both forms of entity, even though there are few limited liability companies with publicly-traded securities. There are, however, also some other differences that make Delaware attractive to limited liability companies.

Cost. The difference in cost in operating a Delaware LLC instead of a Michigan LLC is much less significant than is the case in connection with like-situated corporations. The annual fee in Delaware is $250, and there also would be a cost for a registered office. As is the case for a Michigan-based corporation, this cost is incurred in addition to costs associated with operating a business in Michigan as a foreign entity.

Amendments. Although there is not a frequent need to amend a limited liability statute because of the absence of public company issues and the flexibility of the form, there are periodic amendments to the Delaware statute. As an example of the Delaware flexibility, the Delaware Act provides for a series limited liability company (where liabilities are intended to be isolated across multiple series) while the Michigan act does not.[10] Such innovations are likely to be added more quickly in Delaware.

Flexibility. In general, the Delaware Limited Liability Company Act is derived from the Delaware limited partnership act while the Michigan act follows the structure and provisions of the MBCA. The Delaware Act expressly provides that " [i]t is the policy of the [act] to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."[11] As a baseline rule, then, Delaware favors a broader contractual approach (subject to public policy concerns), while Michigan is less flexible.

One major difference between the two limited liability company acts that arises out of this difference in philosophy is in the treatment of management's fiduciary duties. The Michigan act carries over from the MBCA a formulation of director duties as a standard of duties for managers. In contrast, in Delaware there can be a limitation or even elimination of manager fiduciary duties subject only to the implied covenant of good faith and fair dealing. This ability to restrict fiduciary duties is cited to be an important factor in favor of the selection of Delaware limited liability companies. Although Michigan allows for limitations in the articles of organization or operating agreement,[12] the authorization is not as broad. Moreover, the Michigan act features an oppression provision borrowed from the MBCA that gives minority members recourse against managers or members in control.[13]

Cases. There are many cases interpreting the Delaware LLC act, and Delaware courts have extensive corporation and limited partnership precedents available. The sophistication of the Delaware courts applicable to corporations should generally apply to LLCs as well. Michigan courts also look to corporation law in connection with LLC disputes, owing in part to the Michigan LLC statute's adoption of provisions of the MBCA. As a result, the issues of sophistication and timeliness impacting the Michigan courts' treatment of corporations should likewise apply to their treatment of Michigan LLCs.

This ability to restrict fiduciary duties is cited to be an important factor in favor of the selection of Delaware limited liability companies.

Close Corporations

In 1997, the MBCA added section 488,[14] which allows great flexibility in unanimous shareholder agreements. This provision, based on section 7.32 of the Model Act, permits variation of corporate norms and allows shareholders to organize their relationships without the constraints of ordinary corporate rules. In addition to meeting the needs of small businesses, section 488 is also helpful in corporate joint ventures and parent-subsidiary relationships where the standard corporate model is too restrictive.

MBCA section 489, covering shareholder oppression, remains a valuable tool for protection of minority shareholders in close corporations. Delaware courts have rejected general remedies for unfair conduct but will enforce fiduciary principles to give some

relief for wrongful acts of directors and controlling shareholders. MBCA section 489 provides a more specific discretionary judicial remedy.

Delaware still may be preferred for subsidiaries of Delaware corporations because of the administrative convenience of referring only to a single state law, for corporate joint ventures where the parties are more comfortable with Delaware law, and for businesses where financing sources are fearful of possible Michigan peculiarities and desire the familiar Delaware format. The ease in which a corporation or LLC can now convert to another form or change the state of its organization, however, may make Michigan organization viable even in these instances.

There is a major formal difference between the capital structure permitted in Michigan and the Delaware provisions.

Capital Structure and Reorganizations

There is a major formal difference between the capital structure permitted in Michigan and the Delaware provisions. Michigan has abolished the obsolete concepts of par value and stated capital and the mysteries of determining "surplus." Delaware continues to have the archaic provisions, causing occasional complications in corporate planning for dividends and share repurchases.

Annual amendments to the Delaware statute deal with perceived ambiguities in the statute, caselaw developments, and financing issues. For example, in 2013, a Delaware amendment provided for formula pricing in public offerings,[15] while in 2013 and 2014, amendments addressed short-form mergers after a person obtains a majority of the outstanding shares.[16]

Appraisal Rights

In the past several years, there has been increased activity in Delaware in connection with stockholder appraisal rights.[17] Plaintiffs have been successful in obtaining awards in excess of the consideration offered in mergers. The ability to assert claims with respect to shares acquired after the announcement of a proposed merger and the generous interest rate (five percent over the prime rate) has attracted the interest of hedge funds that speculate on the outcome of merger announcements and appraisal proceedings. Michigan has some advantages: appraisal is not available in Michigan if the consideration received is cash or publicly traded shares, or if the corporation had publicly traded shares before the transaction,[18] after-acquired shares receive some special treatment,[19] and the interest to be paid is the rate at which the corporation pays its principal bank loans.[20]

There are other differences between the statutes in the applicability of the appraisal provisions: Delaware does not allow appraisal in connection with sales of assets and charter amendments, while this is permitted in Michigan.[21]

Directors

Delaware courts have a steady flow of cases dealing with the fiduciary duties of directors. In this area, however, the supposed advantages of predictability of Delaware law and judicial efficiency are not present. The decisions are fact-intensive, and statements by the Delaware Supreme Court involve elaborate schemes of burden shifting that are difficult to interpret and apply.[22] Michigan has a statutory statement of director and officer duties.[23] In practice, however, the results in the sparse Michigan authority are similar to Delaware results. In matters affecting public corporations, Michigan courts tend to look to Delaware caselaw.[24] Accordingly, a claim of Delaware judicial superiority and legal certainty, while applicable in other areas, is not applicable concerning fiduciary duties, where the courts in both states apply general standards to prevent abuse of the corporation and its shareholders. The flexibility given by the Delaware Limited Liability Company Act allows the parties to negotiate and set forth duties and responsibilities of managers in the operating agreement.

The Michigan provisions on exculpation of directors and indemnification are broader than the comparable Delaware provisions. Michigan follows the Model Act in allowing exculpation and indemnification in situations where Delaware would have imposed vague limitations of "good faith" or "duty of loyalty" breaches.[25] In addition, Michigan allows indemnification for settlements of derivative actions where Delaware does not.[26]

Litigation Bylaws

Since 2002, there has been explosive growth in shareholder litigation involving corporate mergers. To cure the filing of suits in multiple jurisdictions, corporations adopted bylaws requiring suits be brought in a single jurisdiction, typically Delaware. In 2013, the Delaware Court of Chancery sustained forum selection bylaws.[27] A similar result is likely if a Michigan corporation designates Michigan as a forum for shareholder litigation. In 2014, the Delaware Supreme Court,

in response to a certified question concerning a non-stock corporation, held permissible a bylaw requiring the loser in a suit against the corporation or its directors and officers to pay the fees and expenses of the winner.[28] In a rapid response, the Delaware State Bar Association proposed legislation preventing the adoption of "fee shifting" bylaws by stock corporations. The Delaware legislature delayed action on the proposal pending continued examination of legislation relating to fee-shifting bylaws and other aspects of corporate litigation.[29]

As a result, since the MBCA has a similar broad bylaw authorization, Michigan corporations appear to have the ability to adopt forum selection as well as fee-shifting and other restrictive bylaws, possibly making Michigan corporations better able to regulate shareholder litigation than Delaware corporations if restrictive legislation is adopted in Delaware. Objections by the class action bar, institutional investors and their advisors, and the Securities and Exchange Commission, however, discourage public-corporation action to reduce shareholder litigation through bylaw provisions.

Takeovers

Chapter 7A of the MBCA deals with corporate takeovers.[30] As initially adopted in 1984, Chapter 7A was a "fair price" statute directed at two-tier tender offers. In 1989, Chapter 7A was amended to add a restriction on business combinations for five years without a supermajority vote, thereby effectively converting the original "fair price" statute into a more protective business combination law. In 2013, the MBCA was amended to make Chapter 7A inapplicable to Michigan corporations that do not have stock registered with the SEC under section 12 of the Exchange Act in place of a more restricted formulation. As a result, some Michigan corporations that would have previously been subject to the chapter are no longer covered.

Chapter 7B,[31] a control share act that was added to the MCBA in 1998, was repealed in 2009 after experience showed that the act had unintended consequences in trapping parties other than the corporate raiders that it was designed to hinder.

Delaware section 203, adopted in 1988, was intended to strike a balance between a free securities market and the need to limit abusive takeover tactics. The exclusions in the statute, notably the exclusion for business combinations with a holder of 85 percent of the voting stock, make section 203 less a deterrent than chapter 7A.[32]

Shareholder rights, or "poison pill" plans, are the main protective devices against hostile tender offers in both states. The Michigan 2001 statutory amendments removed lingering doubts as to the effectiveness of a poison pill plan in Michigan. Under section 342a of the Act,[33] Michigan corporations, like Delaware corporations, can adopt poison pill option plans. The 2001 amendments did not address the problems of continuing director and other poison pill innovations or the fiduciary duties of directors in maintaining plans. In this area, Michigan courts are likely to follow Delaware courts in striking down extreme defensive provisions, especially those limiting shareholder voting rights.

Miscellaneous Provisions

Michigan has not adopted various provisions found in Delaware such as those facilitating majority voting[34] and formation of holding companies.[35] In 2013, Delaware authorized a form of public-benefit corporation.[36] Bills have been introduced in the Michigan legislature from time to time concerning public-benefit corporations but no final action has been taken.

While not directly related to the governance of an entity organized under either Michigan or Delaware law, it is worth noting that state-based "crowdfunding" initiatives are generally only permitted under federal and state securities laws based on the fact that the related funding all takes place on an "intrastate" basis. In particular, Michigan's crowdfunding legislation (made law in December 30, 2013, by adoption of new section 202a of the Michigan Uniform Securities Act[37]) requires as an initial condition that the entity seeking such financing is an entity that is incorporated or organized under the laws of Michigan.

Conversion as Initial Strategy

While the differences between Michigan and Delaware described in this article can be significant, neither corporations nor LLCs are as locked into their states of organization as they were in 1996. Where changing an entity's domicile would before have required a cumbersome merger or similar transaction, in 2009 and 2010, Michigan passed amendments to the MBCA and LLC act allowing for the conversion of Michigan businesses into entities organized in Michigan or another

Since 2002, there has been explosive growth in shareholder litigation involving corporate mergers.

state, provided that the state in question had passed similar laws. As the Delaware acts also provide for conversion rights, the two states' laws now work together to permit relatively streamlined movement between them. Most notably, a Michigan entity's conversion solely to change the state of its organization does not need to go through the appraisal rights process. As a result, the question of where a company should initially incorporate or organize (and in what form) can be made with a greater emphasis on the needs of the entity (and its investors and shareholders) in the present, rather than on what needs it might have in the future; and since a Michigan entity can easily become a Delaware entity when the institutional investors come around, businesses may want to consider avoiding the early costs and logistical issues that arise from initially organizing in another state.

Conclusion

Michigan has not sought to attract out-of-state business incorporations and limited liability company formations. With respect to corporations, Delaware has a preeminent position in attracting incorporations, and its frequent statutory amendments are designed to meet the needs of large, publicly traded corporations incorporated in that state. Michigan courts cannot match the expertise and efficiency of the Delaware courts. Michigan, however, has a modern corporation statute with some advantages in certainty, clarity, and flexibility over the Delaware statute. Michigan has the advantage in cost savings and litigation avoidance.

The conclusion remains the same as in 1996: for closely held Michigan businesses operating as a corporation, Michigan incorporation usually is the best corporate choice. For most publicly traded corporations, Michigan incorporation should be as advantageous as Delaware incorporation and less expensive. For those Michigan-based corporations that rank among the largest in the nation, notably the major automobile manufacturers, Delaware incorporation will remain the most attractive because of the complex financing and major-shareholder-litigation issues that affect those corporations. In the choice of Michigan or Delaware for limited liability companies, most practitioners will choose Michigan for Michigan businesses. As with corporations, where there are investors or investor counsel from outside of Michigan, Delaware will be preferred. The availability of conversion as a relatively low cost option for entities, regardless of their initial state of organization, should also play a factor.

NOTES

1. Moscow, *Michigan or Delaware Incorporation*, 42 Wayne L Rev 1897 (1996).
2. Moscow, *Choosing Between Michigan and Delaware Incorporation 2002*, MI Bus L J Spring 2002, at 21.
3. Moscow note 1 supra at 1947-8.
4. Statistics compiled from the Westlaw Business Law Center, June 2014.
5. Del Code 8-251(h).
6. "By the Numbers: Venture-Backed IPOs in 2013", The Harvard Law School Forum on Corporate Governance and Financial Regulation, Blog, April 16, 2014.
7. Moscow, note 1 supra, at 1918.
8. Del Code 10-3114(a). Delaware corporations also have other disadvantages, such as vigorous enforcement of the escheat law.
9. Michigan Dept. of Licensing and Regulatory Affiars, Corporations Division, 2012/2013, New Corporation and Limited Liability Company Monthly Totals. Delaware Div. of Corporations, 2013 Annual Report.
10. Del Code 18-215.
11. Del Code 18-1101(b).
12. MCL 450.4407.
13. MCL 450.4515.
14. MCL 450.1488.
15. Del Code 8-152.
16. See note 4 supra.
17. See "The Growth of Appraisal Litigation in Delaware", Harvard Law School Forum on Corporate Governance and Financial Regulation, Blog, December 5, 2013.
18. MCL 450.762(g)(2).
19. MCL 450.1771.
20. MCL 450.1761(e).
21. MCL 450.1762(1)(c).
22. See *Kahn v M&F Worldwide Corp*, 88 A3d 635 (Del 2013) and *Chen v Howard-Anderson*, 87 A3d 648 (Del Ch 2014).
23. MCL 450.1541a.
24. See Shulman et. al., *Michigan Corporation Law and Practice*, § 1.4.
25. 21. MCL 209(1)(c) and 564(a)(5) and Del Code 8-102(b)(7).
26. MCL 450.1562.
27. *Boilermakers Local 154 Ret Fund v Chevron Corp*, 73 A3d 934 (Del Ch 2013).
28. *ATP Tour, Inc v Deutscher Tennis Bund*, 91 A3d 554 (Del 2014).
29. Delaware State Senate, 147th General Assembly, Senate Joint Resolution No. 12.
30. MCL 450.1775 et seq.
31. MCL 450.1790 et seq.
32. Delaware General Corporation Law § 203(a)(2).
33. MCL 450.1342a.
34. Del. Code 141(b)
35. Del Code 8-251(g).
36. Del Code 8- subchapter XV.
37. MCL 450.2202a.

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Madugula v Taub: *The Supreme Court Clarifies Some Shareholder Oppression Questions*

By Frederick A. Berg, Jr. and Justin G. Klimko

On July 15, 2014, the Michigan Supreme Court unanimously held in *Madugula v Taub*[1] that shareholder claims for wrongful oppression brought under MCL 450.1489 are purely equitable in nature, triable only to the court without a jury, even when the relief sought is money damages. It further held that breach of a stockholders' agreement may be evidence of wrongful oppression, although it will not automatically establish a claim under the statute.

Plaintiff Madugula sued co-shareholder Taub following termination of Madugula's employment with defendant Dataspace, Inc., a closely held company. Madugula and Taub owned 36 percent and 64 percent, respectively, of Dataspace's outstanding stock. Madugula's complaint asserted several causes of action, all of which were dismissed prior to trial except his shareholder oppression claim under section 489.

The trial court permitted the jury to decide the oppression claim and to deliberate over all forms of relief sought by Madugula. The jury awarded damages and also required the defendants to repurchase Madugula's shares at a price determined by the jury. Taub appealed, claiming that it was error to permit the jury to require repurchase of the shares, since this remedy is equitable in nature. Taub also asserted that Madugula's complaint centered on Taub's failure to observe the supermajority voting provisions of a stockholders' agreement; Taub maintained that such a claim could not be the basis for a shareholder oppression claim, only a breach of contract claim. The court of appeals rejected Taub's arguments and upheld the trial court. Taub sought leave to appeal to the Supreme Court.

In granting leave to appeal, the supreme court framed the following questions: (1) whether claims brought under section 489 are equitable claims to be decided by a court of equity; (2) whether the provisions of a stockholders' agreement can create shareholder interests protected by section 489; and (3) whether Madugula's interests as a shareholder were interfered with disproportionately by the actions of Taub, where Madugula retained his corporate shares and his corporate directorship.[2]

In its *Madugula* opinion, the Supreme Court evaluated both the history of the shareholder oppression statute and the constitutional arguments regarding right to trial by jury, then it reversed and remanded to the trial court, holding that oppression claims brought under section 489 are equitable in nature, triable in a court of equity, and trial by jury was reversible error.

Although it acknowledged that damages are "generally considered legal relief awarded by a jury,"[3] the Supreme Court noted courts of equity also may award damages and found that, based on the history of section 489 and its predecessor, former section 825,[4] "we cannot conclude that the Legislature intended to provide a jury right for claims of shareholder oppression under § 489."[5] Prior to the 1989 amendments to the Business Corporation Act (BCA) that added section 489, shareholder oppression remedies were provided in section 825, which was part of the BCA chapter addressing dissolution. The Supreme Court stated that actions under section 825 clearly had been equitable. The 1989 amendments moved this section to the shareholder rights section of the BCA and added money damages to the nonexhaustive list of remedies for oppression. The Supreme Court held that moving the location of the oppression statute and adding money damages merely clarified that a money damages remedy was within the power of a court of equity to award and did not change the nature of the claim or give rise to a jury trial right.

The Supreme Court next evaluated whether, even in the absence of legislative intent, a right to trial by jury for an oppression claim was protected by the Michigan Constitution. This required the court to deter-

mine whether a section 489 claim "is similar in character to a claim that afforded the right to a jury trial at the time the 1963 Constitution was adopted."[6] The court cited an 1892 Michigan Supreme Court opinion holding that in cases of fraud or breach of trust, the "jurisdiction of a court of equity reaches such a case."[7] It then found oppression cases were analogous to shareholder derivative claims[8] and common law claims for dissolution,[9] which are both equitable in nature. Finally, it found that the flexibility of remedies required to address the complex nature of shareholder disputes made juries unsuitable to "devise specific remedies…deal with complicated interests, or with relief given in successive stages or adjusted to varying conditions," concluding that "courts of law are inadequate to protect the rights and interests of creditors and stockholders."[10] Thus, it held that an oppression claim was not of the type that would have given a right to a jury trial prior to adoption of the 1963 Constitution.

The Supreme Court also held that the form of relief sought by the plaintiff did not dictate the outcome, since the trial court "was free under the language of the statute to grant relief as it considered appropriate, or none at all…."[11] A court that can fashion a remedy "regardless of what the claimant seeks" is a court of equity. The availability of money damages under the statute does not "change the overall equitable nature" of a section 489 claim.[12]

Of significant interest to future section 489 claimants, the court also held that breach of a stockholders' agreement can be evidence supporting an oppression claim.[13] After noting that "willfully unfair and oppressive conduct" occurs under the statute when the alleged conduct substantially interferes with interests of the shareholder as a shareholder, it acknowledged that the courts have never specifically identified or enumerated those interests. A shareholder's relationship with the corporation is "'contractual in its nature,'" the court stated, and arises under the corporation's articles of incorporation as well its bylaws and the governing statutes.[14] One of those statutes, section 488 of the BCA[15] allows shareholders of closely held corporations to modify BCA default rules. In the instant case, the court determined that "the shareholders entered into a stockholders' agreement that modified the shareholders' statutory rights and interests as shareholders. Because these modified rights and interests are statutorily effective among shareholders and the corporation, evidence of a breach of these rights or interests may be evidence of shareholder oppression."[16] However, the court was careful to state that violation of one of those rights does not automatically establish oppression since, under section 489, oppressive conduct must be "a continuing course of conduct or a significant action or series of actions that substantially interferes with the interest of the shareholder as a shareholder."[17] The Supreme Court left it to the trial court on remand to determine whether and to what extent any breach would constitute evidence of oppression in this case.

Many future cases may include claims of breach of a stockholders' agreement or a buy/sell agreement alongside wrongful oppression claims, often arising from the same set of facts. Oppression claims under section 489 will be tried only to the bench, which will have the sole authority to fashion remedies, while breach of contract claims arising from the same circumstances may be tried to a jury where one is requested. Claimants will need to evaluate carefully their facts, their desired remedies, and the disposition of their trial judge when deciding what claims to bring to trial. Proving breach of contract will not necessarily be sufficient to establish oppression, although in appropriate situations it may help establish the predicate acts on which a finding of oppression is based.

Madugula's complaint asserted several causes of action, all of which were dismissed prior to trial except his shareholder oppression claim under section 489.

NOTES

1. 496 Mich 685, 853 NW2d 75 (2014).
2. *Madugula v Taub*, 494 Mich 862, 831 NW2d 235 (2013). The Michigan Supreme Court never reached the third question, determining that it need not address it in light of its decision to reverse the Michigan Court of Appeals' judgment and remand. *See* 496 Mich at 720 n 100.
3. 496 Mich at 703.
4. Former MCL 450.1825.
5. 496 Mich at 703-704.
6. Id at 705.
7. *Miner v Belle Isle Ice Co,* 93 Mich 97, 98-108, 114, 53 NW 218 (1892).
8. 496 Mich at 709 fn. 63.
9. *Id.* at fn. 65-68.
10. *Id.* at fn. 69-71.
11. Id. at 711.
12. The court reached this conclusion even though defendant Taub conceded in the Michigan Court of Appeals that there was a right to trial by jury for Madugula's claim for damages. Rather than treat the issue as abandoned, the Michigan Supreme Court found that "guid-

ance in this area is necessary because courts have struggled to determine whether a right to a jury trial exists under section 489" and therefore "'we cannot consent to be bound by any concession of counsel on so important a question.'" Id. at 716 fn. 86 (citation omitted).

13. Madugula did not assert a breach of contract claim for breach of the shareholder agreement, apparently to avoid an arbitration clause in that agreement. *See Madugula v Taub,* No 298425, 2012 Mich App LEXIS 2137 (Oct 25, 2012)(unpublished), slip op. at 4.

14. 496 Mich at 718.

15. MCL 450.1488.

16. 496 Mich at 719-720.

17. *Id.* at 720 fn. 99.

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Shareholder Oppression Update

By Bruce W. Haffey

Introduction

The owners of a closely held business may have complex relationships. They are typically active in the business, serving in multiple roles as executive management, full-time employees, and perhaps as lenders. There may be multiple business entities, and long-term personal and family relationships may interweave with business relationships. Issues may fester for years due to the lack of marketability of shares before blowing up into a dispute.

When things go wrong, aggrieved parties may allege breach of fiduciary duty and oppression on the basis of conduct such as the failure to share information, engaging in related party transactions, personal use of business assets, the usurpation of business opportunities, and similar conduct. Other claims are as varied as the facts and circumstances and may include breach of contract, breach of covenant not to compete, unjust enrichment, slander, defamation, and fraud.

Statutory Background

The Michigan Business Corporation Act[1] ("MBCA") and Michigan Limited Liability Company Act[2] (the "LLCA") each codifies the fiduciary duties owed by management to the company and establishes a cause of action for oppression by a shareholder or member against those in control. A number of cases have addressed the scope of these rights and duties, such as the meaning of oppression, whether these rights are derivative or direct causes of action, whether they are legal or equitable, statutes of limitations and available remedies, and the law continues to develop. The purpose of this article is to provide a brief overview of the applicable law and discuss several recent cases, focusing on the oppression statutes. Since the corporate and LLC statutes are essentially identical, some of the discussion in this article may reference one statute or the other but applies equally to both.

The current codification of the fiduciary duties of corporate officers and directors was added to the MBCA in 1989, and the fiduciary duties of LLC managers was included in the original LLCA in 1993. Both impose duties of loyalty, care, and good faith.[3]

Similarly, the cause of action for oppression was added to the MBCA in 1989 and was included in the original LLCA in 1993. As originally enacted, each statute established a cause of action by a shareholder or LLC member against the "directors or those in control,"[4] or against the "managers or members in control"[5] for conduct that is "illegal, fraudulent, or willfully unfair and oppressive" to the corporation or shareholder, or to the LLC or member.[6] As originally enacted, no definition of oppression was provided.

In 2001, each statute was amended to include a definition. Willfully unfair and oppressive conduct was defined to mean "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"[7] or "of the member as a member."[8] However, the statutes further provided that the term does not include conduct or actions that are permitted by an agreement, the articles of incorporation or bylaws of a corporation, or the articles of organization, operating agreement or other agreement of an LLC, or a consistently applied written policy or procedure.[9]

A number of states developed a doctrine of reasonable expectations, under which the frustration of the reasonable expectations of a shareholder or LLC member of a closely held business constituted oppression. Keeping in mind the multiple roles of owners of closely held businesses, reasonable expectations might include expectations of employment, lifetime employment or employment terminable only for cause, compensation commensurate with ownership, a seat on the board of directors, and participation in management.[10]

Franchino v Franchino

In the 2004 case of *Franchino v Franchino*,[11] the Michigan Court of Appeals rejected the reasonable expectations doctrine under Michigan law. In *Franchino*, a father and son worked together for over 25 years, and were the only shareholders and directors. The father owned 69 percent of the shares, and the son owned 31 percent. The son's employment could be terminated only by the unanimous vote of the board of directors. Ulti-

mately, the father removed the son from the board of directors and then caused the board of directors to terminate his employment after the son refused to agree to restructure their buy-sell arrangements to accommodate the father's estate planning objectives.

The son claimed oppression and argued that shareholders in close corporations have reasonable expectations of serving on the board of directors, participating in management, and of receiving their share of corporate profits or dividends through their salaries. The son noted that his and his father's salaries averaged approximately $500,000 per year, whereas dividends were only about $3,100 per year. The son argued that the termination of his employment, his removal from the board of directors, and the amendment of the corporate bylaws to change the composition of the board of directors, defeated his reasonable expectations as a shareholder and, therefore, constituted oppressive conduct that affected his interests as a shareholder within the meaning of the MBCA.

The court relied in part on the different language in the Michigan oppression statute compared to the wording of statutes of other states that had adopted the reasonable expectations test.

Notwithstanding the sympathetic facts, the Michigan Court of Appeals declined to adopt the reasonable expectations test and expressly rejected it. The court relied in part on the different language in the Michigan oppression statute compared to the wording of statutes of other states that had adopted the reasonable expectations test. For example, the court noted the New Jersey statute protected "minority shareholders in their capacities as shareholders, directors, officers, or employees," and the South Carolina statute protects a minority "in his capacity as a shareholder, director, or officer of the corporation."[12] In rejecting the reasonable expectations test, the court stated that the rights of a shareholder "are typically considered to include voting at shareholder's meetings, electing directors, adopting bylaws, amending charters, examining the corporate books, and receiving corporate dividends,"[13] but that rights as an employee or director were not shareholder interests subject to protection under the statute.

2006 Amendments

In response to the *Franchino* decision,[14] the Michigan legislature in 2006 amended the definition of oppression to include a reference to termination of employment. "Willfully unfair and oppressive conduct may include the termination of employment or limitations on employment benefits to the extent that the actions interfere with distributions or other shareholder interests disproportionately as to the affected shareholder."[15] A corresponding amendment was made to the LLCA.[16] This resulted in a definition of oppression that seems internally contradictory.

The first sentence of the statutory definition states that oppression is limited to conduct that substantially interferes with the interests of the shareholder as a shareholder, or the member as a member. The second sentence suggests, however, that termination of employment or limitations on employment benefits or compensation may somehow affect shareholder interests so as to constitute oppression. This suggests a statutory intent that shareholder interests are not limited to voting, electing directors, adopting bylaws, amending charters, examining books and records, and receiving dividends as stated in the *Franchino* decision, although the precise scope of shareholder interests remains unclear.

The third sentence of the statutory definition states that oppression does not include conduct or actions permitted by an agreement, the articles, bylaws, or a consistently applied policy or procedure. If a termination of employment is permitted by an employment agreement, the third sentence would preclude an oppression claim. If a termination breached an employment agreement there would be a breach of contract claim, and an oppression claim would be unnecessary. With this uncertain statutory definition, in recent cases, courts have sometimes struggled to apply the statutory definition to the facts of the cases.

Recent Caselaw Developments

In *Schimke v Liquid Dustlayer*,[17] decided under the pre-2006 amendments, the majority shareholder, Rademaker, proposed to cause the corporation to redeem his shares of stock at a price that was not offered to Schimke, the minority shareholder. Schimke commenced litigation claiming oppression, obtained a temporary restraining order prohibiting the proposed stock redemption by Rademaker, and ultimately prevailed in a bench trial, being awarded substantial damages in consideration for his minority shares.

Rademaker argued there was no oppression because the transaction was not consummated, and that the proposed stock redemption was a single act whereas oppression required a pattern of conduct or con-

tinuing course of conduct. He also argued that an award of damages was inappropriate because the defendant had suffered no damages since the proposed transaction was not consummated.

The Michigan Court of Appeals ruled that the statute clearly defined oppression as a "continuing course of conduct or a significant action or series of actions."[18] Thus, a significant single action could constitute oppression. Having determined that Rademaker's conduct constituted oppression, the court had no difficulty finding that the injunction and the award of damages were remedies within the scope of authority granted under section 489.

Interestingly, in approving the award of damages, the appeals court noted that although the injunction prevented the proposed stock redemption, Rademaker continued to cause the corporation to pay himself and another shareholder generous salaries while paying no dividends, thereby "receiving a benefit from their stock ownership, while plaintiff received nothing."[19] Notwithstanding its decision in *Franchino*, and prior to the 2006 statutory amendments, the court of appeals indicated a shareholder interest in compensation received from the corporation.

Also interesting is the lack of any discussion of the last sentence of the statutory definition of oppression, stating that conduct permitted by the articles of incorporation, bylaws or consistently applied corporate policies does not constitute oppression, since there is no indication in the case that the proposed redemption of Rademaker's shares violated any such organizational document.

In *Arevelo v Arevalo*,[20] a married couple (Raymond and Kelley), who each owned 50 percent of a business, continued to be business partners following their divorce. The divorce judgment authorized the maintenance of their prior salaries and positions, including Raymond's position as president. After a couple of years, the relationship deteriorated, and Raymond quit and went to work for a competing business.

Kelley claimed oppression by reason of, among other things, Raymond taking computers and other assets belonging to the business, inducing key employees to quit, inducing customers to quit, misappropriating customer lists and customer files, and charging personal expenses to the business. Incredibly, the court ruled that such conduct did not affect Kelley's rights as a shareholder. "She does not explain how Raymond's alleged act of '[i]nducing key employees to leave their employment' or his alleged act of 'charging personal expenses to the business' affected her rights to vote at shareholder meetings, to elect directors, to adopt bylaws, to amend charters, to examine corporate books, or to receive corporate dividends."[21] While the alleged conduct did not affect her voting rights, if true, they certainly would have affected the value of the business, and therefore Kelley's shareholder interest in the value of her company and the amount of dividends or distributions she might receive.

Interestingly, there was no discussion of the control element of the oppression statute. Since Raymond and Kelley owned the company 50 percent each, it might have been argued that there was no oppression since Raymond was not in control.

The *Berger v Katz*[22] case involved a plaintiff who owned one-third, and two defendants who owned the remaining two-thirds, of a business that distributed cleaning products and a related real estate holding company that leased the premises to the operating company.

Berger moved out of state and withdrew from day-to-day operations. Shortly afterward, the defendants ceased distributions to Berger and stopped consulting with him on decisions. Berger complained and the parties entered into an interim agreement to pay monthly distributions as an advance against profits, and monthly payments of rental income, subject to year-end reconciliation. Defendants eventually ceased payments under the interim agreement as well, claiming a decline in the profitability of the business, while at the same time increasing the amounts paid to defendants as compensation. Notably, the action was taken in compliance with the corporation's bylaws.

The Michigan Court of Appeals upheld the trial court finding of oppression by reason of ceasing the rental payments and profit distributions to the plaintiff while increasing the defendants' compensation and making a capital call when it was questionable whether the company needed the money. The court ruled that the statutory language to the effect that oppression does not include conduct permitted by the articles of incorporation, bylaws, or an agreement "cannot be read as permitting willfully unfair and oppressive conduct under the guise of defendants' general authority to run and manage" the busi-

The Michigan Court of Appeals ruled that the statute clearly defined oppression as a "continuing course of conduct or a significant action or series of actions."

ness.[23] The court also held that the "[p]laintiff was receiving [compensation] as a result of his status as a shareholder in this closely-held corporation, as well as the work he performed on the corporation's behalf," and that therefore such amounts were recoverable as shareholder interests protected under the 2006 amendment to the statutory definition of oppression.[24]

In *Wolding v Clark*,[25] two shareholders founded and operated several related businesses in the high risk insurance business. Wolding desired to retire, and the parties agreed on a plan under which Clark would receive the salary previously paid to Wolding, while Wolding would continue to own 50 percent of the stock of the company, serve on the board of directors, and share equally in dividends and distributions. Clark subsequently reduced dividend payments, which was due allegedly to a decline in the business and to the need for funds to open a couple new stores. Wolding tried to return to work and reassume his position as an officer, but he was denied by Clark.

Wolding claimed oppression by reason of the reduction in dividend payments and the denial of his request to return to work. The court ruled against him, relying in part on the parties' agreement at the time of Wolding's retirement. The court ruled there is no right of employment, and there was business justification for the reduction in dividend payments.

In *Madugula v Taub*,[26] a case recently decided by the Michigan Supreme Court, Madugula began to work and eventually became a minority shareholder of a business founded by Taub. The shareholder agreement between them required a supermajority vote for certain action, effectively requiring Madugula's consent, including a material change in the nature of the business or the compensation of the shareholders.

When the business struggled, Taub decided to change the focus of the business without complying with the supermajority voting requirement. Later, Taub terminated Madugula, again without complying with the supermajority voting requirement. Madugula sued for oppression and in a jury trial was awarded damages of $191,675. In addition Taub was ordered to purchase Madugula's shares for $1.2 million.

Taub appealed to the Michigan Court of Appeals and then to the Michigan Supreme Court. One of the issues on appeal was whether contractual rights established under a shareholder agreement may give rise to shareholder interests protected by the oppression statute. The Michigan Supreme Court held that the MBCA authorizes voting agreements and shareholder agreements to establish rights and relationships between shareholders and a corporation, and that rights under such agreements may constitute shareholder interests subject to protection under the oppression statute.

Conclusion

Although the reasonable expectations doctrine has been rejected in Michigan, the uncertain statutory definition of oppression has left the scope of protected shareholder or member interests uncertain. The statute and some cases suggest that shareholder or member interests may include employment or may be affected by termination of employment, whereas other cases have held that employment is not a protected interest. This lack of clarity results in uncertainty as to the scope of protected interests, and therefore how to protect the interests and expectations of clients engaged in a closely held business.

Although the reasonable expectations doctrine has been rejected in Michigan, the uncertain statutory definition of oppression has left the scope of protected shareholder or member interests uncertain.

NOTES

1. MCL 450.1101 et seq.
2. MCL 450.4101 et seq.
3. MCL 450.1541a(1); MCL 450.4404(1).
4. MCL 450.1489.
5. MCL 450.4515.
6. MCL 450.1489(1); MCL 450.4515(1).
7. MCL 450.1489(3).
8. MCL 450.4515(3).
9. MCL 450.1489(3); MCL 450.4515(3).
10. See, e.g., *Pointer v Castellani,* 455 Mass 537 (2009); *In re Kemp & Beatley, Inc,* 64 NY2d 63 (1984); *Meiselman v Meiselman*, 309 NC 279 (1983).
11. *Franchino v Franchino*, 263 Mich App 172, 687 NW2d 620 (2004).
12. *Id.* at 185.
13. *Id.* at 184.
14. Michigan Department of Labor & Economic Growth Bill Analysis of Enrolled House Bill 5323 (Mar 3, 2006).
15. MCL 450.1489(3).
16. MCL 450.4515(3).
17. *Schimke v Liquid Dustlayer*, No 282421, 2009 Mich App LEXIS 1954 (Sept 24, 2009)(unpublished).
18. *Id* at 6.
19. *Id* at 15.
20. *Arevelo v Arevalo*, Nos 285548, 286742, 2010 Mich App LEXIS 597 (Apr 6, 2010)(unpublished).
21. *Id* at 6.
22. *Berger v Katz*, Nos 291663, 293880, 2011 Mich App LEXIS 1408 (July 28, 2011)(unpublished).

23. *Id* at 13.

24. *Id* at 14-15.

25. *Wolding v Clark*, No 10-10644, 2012 US Dist LEXIS 89924 (ED Mich June 28, 2012).

26. *Madugula v Taub*, 496 Mich 685, 853 NW2d 75 (2014).

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Crowdpleasers? A Comparison of Three New Methods of Securities Crowdfunding for Small Businesses in Michigan

By Mark A. Metz, D. Richard McDonald, and Shang Kong[1]

Introduction

Small businesses seeking to raise equity capital have traditionally been constrained by the investor protections imposed by the Securities Act of 1933 (the "Securities Act") and the related regulations implemented by the Securities and Exchange Commission ("SEC"). Private securities offerings, exempt from the SEC's registration requirements, have typically been the primary source of startup and early stage capital for small businesses. Access to capital in traditional private offerings, however, is limited by a restriction prohibiting the use of general, widespread solicitation of potential investors. SEC interpretations of this restriction limit the investors to whom securities may be offered and sold in a private offering to those who have a preexisting relationship with the issuer or with a broker or placement agent hired to assist with an offering. The result has been that small businesses are faced with either offering to a limited supply of funding sources, which may increase the cost of funding and reduce the capital available, or paying substantial commissions to a placement agent with a longer contact list as a means of expanding the base of potential investors.

In reaction to the Great Recession of 2007–2009 and the slow economic recovery that followed, Congress passed the Jumpstart Our Business Startups Act[2] (the "JOBS Act") in 2012, which made several changes to the Securities Act to expand the options for funding small businesses. The JOBS Act directed the SEC to issue rules that would, among other things, create an exemption for crowdfunding[3] and an exemption eliminating the ban on general solicitation and advertising in the sale of securities in unregistered private offerings sold only to "accredited investors"[4] (the "Rule 506(c) exemption"). Meanwhile, at the state level, legislators in Michigan passed the Michigan Invests Locally Exemption ("MILE") Act[5] in December 2013, which allows Michigan small businesses to seek and obtain capital from investors within Michigan using crowdfunding techniques.[6] As a result of these three new exemptions,[7] Michigan small businesses are now able to market their securities offerings to a larger "crowd" of investors, increasing their chances of raising the capital they need at an acceptable price.

The term "crowdfunding" is used to describe a variety of broad-based fundraising activities through the Internet or other widely disseminated means directly to a large number of potential investors. Most crowdfunding occurring today, including the crowdfunding popularized by funding portals like Kickstarter and Indiegogo, occurs on a "reward" basis. The funding need is publicized on the funding portal and the entrepreneur solicits either straight donations or contributions in return for the product or service offered by the business. This activity typically does not involve selling an ownership stake or a debt security and therefore does not implicate federal or state securities laws. Many small businesses have had success raising limited amounts of startup capital through this type of crowdfunding.

The success of reward-based crowdfunding has raised the question of whether there are circumstances in which widely solicited securities offerings could or should occur without SEC registration, full Securities Exchange Act of 1934 ("Exchange Act") reporting obligations, and the accompanying costs and burdens. With the adoption of the MILE exemption and the Rule 506(c) exemption, as well as the coming federal crowdfunding rules, small businesses now have more exemptions available that permit broad marketing of securities using the Internet and other technology-based means without full SEC registration and reporting obligations.[8] The usefulness of these exemptions, however, varies. The policy choice to make investments in start-ups and other smaller and riskier businesses more available to less affluent and knowledgeable investors who may not be familiar with the issuer or its management carries with it the need for increased protection from potential fraud or investments that

are likely to be highly speculative and risky. As a result, the new exemptions come with various conditions intended to provide additional protection for investors that may, unfortunately, impose limitations and obligations that will be viewed by small businesses as too burdensome to justify use of the new exemptions in lieu of the traditional private offering exemption under Rule 506(b) of Regulation D.

This article briefly reviews the requirements of each of these exemptions and then examines their practical usefulness in comparison with each other. Although the MILE exemption and federal crowdfunding exemption are worthy attempts to expand the capital raising options for small businesses and allow them to take advantage of modern technology to market the investment through the Internet and social media, they impose a number of conditions and obligations on small businesses in the name of investor protection that reduce their usability and are likely to decrease their use in comparison to the Rule 506(c) exemption, which offers much more flexibility and has far fewer conditions.

The Requirements

The primary conditions and characteristics of the three exemptions are compared in the following chart.[9]

	MILE Act	Federal Crowdfunding (Proposed)	Rule 506(c) of Regulation D
Limit on the Amount Raised	$2 million per 12 months with audited or reviewed financial statements; $1 million per 12 months without audited or reviewed financial statements	$1 million per 12 months with audited financial statements; $500,000 with reviewed financial statements; $100,000 if neither audited nor reviewed financial statements are provided	None
Limit on the Number of Investors	None	None	None
Investor Status	Michigan resident	None	Accredited
Issuer Status	Private Michigan entity; cannot be an investment company or Exchange Act reporting company	Private US entity	Any company
Investment Limitation	Investment limit of $10K per non-accredited investor; no limit on investment by an accredited investor	If investor's income/net worth is below $100K, investment limit is the greater of $2,000 or 5% of annual income/net worth; if above $100K, 10% of income/net worth up to $100K.	None
Information Requirement	Disclosure Statement with specific requirements filed with LARA 10 days before offering (including audited financials if proceeds exceed $1 million)	Offering Circular with specific requirements (including audited financials if greater than $500K); Form C filed with SEC before commencement of offering and 21 days before first sale and provided to intermediary and investors; periodic updates required	Form D notice of offering filed with SEC after first sale. Some disclosure to investors may be necessary to address market or liability concerns
Blue Sky Compliance Required?	Yes, filing with LARA as described above	No, federal preemption under JOBS ACT	No, federal preemption
Ongoing Reporting Requirement?	Yes, quarterly report to buyers including disclosure of D&O compensation, discussion of business operations and financial condition of issuer	Yes, file Form C-AR annual report with SEC, including financials meeting requirements in last offering circular	No
Resale Restrictions	Cannot resell within 9 months after initial purchase to non-Michigan resident	Yes, limited during first year	Yes, 1 year for resales by non-affiliates, indefinite for affiliates
Solicitation Restrictions	General solicitation and advertising permitted but only to residents of Michigan. If offered through a website, filings required with LARA and website must meet ongoing conditions	No advertising the terms of the offering but may advertise the offering itself and direct investors to the intermediary	General solicitation and advertising permitted if issuer reasonably verifies each purchaser is AI and reasonably believes each purchaser is AI
Intermediary Required	No	Yes, offering must be conducted through one intermediary	No

The term "crowdfunding" is used to describe a variety of broad-based fundraising activities through the Internet or other widely disseminated means directly to a large number of potential investors.

Michigan Invests Locally Exemption Act (MILE)

In addition to complying with the requirements of the MILE exemption summarized above, all offerings under the MILE exemption must also satisfy the federal intrastate exemption requirements under Section 3(c)(11) of the Securities Act and SEC Rule 147.[10] This means, among other things, that the issuer must be incorporated or organized under Michigan law and that *all offerees* and *purchasers* must be residents of Michigan.[11] Residency may be established for purposes of the MILE exemption by examining any state-issued identification, such as a driver's license or voter registration card.[12]

Under the MILE exemption, the issuer cannot accept more than $10,000 from any purchaser who is not an "accredited investor."[13] In determining whether an investor is accredited or not, the issuer may rely on confirmation from a licensed broker-dealer or another third party.[14] In total, an issuer may raise up to $1 million in any 12-month period without having to provide audited or reviewed financial statements to the Michigan Department of Licensing and Regulatory Affairs ("LARA") or prospective purchasers. The limit increases to $2 million in any 12-month period if the issuer provides LARA and each prospective purchaser with audited or reviewed financial statements for its most recent fiscal year. Sales to controlling persons are excluded for purposes of the aggregate offering limits.

An issuer relying on the MILE exemption has several filing and disclosure obligations. First, it must file notice of the offering with LARA (with a $100 filing fee) at least ten days before commencing the offering. The notice must include: 1) a claim that the offering will be made under the MILE exemption; 2) a copy of the disclosure statement that the issuer will provide to prospective investors; and 3) an escrow agreement with a bank or other depository institution located in Michigan where investor funds will be deposited.[15] Second, once the offering commences, the issuer must furnish each prospective purchaser with a disclosure statement that must include, among other information, a description of the issuer, the identity of its directors and officers and owners with more than ten percent interest, the terms and conditions of the offering, and the identity of individuals and entities assisting the issuer in conducting the offering and sale of the securities.[16] Third, the issuer must inform each prospective purchaser that the securities offered are not registered under federal or state securities laws, are subject to limitations on transfer or resale, and include legends to that effect in the disclosure statement.[17] Fourth, the issuer must satisfy certain other conditions such as obtaining a certification from each purchaser as to specified matters, directing all purchases into an escrow account until the minimum target amount is received, refraining from paying insiders for offering or selling securities in the offering, and limiting the length of the offering to 12 months after the first offer. Finally, the issuer must provide to LARA and the purchasers a quarterly report with disclosures relating to management compensation and the issuer's business operations and financial condition as long as any of the securities issued under the MILE exemption are outstanding.[18]

The MILE Act contains no restriction on the issuer's ability to generally solicit or on the means of advertising and solicitation.[19] Thus, the issuer may advertise the offering in person, through the Internet, or through any other suitable means. However, because all offers and sales must be made solely within the state of Michigan to comply with the applicable federal intrastate exemption and the conditions of the MILE exemption, there are practical limitations on the use of media and the Internet that reach outside the boundaries of the state. Recent SEC staff interpretations make clear that any website that is used would need to be structured to limit access to information about the specific investment opportunity to those investors who affirmatively represent that they are Michigan residents.[20] Moreover, the conditions of the MILE exemption require an issuer that desires to make offers and sales of securities through an Internet website, and the operator of the website, to comply with certain filing and disclosure requirements.[21] For example, the website operator must file a written notice with LARA that includes the operator's name, business address, and contact information and states that it has the proper authority to conduct business in Michigan and is being utilized to offer and sell securities under the MILE exemption.

Recent SEC staff interpretations make clear that any website that is used would need to be structured to limit access to information about the specific investment opportunity to those investors who affirmatively represent that they are Michigan residents.

Federal Crowdfunding

At the federal level, Title III of the JOBS Act, which added Section 4(a)(6) of the Securities Act,[22] directs the SEC to adopt rules that

would exempt interstate crowdfunding from the registration requirements of Section 5 of the Securities Act. The exemption under Title III is not self-effectuating and requires the adoption of rules by the SEC before it may be used. In October 2013, the SEC released proposed rules that would implement interstate crowdfunding when adopted.[23] However, as of mid-November 2014, the SEC has not yet adopted the proposed rules and, therefore, use of the federal crowdfunding exemption is not yet permissible.

Under the proposed rules, a U.S. issuer can raise up to $1 million during the 12-month period preceding the date of the transaction.[24] The total amount sold to any investor by an issuer relying on the exemption during the 12-month period preceding the date of such transaction cannot exceed:

a) the greater of $2,000 or 5% of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; and

b) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000.[25]

The issuer will be required to file an offering document on Form C with the SEC and provide the offering document to offerees and the intermediary who has been chosen to facilitate the offering. The disclosures required by Form C include a description of the financial condition of the issuer, disclosure regarding the issuer's officers, directors and substantial shareholders, a summary of the issuer's business plan and other detailed information regarding the issuer.[26] In addition, depending on the size of the offering, issuers must provide reviewed or audited financial statements to investors and the intermediary.[27] The proposed rules would also require the issuer to provide information about the target offering amount, offering termination date, use of proceeds, the nature of the securities being offered,[28] and the process to cancel an investment commitment or complete the transaction once the target amount is satisfied.[29] The issuer has an ongoing obligation to amend the offering document to reflect any material changes.

In addition, the issuer will be required to file with the SEC an annual report on Form C-AR after the completion of the offering within 120 days after the end of each fiscal year. Form C-AR will require much the same issuer information as provided on the Form C offering document along with financial information updated through the end of the most recent fiscal year.[30] This reporting obligation continues until: a) the issuer becomes subject to regular reporting obligations under the Exchange Act, b) all securities sold in the offering have been repurchased or are otherwise no longer outstanding, or c) the issuer winds down its operations. When eligible to discontinue reports, the issuer will need to make a short notice filing with the SEC to be relieved of the reporting obligation.[31]

All federal crowdfunding offers and sales must be transacted through an intermediary that has registered with the SEC as a broker-dealer or as a "funding portal," a new type of SEC-registered intermediary. Under the proposed rules, the intermediary must take a number steps to protect investors, including providing issuer and risk-related disclosures to prospective investors, ensuring that each investor takes certain actions, causing background checks to be run on each officer, director and 20 percent shareholder of the issuer, policing investing limits, and policing the release or refund of proceeds. The issuer is also restricted from compensating any intermediary to promote the offering.[32]

The issuer will not be permitted to advertise the terms of the offering itself, but may provide notice of the offering through advertising or other means of general solicitation that directs potential investors to the intermediary. The notice may include no more than a statement that the issuer is conducting an offering, the name of the intermediary, a link to the intermediary platform, the terms of the offering and specified information regarding the issuer.[33]

Under the proposed rules, a U.S. issuer can raise up to $1 million during the 12-month period preceding the date of the transaction.

Rule 506(c) of Regulation D – Crowdfunding to Accredited Investors

The most commonly used exemption from registration is the traditional private offering exemption under Rule 506(b) of Regulation D,[34] primarily because it has few requirements and no limits on the size of the offering or the number of accredited investors to whom securities may be offered or sold.[35] A condition to the Rule 506(b) exemption, however, prohibits the use of general solicitation and advertising to market the offering. As interpreted by the SEC, this restriction means

that issuers may sell only to investors with whom they, or the placement agent or broker retained to assist with the offering, have a preexisting relationship.

In September 2013, pursuant to the JOBS Act directive, the SEC implemented the Rule 506(c) exemption under Regulation D, which has no restriction on general solicitation and advertising. Unlike offerings under Rule 506(b), issuers in a Rule 506(c) offering are permitted to solicit all potential investors through the Internet, advertising, investor conferences, and any other lawful means, regardless of whether a preexisting relationship exists. Although not called crowdfunding in the JOBS Act, new Rule 506(c) is, in essence, a form of crowdfunding in which the only intended investors are accredited investors. In order to comply with the new exemption, the issuer must reasonably believe that all purchasers of the securities are accredited investors as defined by SEC rules and take "reasonable steps" to verify that each purchaser in the offering qualifies as an accredited investor.

There are, however, several practical limitations with the MILE and federal crowdfunding exemptions that make the Rule 506(c) exemption a much more practical crowdfunding alternative in many cases.

While Rule 506(c) does not state specifically what steps are considered "reasonable" to satisfy the verification requirements, the rule provides four non-exclusive methods of verifying the accreditation status of purchasers who are individuals: 1) review the purchaser's federal tax forms; 2) review the purchaser's financial documents dated within the last three months that include the purchaser's assets and liabilities; 3) rely on confirmation from a specified third party, such as a registered broker-dealer or investment adviser, who has satisfied the verification requirement within the last three months; 4) certify that the purchaser has had a preexisting investment relationship with the issuer as an accredited investor prior to the effective date of Rule 506(c). The question of whether an issuer has taken sufficiently reasonable steps will otherwise be assessed on a case-by-case basis. Issuers should take a flexible, principles-based approach that considers factors such as the nature of the purchaser, the nature of the solicitation, the terms of the offering, and the type of purchaser information obtained.[36]

Comparison of Crowdfunding Alternatives

Each fundraising method discussed above has unique strengths and shortcomings. There are, however, several practical limitations with the MILE and federal crowdfunding exemptions that make the Rule 506(c) exemption a much more practical crowdfunding alternative in many cases.

First, there is no limit on the amount an individual investor can invest under Rule 506(c). In federal crowdfunding and MILE offerings, there are fairly low limits on the amount an investor may invest in an offering. As a result, an issuer seeking to raise even a moderate amount of equity capital will need to sell to a large number of investors, leaving the issuer with a large number of shareholders post-offering. Many of these shareholders may be unsophisticated and, in any event, would present a significant challenge for management of a small business with little or no investor relations experience. Having a large number of equity investors may also raise logistical problems for future rounds of financing requiring shareholder agreements or other adjustments to the rights of shareholders. In addition, selling securities to a large group of unsophisticated investors is also likely to increase the risk of securities litigation if the business venture is unsuccessful. Conversely, the absence of a cap on the amount an investor may purchase in an offering exempt under Rule 506(c) gives the issuer the ability to limit the number of shareholders it will have post-offering while still satisfying its funding goal, each of which shareholders will be "accredited."

Second, there is no limit to the amount that an issuer can raise using the Rule 506(c) exemption. Federal crowdfunding offerings, once allowed, will be limited to $1 million in any twelve-month period, and offerings under the MILE exemption are limited to $2 million.[37] These limits are even lower if the issuer is unwilling to provide audited or reviewed financial statements. A cap on offering proceeds may be irrelevant to early stage businesses seeking to raise very small amounts of startup capital, but it makes use of the MILE exemption and the federal crowdfunding exemption impractical for companies with more substantial capital needs.

Third, while the federal crowdfunding and MILE exemptions mandate extensive filings and offering document disclosure in connection with the offering and include post-offering reporting requirements, Rule 506(c) imposes no specific disclosure requirement in connection with the offering and no post-offering reporting requirement. The

preparation of offering memoranda, filing notices, financial statements and periodic reports can impose significant financial costs on a small business, levy a huge burden on what is likely to be no more than a skeleton accounting staff, and create additional liability risk for noncompliance or material misstatements or omissions. The ongoing reporting obligations continue until none of the securities issued in the offering remain outstanding or, in the case of the federal crowdfunding exemption, until the issuer is required to file reports under the Exchange Act. In comparison, the Rule 506(c) exemption provides flexibility for the issuer and its counsel to tailor the extent of disclosure to the level they deem appropriate in light of the sophistication of the investors (all of whom must be accredited and are presumed to be sophisticated), their familiarity with the business, the level of due diligence undertaken by investors, investor expectations and requirements, concerns about potential litigation, the level of perceived risk, the issuer's resources, and other factors they deem relevant. Perhaps more importantly, Rule 506(c) imposes no ongoing reporting requirements other than filing with the SEC a report on Form D regarding the results of the offering. Issuers and investors are free to determine what, if any, post-offering disclosure will be required unless the issuer is a reporting company under the Exchange Act or triggers the requirements for becoming a reporting company following the offering.[38]

Fourth, unlike the federal crowdfunding and MILE exemptions, Rule 506(c) has no minimum time requirements, allowing offerings under Rule 506(c) to be accomplished without waiting on minimum notice or filing periods to be satisfied before closing the transaction. The MILE exemption requires that the offering notice and disclosure document be filed with LARA at least ten days before the offering begins, and the federal crowdfunding exemption would require the offering document to be filed before the offering begins and at least 21 days before the first sale. Although some delay between commencement and closing may be inevitable, any delay increases the risk that the closing will be postponed or the offering cancelled.

Fifth, while there are legal and other transactional costs associated with offerings conducted under any of the three exemptions, the costs are likely to be less using the Rule 506(c) exemption. Although the verification of accredited investor status under Rule 506(c) would likely involve some cost to the issuer, the lack of other significant conditions to the exemption would likely result in lower offering costs compared to offerings conducted under the federal crowdfunding exemption and the MILE exemption. Moreover, an issuer has the freedom to determine not to sell to an investor whose accredited investor status would require undue effort or expense to verify.

Conversely, issuers seeking to raise capital under the federal crowdfunding exemption are required to use an intermediary such as a registered broker-dealer or funding portal to facilitate the offering. Given the significant compliance responsibilities of the intermediary, the fee charged to the issuer may be substantial. Issuers seeking to raise capital under the MILE exemption must verify that investors to whom securities are sold are residents of Michigan and that the limits on individual investments are not exceeded. Moreover, in light of the recent SEC interpretations of the intrastate exemption, an issuer seeking to use the Internet under the MILE exemption will likely have to use a third-party website, possibly resulting in a usage fee. Both the federal crowdfunding exemption and the MILE exemption mandate the preparation of disclosure documents for the offering, ongoing reporting obligations and, depending on the size of the offering, audited or reviewed financial statements, all of which requires issuers to shoulder a significant additional cost that may not have to be borne by privately held issuers who use the Rule 506(c) exemption.

Finally, there are limitations under the federal crowdfunding exemption and the MILE exemption on the ability to advertise the offering that are not present in an offering conducted under Rule 506(c). In an offering conducted under the federal crowdfunding exemption, advertising the terms of the offering is prohibited. Instead, issuers are permitted only to publish a notice of the offering and direct potential investors to the intermediary hired to conduct the offering (who will, in turn, make the required offering memorandum available). In an offering under the MILE exemption, because of the need to comply with the federal intrastate exemption, offers may not be made other than to residents of Michigan, severely limiting the types of solicitation that may be used in the offering. Postings on the Inter-

Finally, there are limitations under the federal crowdfunding exemption and the MILE exemption on the ability to advertise the offering that are not present in an offering conducted under Rule 506(c).

net, media advertisements, and the like that are distributed or accessible outside the state of Michigan would disqualify the offering from compliance with the federal intrastate exemption except in narrow circumstances.[39] Rule 506(c) imposes no such limitations. Offers and sales in a Rule 506(c) offering may be made through any legal means to residents of any jurisdiction.

Conclusion

While the new crowdfunding exemptions are laudable attempts to make it easier and cheaper for small businesses to raise capital, the federal crowdfunding exemption and the MILE exemption impose complex limitations and compliance obligations that may offset the benefits intended to be provided and make reliance on such exemptions difficult to justify in light of other available exemptions, such as the new Rule 506(c) exemption and traditional private offering exemption under Rule 506(b). Even the Rule 506(c) exemption is not without its concerns. Issuers and practitioners are wary of using the exemption until regulatory guidance and market practice with respect to what measures constitute reasonable means to verify accredit investor status become more established. For this reason, some in the industry assume that an offering done in reliance on Rule 506(c) used that exemption only because it could not be done using traditional private placement means and therefore view such offerings with distrust.[40] Only time will tell whether Rule 506(c) offerings become more widely accepted and whether changes will be made to ease the restrictions of the MILE exemption and the federal crowdfunding exemption to make their use more practical than the Rule 506(c) exemption or a traditional private offering exemption under Rule 506(b).

NOTES

1. Messrs. Metz and McDonald are members of Dykema Gossett PLLC and Mr. Kong is an associate with the firm. The views expressed in this article are those of the authors and do not necessarily represent the views of Dykema Gossett PLLC.

2. Pub L 112–106, 126 Stat 306 (2012).

3. Title III of the JOBS Act.

4. Title II of the JOBS Act. "Accredited Investor" as defined in Rule 501 of Regulation D, 17 CFR §230.501, includes individuals with a net worth, excluding their residence, of $1 million, income of $200,000 a year (or $300,000 for married couples), officers and directors of the issuer, and certain entities that have more than $5 million in assets.

5. MCL 451.2202a.

6. Only a handful of states currently have a similar exemption.

7. The SEC proposed federal crowdfunding rules pursuant to Title III of the JOBS Act in October 2013 but the federal crowdfunding exemption will not be available until final rules have been adopted.

8. Other capital raising alternatives for small businesses that permit widespread solicitation may be available but tend to be used infrequently. Regulation A under the Securities Act permits widespread solicitation but requires the filing of an offering circular with the SEC and applicable state regulators and imposes other requirements that cause this exemption to be impractical and rarely used. U. S. Government Accountability Office. (July 2012). *Factors that May Affect Trends in Regulation A Offerings*. (Publication No. GAO-12-839). http://www.gao.gov/assets/600/592113.pdf. The SEC's intrastate exemption imposes no limitation on widespread solicitation, but such offerings must comply with a number of conditions designed to ensure the offering is completely contained within state lines and must also comply with state securities exemptions, many of which impose a limitation on general solicitation and advertising.

9. The chart assumes that the federal crowdfunding rules will be adopted in their proposed form, which largely follow the statutory guidelines in the JOBS Act. While the final rules are constrained by the statutory guidelines, the SEC is considering various changes in light of public comments that could modify the requirements as shown in the chart.

10. MCL 451.2202a (1)(b); Securities Act of 1933 § 3(a)(11), 15 USC 77c(a)(11);17 CFR 230.147.

11. MCL 451.2202a(1)(a)-(b). There are various other conditions to the federal intrastate exemption under Securities Act Rule 147, but a discussion of those conditions is beyond the scope of this article.

12. MCL 451.2202a (1)(b).

13. Under the MILE exemption, accredited investor has the same meaning as in Rule 501 of Regulation D. See note 3, *supra*.

14. MCL 451.2202a(1)(d).

15. MCL 451.2202a(1)(e).

16. MCL 451.2202a(1)(e)(ii)(A)-(G).

17. MCL 451.2202a(1)(g).

18. MCL 451.2202a(3).

19. *See* SEC Division of Corporation Finance Securities Act Rules Compliance and Disclosure Interpretation 141.03, confirming that general solicitation does not violate the federal intrastate exemption.

20. *See* SEC Division of Corporation Finance Securities Act Rules Compliance and Disclosure Interpretations 141.04 and 141.05, indicating that use of an Internet site in connection with an offering conducted under the MILE exemption would not be prohibited but the issuer will need to include disclaimers and restrictive legends and take other access restriction measures to ensure that offers of the securities are made only to residents of Michigan. The guidance also makes clear that use of the issuer's own website would typically not satisfy the exemption's restriction on making offers outside the state.

21. *See* MCL 451.2202a(1)(i).

22. 15 USC 77d(a)(6).

23. Crowdfunding, SEC Release No. 33-9470 (October 23, 2014) ("Crowdfunding Release"). According to recent Congressional testimony by Keith Higgins, the Director of the SEC's Division of Corporation Finance, the SEC has received more than 300 comment letters on the proposed rules. Higgins, Keith. Statement to the House, Committee on Financial Services Subcommittee on Capital Markets

and Government Sponsored Enterprises. *Oversight of the SEC's Division of Corporation Finance*, Hearing, July 24, 2014. Available at: https://library.uvm.edu/guides/citation/CitingGovernmentInfo.pdf; Accessed: 08/06/2014.

24. 15 USC 77d(a)(6)(A) and Crowdfunding Release, proposed rule 100. The $1 million limit applies only if audited financial statements are provided. The limit is $500,000 during such period if financial statements reviewed by an independent accountant are provided and the limit is $100,000 if neither audited nor reviewed financial statements are provided.

25. 15 USC 77d (a)(6)(B) and Crowdfunding Release, proposed rule 100.

26. 15 USC 77d-1(b)(1) and Crowdfunding Release, proposed rule 201. https://www.sec.gov/rules/proposed/2013/33-9470.pdf.

27. 15 USC 77d-1(b)(1)(D) and Crowdfunding Release, proposed rule 201. *See* note 22, *supra.*

28. For example, rights and transfer restrictions. Except for certain narrow exceptions, securities issued under Section 4(a)(6) cannot be transferred for one-year following purchase. 15 USC 77d-1(e).

29. Crowdfunding Release, proposed rule 201.

30. Crowdfunding Release, proposed rule 202.

31. 15 USC 77d-1(b)(4); Crowdfunding Release, proposed rule 202.

32. 15 USC 77d-1(b)(3); Crowdfunding Release, proposed rule 205.

33. 15 USC 77d-1(b)(2); Crowdfunding Release, proposed rule 204.

34. U. S. Government Accountability Office. (July 2012). *Factors that May Affect Trends in Regulation A Offerings*. (Publication No. GAO-12-839). http://www.gao.gov/assets/600/592113.pdf

35. Under Rule 506(b), securities may also be offered and sold to up to 35 non-accredited investors who meet certain sophistication requirements if the issuer satisfies certain disclosure requirements.

36. Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, SEC Release No. 33-9415 (July 10, 2013), at 27.

37. *See* note 22, *supra.*

38. Issuers that have more than $10 million in total assets and either 2,000 shareholders of record or more than 499 non-accredited shareholders of record are required to become subject to Exchange Act reporting obligations pursuant to Rule 12g-1. In addition, issuers with securities that are listed on national securities exchanges must register the securities under Section 12(b) of the Exchange Act and are, therefore, subject to Exchange Act reporting obligations under Section 13(a) of the Exchange Act. Issuers that are subject to such Exchange Act reporting obligations are not eligible to use the MILE exemption or the federal crowdfunding exemption.

39. *See* note 19, *supra.*

40. *See, e.g.,* Verrill, David. "SEC Rules Will Clip the Wings of Angel Investors." *The Wall Street Journal* July 24, 2013; Weinmann, Karlee. "5 Reasons Funds Won't Touch JOBS Act Marketing Rules." *Law360* April 10, 2014. http://www.law360.com/articles/526895/5-reasons-funds-won-t-touch-jobs-act-marketing-rules.

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What Do You Know About Business Identity Theft?

By Julia Dale and Alexis Chadderdon*

Introduction and Background

For the year 2012, the U.S. Department of Justice reported that an estimated "16.6 million persons, or 7% of all U.S. residents age 16 or older, were victims of one or more incidents of identity theft."[1] The bulletin further reported that "[f]inancial losses due to personal identity theft totaled $24.7 billion, over $10 billion more than the losses attributed to all other property crimes measured in the National Crime Victimization Survey."[2] Although the report concluded that the "most common type of identity theft (experienced by 15.3 million people) was the misuse or attempted misuse of an existing account,"[3] it also determined that "1.1 million persons had their information misused to open a new account, and about 833,600 persons had their information misused for other fraudulent purposes."[4]

Traditionally, the phrase "identity theft" is most often associated with personal identity theft. News stories regarding criminal schemes targeting unsuspecting consumers or data breaches are becoming increasingly common. However, there is a much less familiar story similarly impacting business entities and organizations throughout the United States—the significant, growing trend of business identity theft.[5]

Business identity theft is very similar to the personal identity theft of an individual,[6] and often more lucrative; it is a "broad term that encompasses a wide variety of crimes involving the [fraudulent] unauthorized use of a business' identity."[7] "According to Dun & Bradstreet, a leading provider of business credit information in the U.S., "business identity theft cases have been reported in at least 26 states."[8] Also, the NASS Business Identity Task Force found an increasing number of incidents of business identity theft are connected with some type of fraudulent filing involving unauthorized changes to the business records on file with the state administrator's office.[9] This has raised a concern about whether the ease of access to corporate or other business entity information across jurisdictions contributes to incidents of business identity theft.

However, the growing threat of business identity theft has not escaped the attention of government administrators across the country. In 2011, the National Association of Secretaries of State (NASS) created a Business Identity Task Force ("Task Force") to track trends in business identity theft cases and to create strategies for protecting the states' increasingly vulnerable business entities.[10] Later that year, the Task Force convened a national forum with top government and private sector experts[11] to help create "a collective framework for state government action and awareness on the issue."[12] Additionally, the International Association of Commercial Administrators (IACA), a professional association comprised of government administrators of business organizations and secured transaction record systems at the state, provincial, territorial, and national levels,[13] has also committed itself to assisting member jurisdictions combat the growing threat posed by business identity theft. For the past four years, the IACA annual conference has addressed various aspects of the issue with sessions focusing on the identification of business identity theft schemes, evolving methodology, fraudulent filings, education, and prevention.[14]

In many states, corporate registrations and business filings with the commercial administrator's office are part of the public record and available online to the public at no charge. Furthermore, change documents, such as the form to change the resident agent or registered office, can be downloaded from the administrator's webpage, completed, and submitted with payment and no proof of identity. According to the NASS Task Force, even if the administrator's office suspected that something was amiss, most are ministerial by nature and without the authority to question submissions that substantially conform to the requirements of the acts of that state.[15] However, the "NASS position on federal legislation [is] consistently opposed to

*The authors would like to thank Dorit Gertsberg, 2015 J.D. candidate, and Samantha Zinnes, 2016 J.D. candidate, for their assistance.

federal law placing expensive and unworkable requirements on state filing offices."[16] While NASS supports "the goal of assisting law enforcement in fighting corruption and other financial crimes, the federal government already has an existing process for collecting beneficial ownership information on business entities that are domestically formed" through the reporting of this information on documents filed by the IRS and U.S. Department of Treasury.[17]

Methodology

Methods of Business Identity Theft

The typical and simplest pattern begins with a business identity thief selecting an established business identity to steal and then establishing a fraudulent office. The business name will then be used to establish either a new line of credit, or a new checking account, and/or access an existing account. The account is then used to purchase goods and services until the credit line or resources are exhausted, and the thief then repeats the pattern.

In 2010, Colorado officials became aware of a scam in which criminals "updated or altered the [business] registration information on file with the state…the criminals used the altered corporate identity to make online applications for credit from various retailers, including Home Depot, Office Depot, Apple, and Dell…. Authorities became aware of the scam after one of the targeted companies was contacted by a major retailer about nearly $250,000 in purchases made in its name."[18] In the end, more than 300 businesses were victimized with losses exceeding $3.5 million.[19] During the same time period, a similar incident occurred in Georgia. "In one case, criminals used the identities of about 3,900 individuals and businesses to conduct more than $5 million in fraudulent transactions."[20]

Dormant, Shell, and Aged Shelf Entities

The NASS Business Identity Task Force concluded that the relative ease with which one can access data from business registries opens the door to another popular, fraudulent scheme, this one involving the renewal or restatement of previously administratively dissolved entities.[21] "Businesses that are no longer in operation, often referred to as 'dormant' or 'dissolved' entities, are particularly vulnerable to this type of crime because their owners are less likely to be monitoring state-held business registration information."[22] Then, an unauthorized third party renews the corporation's existence or restores the limited liability company to good standing only to turn around and market the entity for sale as an entity with a well-established history.[23] Elaine Marshall, North Carolina's Secretary of State and the chair of the NASS Business Identity Task Force, illustrates the situation, "'The easiest target are dissolved corporations…somebody comes up 20 years later and reinstates it. Well, it looks like it's a 40-year-old corporation. And if it was in good standing financially when it was dissolved, then somebody's trying to capitalize on that good standing.'"[24] The wrongdoer takes advantage of a well-established history and credit rating.

The state of Nevada learned that this scheme was used by some illegitimate, commercial-resident-agent companies, which would sell the entities to be used in pump and dump securities fraud schemes.[25] Often, shelf and dormant corporations are marketed to potential buyers as having the benefit of anonymity of officer/director information.[26] The Nevada Corporations and Securities Divisions collaborated to hold the responsible entities in violation of securities regulations. Furthermore, Nevada has strengthened its entity renewal and restoration laws as a result of this fraud scheme.[27]

The intersection of business identity theft being used for securities fraud is not limited to Nevada. In 2008, the Securities and Exchange Commission (SEC) "suspended trading in the securities of 26 companies that appear to have usurped the identity of defunct or inactive publicly traded corporations."[28] The identity thieves incorporated the companies with the same name as a non-operational or inactive publicly traded corporation. Then, they obtained new CUSIP numbers, issued by Standard & Poor's CUSIP Bureau, and NASDAQ ticker symbols for the newly incorporated entities by misrepresenting "that they were duly authorized officers, directors, or agents of the original publicly-traded corporation."[29]

Cloning

Another method of business identity theft has come to be referred to as cloning. In this scenario, identity thieves attempt to "clone" existing businesses through extremely similar, if not identical, business names, addresses, or domain names.[30] In essence, cloning can be described as mistaken identity. The iden-

Business identity theft is very similar to the personal identity theft of an individual, and often more lucrative[.]

tity thieves are misleading a third party, such as a consumer seeking a service or another business seeking to contract with the entity, who does not realize that a slightly different business name could actually be an entirely different business entity than the entity with which they intended to interact.[31] Also, the Better Business Bureau regularly receives reports of scams in which the address or the phone number of a legitimate business is being used by an unauthorized third party who is attempting to "establish credibility with their victims or their targets."[32]

The only example of business identity theft cited on the Federal Bureau of Investigation (FBI) website dates back to 2007 and is an illustration of cloning.[33] The bad actor in the case was a Michigan-based private security company named Executive Outcome Inc., which assumed the identity of a South African company named Executive Outcomes Inc. and attempted to collect "$23 million owed by the government of Sierra Leone for military equipment, security, and training."[34] The FBI got involved and the identity thieves ended up serving prison time and paying significant money damages.[35]

The typical and simplest pattern begins with a business identity thief selecting an established business identity to steal and then establishing a fraudulent office.

EIN Fraud

Another method of perpetrating business identity theft is through the use of stolen, but otherwise legitimate, Employer Identification Numbers (EINs). Identity thieves use EINs in tax fraud, bank, and credit union fraud, and "phishing" e-mail schemes. According to the U.S. Treasury Inspector General for Tax Administration, a contributing factor to the perpetrating of EIN theft and fraud is the relative ease with which this sensitive identifying information may be obtained and the lack of reliable, standardized means to differentiate between a business entity using its own valid EIN and a business entity fraudulently using another business entity's valid EIN.[36] EINs are to business entities what Social Security Numbers (SSNs) are to natural people.[37] EINs are used for tax purposes, as well as for identification. An EIN is widely used and available on many publicly available documents, such as Form S-4 filed with the SEC, and not "sensitive" or "confidential" information under federal law.[38] SSNs are held as confidential by federal statute. There is no federal confidentiality requirement for EINs, and in fact they are widely available. Some states, however, may have laws treating EINs as sensitive or confidential.[39] This can lead to problems with business activities, such as conversions or mergers, even in states such as Michigan where the EIN is not recorded as a means of identifying the entity to the state. If a foreign entity qualifies to transact business in Michigan, but the only form of identification used in its jurisdiction of formation is the EIN, then that entity may be vulnerable to identity theft.

The U.S. Department of Treasury has seen an increase in the number of stolen EINs used in filings with the Internal Revenue Service (IRS).[40] The Treasury Inspector General for Tax Administration also reported that stolen and falsely obtained EINs have been used to report false income and withholding.[41] It reviewed the IRS's policies regarding EINs and revealed that, while the IRS had efficient methods of identifying false or incorrect EINs, the IRS lacked any real method to identify when a valid EIN was being used in a fraudulent way.[42] In 2011, of the 285,670 EINs used to file tax returns:

> 277,624 were stolen EINs used to report false income and withholding on 752,656 tax returns with potentially fraudulent refunds issued totaling more than $2.2 billion[, and] 8,046 were falsely obtained EINs used to report false income and withholding on 14,415 tax returns with potentially fraudulent refunds issued totaling more than $50 million.[43]

Part of the problem is that identity thieves know that the IRS waits until the March deadline to review the EINs so these thieves file very early.[44] In that period of time, the thief collects the tax refund, and then, after the EIN is reviewed, the actual business owner is the one who receives the call from the IRS demanding a return of the tax refund.

Another way stolen EINs are used is to open business bank accounts and to establish credit. Banks and credit unions, as well as other financial institutions, require corporations to provide an EIN to open a business account.[45] The identity thief can use the victim entity's credit history, open the account, and then tarnish the entity's credit by making large purchases on credit without paying.[46] Since it is the entity's EIN on file, it is the entity's business owner who will more than likely be contacted by the financial institution and debt collectors.

"Phishing is a scam typically carried out by unsolicited e-mail and/or websites that pose as legitimate sites and lure unsuspect-

ing victims to provide personal and financial information."[47] Phishing e-mails usually appear as though they are messages from the IRS indicating that the IRS would like to "help" them apply for an EIN. According to the IRS, it does not "request detailed personal information through e-mail" nor does it "send any communication requesting your PIN numbers, passwords, or similar access information for credit cards, banks, or other financial accounts."[48] The IRS has asked people to file a report with the IRS immediately if they believe they have become a victim of a "phishing" scheme, or if they have recently received an EIN via an e-mail from the IRS asking for financial and personal information.

In Michigan's identity theft statute, EINs are considered "personal identifying information."[49] "Personal identifying information" includes "a name, number, or other information that is used for the purpose of identifying a specific person or providing access to a person's financial accounts, including, but not limited to, a person's… place of employment, employee identification, [or] employer or taxation number…."[50] Also, the statute explicitly recognizes that "'person' means an individual, partnership, corporation, limited liability company, association, or other legal entity," which makes EIN theft a form of identity theft.[51] Consequently, in Michigan, preventing EIN identity theft comes down to policy, enforcement, and collaboration with other states, as well as education for business entities. While some states require business entities to record their EINs on all documents filed with the state, the Michigan Corporations Division does not. In fact, when the situation does arise that a business entity records its EIN on a document that is filed by the Corporations Division, the EIN is redacted by the division prior to being made available to the public.[52]

Administrator's Perspective

The Corporations Division promotes economic development and growth by facilitating the formation of business entities in Michigan. The Corporations Division administers statutes related to the formation, life, and dissolution of corporations, limited partnerships, limited liability companies, and limited liability partnerships.[53] The functions of the Corporations Division include the review of (1) all documents related to entities subject to statutes administered by the division to make certain that the documents substantially conform to the law, and (2) the filing of the documents that substantially conform to the requirements of the applicable act. The division maintains a record of the documents filed by these business entities and makes this information available to the public.[54]

The statute administered by the Corporations Divisions provides that "[i]f a document…substantially conforms to the requirements of this act, the administrator shall endorse upon it the word 'filed' with his or her official title and the date of receipt and of filing and shall file and index the document…in his or her office."[55] The entity statutes include provisions regarding the purpose for which an entity may be formed, and if documents may be rejected if the purpose is unlawful or does not substantially conform to what is permitted by the act. In addition, a document may be rejected if the name does not meet the name standards established by the applicable statute. After a document is endorsed "filed," then only the Attorney General has authority to bring an action to dissolve the entity or to enjoin it from transacting unauthorized business.[56]

Best Practices

The presenters of "Encouraging Business While Fighting Fraud" at the recent 2014 IACA conference identified best practices that state administrators can implement in order to deter fraudulent filings, which are a major source of business identity theft.[57] The statutes administered by the state of Michigan Corporations Division provide authority to address very nearly all of these recommendations.

The first best-practice recommendation to deter fraudulent filings is for the state to have an annual reporting requirement for business entities. The purpose of an annual report is for the entity to confirm or update certain information on record with the Corporations Division. In Michigan, all domestic and foreign corporations and limited liability companies must file an annual report or annual statement.[58]

Another best-practice recommendation is that businesses should be required to periodically pay a fee to remain in good standing with the state. This practice aids in deterring business identity theft because it requires action on the part of an individual to pay the fee and the financial means to do so. A state that does not require entities to periodically

Identity thieves use EINs in tax fraud, bank, and credit union fraud, and "phishing" e-mail schemes.

pay such a fee would be very attractive to individuals seeking to commit business identity theft because there would be less time and money needed to keep an entity in good standing. In Michigan, the annual report or annual statement must be accompanied by the payment of a $20 or $25 fee, depending on the type of entity; and, the annual report or statement must continue to be filed each year for the entity to remain in good standing.[59]

The third best-practice recommendation is for the administrator to have authority to administratively dissolve an entity for failing to file the periodic report. This is important because an entity verifies or updates its resident agent, registered office address, and officer/director information on its annual report or statement.[60] If a lawsuit is initiated against an entity, then, depending on the type of entity, service of process is made on the resident agent, officer, or director.[61] In Michigan, the entity statutes provide for dissolution by operation of law of corporations and loss of good standing status of limited liability companies without any action or proceeding by the state if annual reports or annual statements are not filed within two years of the statutory due date. Specifically, section 922(1) of the Business Corporation Act (BCA) states:

> If a domestic corporation neglects or refuses to file any annual report or pay any annual filing fee or a penalty added to the fee required by law, and the neglect or refusal continues for a period of 2 years from the date on which the annual report or filing fee was due, the corporation shall be automatically dissolved 60 days after the expiration of the 2-year period.[62]

If a foreign corporation neglects or refuses to file an annual report for one year, then its Certificate of Authority is automatically revoked.[63] Also, pursuant to section 207a(2)-(3) of the Michigan Limited Liability Company Act (LLCA), if a Michigan limited liability company or a foreign limited liability company authorized to transact business in Michigan fails to file an annual statement for two consecutive years, then the Corporations Division notifies the company of the consequences of the failure to file. If the limited liability company does not file all annual statements it has failed to file and the applicable fees within 60 days after the notice is sent by the Corporations Division, then the limited liability company is not in good standing.[64]

The first best-practice recommendation to deter fraudulent filings is for the state to have an annual reporting requirement for business entities.

The fourth and fifth best-practice recommendations are related to the service of process issues noted with the third recommendation. The fourth best-practice recommendation is to require every legal entity to have a registered office address in the state that is a real, physical street address. The fifth best-practice recommendation would require every legal entity to have a resident agent located within the state. Michigan statutes already meet the criteria for both of these recommendations through direct statutory provisions. Section 241 of the BCA requires each Michigan and foreign corporation to have and continuously maintain a resident agent and registered office in this state.[65] Section 202(f) of the BCA requires the Articles of Incorporation to include "[t]he street address, and the mailing address if different from the street address, of the corporation's initial registered office and the name of the corporation's initial resident agent at that address."[66] Also, the LLCA contains provisions that are nearly identical to the BCA.[67]

The sixth best-practice recommendation is for the careful review of filings by state employees. This is particularly noteworthy in light of the push toward e-government solutions. Columbia University Professor Hugh Thompson, Ph.D., believes that business identity thieves are "taking advantage of the fact that so much more business is done online these days."[68] This may be true if an e-government solution was used to fully automate a process; however, this best-practice recommendation is in place for this very reason. The Delaware Chief Deputy Secretary of State, Rick Geisenberger, cautioned the IACA 2014 Annual Conference attendees that by fully automating the review process, without a human being involved at all, there could be an increase in fraudulent filings.[69]

In Michigan, regardless of the method used to submit a document to the Corporations Division, division staff manually reviews each document. The document must be reviewed to determine that it substantially conforms to the requirements of the relevant statute(s), applicable Attorney General Opinions, guidelines, and policies. The name must be available for use, the document must be signed, and filing fees must be paid. Corporations Division employees strive to ensure that personal identifying information

is removed or redacted prior to or at the time a document is filed.

Lastly, the seventh best-practice recommendation is for the states' corporate and limited liability company laws to provide clarity on how law enforcement could access entity ownership information. This recommendation is aimed at helping law enforcement take quick action when business identity theft occurs. In Michigan, the statutes administered by the Corporations Division do not require the business entity to provide the names of the members, managers, or shareholders of a limited liability company or corporation (except for professional limited liability companies and professional corporations in which the members, managers, or shareholders must be included on the annual report or statement). Thus, the Corporations Division does not receive this information, nor does it have authority to record such information.

Prevention

One of the most effective ways to prevent business identity theft is through careful monitoring of the business entity's information on file with the Corporations Division and the documents filed on behalf of the entity.[70] This information is available through the Corporations Division's Business Entity Search website for no charge. The Business Entity Search is available at: www.michigan.gov/entitysearch.

Also, if a document filed on behalf of an entity was at the time of filing an inaccurate record of the action referred to in the document, or if the document was signed by an unauthorized person, then a Certificate of Correction may be submitted to the Corporations Division in order to correct an error or inaccuracy contained in the document, or execution of the document, previously filed.[71]

Victim Reporting

The number of entities that have been the victim of business identity theft is unknown. Currently, there are no federal or state statistics gathered on this issue.[72] Professor Thompson notes that, "'Business identity theft is incredibly underreported.'…And Thompson says few victims are willing to report it. 'There's a big stigma attached with it….Imagine you're a company trying to portray an image of being solid and reliable out to your customers. It's not something that you want to readily admit it.'"[73]

However, according to NASS Business Identity Task Force, the impact of business identity theft is very costly and time consuming to remedy, not to mention the tarnished business credit history and the difficulties that the company may face in the future when trying to obtain credit. Thus, it is important to report business identity theft to the proper authorities.[74] An excellent resource developed by NASS and the Identity Theft Protection Association is a website dedicated to this issue: www.BusinessIDTheft.org.[75]

In Michigan, if your business is a victim of business identity theft, you should report the crime to your local law enforcement agency.[76]

In some cases, you may also report business identity fraud to the Michigan Attorney General.[77] If you have a consumer complaint, you may contact the Attorney General's Consumer Protection Division at:

Consumer Protection Division
P.O. Box 30213
Lansing, MI 48909
517-373-1140
Fax: 517-241-3771
Toll free: 877-765-8388
www.michigan.gov/ag (online complaint form)

Also, the Michigan State Police Identity Theft Teams investigate and assist federal and local law enforcement agencies with investigating criminal identity theft while providing victims with the resources available to prevent further victimization.[78] The Michigan State Police (MSP) has developed resources for victims of personal identity theft, which are available through its website at www.michigan.gov/identity-theft.[79] "By creating teams solely responsible for investigating various types of fraud, sometimes known as 'white collar crime,' the MSP has been proactive in responding to this growing crime trend. Detectives in the Fraud Investigation Section receive specialized training in multiple areas of fraud including identity theft, mortgage fraud, healthcare fraud, and Bridge Card fraud."[80]

Future Developments

The Fiscal Year 2015 White House Budget Proposal demonstrates a growing concern with business identity theft. The connection between business identity theft, introduced federal legislation, and the White House Budget Proposal is in the context of business identity theft that occurs through the marketing and sale of shell companies with hid-

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den owners.[81] The White House specifically cites that this proposal is meant to build on the dedication to this issue demonstrated by Michigan U.S. Senator Carl Levin, "who has long been an advocate for shuttering these tax loopholes and promoting greater corporate transparency in the United States and abroad."[82]

Advertising and selling shell entities that have filed tax returns and already have an EIN, "even though that company [has] never actually engaged in any business operations…invites fraud by enabling hidden owners to pretend they've had a corporation operating in the United States for years when they haven't."[83]

Also, the budget proposal seeks to make reforms and expand the IRS's information reporting in order to grant authority for the IRS to make a company's beneficial ownership information readily available to law enforcement.[84] "This proposal would require the Internal Revenue Service to collect information on the beneficial owner of any legal entity organized in any state," and would authorize the IRS to provide that information to law enforcement.[85] "Knowledge of beneficial owners can help law enforcement officials identify and investigate criminals who form and misuse U.S. companies to commit financial crimes, including laundering criminal proceeds and financing terrorism through the international banking system."[86]

To accomplish this, the budget proposal will "require all companies that are formed in the United States to obtain an EIN" from the IRS.[87] Additionally, new federal legislation proposals may be forthcoming; as indicated at last year's G-8 summit, the President and his fellow leaders committed to "continue to advocate for comprehensive legislation to require identification and verification of beneficial ownership information at the time a company is formed."[88]

Conclusion

Overall, it does not appear that business identity theft is going away anytime soon. The number of incidents and level of sophistication is only increasing as this crime continues to spread throughout the United States. Fortunately, Michigan corporate laws and the practices of the Corporations Division are already in-line with the best practices recommended by NASS to confront the problem and prevent it from spreading. The Corporations Division remains dedicated to curbing the trend of business identity theft, particularly in relation to altered business records, and will continue to be proactive in seeking strategies to stop these schemes.

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79. *Id.*

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81. Office of Mgmt & Budget, Executive Office of the President, *Budget of the United States Government: Analytical Perspectives, Fiscal Year 2015*,168-169 (2014), http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/spec.pdf; *see* U.S. Senator Carl Levin, *On the Issues, Shell Corporations,* http://www.levin.senate.gov/issues/shell-corporations (last visited July 31, 2014).

82. Carolina Atkinson, Deputy Nat'l Sec. Advisor for Int'l Economics, *Beneficial Ownership Legislation Proposal*, The White House Blog (April 4, 2014), http://

www.whitehouse.gov/blog/2014/04/04/beneficial-ownership-legislation-proposal.

83. U.S. Senator Carl Levin, On the Issues, Shell Corporations, http://www.levin.senate.gov/issues/shell-corporations (last visited July 31, 2014).

84. *Id.*at 168.

85. Carolina Atkinson, Deputy Nat'l Sec. Advisor for Int'l Economics, *Beneficial Ownership Legislation Proposal*, The White House Blog (April 4, 2014), http://www.whitehouse.gov/blog/2014/04/04/beneficial-ownership-legislation-proposal.

86. *Id.*at 169.

87. *Id.*

88. Press Release, The White House, Office of the Press Secretary, *United States G-8 Action Plan for Transparency of Company Ownership and Control* (June 18, 2013), available at: http://www.whitehouse.gov/the-press-office/2013/06/18/united-states-g-8-action-plan-transparency-company-ownership-and-control.

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Case Digests

LLCs—Arbitration of Disputes; Withdrawal of Member

Altobelli v Hartmann, No 313470, 2014 Mich App LEXIS 2140 (Nov 4, 2014). Where plaintiff alleged that defendants wrongfully terminated his property interest in his membership in a law firm organized as a professional limited liability company (PLLC), the trial court did not err in denying defendants' motion to compel arbitration because the claims asserted by plaintiff in this case (breach of fiduciary duty, illegal shareholder oppression, conversion, bad faith misrepresentation, tortious interference with a business relationship or expectancy, and civil conspiracy) did not fall within the arbitration clause in the PLLC's operating agreement. However, the court of appeals held that there remained a genuine issue of material fact regarding whether plaintiff voluntarily withdrew from the firm, and the trial court erred in granting plaintiff's motion for partial summary disposition.

Summer Resort Owner's Act—Time Limit on Corporate Existence

Hogg v Four Lakes Ass'n, Inc, No 316898, 2014 Mich App LEXIS 1994 (Oct 23, 2014). The 30-year limit on corporate existence under the Summer Resort Owner's Act, MCL 455.202, was superseded by MCL 450.371 of the General Corporation Act, which allowed the term of existence of any Michigan entity incorporated under any Michigan law to exist perpetually or for any terms fixed by the entity's articles. The Summer Resort Owner's Act does not violate the Title Object Clause of Mich Const 1963 art 4, §24.

Tortious Interference with an Economic Expectancy

Saab Auto AB v GM Co, 770 F3d 436 (2014). Saab Automobile AB ("Saab") and its parent company sued General Motors Company ("GM") for tortious interference with economic expectancy under Michigan law, claiming that GM made public statements that caused a transaction between Saab and a Chinese investor to fall through and that drove Saab into bankruptcy. The district court granted GM's motion to dismiss for failure to state a claim, ruling that plaintiffs failed as a matter of law to establish a valid business expectancy and intentional interference. The Sixth Circuit affirmed, finding that plaintiffs failed to establish that GM intentionally interfered with their alleged economic expectancy. GM's statements were made within its contractual consent right and concerned legitimate business reasons for not consenting to a framework agreement, and thus could not constitute per se wrongful or malicious acts. Even if GM had misinterpreted an automotive technology license agreement and did not actually have the consent right that it claimed regarding the framework agreement, plaintiffs' argument still failed as a matter of law because GM's statements would have at most amounted to a mistake. Since the court found that plaintiffs have failed as a matter of law to establish that GM intentionally interfered with their alleged economic expectancy, the court did not need to address whether plaintiffs had a valid business expectancy in the framework agreement.

Unemployment Insurance—Medical Marijuana

Braska v Challenge Mfg Co, No 313932, 315441, 318344, 2014 Mich App LEXIS 2112 (Oct 23, 2014). Although the claimants tested positive for marijuana and would ordinarily be disqualified for unemployment benefits, because there was no evidence to suggest that the positive drug tests were caused by anything other than the claimants' use of medical marijuana in accordance with the Michigan Medical Marihuana Act (MMMA), the denial of the benefits constituted an improper penalty for the medical use of marijuana under the MMMA. Since the MMMA preempts the Michigan Employment Security Act, the circuit courts did not err in reversing the Michigan Compensation Appellate Commission's rulings that the claimants were not entitled to unemployment compensation benefits.

Index of Articles

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Published in cooperation with
THE INSTITUTE OF CONTINUING
LEGAL EDUCATION
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SECTION CALENDAR

Council Meetings

DATE	TIME	LOCATION
March 12, 2015	3:30 p.m.	State Bar of Michigan, Lansing
June 4, 2015	3:30 p.m.	Jaffe Raitt Heuer & Weiss, Southfield

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January 22-23, 2015	Inn at St. John's, Plymouth