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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, Brendan J. Cahill, *The Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, Michigan 48304, (248) 203-0721, bcahill@dykema.com, or through Max H. Matthies, ICLE, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, matthies@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://connect.michbar.org/businesslaw/newsletter.

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 deadlines for submitting articles are as follows:

Issue	Article Deadline
Spring 2022	November 30, 2021
Summer 2022	March 31, 2022
Fall 2022	July 31, 2022
Spring 2023	November 30, 2022

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, Brendan J. Cahill, the *Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, MI 48304, (248) 203-0721.

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.

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Volume XXII, Issue 1, and subsequent issues of the *Journal* are also available online by accessing http://connect.michbar.org/businesslaw/newsletter

From the Desk of the Chairperson

By Julia A. Dale

As I write this, my final column as Chair of the Business Law Section, a shift is occurring across Michigan. Half of Michigan residents have completed their vaccination and more than 60 percent have received their first shots; the positivity rate has been below 2 percent for the last seven days, and the effort continues to vaccinate those ages 12 and up. We are just days from celebrating my daughter's 12th birthday, and top on her list for marking this special occasion is getting her first COVID-19 vaccination.

On Thursday, June 17, 2021, the Michigan Department of Health and Human Services (MDHHS) issued an order rescinding many of the COVID-19 pandemic related emergency orders including those impacting gatherings and masking. Beginning June 22, restrictions on capacity for indoor and outdoor settings ceased, and the state no longer requires residents to wear face masks. The presence of variants requires us to keep our guard up, but it is hard to suppress the collective exhale and sigh of relief as summer in Michigan signals a gradual return to normal.

Michigan summers are marked by a slower pace as residents flock to the many lakes in and around the state, head up north at a crawl along U.S. 127, and settle in for a season of campfires, fishing, and tubing. Ironically, just as things seem to be slowing down across the state, things are just starting to pick up for the Business Law Section. It has been more than 18 months since the Council of the Business Law Section has met in person, and I am happy to share that this hiatus is coming to an end! I hope that many of you will join us on September 28, 2021, from 3:30 p.m. to 6:00 p.m. for the annual/council meetings as well as the presentation of the Schulman Award. The meetings and reception will be held at the Detroit Novi Sheraton located at 21111 Haggerty Road. Any questions may be directed to businesslawsection@gmail.com or (248) 953-9022. For those unable to join us in person, the option to participate online will still be available.

An invitation from the Michigan Supreme Court to submit an amicus brief in the matter of *Murphy v Inman* by August 30, 2021, brought a flurry of activity this spring that will continue through the summer months. The Executive Committee of the Council of the Business Law Section quickly came to consensus on the creation of an ad hoc committee for the development and drafting of the amicus brief, appointing Doug Toering (member and prior BLS council chair) as head of the committee. Under Mr. Toering's leadership the committee is working diligently to develop a position and prepare a brief on behalf of the section for council approval.

Unfortunately, the lifting of restrictions and resumption of activities came too late to allow for the planning of a 2021 Annual Business Law Institute. However, please mark your calendars for the 2022 Annual Business Law Institute to be held October 7, 2022, at the JW Marriott in Grand Rapids.

On the heels of the pandemic and a lifting of restrictions, I would be remiss if I did not take advantage of the opportunity to encourage each of you to become more involved in the section. *The strength and value of the section is found in its members!* We build upon and maximize our strength with the engagement of each person, with our diversity of experiences serving to enrich the conversation. If you are not sure how to engage with the section (beyond paying your annual section fees) please consider the following:

- **Join a committee.** There are more than twelve different standing committees. Whether your interest is with the Small Business Forums or contemplating amendments to the Business Corporation Act, there is plenty of opportunity to be had. You can learn more about each of the standing committees by visiting the Business Law Section website. There you will find prior committee reports as well as contact information for the committee chair. You can even complete an electronic form to communicate your interest in a particular committee.
- **Submit an article for publication**. If you are reading this column, you already have some familiarity with the *Michigan Business Law Journal*. The journal is published three times a year, each volume assigned to a different committee within the section. The committee assignments are made well in advance and provide plenty of time to prepare an article for publication. The guidelines for submitting an article for the *Michigan Business Law Journal* can be found on the section website. The Fall 2021 issue is assigned to the Uniform Commercial Code Committee, and the Spring 2022 issue is assigned to the Commercial Litigation Committee. Please consider contacting the committee chairs to discuss submitting an article for publication.
- **Attend a meeting**. Attending a council meeting is a low-risk way to dip your toe in the Business Law Section engagement waters. The next council meeting is scheduled for September 28, 2021, at 3:30 p.m.; it will be immediately followed by our Annual Meeting and the presentation of the Schulman Award. Afterwards, there will be a cocktail hour, providing the perfect opportunity to network with other Business Law attorneys in Michigan.

I want to extend my sincere gratitude to all the committee and directorship chairs and members for the

time and effort invested in the section over the last year. Your time and energy are precious resources; never more so than over the last year as home and work boundaries blurred and each of us has taken on additional work and responsibility. I also want to thank my fellow officers, John Schuring (Vice Chair), Mark Kellogg (Treasurer), and Judge Christopher Yates (Secretary). These gentlemen entered a term like no other and extended such grace as we made our way through challenging times. I appreciate their wise counsel, and ability to pivot and make decisions quickly. The section is in excellent hands with their continued leadership.

Finally, I want to close with extending a public and heartfelt thanks on behalf of the section to Terri Shoop, our section administrator. If you have had any interaction with the Business Law Section, you have likely had contact with Ms. Shoop. The makeup of the Business Law Council changes each year; new officers come on and old officers step off. Committee chairs change each year as does leadership at the State Bar. Ms. Shoop is the one constant having served and supported the section for almost 20 years. Trusted with the big and little details, it seems she knows the answer to all the questions; her institutional knowledge is only surpassed by the warmth of her personality. With a "can do" attitude and willingness to roll up her sleeves, the entire section benefits from her effort and work ethic. As chair I could not ask for a better ambassador on behalf of the section.

It has been my honor to serve as chair during these difficult days, and I look forward to seeing many of you in Novi this September.

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 By Alexis Lupo

An Introduction to the Corporate Transparency Act

Business lawyers should become familiar with the Corporate Transparency Act and beneficial ownership terminology. The Corporate Transparency Act (CTA) was passed by Congress on January 1, 2021, as part of the National Defense Authorization Act for Fiscal Year 2021.[1] The CTA requires the creation of a national database for beneficial ownership information for many business entities. The United States Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) is responsible for developing the regulations by January 2022.

The idea behind the collection of beneficial ownership information began internationally. In 1989, the G-7 Summit established the Financial Action Task Force (FATF) due to growing concerns about money laundering.[2] In 1990, FATF issued a report containing forty recommendations to combat money laundering. In 2012, FATF reviewed and reissued its recommendations with the goal of providing governments with actionable tools to fight against financial crime. Recommendation 24 addresses beneficial ownership reporting and indicates that governments should take measures to prevent the misuse of legal persons, such as business entities, for money laundering or financing terrorism.[3] The recommendation specifically states that "[c]ountries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities."[4] Governments in Europe, South America, and Asia began implementing beneficial ownership reporting requirements.[5] In the United States, beneficial ownership reporting legislation was first introduced by Senator Carl Levin in May 2008.[6] Now with the passage of the CTA, beneficial ownership reporting will soon be a reality.

The CTA will require reporting companies to register personally identifiable information of beneficial owners and applicants with FinCEN.

Reporting Companies

A reporting company is a corporation, limited liability company, or other similar entity that is created by filing with the Secretary of State (or other equivalent office) or "Indian tribe."[7] Michigan is one of a few states in which business entity filings are handled by a department other than the Secretary of State. The definition also includes foreign entities formed under the laws of a foreign country and authorized to transact business in the United States by filing a document with the Secretary of State or equivalent office of a state or Indian Tribe.[8] The CTA lists twenty-four exemptions, such as banks, publicly traded entities, and tax-exempt entities. Another notable exception applies to entities that employ more than twenty employees on a full-time basis in the United States, had gross receipts or sales greater than $5,000,000 in the previous year, and have an operating presence at a physical office within the United States.[9] There are many parts of this exemption that are lacking clarity, such as the definitions of "full-time employee" and "operating presence." The forthcoming rules and regulations give FinCEN the opportunity to provide further specifics.

Personally Identifiable Information

The CTA requires personally identifiable information for each beneficial owner of a reporting company and each applicant with respect to that reporting company to be filed with FinCEN. The specific information includes full legal name, date of birth, current residence or business address, and the unique identifying number from an acceptable identification document or FinCEN identifier.[10] An acceptable identification document is defined in the act—for example, a nonexpired driver's license or passport.[11]

Disclosing the beneficial owner's reported information is restricted. FinCEN may only disclose the information upon a request following the appropriate protocols from a federal agency engaged in national security, intelligence, or law enforcement activity or request from a state, local, or tribal law enforcement agency after a court of competent jurisdiction authorizes the agency to seek the information in a criminal or civil investigation.[12] The CTA also allows disclosure to a federal agency following a request from law enforcement of another country, a financial institution subject to customer due diligence requirements, with the consent of the reporting company, or, a federal regulator complying with additional requirements.[13]

Beneficial Owners and Applicants

A beneficial owner is defined in the CTA as "an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise—(i) exercises substantial control over the entity; or (ii) owns or controls not less than 25 percent of the ownership interests of the entity."[14] The act does not further define "substantial control," but hopefully the rules and regulations will provide more guidance. The act makes specific exclusions for minor children, those acting as nominees or custodians, creditors of an entity, individuals whose only interest in an entity is through inheritance, or individuals acting solely as employees whose control over or economic benefits from the entity are derived solely from their employment status.[15]

Since personally identifiable information for each applicant of a reporting company is required to be reported to FinCEN, it is important to note that an applicant is defined as any individual who files an application to form an entity or an application to register a foreign entity with a state or Indian tribe.[16] Business lawyers

should be aware that this could apply to them when acting as incorporators or organizers for their clients or simply submitting the documents for their client. Again, FinCEN may provide further clarification in the rules and regulations.

Clearly, the CTA is a monumental change in corporate transparency in the United States. There are several unresolved matters regarding the act. Hopefully, the forthcoming rules and regulations will assist with the interpretation and administration. State filing offices will be required to inform applicants of their filing requirements under the CTA,[17] and thus you can look forward to future updates. However, business lawyers should spend time educating themselves on the nuances of the act so that they will be prepared to advise clients in the very near future.

Alexis Lupo is the Corporations Division Director in the State of Michigan's Corporations, Securities & Commercial Licensing Bureau. Ms. Lupo serves as Treasurer for the International Association of Commercial Administrators, and she is a member of the Business Law Section.

NOTES

1. Title LXIV of the National Defense Authorization Act (NDAA), H.R. 6395, Public Law 116-283.
2. History of the FATF, https://www.fatf-gafi.org/about/historyofthefatf/
3. FATF (2012-2020), International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, FATF, Paris, France, www.fatf-gafi.org/recommendations.html
4. *Id.* at p.22.
5. United Kingdom *see* Part 21A Companies Act 2006, https://www.legislation.gov.uk/ukpga/2006/46/part/21A. Brazil *see* Instrucao Normitiva RFB No. 1863/2018, http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?visao=anotado&idAto=97729#1954228. Hong Kong *see* Companies Ordinance (Chapter 622 of the Laws of Hong Kong), https://www.elegislation.gov.hk/hk/cap622.
6. Incorporation Transparency and Law Enforcement Assistance Act, S.2956, https://www.congress.gov/bill/110th-congress/senate-bill/2956/text
7. NDAA, § 5336(a)(11).
8. *Id.*
9. NDAA, § 5336(a)(1)(11)(b)(xxi).
10. NDAA, § 5336(b)(2)(a).
11. NDAA, § 5336(a)(1).
12. NDAA, § 5336(b)(6)(2)(B).
13. NDAA, § 5336(b)(6)(2)(B)(ii)-(iv).
14. NDAA, § 5336(a)(3)(A).
15. NDAA, § 5336(a)(3)(B).
16. NDAA, § 5336(a)(2).
17. NDAA, § 5336(e)(2).

 By Eric M. Nemeth

The trend of lengthened prison sentences for tax crime convictions seems to be continuing. On June 15, a former construction executive was sentenced to 46 months in prison and ordered to pay $661,000 in restitution related to failure to pay taxes on bribery income. (Yes, bribes are taxable income). In addition to the length of the sentence, what was also instructive was the judge's observation of Judge Castel that he was "somewhat startled" that the defendant had not yet paid back any money to the IRS despite admitting guilt. See *United States v Olson*, No 1:20-cr-00356 (SDNY 2021).

Practice Point: I have often been asked if paying the tax liability during a criminal investigation or after conviction matters. While each case is different, if a client is not contesting guilt and/or liability then evidence of dealing in good faith by paying the uncontested liability or agree to a monthly payment to the best of his/her ability is the minimum expected. A tangible act of acceptance of responsibility and a tangible act of changed behavior for the better provides evidence that can turn down the proverbial heat. Additionally, nearly all Rule 11 criminal plea agreements require full cooperation with the IRS. Thus, failure to pay could violate the terms of the plea agreement and/or the terms of the sentence placing the client in much greater jeopardy.

Improper Disclosure of Tax Information

There has been a lot of coverage about apparent disclosure of the tax information of some ultra-wealthy individuals. While that investigation is ongoing, recently the Federal Circuit Court offered that the IRS can fire a revenue agent for inadvertently disclosing the information to unauthorized individuals.

Interestingly, the disclosure that resulted in the agents' termination was to her attorney in defense of an action against her for unprofessional conduct.

It has been my personal experience that IRS employees are very guarded about tax information disclosures. What practitioner has not been frustrated about being told that their POA on file does not cover the necessary tax periods?

Basis Calculation

As many practitioners have experienced that the correct tracking and calculation of a taxpayer's basis can be a never-ending exercise, and one that can have profound adverse tax consequences. Recently, the IRS Large Business and Intellectual Concept Unit released rules concerning the calculation of a partner's outsourced basis under IRC 705. See (DCN) PAR-P-002 dated May 19, 2021.

Cybercurrency

What would a tax column be without at least one reference to cryptocurrency? Well, on June 9, El Salvador became the first country in the world to recognize Bitcoin as legal tender. El Salvador's official currency will remain the U.S. dollar. The exchange rate between the two mediums will be set by the market. On the domestic front, the IRS continues its laser-focused investigation of the cryptocurrency industry and owners of such currency. Recently, the IRS scored a significant win when the U.S. District Court for the Northern District of California entered an order authorizing the IRS to serve a John Doe Summons on a cryptocurrency exchange. The summons seeks information on U.S. taxpayers who contributed the equivalent of at least $20,000 in total transactions for the years 2010-2020. Coinbase and Poloniex summons served by the IRS were already upheld by other courts. In court filings, the IRS articulated their need for the requested information by stating their findings from previous summons information. The taxpayers are using aliases, false addresses, and other means to disguise their identities, and, as such, taxpayers that engage in such conduct are more likely to evade their taxes.

IRS Budget

During Congressional testimony, IRS Commissioner Charles Rettig stated that the proposed budget increases at the IRS would be focused upon wealthy taxpayers, including the over four million partnership tax returns filed annually. He indicated that aggressive hiring will be a top priority to reversing the loss of 17,000 IRS personnel over the last decade, and that one proposal being discussed is a proposal to increase the data financial custodians, who would provide the IRS information about financial account flows. In addition, he stated that past changes in credit card payments to businesses have resulted in significant revenue enhancements.

Recently, Commissioner Rettig agreed that the tax gap was in excess of $1 trillion annually.

"Dirty Dozen" Tax Scams

The IRS released its popular, annual list of "Dirty Dozen" tax scams. This year's list covers a wide range of "scams" directed at the most vulnerable of taxpayers and the wealthiest. As always, have your client consult an independent and competent tax advisor before undertaking any tax-centric transactions. Remember, if it is too good to be true … you know the rest.

IR 2021-144 provides that the following transactions or pitches may be ripe for fraud upon both the taxpayer and IRS. Syndicated Conservation Easements, Abusive Micro-Captive "Insurance" Arrangements, Potentially Abusive Use of the U.S.-Malta tax treaty, Improper Claims of Business Credits, Improper Monetized Installment Sales, Fake Charities, Immigrant/Senior Fraud, Offer-in-Compromise Mills, Unscrupulous Tax Return Preparers, and Unemployment Insurance Fraud.

If any of your clients may have been involved with any of the above-listed transactions or fallen victim to an unscrupulous promoter or perpetrator, seek experienced tax counsel to help address any potential tax consequences.

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 By Michael S. Khoury and Susan V. Warner

Websites and the Americans with Disabilities Act

[Disclosure: This column seeks to review the state of the law and the issues raised by this topic. In the interests of full disclosure, please note that co-author Susan V. Warner was counsel for the Winn-Dixie Stores in the circuit case discussed in this article.]

The Americans with Disabilities Act of 1990 ("ADA"), as amended,[1] is a federal law that prohibits discrimination against individuals with disabilities in such areas as jobs, schools, transportation, and all public and private places that are open to the general public. While the law addressed these physical places and telecommunications systems, Congress has not expanded the ADA's definition of places of public accommodations to include Internet websites, and no regulations may be directly applicable to the websites of your clients.

This article explores some of the issues being litigated in the federal courts. However, this article does not review the various technologies used by website operators to make the sites accessible.

The ADA and Places of Public Accomodation

Let's first take a look at what the ADA specifically says. The general rule is stated as:

> No individual shall be discriminated against on the basis of disability in the full and equal enjoyment of the goods, services, facilities, privileges, advantages, or accommodations of any place of public accommodation by any person who owns, leases (or leases to), or operates a place of public accommodation.[2]

The key issue, of course, is what constitutes a "public accommodation" in the law. The statute actually has quite a long definition,[3] but paraphrased, the following private entities[4] are considered public accommodations:

> (A) an inn, hotel, motel, or other place of lodging;
>
> (B) a restaurant, bar, or other establishment serving food or drink;
>
> (C) a motion picture house, theater, concert hall, stadium, or other place of exhibition or entertainment;
>
> (D) an auditorium, convention center, lecture hall, or other place of public gathering;
>
> (E) a bakery, grocery store, clothing store, hardware store, shopping center, or other sales or rental establishment;
>
> (F) a laundromat, dry-cleaner, bank, barber shop, beauty shop, travel service, shoe repair service, funeral parlor, gas station, office of an accountant or lawyer, pharmacy, insurance office, professional office of a health care provider, hospital, or other service establishment;
>
> (G) a terminal, depot, or other station used for specified public transportation;
>
> (H) a museum, library, gallery, or other place of public display or collection;
>
> (I) a park, zoo, amusement park, or other place of recreation;
>
> (J) [schools];
>
> (K) a day care center, senior citizen center, homeless shelter,…; and
>
> (L) a gymnasium, health spa, bowling alley, golf course, or other place of exercise or recreation.

While some of the definitions have been shortened, all of subsection (F) has been left in so you can see that your law office is included.

As part of its regulatory powers, in 2010 the United States Department of Justice ("DOJ") planned to undertake rulemaking on the issues of "making the goods, services, facilities, privileges, accommodations, or advantages offered by public accommodations via the Internet, specifically at sites on the World Wide Web (Web), accessible to individuals with disabilities" and requested written comments from the public on the potential proposed rule.[5] The DOJ did not set forth any proposed regulations. Instead, the DOJ advised that:

> Although the Department has been clear that the ADA applies to Web sites of private entities that meet the definition of "public accommodations," inconsistent court decisions, differing standards for determining Web accessibility, and repeated calls for Department action indicate remaining uncertainty regarding the applicability of the ADA to Web sites of entities covered by title III. For these reasons, the Department is exploring what regulatory guidance it can propose to make clear to entities covered by the ADA their obligations to make their Web sites accessible.[6]

Clear as muddy water, right? While the DOJ has issued very specific regulations for the accessibility guidelines for the physical locations of public accommodations,[7] there is no guidance for a public accommodation as to what it would need to do to its website to comply with the ADA, even if the statute did apply to Internet websites. Ultimately, the DOJ formally withdrew its planned rulemaking in 2017 and has not promulgated any specific regulations to date.

Developing Caselaw

It should surprise no one that there is a split among the federal circuits. The Third, Sixth, Ninth and Eleventh Circuits have limited the ADA application to physical locations. The general analysis has been that the list of "public accommodations" in the law were not ambiguous and did not refer to non-physical access[8] or that places of public accommodation are intended to mean actual, physical places.[9]

The most recent case was from the Eleventh Circuit earlier this year that overturned a lower court decision that interpreted the scope of the ADA to

include the website of Winn-Dixie Stores, the grocery chain. In *Gil v Winn-Dixie Stores, Inc,*[10] the Eleventh Circuit made the following finding.

> The statutory language in Title III of the ADA defining "public accommodation" is unambiguous and clear. It describes twelve types of locations that are public accommodations. All of these listed types of locations are tangible, physical places. No intangible places or spaces, such as websites, are listed. Thus, we conclude that, pursuant to the plain language of Title III of the ADA, public accommodations are limited to actual, physical places. Necessarily then, we hold that websites are not a place of public accommodation under Title III of the ADA.[11]

In a subsequent article[12] discussing the ruling in the case, the holding and result was succinctly stated as follows:

> The 11th Circuit majority used a strict textualist approach to determine that websites are not places of public accommodation. The ADA, which demands that disabled people have equal access to goods and services provided by any public place, includes an extensive list of such examples, including stores, hotels, schools, concert venues—pretty much all "physical locations in which individuals will find themselves in their daily lives," the 11th Circuit said.
>
> But the list is limited to "actual, physical spaces," the 11th Circuit said. Intangible spaces, like websites, simply aren't places of public accommodation under the ADA, the court said.

The First and Seventh Circuits and a few U.S. District Court decisions[13] have allowed a more expansive definition. In the *Doe* decision referenced in the preceding endnote, the 7th Circuit noted that a "place of public accommodation" encompasses facilities open to the public in both physical and electronic space, including websites.[14]

What Is Next?

As is often the case, this circuit split will have to be addressed by Congress or the U.S. Supreme Court. The plaintiff in the *Winn-Dixie Stores* case has requested a rehearing *en banc* and has promised to seek a writ of certiorari to the Supreme Court if they do not prevail. In the meantime, businesses should consider that their websites may be subjected to scrutiny related to access by disabled persons in addition to all the other issues facing the providers of the websites.

NOTES

1. Pub. L. No. 101–336, 104 Stat. 328 (1990); ADA Amendments Act of 2008, Pub. L. No. 110-325. 122 Stat. 3553 (2008).
2. 42 USC 12182(a).
3. 42 USC 12181(7).
4. Public entity facilities and transportation is dealt with separately in the ADA.
5. Nondiscrimination on the Basis of Disability: Accessibility of Web Information and Services of State and Local Government Entities and Public Accommodations, 75 Fed. Reg. 43460 (proposed July 26, 2010).
6. 75 Fed. Reg. 43464
7. *See generally* 2004 ADAAG, 36 CFR 1191 *et seq*.
8. *Parker v Metropolitan Life Ins Co*, 121 F3d 1006, 1011 (6th Cir 1997) (en banc).
9. *Weyer v Twentieth Century Fox Film Corp*, 198 F3d 1104, 1114 (9th Cir2000). *See also*, *National Fed'n of the Blind v Target Corp*, 452 F Supp 2d 946, 952 (ND Cal 2006), and *Rendon v Valleycrest Prods, Ltd*, 294 F3d 1279, 1285-86 (11th Cir 2002).
10. 993 F3d 1266 (11th Cir 2021).
11. *Supra*, at 1276-1277.
12. https://www.reuters.com/article/us-otc-ada-idUSKBN2BV2UU.
13. *See Carparts Distribution Ctr, Inc v Automotive Wholesaler's Ass'n. of New England, Inc*, 37 F3d 12, 19-20 (1st Cir 1994); *Doe v Mutual of Omaha Ins Co*, 179 F3d 557 (7th Cir 1999); *National Ass'n of the Deaf v Netflix, Inc*, 869 F Supp 2d 196, 200 (D Mass 2012); *National Fed'n of the Blind v Scribd Inc*, 97 F Supp 3d 565, 570–71 (D Vt 2015).
14. *Doe v Mutual of Omaha Ins Co*, 179 F3d 557, 559 (7th Cir 1999).

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 By Douglas L. Toering and Nicole B. Lockhart

Business Dockets in Michigan – Ten Years with More to Come

In this column, we look back on ten years of business courts in Michigan by reflecting on the ten years since the Macomb County Specialized Business Docket took effect, analyze how far we have come, and anticipate the future of the Macomb County Business Court. On another front, we also interview Genesee County Business Court Judge Brian S. Pickell, who explains his approach to business court cases.

History of Business Courts

In October 2012, then-Governor Rick Snyder signed the business court legislation. This was the culmination of a roughly 12-year effort to establish business courts in the state. The effort was led by the State Bar of Michigan Business Law Section with later study by the State Bar's Judicial Crossroads Task Force and its Business Impact Committee. Macomb County adopted its specialized business docket beginning November 1, 2011, and Kent County adopted its business docket beginning March 1, 2012 (under Judge Christopher P. Yates).[1] The business court statute took effect statewide January 1, 2013.[2]

The goal of the business courts is to:

a) Establish judicial structures that will help all court users by improving the efficiency of the courts.
b) Allow business or commercial disputes to be resolved with the expertise, technology, and efficiency required by the information age economy.
c) Enhance the accuracy, consistency, and predictability of decisions in business and commercial cases.[3]

Macomb County Specialized Business Docket and Business Court

Macomb County was the first business court or specialized business docket in Michigan. Then Chief Judge Mark S. Switalski of the Macomb County Circuit Court implemented the specialized business docket under Local Administrative Order 2011-05.[4] Judge John C. Foster presided over the first business court docket. Under Judge Foster's direction, the specialized business docket established initial discovery protocols for business contract disputes, business organization disputes, employment cases, and non-compete cases.[5] Judge Foster also implemented a variety of other protocols to streamline business cases in his court.

Fast forward a few years. The Michigan Supreme Court appointed Judge Kathryn A. Viviano as the second business court judge in Macomb County in February 2015. Judge Foster retired effective April 30, 2015. Then in August 2015, the Michigan Supreme Court appointed Judge Richard L. Caretti to the Macomb County Business Court. Judge Caretti and Judge Viviano remain the business court judges in Macomb County.

In 2013, the National Association of Counties recognized the Macomb County Circuit Court with an "Achievement Award" in the Court Administration and Management Category for its "exceptional results and unique innovations" in establishing the business court in Macomb County.[6]

With the tenth anniversary of the Macomb County Specialized Business Docket coming up on November 1, 2021, we interviewed Judge Viviano and Judge Caretti for their reflections about those ten years and where the Macomb County Business Court is headed.

Judge Richard L. Caretti and Judge Kathryn A. Viviano and the Macomb County Business Court

When the Macomb County Specialized Business Docket opened in November 2011 and when the business court legislation was passed in October 2012, there was much uncertainty. How would the business court work? Would lawyers support it? These were questions in Judge Caretti's mind. He supported the business court. It was "new and interesting;" he was "happy to participate." But how would the lawyers respond? Many years later, notes Judge Caretti today, the lawyers strongly support the business court. Judge Viviano agreed that the business court was a "good idea" and has developed well. Each judge has a business, general civil, and criminal docket.[7]

With the goals of the business courts being generally efficiency and predictability, has the Macomb County Business Court met the goals? Yes, according to both judges. As evidence, from January 1, 2016 through July 2, 2021, the Macomb County Business Court has disposed of 1,680 cases. During those years, filings total 1,569. So, the business courts are actually disposing of more cases each year than are filed. (This imbalance will not last; over the long term, disposal rates and filings will be equal.)

What accounts for the efficiency? As in many business courts, the answer comes via early judicial intervention and early mediation where appropriate. Regarding the former, both judges set an initial business conference. Prior to the initial business conference, counsel submit a joint pretrial report identifying the claims and defenses and other information about the case. This gives the judges, at the initial business conference, the opportunity to identify factual and legal issues (and how they might be narrowed), damages, settlement possibilities, the possibility of early ADR, and so forth. This helps focus counsel and the parties on resolving the dispute at an early stage.

As Judge Caretti notes, "business clients know the time value of money," and they generally do not want to waste time or money. Echoing this, Judge Viviano points out that business cases are generally different than, say, personal injury cases. Business cases often involve liquidated damages, whereas personal injury cases typically do not. She adds, the

initial business conference with the joint pretrial report is a "great idea for commercial cases."

Discovery does, of course, occupy a considerable amount of these judges' time, as it does for most business judges (and other circuit judges throughout Michigan, as well). Judge Caretti advises counsel to "make every effort to resolve discovery issues before filing a motion. I'm not a discovery referee." Judge Viviano concurs. That being said, both take an active involvement in handling discovery disputes. On motions generally, both judges recommend that the motion provide a preview of the issues, rather than simply referring to the brief.

According to Judge Viviano, another way to increase efficiency in an appropriate case is for the judge to appoint (with consent of counsel) an independent expert on a particular issue.

Going forward, the Macomb County Business Court (like courts throughout the state) will continue to use Zoom. Both judges like Zoom for procedural matters, such as the initial business conference and procedural motions. Judge Viviano prefers in-person hearings, however, for substantive matters, such as summary disposition motions, trials, and settlement conferences. On the other hand, Judge Caretti conducts most matters other than trials on Zoom. Zoom is certainly more efficient (it saves travel and waiting time). But whether to use Zoom for a particular matter should be at the discretion of the trial judge, according to both judges. For more complex matters, Judge Viviano notes, virtual court proceedings miss the in-person engagement and back-and-forth that is helpful for those kinds of proceedings. Also, Judge Viviano observes, with so few civil cases being tried, newer attorneys miss the training (and the opportunity to get to know the judge) that in-person hearings allow. That said, if counsel request a matter be handled by Zoom, the judges will typically comply. Both judges allow hearings on their motions and generally do not decide matters on the briefs, unless counsel request this.

As to advice for litigators, Judge Caretti recommends, "Be prepared, be punctual." Judge Viviano readily agrees. She adds, counsel should "know the rules, know your judge, and be prepared to make a record."

Another thing both judges agree on is that the future of the Macomb County Business Court is bright.

Genesee County Business Court

Judge F. Kaye Behm and Judge Brian S. Pickell are the business judges for Genesee County. Judge Behm replaced Judge Judith Fullerton, who retired. (This column included an interview with Judge Behm in the Summer 2019 issue of the *Michigan Business Law Journal*.[8]) Judge Pickell was elected to the Genesee County bench; his first official day was January 1, 2019. He was appointed to the business court on March 19, 2020.

Before being elected to the court, Judge Pickell practiced intellectual property law (primarily, patent law) for about 20 years. Most of his litigation involved federal matters, but his work in trademarks and trade secrets involved state law as well. His undergraduate degree is in economics, but with a heavy emphasis in physics. He became interested in patent law while attending law school. He had enough science background to take and pass the patent bar.

In addition to business cases, Judge Pickell's caseload includes general civil, criminal, and juvenile law cases. The juvenile cases include cases in the Infant and Toddler Treatment Court.

Regarding his business docket, Judge Pickell handles business cases in the same way he handles other general civil cases. He expects to hold early status conferences, at which he will discuss the claims and defenses, discovery, early mediation, and settlement possibilities. Judge Pickell agrees with the general approach of most business court judges—early and active judicial involvement and early mediation. (Judge Pickell will encourage but not require early mediation.) He holds mandatory settlement conferences before trial.

As for motions, the motion hearing day is Monday afternoons, although Judge Pickell will set a special hearing day on request. He generally holds oral arguments on motions, unless the parties agree to have him decide the matter on the briefs. Judge Pickell has no particular protocol for motions seeking a temporary restraining order or a preliminary injunction.

Regarding discovery, Judge Pickell's approach is to start narrow and then broaden discovery if the case does not settle. He is willing to use discovery mediators if the parties request it.

Overall, Judge Pickell believes that handling business court cases is a cooperative effort among the lawyers and the judge. Accordingly, he wants to be available to counsel to assist them in resolving cases and to be flexible in his approach depending on the particular case. His goal is to process cases efficiently, consistent with the goals of the business court. Judge Pickell maintains a dialogue with Judge Behm and endeavors to make his protocols consistent with hers.

His advice for litigators? "Keep your oral argument concise." Judge Pickell reads the briefs and wants to give counsel adequate time for argument. Nevertheless, he encourages counsel to keep their oral arguments brief.

As for transactional attorneys, Judge Pickell reminds us that the meaning of a clause (or an agreement, for that matter) can "turn on a word." If the same word is used throughout the agreement, then make sure that the use of that word is consistent. Defined terms are often helpful.

As to the future, Judge Pickell looks forward to "getting deeper in the waters" of the business cases and to "getting to know the attorneys and to be helpful to them." In that way, he hopes "we can get a lot of cases resolved together."

NOTES

1. A more complete summary of the history of Michigan's business court statute appeared in Toering, *The New Michigan Business Court Legislation: Twelve Years in the Making*, Business Law Today, ABA (January 2013), https://www.americanbar.org/groups/business_law/publications/blt/2013/01/03_toering/. *See also* Toering and Williamson, *Business Courts in Michigan: Seven Years and Counting*, 99 Mich B J 20 (Jan. 2020).

2. MCL 600.8031 *et seq*.

3. MCL 600.8033(3).

4. https://circuitcourt.macombgov.org/CircuitCourt-BusinessDocket.

5. https://circuitcourt.macombgov.org/CircuitCourt-BusinessDocket. The discovery protocols are not currently being used.

6. https://circuitcourt.macombgov.org/sites/default/files/content/government/circuitcourt/pdfs/MacombBusinessCourtgainsnationalrecognition-MacombDaily6-17-13.pdf.

7. For more information about Judge Viviano, Judge Caretti, and their approach to business court cases, *see* Toering and Fields, *Touring the Business Courts*, 39 Mich Bus L J 11 (Summer 2019), https://higherlogicdownload.s3.amazonaws.com/MICHBAR/ebd9d274-5344-4c99-8e26-d13f998c7236/UploadedImages/pdfs/journal/Summer19.pdf#page=13.

8. *See* Toering and Fields, *Touring the Business Courts*, 39 Mich Bus L J 11 (Summer 2019), https://higherlogicdownload.s3.amazonaws.com/MICHBAR/ebd9d274-5344-4c99-8e26-d13f998c7236/UploadedImages/pdfs/journal/Summer19.pdf#page=13.

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Michigan Dramatically Expands Existing Receivership Law with the Enactment of the Receivership Act

By Paul R. Hage and Michael S. Leib

Introduction

A receivership is an important state court insolvency tool. However, before 2014, there was a dearth of substantive law and procedural guidance for practitioners and judges in Michigan regarding receiverships. The process of providing guidance to the bench and bar about Michigan receivership law and procedure began in earnest in 2014 with the creation of court rules that apply to all receiverships. In 2018, the Michigan legislature passed, and Governor Rick Snyder signed, the Uniform Commercial Real Estate Receivership Act, MCL 554.1011 *et seq.* ("UCRERA"), which applied to commercial real estate and related property.[1] Effective October 15, 2020, Michigan took another step on the guidance highway by enacting the Receivership Act, 2020 PA 210 (the "Receivership Act"), which amends, and extends the applicability of, UCRERA in important ways.

The Receivership Act is a significant expansion of receivership law in Michigan. As discussed herein, the new law contemplates substantially greater powers for receivers of both commercial real and personal property. It also creates additional responsibilities and duties for receivers. While significant progress has been made with respect to Michigan's receivership law, more work remains to be done.

Background

The Debtor Creditor Rights Committee of the Business Law Section of the State Bar of Michigan (the "Debtor Creditor Committee") observed in 2013 that receiverships in Michigan were like the "wild west." Those who practiced regularly in the area developed their procedure built on norms established by others who practiced in the area, but without much caselaw or any definitive court rules to assist. This was fine for those who were familiar with the practice, especially during the Great Recession of 2008, when there were many failed real estate projects. However, there was scant authority that was readily available for the bench and practitioners across the state.

Seeking to address this problem, the Debtor Creditor Committee began drafting court rules to assist the bench and bar with respect to the administration of receivership proceedings. Working with the State Court Administrative Office, draft court rules were submitted to the Michigan Supreme Court, which rules, with some variation, were ultimately enacted as MCR 2.622 in 2014. MCR 2.622 addressed basic receivership procedures concerning the selection of a qualified receiver, disqualification, duties, powers, orders, and receiver bonding.

MCR 2.622 provides that, "Upon the motion of a party or on its own initiative, and for good cause shown, the court may appoint a receiver as provided by law."[2] The rule further provides that a receiver appointed in Michigan "is a fiduciary for the benefit of all persons appearing in the action or proceeding."[3]

MCR 2.622 next addresses the at times uncomfortable issue of selection of receivers. First, MCR 2.622 provides that any receiver appointed by the court must "have sufficient competence, qualifications, and experience to administer the receivership estate."[4] The court rule then provides that the parties can agree on a receiver, or a party can request the appointment of a specific receiver by demonstrating that such receiver meets the aforementioned requirements.[5] If there is no objection to the proposed receiver, the court rule provides that the trial court must appoint the selected receiver.[6] However, if a party objects, or if the court objects to the selected receiver, the court can yet appoint a different receiver *if* the court explains its rationale considering the following factors:

a) experience in the operation and/or liquidation of the type of assets to be administered;
b) relevant business, legal and receivership knowledge, if any;
c) ability to obtain the required bond-

ing if more than a nominal bond is required;

d) any objections to any receiver considered for appointment;

e) whether the receiver considered for appointment is disqualified under subrule (B)(6); and

f) any other factor the court deems appropriate.[7]

It was not long before a judge tested the new court rule by attempting to appoint its own receiver without complying with MCR 2.622(B)(5). In *Casa Bella Landscaping, LLC v Lee*,[8] the Michigan Court of Appeals found that the trial court did not comply with MCR 2.622(B) when it declined to appoint the receiver requested by the plaintiff without objection by the defendant and, instead, appointed its own receiver. The court of appeals found that the trial court failed to make any findings of fact that the proposed receiver was not qualified and failed to reference consideration of any of the factors set forth in MCR 2.622(B)(5) in making its appointment. Ultimately, the court's order appointing a different receiver was vacated, the case was remanded to the trial court, and the plaintiff was permitted to nominate another receiver to be considered by the trial court in accordance with MCR 2.622(B).

The Receivership Act expands the UCRERA such that it now applies to all commercial property, both real and personal.

Not long after *Casa Bella* was decided, UCRERA was enacted in Michigan. It is, first, an attempt to join other states in adopting uniform substantive receivership laws. Indeed, most of the text of the legislation originated from the Uniform Law Commission.[9] By its terms, however, the UCRERA was limited to receiverships involving commercial real property and any personal property related to or used in operating the real property.

After reviewing UCRERA and discussion, a subcommittee of the Debtor Creditor Committee,[10] the Honorable Christopher Yates (Kent County Circuit Court) and State Representative Brandt Iden began work in 2018 to revise UCRERA. The goal of this group was to, among other things, expand the applicability of UCRERA and to harmonize UCRERA with the receiver selection process set forth in MCR 2.622 (compare section 7 of UCRERA and MCR 2.622(B)). The result of those efforts was the Receivership Act, which Governor Gretchen Whitmer signed into law on October 15, 2020.

The Receivership Act

Receivership Law Expanded

The Receivership Act is a significant expansion of receivership law in Michigan. As noted, the UCRERA applied solely to real estate receiverships. The Receivership Act expands the UCRERA such that it now applies to all commercial property, both real and personal.[11] In actuality, receivership proceedings involving operating businesses have existed in Michigan for years. However, until the enactment of the Receivership Act, there was no statutory framework for them.

Additionally, the Receivership Act also harmonized the UCRERA with MCR 2.622, effectively codifying that court rule and its process for selecting a receiver.[12]

A Condensed Version of the Bankruptcy Code

Like most state laws that affect the debtor-creditor relationship, the focus of receivership law in Michigan has traditionally been on creditor remedies. A receiver was frequently appointed if the debtor was insolvent, wasting assets or dissolving. A plaintiff in litigation often sought the appointment of a receiver to preserve the defendant's assets pending resolution of the litigation. Courts also appointed receivers to facilitate an orderly liquidation of assets and the payment of creditor claims from the proceeds. Receivership law was frequently used by creditors in conjunction with other state law creditor remedies such as foreclosure actions, collection actions, and fraudulent transfer law.

The Receivership Act enlarges the role and powers of the receiver such that receivership law in Michigan is now much more than just a creditor remedy for preserving or liquidating assets. It is, in many ways, a condensed version of the Bankruptcy Code[13] that can be utilized to facilitate the continued operation or sale of a business.

Upon the commencement of a receivership proceeding under the Receivership Act, a receivership estate is created. The Receivership Act borrows the broad definition of property of the estate from section 541(a) of the Bankruptcy Code. Specifically, section 2(n) of the Receivership Act defines receivership property as "all of a person's right, title, and interest, both legal and equitable, in real property, personal property, and fixtures tangible and intangible, wherever located and however acquired. The term includes

proceeds, products, offspring, rents, or profits of or from the property."[14]

Like the Bankruptcy Code, the Receivership Act imposes a broad automatic stay. Specifically, section 14 of the Receivership Act stays, among other things, all acts, actions or proceedings to: (a) "obtain possession of, exercise control over, or enforce a judgment against receivership property," and (b) "[e]nforce a lien against receivership property to the extent the lien secures a claim against the owner that arose before entry of the order."[15] As with the Bankruptcy Code, the Receivership Act expressly carves out certain acts and actions from the broad scope of the automatic stay, including, (a) acts by the person who sought appointment of the receiver "to foreclose or otherwise enforce a security agreement," (b) acts "to perfect, or maintain or continue the perfection of, an interest in receivership property," (c) the commencement or continuation of a criminal proceeding, (d) police and regulatory powers by governmental agencies, and (e) establishment of tax liability or appeal of liability by a governmental unit.[16]

In addition to the foregoing, the Receivership Act grants to a receiver substantial rights and powers similar to those conferred upon a trustee in bankruptcy. Section 12(1) of the Receivership Act provides that a receiver may take certain actions, "except as limited by court order or applicable law," including: (a) collecting, controlling, and managing receivership property, (b) operating a business in the ordinary course of business, (c) incurring debt in the ordinary course of business, (d) asserting claims and causes of action belonging to the receivership estate, and (e) employing professionals.[17] Subsection (1) of section 12 also contains a catch-all, which provides that a receiver may "[e]xercise any power conferred by court order, this act, or law of this state other than this act.[18]

Section 12(2) identifies certain additional powers that may be conferred upon a receiver with court approval, including: (i) incurring debt other than in the ordinary course of business, (ii) making improvements to receivership property, (iii) selling property of the receivership estate free and clear of liens other than in the ordinary course of business, (iv) adopting or rejecting executory contracts of the owner, (v) recommending allowance or disallowance of a claim of a creditor, and (vi) making a distribution of receivership property.[19]

The Receivership Act expressly provides that "[t]he powers and duties of a receiver may be expanded, modified, or limited by court order on reasonable notice as determined by the court."[20] This language was included in UCRERA. At the request of the Debtor Creditor Committee, such provision was modified slightly to require "reasonable notice as determined by the court" before the powers and duties of a receiver may be expanded, modified, or limited.[21]

Perhaps the most controversial of the powers identified above are (i) the power to adopt or reject executory contracts of the owner, and (ii) the power to sell property other than in the ordinary course of business "free and clear" of liens. The grant of such powers is controversial because it may be subject to constitutional challenge based on the Bankruptcy Clause,[22] the Supremacy Clause,[23] and/or the Contracts Clause[24] of the United States Constitution and principles of federal preemption.[25]

The power of a receiver to adopt or reject executory contracts of the owner is detailed in section 17 of the Receivership Act. Subsection (b)(2) of section 17 provides, subject to certain exceptions identified in the statute, that:

> Except as otherwise provided in subsection (8), with court approval, a receiver may adopt or reject an executory contract of the owner relating to receivership property. The court may condition the receiver's adoption and continued performance of the contract on terms appropriate under the circumstances. If the receiver does not request court approval to adopt or reject the contract within a reasonable time after the receiver's appointment, the receiver is deemed to have rejected the contract.[26]

Subsection (b)(4) of section 17 overrides so called *ipso facto* clauses, allowing the receiver to assume or reject a contract notwithstanding a provision in such contract, which provides that a party's insolvency or the appointment of a receiver constitutes a default.[27] Finally, subsection (b)(6) authorizes a receiver to assign executory contracts with court approval if, "at the time a receiver is appointed, the owner has the right to assign" such contract.[28] The aforementioned language generally tracks language set forth in section 365 of the Bankruptcy Code relevant to assumption, rejection, and assignment of

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The Receivership Act clarifies that a secured creditor has the right to credit bid all or a portion of its secured indebtedness to acquire its collateral at a sale of such collateral.

executory contracts and unexpired leases, although important concepts from the Bankruptcy Code (such as the obligations to cure defaults and provide adequate assurance of future performance) are excluded.[29]

The power of a receiver to sell property other than in the ordinary course of business "free and clear" of liens is set forth in section 16 of the Receivership Act. That section provides, in relevant part:

> (3) With court approval, and after notice and an opportunity for a hearing is given to all creditors and other known interested parties unless the court orders otherwise for cause, a receiver may transfer receivership property other than in the ordinary course of business by sale, lease, license, exchange, or other disposition. Unless the agreement of sale provides otherwise, a sale under this section is free and clear of a lien of the person that obtained appointment of the receiver, any subordinate lien, and any right of redemption but is subject to a senior lien.
>
> (4) A lien on receivership property that is extinguished by a transfer under subsection (3) attaches to the proceeds of the transfer with the same validity, perfection, and priority the lien had on the property immediately before the transfer, even if the proceeds are not sufficient to satisfy all obligations secured by the lien.[30]

The Receivership Act clarifies that a secured creditor has the right to credit bid all or a portion of its secured indebtedness to acquire its collateral at a sale of such collateral.[31] Finally, subsection (6) of section 16 provides that reversal of a sale order under the Receivership Act does not affect the validity of the transfer to a person who acquired the property in good faith.[32] Bankruptcy practitioners will note that these provisions mirror language set forth in section 363 of the Bankruptcy Code.[33]

Although section 16 incorporates many of the "free and clear" sale concepts of section 363, noticeably absent from the Receivership Act is the recitation of the traditional requirements for obtaining approval of such a sale in bankruptcy, which requirements are set forth in section 363(f) of the Bankruptcy Code. That section provides that, for property to be sold "free and clear of any interest in such property of an entity other than the estate," the trustee must establish one of the five requirements:

> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> (2) such entity consents;
>
> (3) such interest is a lien, and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[34]

It is surprising that the drafters of the uniform law, who went to great lengths to incorporate many of the provisions of section 363 of the Bankruptcy Code, decided not to include these tests with respect to a "free and clear" sale under the Receivership Act. While the Debtor Creditor Committee debated whether to add such language to the Receivership Act, ultimately a compromise was reached whereby the "free and clear" sale power is conditioned on the provision of "notice and an opportunity for a hearing given to all creditors and other known interested parties unless the court orders otherwise for cause …."[35] Although the section 363(f) factors are not expressly incorporated into the Receivership Act, it is likely that parties and courts will consider such factors in deciding whether to approve a proposed "free and clear" sale in a receivership proceeding.

Enhanced Notice Requirements

Given the collective, bankruptcy-like nature of commercial receivership proceedings under the Receivership Act, the Debtor Creditor Committee incorporated certain procedural and notice requirements into the legislation that ultimately became the Receivership Act. These changes incorporate concepts from the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). A few of these changes warrant mention here.

First, the UCRERA did not require notice to all creditors of the appointment of the receiver. This was troubling to the Debtor Creditor Committee. In a traditional real estate receivership proceeding, which is often a two-party dispute, notice of the appointment of a receiver is less important because the key stakeholders are, themselves, parties to the receivership proceeding. However, in a collective proceeding involving an ongo-

ing business operation, it is important that all creditors and interested parties know that the entity that they are doing business with is in a receivership. As a matter of due process, it is also important that creditors know that their rights may be impacted by the receivership proceeding, so that they have a meaningful opportunity to participate.

In an effort to address this concern, subsection (d) was added to section 13 of the Receivership Act, which sets forth duties of the owner (defined as the person for whose property a receiver is appointed, *e.g.,* the debtor). A new duty was added:

> Except as may be otherwise ordered by the court for cause, within 7 days after the entry of the order appointing the receiver, [the owner shall] deliver to the receiver a list containing the name and address of all creditors and other known interested parties of the receivership estate.[36]

This language is comparable to Bankruptcy Rule 1007,[37] and it obligates the owner to provide the receiver with a reasonably accurate notice list. Upon receipt of the notice list, section 20 of the Receivership Act provides:

> Within 7 days after receipt by the receiver of the list required under section 13(1)(d), the receiver shall provide all creditors and any other known interested parties with notice and a copy of any order governing its appointment.[38]

Collectively, these provisions should ensure that, where possible, all known creditors and interested parties receive notice of the commencement of the receivership proceeding. Nevertheless, because flexibility is important in receivership proceedings, the statute provides, "[n]otwithstanding the foregoing, the court may delay, limit, or eliminate the notice required by this subsection on finding that cause exists for doing so."[39]

This extra obligation may not be popular with some who serve as receivers, particularly in cases where it appears that there are no assets available to make a distribution to creditors other than the secured creditor who commenced the receivership proceeding. That said, the provision of notice to creditors and other interested parties might result in the discovery of unknown claims and causes of action, hidden or concealed assets, or competing bidders for receivership property that might help bring about a competitive sale process and, as a result, increased sale proceeds for distribution. In any event, in a collective proceeding, a minimal amount of notice is necessary to ensure that third parties are afforded due process.[40]

A second revision to the legislation inserted at the request of the Debtor Creditor Committee involved the notice of a bar date for the filing of claims against the receivership estate. Specifically, a provision was added to section 20 of the legislation providing:

> If the receiver concludes that receivership property is likely to be sufficient to provide a distribution to creditors other than those holding a perfected lien on the property, the court shall order that the receiver give notice to all creditors and any other known interested parties that they need to submit claims under this section.[41]

Under the UCRERA, notice to creditors of the need to file claims against the receivership estate was optional, even in cases where the receiver anticipates that there will be funds available for distribution to unsecured creditors. The amended language in the Receivership Act mandates the provision of such notice. Nevertheless, as in chapter 7 of the Bankruptcy Code, no notice is required, and there is no need to file a proof of claim, if sufficient assets do not exist to provide a distribution to unsecured creditors.

Third, the Receivership Act requires interim reporting to parties in interest by the receiver. With respect to reporting by the receiver, the UCRERA provided that "[a] receiver may file, or if ordered by the court, shall file an interim report." The Debtor Creditor Committee concluded that periodic reporting should generally be required in a collective, multi-party proceeding. However, members of the committee did not agree on how frequently such reporting should be required. Some members believed that monthly reporting was appropriate, whereas others advocated for less frequent reporting, noting the expense associated with preparing such reports. After debate, the members of the Debtor Creditor Committee compromised at quarterly reporting, while preserving the right of the court "for cause" to require more or less frequent reporting.[42] The Receivership Act provides that reports under section 19 should include the following information: (a) the activities of the receiver since appointment or a previous report; (b) receipts and disbursements, including a payment made or proposed to be made to a professional engaged by the receiver; (c) receipts and dispo-

As a matter of due process, it is also important that creditors know that their rights may be impacted by the receivership proceeding, so that they have a meaningful opportunity to participate.

sitions of receivership property; and (d) detail regarding the fees and expenses incurred by the receiver.[43]

What's Next?

Much has been done to tame the "wild west." As noted, court rules were enacted in 2014, the UCRERA was enacted in 2018, and the Receivership Act became law in 2020. Yet, there is more work to be done. The authors of this article respectfully submit that two issues, in particular, should be addressed in the near future.

Scope of the Receivership Act

We expect that, in the next few years, the Debtor Creditor Committee will seek to draft amendments that expand the applicability of the Receivership Act to all receiverships. Certainly, the Debtor Creditor Committee intended, with the proposed 2020 amendments, to expand the applicability of UCRERA to all receiverships. The legislative process did not allow for that expansion.

Receiverships are useful in situations that may not be commercial. For example, a receivership is a post-judgment remedy found explicitly in MCR 2.621(E) and is not limited to commercial fact patterns. Similarly, the receivership court rules, MCR 2.622, are not limited to commercial cases and assets. There is a strong argument that the Receivership Act should likewise not be limited to commercial property. There is plenty of flexibility contained in the Receivership Act that would make it user friendly in noncommercial cases. The authors hope that, as the bench and bar become familiar with the Receivership Act, the logical next step for expansion of the applicability of the Receivership Act will be recognized and adopted by the legislature.

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Adequate Protection

A significant flaw of the Receivership Act is the exclusion of the concept of adequate protection for parties who have an interest in property that becomes property of the receivership estate. As noted, traditional real estate receivership proceedings usually arise out of a two-party dispute; there is a debtor and a mortgage holder. The Receivership Act expands receiverships in Michigan to operating business entities, which will necessarily involve many other parties. One of the primary goals of the Debtor Creditor Committee in amending the UCRERA was to incorporate certain protections from the Bankruptcy Code that were viewed as necessary to ensure that the receivership process is fair and equitable to all. In furtherance of this goal, the draft legislation that was submitted to the Michigan Legislature included language that provided for the adequate protection of a creditor or interested party's interest in receivership property. The adequate protection concept protects such parties from the risk that a diminution or loss will occur with respect to their interest in the property while the receivership proceeding is pending.[44]

Like the Bankruptcy Code, the Receivership Act imposes an automatic stay and allows a receiver to use, sell, or lease property without the consent of a third party (usually a secured creditor or a lessor) who has an interest in such property.[45] The tradeoff to this extraordinary power in the Bankruptcy Code is that the third party is entitled to receive adequate protection of its interest, so that such interest is not harmed during the receivership proceeding. The concept of "adequate protection" has worked very well in the Bankruptcy Code for decades, and there is ample caselaw providing guidance to the bench and the bar regarding what forms of adequate protection are appropriate and when.

As recently as February 2020, the version of the legislation that became the Receivership Act included a section 12(4), which provided:

> Notwithstanding any other provision of this act, at any time, on request of a person that has an interest in property used, sold, or leased by the receiver, the court shall prohibit or condition the use, sale, or lease as is necessary to provide adequate protection of the value of the interest.

This language mirrored section 363(e) of the Bankruptcy Code.[46] It did not make adequate protection mandatory in all cases; rather it only made the provision of adequate protection mandatory upon the request of a party whose property or collateral is being used or sold against its will. Unfortunately, section 12(4) was removed from the version of the receivership legislation that was approved by the Michigan House of Representatives in early March 2020. The authors of this article provided testimony to the Michigan legislature in July 2020 urging that section 12(4) be added back into the bill. However, no such change was made.

From an equity and fairness perspective, the concept of adequate protection is an im-

portant one. In the multi-party receivership proceedings contemplated by the Receivership Act, secured creditors and lessors are generally precluded from enforcing their state law contractual rights under their loan or lease documents due to the automatic stay. An exception to this general rule exists in section 14(4), but that exception only applies to the particular secured creditor who moved to commence the receivership proceeding.[47] There is no reason for this disparate treatment amongst similarly situated parties. All secured creditors, but particularly those who are involuntarily drawn into the receivership proceeding, are entitled to adequate protection of their property interests when their collateral is to be used, sold, or leased by the receiver without their consent.

Additionally, the term "adequate protection" is actually used in the Receivership Act in the limited context of secured creditors with possessory liens. Section 11(3) provides that a secured creditor who has a security interest in property that is perfected by possession, custody, or control need not turn over such property to the receiver "until the court orders adequate protection of the creditor's lien."[48] It is appropriate that the legislature provided for adequate protection to possessory lien holders. Such protection should also be provided to other parties who have an interest in property that is possessed by the receiver.

Although the Receivership Act does not expressly provide for the provision of adequate protection to all parties who have an interest in receivership property, such parties should not be afraid to ask the receiver and, if necessary, the court for adequate protection. The bench and the bar should understand that the adequate protection concept derives from the Fifth Amendment due process protection of property interests.[49] The United States Supreme Court has reiterated on several occasions the principle that secured creditors should not be deprived of the benefit of their bargain without compensation.[50] That is why adequate protection is necessary. Though the creditor might not receive its bargain in kind, the adequate protection concept ensures that the creditor receives in value essentially what it bargained for. Based on the foregoing, individuals serving as receivers should consider reasonable requests from interested parties for adequate protection. If a negotiated resolution of such requests cannot be achieved, courts should be willing to order the provision of adequate protection where appropriate.

All third parties with an interest in property used, sold, or leased by the receiver should be entitled, upon request, to adequate protection, as they are under the Bankruptcy Code. Courts should be free to determine what form and amount of adequate protection is appropriate. The authors of this article hope that language expressly incorporating the adequate protection concept for all parties with an interest in receivership property will be added to the Receivership Act in the future.

Conclusion

The Receivership Act is a significant expansion of receivership law in Michigan. It represents a major step forward in terms of taming the "wild west" that previously existed. While significant progress has been made with respect to Michigan's receivership law, more work remains to be done.

Although the Receivership Act does not expressly provide for the provision of adequate protection to all parties who have an interest in receivership property, such parties should not be afraid to ask the receiver and, if necessary, the court for adequate protection.

NOTES

1. UCRERA became effective on May 7, 2018.
2. MCR 2.622(A).
3. *Id.*
4. MCR 2.622(B).
5. MCR 2.622(B)(1).
6. *Id.*
7. MCR 2.622(B)(5).
8. *Casa Bella Landscaping, LLC v Lee*, 315 Mich App 506, 890 NW2d 875 (2016).
9. As of the writing of this article, the Uniform Commercial Real Estate Receivership Act put forth by the Uniform Law Commission has been enacted in nine states: Oregon, Utah, Nevada, Tennessee, Michigan, Arizona, Maryland, North Carolina and Florida. Legislation has also been introduced in Connecticut.
10. Members of the subcommittee included Judy Calton, Gregory DeMars, Robert Diehl, David Findling, Judith Greenstone Miller, Paul R. Hage, Kay Standridge Kress, Michael S. Leib and Brian Trumbauer.
11. *See* MCL 554.1014, which provides, in pertinent part, "this act applies to a receivership for an interest in any of the following commercial property (a) real property, fixtures and any personal property related to or used in operating the real property, (b) personal property."
12. MCL 554.1017.
13. The Bankruptcy Code is codified at 11 USC 101 *et seq.*
14. MCL 554.1012(n).
15. MCL 554.1024(1).
16. *See* MCL 554.1024(4).
17. *See* MCL 554.1022(1).
18. *Id.*
19. *See* MCL 554.1022(2).
20. MCL 554.1022(4).
21. *Id.*

22. The Bankruptcy Clause gives Congress the authority to establish "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. art 1, § 8, cl. 4.

23. The Supremacy Clause provides that "This Constitution, and the laws of the United States which shall be made in pursuance thereof … shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding." U.S. Const. art VI, cl. 2.

24. The Contracts Clause provides that "No State shall … pass any … Law impairing the Obligation of Contracts…." U.S. Const. art 1, § 10.

25. Whether provisions of the Receivership Act pass muster under constitutional law is outside the scope of this article. For a thoughtful discussion of constitutional law issues related to state receivership laws, *see* Hon. Michelle M. Harner, *Rethinking Preemption and Constitutional Parameters in Bankruptcy,* 59 Wm. & Mary L. Rev. 147 (2017).

26. MCL 554.1027(b)(2).

27. MCL 554.1027(b)(4).

28. MCL 554.1027(b)(6).

29. *See* 11 U.S.C. § 365.

30. MCL 554.1027(3)-(4).

31. MCL 554.1027(5).

32. MCL 554.1027(6).

33. *See* 11 USC 363.

34. 11 USC 363(f).

35. MCL 554.1026(3).

36. MCL 554.1023(1)(d).

37. *See* Fed.R.Bankr.P. 1007.

38. MCL 554.1030(1).

39. *Id.*

40. The Supreme Court has noted that "An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Mullane v Central Hanover Bank & Tr Co,* 339 US 306, 314 (1950).

41. MCL 554.1030(2).

42. MCL 554.1029.

43. *Id.*

44. Section 361 of the Bankruptcy Code provides:

When adequate protection is required under … this title of an interest of an entity in property, such adequate protection may be provided by—

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that [the automatic stay], use, sale, or lease …, or any grant of a lien … results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief …, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 USC 361.

45. *See supra* Part III.B.

46. The proposed legislation approved by the Debtor Creditor Committee also included a section 2(a), which mirrored the definition of adequate protection set forth in section 361 of the Bankruptcy Code.

47. MCL 544.1024(4)(a) provides that the commencement of a receivership proceeding "does not operate as a stay or injunction of … [a]n act, action, or proceeding to foreclose or otherwise enforce a security agreement by the person seeking appointment of the receiver."

48. MCL 554.1021(3).

49. *See, e.g., Wright v Union Cent Life Ins Co,* 311 US 273, 277-79 (1940) (noting that safeguards must be provided in insolvency laws "to protect the rights of secured creditors, throughout the proceedings, to the extent of the value of the property."); *Louisville Joint Stock Land Bank v Radford,* 295 US 555 (1935) (striking down the Frazier-Lemke Act for unconstitutionally taking a mortgagee's property rights without just compensation and identifying certain constitutionally protected rights of secured creditors).

50. *See, e.g., United States v Whiting Pools, Inc,* 462 US 198, 203-04 (1983) ("Although Congress might have safeguarded the interests of secured creditors outright by excluding from the estate any property subject to a secured interest, it chose instead to include such property in the estate and to provide secured creditors with 'adequate protection' for their interests. At the secured creditor's insistence, the bankruptcy court must place such limits or conditions on the trustee's power to sell, use, or lease property as are necessary to protect the creditor.")

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Exempt Organization Investment and the New UBIT Silo'ing Rules: Beware of What You Wish For

By Emily Kwolek and Jennifer Miller Oertel

While the UBIT silo'ing rules were a vast departure from the former rules that permitted all of an exempt organization's taxable gains to be offset against losses from taxable business activities, a rather surprising (and negative) result arises if the tax-exempt investor negotiates certain governance rights in the investee.

Prior to the 2017 Tax Cuts & Jobs Act, a tax-exempt organization deriving gross income from the regular conduct of two or more unrelated trades or businesses calculated its unrelated business income tax by aggregating gross income from all unrelated trades or businesses and reducing that amount by the aggregate deductions allowed with respect to all unrelated trades or businesses. The 2017 Tax Cuts and Jobs Act added Section 512(a)(6) to the Internal Revenue Code ("IRC"), which requires tax-exempt organizations to compute unrelated business income separately for each of its unrelated trades or businesses.[1] This calculation of unrelated business income tax for each separate unrelated trade or business is referred to as the "silo'ing" rules. The effect is that an exempt organization can no longer offset income from a profitable unrelated trade or business with losses from an unprofitable unrelated trade or business unless they are deemed to be in the same line of business.

Like much of the Tax Cuts and Jobs Act, interpretive regulations were not promulgated until years later. The final regulations for the silo'ing rules were adopted in late 2020 and are generally applicable with respect to taxable years beginning on or after December 2, 2020.[2] Under the regulations, a tax-exempt entity is generally required to identify each of its separate unrelated trades or businesses using the first two digits of the North American Industry Classification System (NAICS) code that most accurately describes the trade or business.[3] However, a tax-exempt organization may treat certain activities in the nature of investments collectively as one separate trade or business and, as such, aggregate the income and losses from all such investments activities in one silo.[4] The IRS has stated that the purpose of aggregating qualifying investment activities into one "silo" is to reduce the administrative burden on a tax-exempt investor of obtaining information regarding the underlying trade or business activities of lower-tier partnerships where the tax-exempt investor holds a relatively small interest.[5]

Under the regulations, the investment activities aggregated as one trade or business are (i) qualifying partnership interests, (ii) qualifying S corporation interests, and (iii) debt-financed properties.[6]

For purposes of this discussion, we focus upon a tax-exempt investor's investment in a partnership and the rather surprising negative results that stem from negotiating strong governance rights that may in fact take the investment out of the general "investment" silo thereby not allowing gains or losses to offset those of other qualifying investments. As noted above, for an investment in a partnership to remain within the collective investment activities silo, the partnership interest must be a qualifying partnership interest (a "QPI").[7] A QPI is generally defined as a partnership interest that meets one of two tests: (1) a *de minimis* test which is satisfied if the tax-exempt investor holds, directly or indirectly, no more than two percent of the profits interest and no more than two percent of the capital interest of the partnership; or (2) a participation test which is satisfied if the tax-exempt organization holds, directly or indirectly, no more than 20 percent of the capital interest and does not "significantly participate in" the partnership.[8] If the tax-exempt investor's capital interest and participation in the partnership investment exceed the participation test thresholds, then income and losses from that particular investment will not be included in the collective investment silo but will be calculated separately as its own separate trade or business (without

the benefit of any other investment's offsetting gain or losses).

The final regulations (issued late in 2020) differ from the initially proposed regulations with respect to the determination of a QPI. The final regulations list four tests for what counts as "significant participation" (which was called the "control" test under the proposed regulations). The proposed regulations set forth four *per se* factors that would cause a partnership interest to fail the control test, but otherwise the control test was based on a general facts and circumstances determination. The final regulations retained the four *per se* factors but eliminated the facts and circumstances test as it was deemed too difficult to administer.[9] As such, there is no "totality of the circumstances" determination with respect to the investment activities, but rather a tax-exempt investor's interest in a partnership investment either fails one of the four tests or it does not.

The final regulations for the silo'ing rules were adopted in late 2020 and are generally applicable with respect to taxable years beginning on or after December 2, 2020.

Two of the four tests concern the powers of the tax-exempt investor. Significant participation will be found if the tax-exempt investor, acting by itself, (i) may require or prevent the partnership from performing any act that significantly affects the operation of the partnership, *or* (ii) may appoint or remove any of the partnership's officers or employees or a majority of directors.[10]

"Significant participation" includes the right to select or remove a single officer or employee or the right to select or remove a majority of the members of the board. Also, a tax-exempt investor with a member on an investment committee that has a veto right over any particular investment may constitute significant participation.

"Significant participation" does *not* include the right to (i) vote to select or remove a single member of the board (although the investor cannot control the right to elect or remove a majority of the board), (ii) send a nonvoting observer to board meetings that can participate in deliberations (but not have a vote like the board members do), and (iii) select a director to sit on a certain board committee (however, if that committee's vote is binding, there may be a question about the tax-exempt investor's participation in an action that significantly affects the operation of the partnership).

The other two factors to determine if a tax-exempt investor significantly participates in a partnership hinge upon whether the officers, directors, trustees, or employees of the tax-exempt investor have (i) any rights to participate in the management of the partnership, *or* (ii) the right to conduct the partnership's business at any time.[11] The IRS received comments to the final regulations requesting modification of these factors because a partnership interest may not qualify as a QPI as a result of a director's, officer's or trustee's affiliation with or activities related to the partnership (or a sponsor, general partner or manager of a partnership). The IRS declined to modify these factors stating that the factors relating to the directors, officers, or trustees may not always represent control, but these factors indicate that a tax-exempt organization participates in the partnership investment to an extent that is sufficient to obtain information necessary to identify the underlying separate trade or business.[12] As such, the activities and affiliations of officers, directors, and trustees of the tax-exempt investor should be reviewed in connection with the investment in a partnership to ensure that a director's, officer's or trustee's affiliation does not preclude the partnership from qualifying as a QPI.

If the partnership provides for unanimous voting requirements or minority consent rights, this could have been deemed a grant of power to a limited partner to prevent an action of the partnership. Several comments were received by the IRS prior to the issuance of the final regulations pointing out that unanimous vote requirements or minority consent rights could cause a partnership investment not to qualify as a QPI. The IRS noted that the significant participation test was not intended to cover unanimous vote requirements or minority consent rights, and so these voting rights were specifically excluded from the significant participation test despite the fact that a unanimous consent requirement effectively gives any investor a veto right.[13] However, a tax-exempt investor will be deemed to significantly participate if it has the unilateral right to consent to or veto any actions of the partnership. The right to make significant operating decisions will also create significant participation risk.

A tax-exempt investor should be able to request the following rights with respect to its investment in a partnership and not be deemed to significantly participate: (i) a covenant from the partnership to the tax-exempt investor about exercising reasonable efforts to avoid UBTI-producing investments (as opposed to a complete prohibition on making

investments that generate UBTI); (ii) the right to access information reporting or books and records; or (iii) partnership audit-related covenants (this may involve rights to notice or participation in an audit or a covenant to make a push out election).

When representing tax-exempt investors in their investments in partnerships and negotiating side letters and other terms relating to such investments, attorneys will want to be aware of rights or powers that permit the tax-exempt investor, by itself, to require the partnership to perform or to refrain from any act that significantly affects the operations of the partnership or rights that grant the tax-exempt investor with the power to appoint or remove officers or employees or a majority of directors. Further, tax-exempt investors should be advised to look into any affiliation or activities that its directors, officers, or trustees have with the sponsor, general partner, or manager of a partnership that could result in such director, officer, or trustee having rights to participate in the management of the partnership or to conduct the business of the partnership.

NOTES

1. 13702 Pub. L. No 115-97, 131 Stat. 2054 (2017); IRC 512(a)(6).

2. Treas. Reg. 1.512(a)-6(i). Taxpayers may choose to apply 512(a)(6) and Treas. Reg. 1.512(a)-6 to taxable years beginning on or after January 1, 2018.

3. Treas. Reg. 1.512(a)-6(b).

4. Treas. Reg. 1.512(a)-6(c).

5. 85 Fed. Reg. 77952 at *77962-77963.

6. Treas. Reg. 1.512(a)-6(c)(1).

7. Treas. Reg. 1.512(a)-6(c)(1)(i).

8. Treas. Reg. 1.512(a)-6(c)(2)(i), Treas. Reg. 1.512(a)-6(c)(3), and Treas. Reg. 1.512(a)-6(c)(4).

9. 85 Fed. Reg. 77952 at *77962.

10. Treas. Reg. 1.512(a)-6(c)(4)(iii)(A), (D).

11. Treas. Reg. 1.512-6(c)(4)(iii)(B)-(C).

12. 85 Fed. Reg. 77952 at *77962.

13. 85 Fed. Reg. 77952 at *77963, Treas. Reg. 1.512-6(c)(4)(iii)(A).

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Charitable Giving: Scholarships and Other Grants to Individuals

By Brittany Kienker, Ph.D. and Jennifer Miller Oertel

Introduction

The COVID-19 pandemic has brought to the forefront questions around how philanthropic organizations may make grants to individuals in a legally compliant manner. In a similar vein, we addressed Disaster Relief Philanthropy in last summer's *Michigan Business Law Journal*.[1] As the United States emerges from the pandemic, charitable organizations continue to look for ways to ameliorate the financial devastation caused by the pandemic and our country's underlying racial injustice that was brought to the forefront during the past year. In this article, the authors will highlight the general criteria of scholarships and other grants to individuals, as well as indicate opportunities for public charities, private foundations, corporate grantmakers, and donor-advised funds to participate in these activities.

This article was adapted from a resource the authors created for the Council of Michigan Foundations entitled "Navigating Scholarships and Grants to Individuals: A Comparison of Philanthropic Giving Options." This publicly accessible resource highlights the regulatory environment and strategies of public charities, private foundations, and corporate giving programs and is available in its entirety through the Council of Michigan Foundation's website.[2]

General Criteria of Scholarships and Grants to Individuals

Nonprofit organizations are required to use their assets to further charitable purposes, including education.[3] Otherwise, charitable organizations risk their tax-exempt status, and additional penalties for taxable expenditures may apply to private foundations and sponsoring organizations that hold donor advised funds.[4] Charitable grants can be made to benefit individuals in need, as part of a scholarship program, disaster relief effort, or to provide monetary awards in certain other limited circumstances.

Foundations and other organizations planning to engage in grantmaking to individuals should first ensure that they have the necessary infrastructure in place. Foundations, in particular, should first check their governing documents (articles of incorporation and bylaws, or the trust agreement, as applicable) to ensure that they are permitted to make grants to individuals. Some governing documents, especially for private foundations, restrict them to providing grants to other 501(c)(3) organizations. For an organization interested in adding this type of activity to its grantmaking portfolio, counsel should make necessary updates to governing documents. Further, private foundations desiring to directly manage their own scholarship programs must secure Internal Revenue Service (IRS) approval of their scholarship procedures in advance; this is not required for grants to individuals in need that are not scholarships or other grants for "travel, study or similar purposes."[5]

Grants to individuals, including scholarship programs and disaster assistance/relief grants, require the designation of a sufficiently large (indefinite) "charitable class," so that it is not possible to know the identity of the recipient in advance.[6] The charitable class is comprised of potential recipients who meet the requirements of the program's criteria, while illustrating a benefit to the general community. Scholarships and other programs benefitting individuals cannot be established to benefit preselected individuals or a relatively small group of people, such as members of a family. Examples of acceptable charitable classes may include graduating seniors of a local high school or first-generation students of a local university. These charitable classes benefit from the fact that future classes are also eligible for these scholarships, making for an indefinite charitable class.

The following discussion involves scholarships or fellowships that qualify under Internal Revenue Code of 1986, as amended ("IRC") section 117(a) as not taxable income to the recipient. Scholarships must be used for study at an educational organization described in IRC 170(b)(1)(A)(ii) and may also entail certain grants constituting a prize or award if the recipient is selected from the

general public, or for grants whose purpose is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching or other similar capacity, skill or talent of the grantee (collectively referred to herein as “scholarship”).

As previously noted, private foundations desiring to conduct their own scholarship program (as opposed to donating money directly to a community foundation or educational institution for such grantee to choose scholarship awardees) must have their “objective and nondiscriminatory” award guidelines approved in advance by the IRS. Otherwise, the grants will be deemed to be taxable expenditures. Further, any scholarship must meet the following requirements:

- Grant recipients must be chosen from a sufficiently large charitable class.
- The selection criteria for recipients must be reasonably related to the purposes of the scholarship or individual grant program.
- Selection committee members must not derive direct or indirect private benefit from the selection of specific grant recipients.
- Grant selection must be made based on a procedure that will reasonably result in grantees carrying out the activities intended by the grant dollars.
- The grantor must receive reports to determine that the intended activities funded by the grant are successfully completed. In the case of grants to schools and universities, the foundation may receive these reports directly from the organization. Grants made directly to individuals must require that the individuals themselves report back to the grantor regarding the use of their funds, and certain additional investigation is required to ensure that the funds are used for charitable purposes.
- Grants and scholarships may be renewed if the foundation has received all required reports on time, all criteria and procedures are objective and nondiscriminatory, and the grantor has not received information indicating the misuse of the original funds. The foundation must pursue recovery of funds that have been misspent.[7]

Scholarships can be established to benefit students attending educational institutions, including traditional preschool, K-12 schools, and colleges/universities. In addition, scholarships may be granted to students attending trade schools and for-profit educational institutions, if the institution meets the following criteria:

- A regularly-scheduled curriculum.
- A regular faculty.
- An enrolled body of students attending the institution.

A foundation paying out a scholarship to a student attending a for-profit institution that fits this criteria would be considered a charitable activity. However, it would likely be a prohibited private benefit to establish a scholarship fund specifically benefitting a particular for-profit educational institution. In other words, the funds must follow the student (or a charitable educational institution).[8]

Private foundations may still make grants to individuals for purposes other than scholarships, such as grants to low-income individuals to assist them with basic needs, so long as the private foundation keeps sufficient records to be able to demonstrate to the IRS that the payments were made for acceptable charitable purposes.

Nonprofit organizations are required to use their assets to further charitable purposes, including education.

Special Rules for Corporate Programs

Corporations (including their related foundations) face significant restrictions on grantmaking when it is limited to employees and/or their children to ensure that there is no self-dealing involved (foundation assets benefiting the related corporation)[9] and also that the payments are not additional compensation cleverly disguised as charity.[10] Except in the context of a federally qualified disaster, employee hardship programs may only be conducted by an independent public charity. Further, payments to individuals, even for charitable purposes, are not entitled to a charitable contribution deduction.

Corporate-sponsored scholarship programs, including scholarship funds established at community foundations by corporations or corporate foundations for the benefit of a particular employer’s employees, have additional restrictions that stem from revenue procedures designed to ensure that these programs are not providing employer

benefits such as additional compensation or employee retention and recruitment under the guise of charity. The main IRS guidance on this subject, IRS Rev. Proc. 76-47, requires that such scholarship programs must meet the following factors:

1. The program is not used as a means of inducing employees to continue employment or follow a course of action.
2. The selection committee is independent of the employer.
3. The program identifies minimum requirements for grant eligibility.
4. Recipients are selected based on substantial objective standards unrelated to the employment of the recipients or their family members and to the employer's line of business.
5. The grant is not terminated because the recipient or his/her family member terminates employment.
6. The course of study for which grants are available are not limited to those that would be of a particular benefit to the employer.
7. The terms of the grant and the course of study for which grants are available must meet all other requirements of IRC 117 and the regulations thereunder, and they must be consistent with a disinterested purpose of enabling the recipients to obtain an education in their individual capacities solely for their personal benefit and must not include any commitments, understandings or obligations, conditional or unconditional, suggesting that the studies are undertaken by the recipients for the benefit of the employer (or the related foundation) or have as their objective the accomplishment of any purpose (even though consistent with exempt status) other than enabling the recipients to obtain an education in their individual capacities and solely for their personal benefit.

In addition, the foundation must limit the number of scholarships awarded to (a) 25 percent or fewer of the eligible applicants who were actually considered by the selection committee in selecting recipients of grants in that year, or (b) 10 percent or fewer of the employees' children who can be shown to be eligible for grants (whether or not they submitted an application) in that year.

Scholarships can be established to benefit students attending educational institutions, including traditional preschool, K-12 schools, and colleges/ universities.

Even when corporations establish employee hardship or employee scholarship programs through an independent charity, such as a community foundation, the same rules applicable to corporations conducting the programs directly should be followed by the independent charity in order to avoid the appearance that the charity is simply a means by which the corporation may avoid the rules by using an intermediary. Selection committees involving a corporate-funded program for its employees must be comprised of individuals who are independent of the company. In the case of a corporate-sponsored program hosted by a community foundation or other public charity, selection committees may include individuals unaffiliated with the company and/or require that less than a majority of the committee consist of lower-level corporate employees that do not provide substantial influence over the donor corporation.

Donor Advised Funds

Donor Advised Funds (DAFs) are prohibited from making grants to individuals. IRC 4966, which defines Donor Advised Funds, includes an exception to DAFs with respect to an advised fund that provides grants for travel, study, or other similar purpose, if –

I. Such person's advisory privileges are performed exclusively by such person in the person's capacity as a member of a committee all of the members of which are appointed by the sponsoring organization,
II. No combination of donors, advisors and their respective family members control, directly or indirectly, such committee, and
III. All grants from such fund or account are awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the board of directors of the sponsoring organization, and such procedure is designed to ensure that all such grants meet the requirements of paragraph (1), (2), or (3) of section 4945(g).

While DAFs cannot be used to provide grants directly to individuals, there are ways for these funds to support scholarships and

similar initiatives. For example, DAFs can provide grants directly to educational institutions or organizations that operate scholarships that benefit students (or a specific population of students). Likewise, donors can use DAFs to establish a more specific scholarship at an educational institution, where the organization manages the selection of recipients, using restrictions and/or criteria set in conjunction with the original donor.

Typically, if a DAF wants to fund a scholarship, the community foundation (or sponsoring organization) will appoint members to a selection committee to vet potential recipients based upon criteria approved by the organization's board of directors. In such cases, the donor and other DAF advisors and their family members, collectively, must compose less than a majority of such committee. It is not uncommon for a sponsoring organization to have set limitations on the amount of permitted donor involvement in these efforts, which may vary by institution.

Scholarship Logistics

When private foundations make grants to individuals, there is always the requirement to:

1. Ensure funds were spent for charitable purposes;
2. Take reasonable steps to recover any unused funds; and
3. Not make any more grants to a person who diverted funds until they have fully restored any diverted funds and have provided assurances ("extraordinary precautions") that a diversion will not occur again.

Foundations oftentimes prefer to send scholarship funds directly to the educational institution attended by the grant recipient. The school then becomes responsible for monitoring the use of the funds, ensuring they are used for the charitable (educational) purpose for which they are intended. Otherwise, the foundation providing the grants directly to students must require reporting from the students about how they used the funds, in keeping with the original criteria of the scholarship program, and verification that the student is still in school and otherwise continues to meet scholarship criteria.

If the scholarship funds are paid to the school to offset the costs of tuition (and living expenses, if applicable), oversight is much easier as there is certainty that the funds are used for charitable purposes. However, if the funds are paid directly to the student there must be oversight to ensure they are used for charitable purposes. Since funds are fungible, then proof of tuition, living and related expenses (or whatever expenses are authorized by the scholarship) would be required to show that those costs add up to the scholarship amount or greater. If the student is no longer enrolled, the student must return the funds.

Foundations should maintain records of all grants, including those directed to individuals through scholarship programs and similar initiatives. These records should be kept in accordance with the organization's records retention and destruction policy for a time beyond the annual IRS Form 990 or 990-PF filing covered by the last grant payment.[11] Records for each grant should include:

- Information related to the individual grant program, including records related to complying with the required grantmaking procedures.
- All records and information used to evaluate grant applicants, both potential recipients and successful grant recipients.
- Information related to the purpose and amount of each grant or scholarship.
- Identification information for grant recipients.
- Information related to grant applicants with relationships to selection committee members (and their family members) and disqualified persons to the foundation.

Scholarships for tuition, fees, books, and supplies specifically required by a course (not general school supplies) are not considered taxable income to the recipient. However, costs such as room and board are considered taxable income to the recipient (although still charitable uses of scholarship funds).

In most cases, community foundations and other organizations that manage scholarships have pre-established rules that define who is eligible for a scholarship or other grant program. Generally, best practice in the field dictates that these grants cannot be made to a board member, staff person, member of a selection committee, or a donor or their family members. Exceptions may be made, for example, if the high school principal always sits on the selection committee and the principal's child is a potential grant

Foundations should maintain records of all grants, including those directed to individuals through scholarship programs and similar initiatives.

recipient. In that case, the principal could recuse themselves from the selection.

Some organizations go so far as to define who constitutes a "family member" or only provides this limitation to "substantial contributors" or those who created the specific scholarship fund. In addition, many procedural documents indicate that scholarships cannot be given to family members of these individuals, including those on the selection committee itself. In some cases, internal procedures may allow for selection committee members to recuse themselves for decisions that may impact family members' eligibility to be considered for a scholarship program. Scholarships provided by private foundations and DAFs may not benefit any disqualified persons.[12]

> Foundations can provide disaster relief grants to individuals in response to federally declared or local disasters that do not receive a federal emergency declaration.

Community foundations are frequently approached by non-501(c)(3) organizations to establish scholarship funds that benefit their members and family members. This would not be deemed charitable because the scholarship fund would provide direct benefit to members of these groups. However, if such an organization approached the foundation to establish a scholarship for students attending a local educational institution and/or program that is not restricted to members and their family members, that option may be considered if the potential charitable class is sufficiently large. For example, a chamber of commerce or a Rotary may want to establish a scholarship fund for students in the geographic region they serve and will work with a community foundation so that contributions to the scholarship fund will be deductible charitable contributions.

Donors and foundations are often interested in establishing scholarships particularly for students of color. Scholarship applications may ask applicants to self-identify their race. Best practice in the field for selection criteria includes consideration of a number of characteristics of recipients, which may include race in addition to additional factors, such as financial need, being a first-generation student at a higher education institution, or something similar. Further information is also available via the College Board's resource, "Key Non-discrimination Principles and Actionable Strategies for Institutions of Higher Education and Private Scholarship Providers."[13] It is important to note that in Michigan and certain other states, state funds (even if granted to a community foundation) may not be used for affirmative action purposes, including gender- and race-based scholarships that would otherwise be permitted by a private institution.[14]

Disaster Relief to Individuals

Foundations can provide disaster relief grants to individuals in response to federally declared or local disasters that do not receive a federal emergency declaration. Grantmaking efforts may serve as an extension of a foundation's standard grantmaking program or follow a special set of procedures that are only followed in the case of a federally qualified disaster. Rules against impermissible private benefit, self-dealing, and recipient charitable class still apply for disaster situations, and grants of this kind should not be intended to benefit disqualified persons.

Public charities, including community foundations, can manage general disaster relief funds that benefit individuals. However, federally qualified disaster declarations are required for private foundations and corporations to provide direct assistance to employees. Additional information about disaster grantmaking and forms of individual assistance is available in IRS Publication 3833.

Disaster grants for individuals, as well as employee hardship funds, are not designed to, and may not, duplicate Federal Emergency Management Agency (FEMA) payments or insurance or other payments to individuals or families. As a result, emergency relief from community foundations and other charitable efforts are designed to help cover the remainder of basic needs created by a federally declared emergency. An individual applying for this category of funding may receive assistance with medical expenses, funeral expenses, temporary housing, travel expenses for family members assisting a victim of a disaster, and other similar expenses resulting from the qualified disaster. Beyond the immediate aftermath of a disaster situation (when all individuals directly impacted may be in need of assistance regardless of personal wealth), organizations must use objective criteria for evaluating victims' financial need to be considered charitable. These funds cannot be used to provide aid to predetermined individuals or families (i.e. funds created to help a family facing a devastating fire), but these individuals can benefit from previously established funds that assist families facing crises, or funds can be created to benefit them and similar disaster situations with an open-ended charitable class.

In conclusion, although IRC 139 provides a bit more leeway, even a federally qualified disaster does not give charitable organizations free rein to provide relief without complying with the very basic tenets governing their charitable activities.

Conclusion

Due to the potential that charitable assets may wrongfully inure to private individuals, charitable organizations must take care when making grants to individuals. Even a global pandemic is no free ticket to set aside the typical prudent operating guidelines of properly crafted objective and nondiscriminatory grant criteria, oversight, and record keeping.

NOTES

1. See https://higherlogicdownload.s3.amazonaws.com/MICHBAR/ebd9d274-5344-4c99-8e26-d13f998c7236/UploadedImages/pdfs/journal/Summer20.pdf#page=19.

2. For a full listing of recommended resources and references used by the authors, see the original document, available at: https://www.michiganfoundations.org/resources/navigating-scholarships-and-grants-individuals.

3. IRC 501(c)(3).

4. Public charities and private foundations are both tax exempt under IRC 501(c)(3). The term "charitable organization" is used in this article to refer to both types of entities.

5. IRC 4943.

6. IRS Publication 3833

7. The New York Community Trust, "Grants by Public Charities to Individuals," Professional Tax and Estate Planning Notes, Issue 2 (June 2002), 2; Council on Foundations, "Scholarship FAQs," https://www.cof.org/content/scholarships-faqs.

8. Charitable organizations and charitable activity cannot be organized to benefit private interests, including people with a personal or private interest in the activities. For example, in the case of a scholarship designed for a broad class of students attending a specific for-profit institution, such a scholarship could be created by owners or beneficiaries of the for-profit, providing personal benefit to the business owners, regardless of the intended "charitable" purpose of serving students attending the institution, and this would therefore likely be prohibited.

9. IRC 4941.

10. *See* IRC 139

11. In the case of an IRS audit, they can request information going back several years. While 3 years is a minimum for maintaining records, best practice may suggest retaining these records beyond that point.

12. IRC 4941 defines self-dealing and IRC 4946 defines disqualified persons.

13. This resource is available at: https://professionals.collegeboard.org/pdf/federal-legal-and-policy-primer-scholarships.pdf.

14. Section 26 of the State Constitution of Michigan of 1963 (eff. Dec 23, 2006).

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Case Digest

Soaring Pine Capital Real Estate & Debt Fund II, LLC v Park St Grp Realty Servs, LLC, Nos 349909, 350159 ___ Mich App ___, ___ NW2d ___ (June 10, 2021)

Defendants received $1 million in loans from plaintiff that provided operating capital for their business flipping tax-foreclosed homes. The note stated that the interest on the principal was twenty percent per annum, and that defendants would pay a commitment fee of $50,000 at closing. Defendants were also responsible for paying all closing costs, including reasonable attorneys' fees paid by plaintiff in connection with the consummation and closing of the loans. The repayment schedule also included a $1000 "success fee" upon the sale of each home or lot sold by defendants. The last relevant term of the contract was a usury-savings clause, which provided that if the interest rate under the contract was determined to be usurious; it would revert to the maximum legal interest rate. After paying plaintiff more than $140,000 in interest, defendants stopped paying on the loans. Plaintiff issued a demand for payment of the amounts still owed and sought interest in the amount of 23.4 percent. When defendants failed to pay, plaintiff sued for breach of contract and fraud, while defendants counterclaimed. Both parties filed motions for summary disposition.

The court found that because the loan contract contained a usury-savings clause, coupled with a stated interest rate at or below the statutory maximum, the loan contract on its face did not violate the criminal usury statute. The trial court properly looked beyond the interest rate stated in the contract and determined that plaintiff's $50,000 "commitment fee" was in fact an additional interest charge, and not acceptable fees and costs under the usury statute. The actual interest rate exceeded more than a 25 percent in violation of the usury statute, and the trial court did not err in granting summary disposition in favor of defendants on this issue. Although the contract was not facially unlawful as it stated the parties' intent to limit the interest rate charged or collected to no more than 25 percent, it was plaintiff's attempt to collect an actual interest rate above the statutory maximum by filing the instant lawsuit that violated MCL 438.41. In light of that fact, the trial court properly applied the wrongful-conduct rule by precluding plaintiff from collecting any interest, but allowing plaintiff to recover the principal of the loan.

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