State Bar of Michigan
BLS
Business Law Section

The Michigan Business Law JOURNAL

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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 Kanika S. Ferency, ICLE, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, (734) 936-3432, ferencyk@icle.org. General guidelines for the preparation of articles for the Michigan Business Law Journal can be found on the Section's website at http://michbar.org/business/bizlawjournal.cfm.

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

Issue	Primary Theme/Committee	Article Deadline
Summer 2018	Nonprofit Corporations Committee	March 31, 2018
Fall 2018	Uniform Commercial Code Committee	July 31, 2018
Spring 2019	Commercial Litigation Committee	November 30, 2018
Summer 2019	LLC & Partnership Committee	March 31, 2019

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://www.michbar.org/business/bizlawjournal.cfm

From the Desk of the Chairperson

By Judy B. Calton

This is my final column as Chair of the Business Law Section. I am being succeeded by the very able and dedicated Mark Peters of Bodman PLC, but I will continue as an ex officio member of the Business Law Council.

I want to take this opportunity to highlight activities and accomplishments of the Section. I believe when our members are aware of the Section's activities, they become more engaged in those activities, and engagement lends to benefit from the Section. I want to encourage that involvement.

The Strategic Plan

In the last year, the Section updated its Strategic Plan under the leadership of Tania (Dee Dee) Fuller of Fuller Law & Consulting, P.C. The Strategic Plan is posted on the Section's page of the State Bar of Michigan website, and you are invited to view it at http://connect.michbar.org/businesslaw/council/councilinfo. The Section attempts to keep Michigan business law current with national trends and compete with business law environments in other jurisdictions. The update incorporated into the Strategic Plan recommendations of the State Bar's 21st Century Practice Task Force. The Strategic Plan outlines objectives and measurable outcomes for achieving the Section's mission (a) of expanding resources for business lawyers by providing educational, networking, and mentoring opportunities; (b) reviewing and promoting improvements in Michigan's business legislation and regulations; (c) providing a forum to facilitate service with commitment to promote ethical conduct and collegiality within the practice; and (d) assisting the Section's members in leveraging technology to more effectively provide legal services.

Educational and Networking Opportunities

The Section excels at providing educational and networking opportunities. Annually, the Section presents the Business Law Institute, a full day session that includes substantive programs and social activities. This year, and for the past several years, it has been held in October in conjunction with the Section's Annual Meeting and quarterly Council Meeting, in Grand Rapids during ArtPrize.

The Section also biennially presents its two day Business Boot Camp to teach newer attorneys in several practical core business law topics. The next sessions will be November 6 and 7, 2017 at the Amway Grand Plaza Hotel in Grand Rapids, and January 29 and 30, 2018 at the Inn at St. John's in Plymouth. Boot Camp information is available on the website at http://connect.michbar.org/businesslaw/home.

The Section has also been working with other Sections and groups to provide educational programs, including on BREXIT with the International Law Section; on employee benefits aspects of mergers and acquisitions with the Taxation Section; and on Michigan's business courts with the Michigan Judicial Institute. The Section also sponsors several ICLE programs throughout the year.

The Section's committees also present educational and networking programs. In the last year, committee programs have included seminars on Michigan's New Domestic Asset Protection Act; Unique Challenges in Representing a Medical Practice; and the Pervasiveness of Privacy on the expanding landscape of privacy issues. Committee meetings frequently include substantive discussions of new Michigan law, such as the Debtor/Creditor Rights Committee having presentations and discussions on Michigan's adoption of the Uniform Voidable Transaction Act, which amended Michigan's Uniform Fraudulent Transfer Act and on the consequences of the Sixth Circuit's recent assignment of rents opinion, *Town Ctr Flats, LLC v ECP Commercial II LLC (In re Town Ctr Flats, LLC*, 855 F3d 721 (6th Cir 2017), and the Nonprofit Corporations Committee discussing the Michigan Community Foundation Act. These committee meetings are great opportunities to keep up to date on and to shape new law and to network with practitioners in specific fields.

The Section could and should focus on increasing its mentoring opportunities.

Advocacy to Change the Law

The Section promotes improvements in Michigan law by advocating changes to Michigan law and regulation. This is a great strength of the Section, although we are probably too quiet about the Section's achievements. To help the Section monitor business related legislation, the Section's Legislative Review Directorship creates a quarterly report on recently enacted and pending Michigan business legislation. These reports are posted on the Section's webpage http://connect.michbar.org/businesslaw/council/directors/legislation.

Most of the Section's advocacy is at the committee level. This advocacy has included the Corporate Laws Committee preparing a round of amendments for the Michigan Business Corporation Act, which it is working on having enacted. The Corporate Laws Committee also worked with the sponsors of Benefit Corporation Legislation, reviewing and making suggestions in the drafting stage, and supporting passage. The Debtor/Creditor Rights Committee is advocating amendments to Michigan's exemptions so that all of a debtor's eligible Individual Retirement Accounts (IRA) and college savings plans will he exempt, not just one IRA and one college savings plan. The Debtor/Creditor Rights Committee also commented on a proposed Federal Rule of Bankruptcy Procedure 9018.1 regarding the ability to file objections in District Court to entry of judgment on Bankruptcy Court proposed findings of fact and conclusions of law. At the Debtor/Creditor Rights Committee meeting regarding the recent *Town Ctr Flats, LLC* opinion on assignment of rents, discussed above, the committee decided to work on amending Michigan's assignment of rents statutes. The Regulation of Securities Committee commented on proposed administrative securities rules published in the *Michigan Register*.

The Section supported amendments to MCR 7.213 on the composition of mediation panels, and it opposed passage of HB 4463, which would have authorized non-attorneys to represent limited liability companies in certain circumstances.

I encourage Section members to identify desirable potential changes in Michigan business law and work with the appropriate committee to advocate that change.

A Forum for the Business Law Community

The Section constitutes a forum for promoting ethical conduct and collegiality in the practice of law. Section leadership and participants in committees form a bond with the others active in the Section. These relationships form a basis for referring cases, obtaining advice in the practice of law, and friendship. The Business Law Digest, which is distributed by SBM Connect, is a great means for communication among Section members. Any member can participate. I encourage you to visit http://connect.michbar.org/businesslaw/communityresources/ourdiscussiongroup?CommunityKey=9b7cae31-2218-4aba-8021-fd0263d0411f&tab=digestviewer to participate in the Digest.

An example of the Section as a community occurred recently when a Section member was brought unconscious to a local hospital with his only identification being his bar membership card. There was no answer at his phone number listed with the bar. The hospital reached out to me as Section Chair to see if I knew how to contact his family to let them know he was hospitalized. I e-mailed the Section leadership, who in turn e-mailed others they knew. Within about ten minutes, his family had been contacted and was on the way to the hospital.

I would appreciate suggestions on other ways the Section can fulfill this portion of its mission.

Leveraging Technology

I personally have been a poor choice to move the Section forward in assisting members in leveraging technology because I have less technological skills than anyone else I know. The Section did partner with ICLE on an internet-based competency map for a merger and acquisitions practice.

I would appreciate any suggestions as to how our Section can better assist members in leveraging technology.

I am a firm believer that the more one participates in an organization, the more one benefits from the organization. Please help yourself and the Section by participating in the Section. In conclusion, visit the Business Law Section website and participate in events and the Business Law Digest. Help the Section improve and achieve its mission.

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 By Kim Breitmeyer

The Corporations, Securities and Commercial Licensing Bureau (CSCL) within the Department of Licensing and Regulatory Affairs (LARA) is responsible for administering just under 20 different statutes with administrative enforcement provisions ranging from the ability to issue safety cessation orders based on an inspection or the impeding of an inspection to the ability to fine, revoke, restrict, or suspend a license or registration, and to the ability to direct a person (licensed or unlicensed) to cease and desist from violating the administrative law. Aside from the statutes that its Corporations Division administers related to business entity formation and filings, the following general categories of professions fall within CSCL's regulatory enforcement authority:

- Carnival and amusement rides (includes zip lines)
- Cemeteries (not owned by a religious institution or a municipal corporation)
- Continuing care communities
- Funeral homes and funeral directors
- Prepaid funeral and cemetery sales contract sellers
- Polygraph examiners
- Postsecondary schools (private proprietary schools and distance education)
- Professional employer organizations
- Professional investigators
- Securities regulation (offerings, investment markets, investment advisers, and stockbrokers)
- Security Alarm Contractors
- Security Guards
- Ski lifts
- Transportation companies (limousines, taxis, and transportation network companies)
- Unarmed combat (professional boxing and professional and amateur mixed martial arts)
- Vehicle protection product warrantors

Boards and Commissions

CSCL works with two government-appointed advisory boards and one advisory commission for purposes of administering the statutes it regulates. These include the Board of Examiners in Mortuary Science, the Ski Area Safety Board, and the Unarmed Combat Commission. All three of these bodies assist CSCL in promulgating and revising administrative rules authorized under the Occupational Code, MCL 339.101 *et seq.*, the Ski Area Safety Act of 1962, MCL 408.321 *et seq.*, and the Unarmed Combat Regulatory Act, MCL 338.3601 *et seq.* Individual members also offer expert guidance to CSCL from the perspective of the respective industries in investigating violations of the administrative laws, participating in both investigations and contested case proceedings. The Cemetery Commissioner oversees the Cemetery Regulation Act, and the Bureau Director, who is also the Securities Administrator, makes final disciplinary decisions concerning the remainder of the statutes CSCL administers. The boards and commission generally only meet a handful of times per calendar year.

Statements of Complaint

Any person may file a statement of complaint with CSCL alleging a violation of a law or laws that it administers, including CSCL on its own initiative. Upon receipt of a complaint from the public, CSCL will generally send the complaining person a written acknowledgement of receipt within five days. If it determines that it has no jurisdiction over the matter, CSCL will notify the complaining person in writing as soon as possible. Otherwise, CSCL will assign the matter to an investigator, examiner, auditor, or inspector for further review. CSCL's Statement of Complaint form can be found at: http://www.michigan.gov/documents/lara/Complaint_Form_3-17_572206_7.pdf, or by visiting www.mi.gov/cscl, and clicking on "Forms & Publications" and then "Complaint Form."

Investigation, Inspection, Audit, or Examination

CSCL has the authority to inspect carnival and amusement rides, ski lifts, funeral homes, proprietary schools, and transportation companies. Many others of the statutes CSCL is responsible for administering permit the Cemetery Commissioner, the Securities Administrator, or CSCL to examine, audit, or investigate books and records maintained by a licensee or registrant. Investigators may reach out to the complaining person, the individual, or business entity being accused of violating the law, their attorney, or other organizations to verify whether a violation of a law CSCL administers occurred. CSCL's Securities & Audit and Licensing divisions are responsible for making this determination before the Securities Administrator issues an initial denial or disciplinary order under the Uniform Securities Act (2002), MCL 451.2101 *et seq.* or referring the matter to CSCL's Regulatory Compliance Division for formal action or the issuance of a denial order under the other statutes it administers.[1]

Formal Disciplinary Action

Attorneys within the Regulatory Compliance Division[2] generally review the complaint file forwarded to it from the Securities & Audit or Licensing division and draft formal legal pleadings or orders setting forth violations of the administrative law and providing notice to the recipient of their legal rights and obligations in response to the pleadings or orders. These pleadings and orders will indicate whether a license or registration is summarily suspended pending receipt of a petition to dissolve, if a person is directed to cease and desist from violating the law pending receipt of a request for hearing to challenge it, or if the person is simply put on notice of the intent to take a certain disciplinary action against them with a hearing or right to hearing offered to challenge it.

If the person already holds a license or registration, and if the administrative action contemplates the suspension, withdrawal, amendment, or revocation of that license or registration, that person must also be given an opportunity to show compliance with the law, unless a greater degree of due process is required under the specific statute. The Notice of Opportunity to Show Compliance will include a form asking the person to elect a compliance conference or proceed directly to a formal administrative hearing generally within 15 days after receipt before CSCL requests a hearing on its own initiative.

Compliance Conferences

Compliance conferences generally have two purposes: (1) to offer a licensee or registrant an opportunity to demonstrate compliance with the law at all times relevant to the complaint; or (2) to offer a licensee or registrant an opportunity to voluntarily engage in settlement negotiations with CSCL. Either an employee within the Regulatory Compliance Division or an assistant attorney general will serve as the conferee of these meetings that may be attended by CSCL staff, a professional board member, the licensee/registrant, and their attorney. If, after the conclusion of the meeting or a reasonable period of time afterwards, the matter is neither closed with no disciplinary action taken nor resolved by settlement, CSCL or the Department of Attorney General will request a formal administrative hearing date before the Michigan Administrative Hearing System. The Uniform Securities Act and Cemetery Regulation Act have unique provisions regarding the timing of formal administrative hearings and specify whether an opportunity for hearing or an actual hearing is required to finalize the matter.

Formal Administrative Hearings

Formal administrative hearings, also referred to as "contested case proceedings," are held before an administrative law judge (ALJ) employed by the Michigan Administrative Hearing System. The ALJ rules on all motions and objections, sets time frames for submitting briefs, exchanging witness and exhibit lists and documents, and conducts prehearing conferences and evidentiary hearings. CSCL is represented by an attorney in the proceeding.

For cases brought under the Unarmed Combat Regulatory Act and the Occupational Code, the ALJ will issue a "Hearing Report" containing findings of fact and conclusions of law that may not be modified by the Board of Examiners in Mortuary Science or the Unarmed Combat Commission. The Board or Commission then has the authority to determine the appropriate licensing penalties.

For cases brought under the other statutes administered by CSCL, the ALJ issues a "Proposal for Decision" containing findings of fact and conclusions of law that may be modified by the Cemetery Commissioner or Bureau Director based upon a review of the record of proceedings and any Exceptions or Response to Exceptions filed by the parties to the proceeding. The Cemetery Commissioner or Bureau Director also determines any licensing penalties.

Final Orders and Compliance Monitoring

After a board or commission, the Cemetery Commissioner, or the Bureau Director make a final licensing penalty determination, a Final Order is issued and mailed to the respondent or applicant. Final orders may direct the respondent to perform additional actions to bring themselves in compliance with the law or may place the respondent or applicant on a period of probation during which time a heightened degree of review of their activities is required. Documents and administrative fines or administrative or audit costs required by those orders must be submitted to CSCL's Securities & Audit Division – Final Order Monitoring area within the time frames specified in the Final Order. Failure to comply within the time frames specified may result in additional civil or administrative action, may result in the immediate suspension of a license or registration, or may require the person to petition a decision maker, board, or commission for reinstatement following late compliance. Overdue fines and costs may be referred to the Michigan Department of Treasury for collection action after six months. Final Order Monitoring may be reached at (517) 241-9180.

NOTES

1. Disciplinary and denial orders issued under the Uniform Securities Act since mid-2016 may be reviewed by visiting www.mi.gov/securities, clicking on "Disciplinary Action Reports," and then on "Securities Reports." All other final disciplinary actions taken by CSCL under the other acts it administers may be reviewed by month by clicking on "Licensing Reports."

2. You may review what to do upon receipt of a formal complaint or order alleging a violation of the administrative law by visiting www.mi.gov/cscl, and clicking twice on "Regulatory Compliance Division."

Kim Breitmeyer is the Regulatory Compliance Division Director of the Corporations, Securities & Commerical Licensing Bureau. In that capacity, she oversees the drafting and service of legal pleadings, orders, settlement agreements, the Bureau rulemaking process, and the compliance conference and contested case hearing programs for the Bureau. She also serves as the Bureau Freedom of Information Act Liaison.

 By Eric M. Nemeth

Now that Fall is upon is, we turn our attention to the traditional seasonal tax customs such as endless debate over tax "reform" or at least thinking around the edges. I will make no bold predictions nor profess any special mystical powers with one caveat: the easiest thing for Congress to do is nothing. I remind you that few observers thought that Congress would let the estate tax laps for a year. Something, anything, had to be done to prevent such an occurrence. Since there was no "grand bargain," nothing happened, which caused something to happen. Plan accordingly.

In past columns I have written cautionary tales concerning the IRS "Dirty Dozen" list. One item on that list was related to micro-captive insurance companies. The now annual list provides an excellent guide for practitioners to warn, counsel, or perhaps admonish clients concerning engaging in possible tax "strategies" presented to them by various advisors. In my experience, business and corporate lawyers are generally not part of the early discussion group, if at all, concerning such strategies and who "promotes" them. There are many reasons that this happens. Sometimes the client is counseled that the strategy is proprietary or secret. Sometimes the client does not want to hear the cautionary tales, i.e. "my lawyer hates everything," and sometimes the client is very fee conscious. This is short-term thinking. Two very recent Tax Court opinions provide eye-opening and sober observations about the consequences of aggressive tax strategies. At the writing of this column, it is unknown if the cases will be appealed or the result of any such appeals. Regardless, clients should understand that the IRS will litigate transactions that they believe lack economic substance or claim outsized tax savings. The results are not encouraging for taxpayers.

In *Avrahami v Commissioner*, 149 TC No 7 (2017), we have an August Tax Court case analyzing the tax consequences under Section 162 of a captive insurance company. The court reviewed whether the various related entities' election under Section 831(b) to be taxed as a small business corporation and Section 953(d) to be taxed as a domestic corporation were valid. They weren't according to the Tax Court. The 105-page opinion delves into the somewhat mystical world of insurance and the calculation of premiums. Judge Holms undertakes a step-by-step journey, often with colorful analogies and statements. Somewhat surprisingly "insurance" is neither defined in the Code nor regulations. However, by crafting and hearing caselaw, what emerge are the characteristics of insurance that guide the analyses. The four guiding criteria that emerge:

- Risk shifting
- Risk distribution
- Insurance risk
- Meet commonly accepted notions of insurance

One factor that seemed to catch particular scrutiny, the captive insurance premiums were far in excess of the traditional business liability insurance premiums that the taxpayer kept in force. Another important factor in the analysis of the court was the apparent remoteness of the coverage in relation to the actual risk. The result was an early victory for the IRS in the likely protracted captive insurance litigation arena. The outcome of the case likely will guide and impact IRS appeals settlement proposals of similar cases. The opinion presents an enlightening discourse concerning reasonable reliance on advisors, and, perhaps even more importantly, who is an advisor and who is a promoter. Promoters cannot be relied upon in good faith *See 106 Ltd v Commissioner*, 136 TC 67, 79-80 (2011), *aff'd*, 684 F3d 84 (DC Cir 2012).

The second case involves a gift to the University of Michigan. In *RERI Holdings I, LLC v Commissioner*, 149 TC No 1 (2017), Judge Halpern disallowed a claimed $33 million write-off. The court held that an omission of the cost basis or other adjusted basis contained in Form 8283 violated the substantiation requirement of the Income Tax Regs. In a very hard-hitting decision, the court noted that the University of Michigan ultimately realized less than $2 million, while the donating partnership claimed a charitable contribution of over $33 million. The full array of penalties was upheld amounting to 40 percent.

Ponzi Scheme Checklist

A recent unpublished panel decision in the Ninth Circuit ruled that the IRS had to return approximately $13 million of tax payments to the trustee in bankruptcy. The payments by DBSI on behalf of its now jailed, former CEO were the proceeds of a Ponzi scheme. The court found that Congress passed legislation waiving sovereign immunity.

IRS.gov

Recently, the IRS has done a major overhaul of their website. Some of the upgrades include links to request tax records, pay current and past due taxes, as well as forms and instructions.

Update

The recent indictments of Paul Manafort and Richard Gates provide a detailed and surgical-like insight into the investigative process of foreign financial accounts. Although the indictment contained no specific Title 26 offenses (tax) contrary to many media reports, make no mistake, the indictments are tax-centric. Unfiled FBARs and unreported income are the central theme. Of particular interest to tax practictioners were several references that the defendants lied to their "bookkeepers, tax accountants, and legal counsel." Regardless of the outcome of the legal proceedings, best practices dictate contemporaneous writings with clients concerning tax and financial reliance and representations.

Lastly, I have written before about law firms being targets for hackers to secure taxpayer and client information. In the last several weeks, the Appleby Law Firm of Bermuda and other tax senstive jurisdictions, had the product of its legal files published. Many prominent individuals had their financial and business affairs exposed. There is little doubt that the investigative arms of the tax authorities of various countries will read the material with interest. Clients (and their advisors) must understand that files maintained online are irresistible targets for sophisticated hackers. American Bar Association Model Rule 1.6 requires lawyers to proactively adopt reasonable security safeguards to protect client data.

Caveat emptor.

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By Michael S. Khoury, Michael Pierson, Tyler Giles, and Lara Slachta

Blockchain and Distributed Ledger Technologies

Blockchain is a foundational technology that has great potential to change business models in the long term and to create new foundations for global economic and social systems, and it is often referred to as disruptive technology. "It will change everything!" Well, will it? What is it? As part of the preparation of this article, I worked with three of my partners who are also members of our firm's FinTech and Blockchain practice group.[1]

What Is Blockchain and How Does It Work?

In the past, businesses used paper account ledgers as the primary reference for the input and maintenance of financial information in a business. If more than one person maintained an identical ledger and records for each transaction, there would be a level of trust and *assurance* that the information contained in all ledgers was accurate. Now consider *digital* ledgers shared across computer networks. As each set of data is changed, such as through a transaction, the change is recorded across numerous distributed ledgers. Before a block of transactions can be added to a blockchain, participants in that blockchain's network must verify the authenticity of the transactions. Once a block is added to a blockchain, the block cannot be modified or removed, thereby providing a heightened level of assurance about the accuracy of the data without the necessity of a third-party intermediary.

Simply put, a blockchain is a continuously growing list of records that are linked and secured using cryptography.[2] A blockchain can serve as a distributed ledger that is managed by a peer-to-peer network adhering to a protocol for validating the addition of new blocks that permanently record data from digital transactions. The first distributed blockchain was created in 2008 and became the core component of the digital currency called Bitcoin and is the public ledger for all transactions in Bitcoin. Bitcoin is a "cryptocurrency" meaning that it is a medium of exchange that functions like money, but, unlike traditional currency, it is independent of central banks or sovereign countries with transactions being recorded on a distributed ledger. Bitcoin is not a data file maintained or held by the owners. It is represented by transactions recorded in a blockchain that are updated and verified and then stored in a block that is linked to the preceding block creating a chain. To ensure validity, each block is part of a sequence from —and must refer to— the preceding block.

What are the benefits of blockchain and distributed ledger? While actual implementations are relatively few, here are some of the key features:

- Only transactions that can be verified are recorded in the blockchain.
- The blockchain data cannot be altered because every block is permanently time stamped and stored across the distributed ledgers.
- The blockchains themselves are distributed so there is no central database that can be hacked or altered.
- The blockchain information itself can be verified at any time. The information resides on the distributed network with no single entity or group that maintains or controls the information. Importantly, the information is public. Anyone using it can review all entries, including the history.
- The blockchain is protected through encryption technology, so it has a high level of security.

Because of these features, blockchain and distributed ledger have the potential to change the way many business transactions are conducted by replacing middlemen and increasing efficiency. Blockchain is currently being used to store records of digital currency and token transactions (more about that later). Startups all over the world are developing blockchain-based technology for use in industries ranging from financial services to manufacturing to retailing.

Which Businesses Might Use Blockchain?

There are several nonprofit alliances that have been established and platforms created. One such platform is the Ethereum platform,[3] which is available for developers to use to build these applications. Banks and other financial services companies, which are part of a growing FinTech industry (or financial services using blockchain technology) are some of the earliest enterprises to experiment with incorporating blockchain applications. This area is being watched closely and is expected to be among the industries that may be transformed the quickest. Financial services companies see blockchain as a way to streamline transactions by eliminating middlemen, paperwork, and errors. Using blockchain could facilitate the speed of (or eliminate the need for) the clearing systems by banks,[4] exchanges,[5] or payment processors. References are provided in the footnotes for further reading and industry and regulatory reports.

Blockchain is seen as such a gamechanger that there are consortia of financial services groups and companies that are focused on developing blockchain and distributed ledger platforms, systems, and applications. One example in the U.S. is the Wall Street Blockchain Alliance,[6] which is a nonprofit industry association that seeks to provide an unbiased approach to the deployment of blockchain. The for-profit side is also active, of course. The for profit R3 Consortium[7] describes itself as an "enterprise software firm working with over 100 banks, financial institutions, regulators, trade associations, professional services firms and technology companies to develop Corda, its distributed ledger platform designed specifically for financial services."[8]

It has released this platform to accelerate the development of applications for the industry.

A report from the consultancy PriceWaterhouseCoopers released a report[9] in March 2016 that blockchain would be the biggest driver of disruption in the financial services industry and would be the "epicentre of disruption"[10] for the industry. The report concluded that "[d]isruption of the [financial services] industry is happening and FinTech is the driver. It reshapes the way companies and consumers engage by altering how, when and where FS and products are provided. Success is driven by the ability to improve customer experience and meet changing customer needs."[11]

Blockchain is seen to have practical applications far beyond FinTech, including processing transactions for retail or e-commerce businesses, enabling payment systems that can be spread out and used in Internet-based transactions, peer-to-peer lending, real estate transactions, supply chain, health care, and smart contracting.

Let us take a look at a couple of examples. In each of these, a third-party intermediary is involved. In the real estate area, blockchain might reduce the need for paper-based recordkeeping. There could be a distributed ledger that could verify transactions and then record and transfer title. The parties to a closing could even use it to trigger the release of funds from escrow. In the healthcare industry, a blockchain can store records securely, record data accurately, and speed up claims processing by reducing errors.

Smart contracts provide a very interesting use of the blockchain technology. A user could automatically interact with other similar users to create and execute contracts with no human involvement (other than the lawyers that need to be involved at the front end and in the administration of the processes). The parties could agree to purchase goods through a smart contract programmed to execute a contract within certain parameters. The smart contract could then facilitate the delivery of the goods and confirm delivery. As soon as delivery occurs, the funds would be released and sent to the seller.

Regulation of Cryptocurrencies

Are bitcoin and other digital assets considered currency under the law? Commodities? How are they regulated? Should they be regulated? These are some of the developing questions, and some answers are starting to coalesce as the technology and its commercial applications evolve.

First, remember that the regulatory environment in the U.S. is not a complete vertical. Different agencies will have jurisdiction over different types of assets or transactions. Also, different legal regimes may treat them differently. An analysis under the Uniform Commercial Code may determine that bitcoin is not currency that can be secured like cash.[12] Under other regulations, it may be considered to be a currency, a commodity, or none of the above. This is all developing.

States are even being asked to consider legislation that would require a license for those who transact in cryptocurrencies in order to provide consumer protection.[13] Whether new regulations will be drafted or existing regulations extended to cover crptocurrencies is an open question. Although cryptocurrencies emerged from an effort to supplant national currencies and seamlessly cross borders, even big banks believe they cannot grow without regulation.[14]

ICOs

An initial coin offering (ICO) is a blockchain-related method used to raise funding (typically to fund a project) through the sale of tokens in consideration for payments in cryptocurrencies. The tokens are liquid, meaning that investors can make money by speculating on tokens that increase in value following an ICO. Though an ICO may be similar to an initial public offering (IPO) in certain ways, there are intrinsic differences. For example, an IPO allows the public to purchase shares of a listed company, which typically carry rights to dividend and voting. Conversely, most tokens issued in an ICO do not carry any of those benefits, and some tokens may merely give its holder a right to access a network.

In the wake of an increasing number of ICOs, various regulators are weighing in on how to apply existing regulation to the blockchain-enabled funding mechanism. For instance, the Chinese regulators have recently declared ICOs to be illegal, requiring those who have completed ICO fundraising to unwind the investments and make arrangements to return the funds raised. Additionally, in July 2017, The U.S. Securities and Exchange Commission's Division of Enforcement issued a report of investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934 regarding the application of the federal securities laws to the offer and sale of tokens, including whether the issuance of a digital "coin" or "token" invokes securities laws, particularly the need to register offerings of ICOs under the federal securities laws.[15] In another recent event, the U.S. Commodity Futures Trading Commission has determined that bitcoin are commodities subject to CFTC enforcement actions.[16]

Conclusions

Blockchain really does have the potential to be a disruptive and game-changing technology. Will it mean the end of business as we know it as some have predicted, or perhaps an evolutionary shift that will transform business? This remains to be seen, but this is something that every business lawyer should keep on her or his radar.

NOTES

1. Many firms such as ours have established multidisciplinary practice groups that bring together expertise in capital markets, data security and privacy, securities and private equity, fund formation, intellectual property and technology. Our firm is also a member of the Enterprise Ethereum Alliance, which is composed of blockchain companies, law firms, research groups, and Fortune 500 companies seeking to coordinate the engineering of an open-source reference standard and private, "permissioned" version of the Ethereum blockchain that can address the common interests of enterprises in banking, management, consulting, automotive, pharmaceutical, health, technology, mobile, entertainment, and other industries.

2. Cryptography involves the use of mathematical formulae to essentially "lock" or encrypt information so that the accuracy of the information is secured by protecting the text or other information from being changed.

3. https://ethereum.org/

4. See Federal Reserve Bank Report "Distributed ledger technology in payments, clearing, and settlement" at https://www.federalreserve.gov/econresdata/feds/2016/files/2016095pap.pdf

5. See FINRA Report "Distributed Ledger Technology: Implications of Blockchain for the Securities Industry" at https://www.finra.org/sites/default/files/FINRA_Blockchain_Report.pdf

6. https://www.wsba.co/

7. https://www.r3.com/

8. *Id.*

9. https://www.pwc.com/gx/en/advisory-services/FinTech/pwc-FinTech-global-report.pdf

10. https://www.pwc.com/gx/en/advisory-services/FinTech/pwc-FinTech-global-report.pdf at Pg. 8.

11. https://www.pwc.com/gx/en/advisory-services/FinTech/pwc-FinTech-global-report.pdf at Pg. 29.

12. *See generally* MCL 440.1201(2)(x).

13. This approach is being proposed as part of the Uniform Regulation of Virtual-Currency Businesses Act which was published this summer by National Conference of Commissioners on Uniform State Laws. See http://www.uniformlaws.org/shared/docs/regulation%20of%20virtual%20currencies/URVCBA_Final_2017oct9.pdf

14. https://www.bloomberg.com/news/articles/2017-06-13/morgan-stanley-says-bitcoin-needs-regulation-to-keep-rising

15. https://www.sec.gov/litigation/investreport/34-81207.pdf

16. See "CFTC Charges Nicholas Gelfman and Gelfman Blueprint, Inc. with Fraudulent Solicitation, Misappropriation, and Issuing False Account Statements in Bitcoin Ponzi Scheme" at http://www.cftc.gov/PressRoom/PressReleases/pr7614-17

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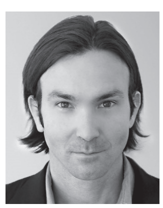

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Touring the Business Courts By Douglas L. Toering*

In this issue, we begin a regular column on the business courts in Michigan. What is happening in the Michigan business courts is of interest to all business attorneys, whether transactional lawyers or litigators. In this issue, we focus on the 2017 amendments to the business court statute. Future issues will review significant business court cases and discuss specific issues in individual business courts.

Michigan Business Courts: Background

A mere five years ago, Public Act 333 of 2012 was enacted, mandating that circuit courts with three or more judges establish specialized business courts.[1] The business courts were created with three purposes:

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.[2]

In the sixteen Michigan circuits with a business court,[3] every "business or commercial dispute" must be assigned to the business court.[4] The statute defines what constitutes a "business or commercial dispute" and what does not. The business courts are generally regarded as a success by the legal community.[5]

Nevertheless, a number of unexpected claims have made their way into the business courts.[6] These include suits against members of credit unions and disputes over residential property.[7] Although those claims often "technically fit" under the language of the original statute, they were not meant to be litigated in the business courts.[8]

In April 2017, Michigan Senators Rick Jones and Marty Knollenberg introduced a bill to address these jurisdictional issues and reduce delays.[9] SB 333 proposed amending MCL 600.8031 and MCL 600.8035 to refine and clarify the business court's jurisdiction.[10] Supporters of the bill stressed the importance of maintaining proper jurisdiction and the purpose for which the business courts were created.[11] The amendments passed and took effect October 11, 2017.[12] In general, the amendments are designed to ensure that cases that are truly business disputes will be assigned to the business courts, whereas cases that are not truly business disputes will be assigned to the general civil docket.

Amendments to MCL 600.8031: Business Court Jurisdiction

The 2017 amendments affect the definition of a "business or commercial dispute." With the amendments, a "business or commercial dispute" now:

- Excludes disputes in which all parties are business enterprises where the claims are all expressly excluded under subsection (3);[13]
- Clarifies that "members" mean "members of a limited liability company or similar business organization;"[14]
- Adds "guarantors of a commercial loan" to the list of acceptable parties in an action involving a business enterprise;[15] and
- Moves subsection (1)(c)(iv) to subsection (2)(a). Thus, business or commercial disputes now include actions involving "the sale, merger, purchase, combination, dissolution, liquidation, organizational structure, governance, or finances of a business enterprise."[16]

The other amendments to MCL 600.8031 expressly *exclude* the following:

- Supplementary hearings regarding proceedings to enforce judgments of any kind;[17]
- Construction and condominium lien foreclosure matters;[18]
- Actions involving enforcement of condominium and homeowners' governing documents;[19]
- All motor vehicle insurance coverage disputes;[20] and
- Additional Revised Probate Code sections referenced.[21]

Amendments to MCL 600.8035: Clarification of Jurisdictional Requirements

Section 8035 was also amended. It now:

- Provides business court jurisdiction for "business and commercial disputes in which equitable or declaratory relief is sought," or for actions that otherwise meet the jurisdictional requirements of the circuit court;[22]
- Replaces "shall" with "must" in the provision requiring that business or commercial disputes filed in a court with a business docket be maintained in the business court;[23] and
- Replaces "shall" with "must" in the provision requiring a blind draw for assignment of judges.[24]

Developments in Various Business Courts

Ingham County

Judge Joyce A. Draganchuk recently attended a comprehensive course on electronically stored information including preservation, searching, retrieval, and admission. She reports that "ESI is everywhere and it is not going away." She adds, "[A]ttorneys who appear before me should now expect that I will have a firm grasp on all aspects of ESI and if they are not likewise educated in this area they had better become educated."

**The author would like to thank Emily S. Fields for her help in researching and drafting this column. Ms. Fields is an associate at the Troy, Michigan office of Mantese Honigman, PC.*

Kent County

As of January 1, 2017, Judge J. Joseph Rossi has assumed one-third of the business docket. Judge Christopher P. Yates has the other two-thirds of the business docket.

Oakland County

The Business Court Advisory Committee is currently making recommendations regarding revisions to the Protocols and Standing Orders.

Wayne County

The first annual Wayne County Business Court – Bench Bar Meeting occurred October 20, 2017 in the jury room of the Coleman A. Young Municipal Center. It was well-attended and very informative

Conclusion

Michigan business courts were designed to efficiently and consistently resolve business disputes with trained business court judges. The recent amendments to MCL 600.8031 and MCL 600.8035 should help further these goals. By clarifying business court jurisdiction, the amendments will help assure that only those cases that are truly "business or commercial disputes" are filed in the business courts.

NOTES

1. MCL 600.8031 *et seq.* (amending the Revised Judicature Act of 1961).
2. MCL 600.8033(3).
3. Business courts are found in the following Michigan counties: Berrien County; Calhoun County; Genesee County; Ingham County; Jackson County; Kalamazoo County; Kent County; Macomb County; Monroe County; Muskegon County; Oakland County; Ottawa County; Saginaw County; St. Clair County; Washtenaw County; and Wayne County.
4. MCL 600.8035(3). A fuller summary of Michigan's business court statute appeared in Mantese & Toering, *It's My First Business Court Case: What Should I Expect?*, 95 Mich Bar J 46 (Nov. 2016), http://www.michbar.org/file/barjournal/article/documents/pdf4article2881.pdf; and Toering, *The New Michigan Business Court Legislation: Twelve Years in the Making*, Bus L Today (Jan. 2013), http://www.americanbar.org/publications/blt/2013/01/03_toering.html. The ABA also publishes an annual Review of Developments in Business and Corporate Litigation, which contains a section on the Michigan business courts.
5. Senate Legislative Analysis, SB 0333, May 22, 2017.
6. House Legislative Analysis, SB 0333, August 3, 2017.
7. *Id.*
8. *Id.*
9. 2017 Senate Journal 487 (No. 39, April 26, 2017).
10. Senate Legislative Analysis, SB 0333, May 1, 2017.
11. House Legislative Analysis, SB 0333, August 3, 2017. No arguments were submitted in opposition to the bill.
12. MCL 600.8031 and MCL 600.8035.
13. MCL 600.8031(1)(c)(i). Subsection (3) provides a list of seventeen types of actions that are expressly excluded from business court jurisdiction, including, for example, personal injury matters, criminal actions, and probate matters.
14. MCL 600.8031(1)(c)(ii).
15. *Id.*
16. MCL 600.8031(2)(a). Relocating this provision would not appear to have a significant effect on the actual jurisdiction of the business courts in such actions. The move is for clarification only.
17. MCL 600.8031(3)(i).
18. MCL 600.8031(3)(k).
19. *Id.*
20. House Legislative Analysis, SB 0333, August 3, 2017. Under the previous language of MCL 600.8031(3)(l), motor vehicle insurance coverage disputes under the Insurance Code were excluded unless two or more parties were insurers. Under the amendment, "business or commercial disputes" expressly excludes all motor vehicle insurance coverage actions.
21. *Id.*
22. MCL 600.8035(1). The previous version required an amount in controversy exceeding $25,000. By its terms, that meant that a declaratory judgment case that did not seek damages could be excluded from the business court.
23. MCL 600.8035(3).
24. MCL 600.8035(4).

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 By Julie Missler and Kim Yapchai

Exploring Compliance Career Opportunities

More and more companies are carving out and defining the role of compliance within their organizations. Boards of directors and CEOs are realizing the need for a compliance officer that will offer protections not only for the company but for them individually, as well as to identify fraud, waste, and abuse. Research shows that a well-developed and effective compliance program not only helps to shield a company from costly government investigations and lawsuits, but companies with cultures of high integrity actually perform better than those that do not. So if you have not thought about a career in compliance before, now is a good time to start.

The most commonly known position in compliance is the Chief Compliance Officer (CCO), but it is not the only position. The compliance field has a surprising variety of positions from which to choose. An entire industry has grown from the regulations set forth in the U.S. Sentencing Guidelines 20 years ago. For example, there are third-party due diligence companies, training vendors, enterprise risk management solutions, investigators, corporate monitors, hotline providers that provide anonymous complaint reporting channels, and more.

If you explore corporate compliance programs, you will find that the scope and structure varies from company to company. Some compliance teams report directly to the CEO or Audit Committee. Others are part of the legal, internal audit, or human resources departments. Some people say the ideal structure is to have the compliance function as a separate department reporting to the Audit Committee. Regardless of which structure is selected, having the buy-in and support of the Board of Directors and business leaders is of the utmost importance. If you are considering a job offer, be sure that you understand the scope and structure of the role before you accept.

Many compliance officers have backgrounds in antitrust, anticorruption, corporate investigations, or other legal areas. That is not surprising since "compliance" is a word that many people understand as complying with laws and regulations. Sometimes, the role is combined with the general counsel position. Similar to a general counsel's role, a chief compliance officer's role spans the company operations and the company's legal risks. CCO roles typically involve interaction with the Board of Directors and Audit Committee in addition to company leaders. Other compliance roles may be focused on particular legal topics such as import/export, anti-corruption, or privacy.

CCO's also commonly have backgrounds other than law, such as internal audit and human resources. These diverse work experiences reflect the multi-disciplined approach needed for a successful compliance program. For example, compliance programs involve training and leadership development, which also overlaps with human resources. Internal auditors deal with auditing, controls, and fraud, which help to mitigate and detect non-compliance. CCO's without a legal background still work closely with lawyers though. When law firms and in-house lawyers understand these other functions, they can be more successful at providing advice and solutions and accomplish more. By working together, compliance, legal, internal audit, and human resources can be highly effective and save the company time and money.

Regardless of whether you have a legal background or not, the broadest of compliance roles encompasses many skills. Here are some examples of competencies demonstrated by a successful compliance professional:

> You are a MARKETER because you need to creatively promote the compliance program and communicate with employees. Engaging a public relations professional can be worth its weight in gold for communicating your compliance messages.
>
> You are a COUNSELOR because you need to keep information confidential, exhibit strong listening skills, and calmly help people through sometimes stressful situations.
>
> You are a DETECTIVE because you need to identify root causes to help design corrective action plans.
>
> You are a PSYCHOLOGIST because you need to understand what motivates and inspires employees and what drives a culture of integrity.
>
> You are a DATA ANALYST because you report compliance program metrics.

You also need to use skills like executive presence and strategic thinking as discussed in this column last year, "Professional Development: Taking the Next Step in Your Career" (Fall 2016). If you are fortunate, you have an entire team with these skill sets. Whether you have a dedicated team or not, you will need to use leadership skills to develop supporting roles within the organization since compliance is a fluid concept that requires every employee to do his or her part.

Fortunately, the compliance community is supportive and provides many best practice sharing and educational opportunities. In fact, all the available resources can be overwhelming. There are so many, it is not possible to list all of them but here are a few organizations with conferences that we have attended:

- Ethics & Compliance Initiative
- Ethisphere® Institute
- Compliance Week
- Corporate Executive Board (CEB), now Gartner
- Society of Corporate Compliance & Ethics

Many consultants and service providers create regional opportunities for their customers to gather for roundtable discussions if you are looking for something smaller and more convenient. Additionally, there are many free webinars, blogs, and other resources. The point is that you do not have to figure it out on your own, and it helps to embrace a growth mindset as the compliance field continues to evolve. Some recent examples of change are the U.S. Department of Justice's publication, *Evaluation of Effective Compliance Programs*, and the ISO 37001 standard regarding anti-bribery management systems.

As you navigate the channels of compliance, you will quickly find that there are many options from which to choose. A compliance career, be it in-house, for a law firm, or a vendor, can be challenging and very rewarding. Not only will you gain continuous professional growth, but you will have the opportunity to personally affect the betterment of your surroundings. This happens because many companies go beyond the law's requirements in their pursuit of ethical leadership. They believe it is the right thing to do, and you can be a part of it.

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2017 Amendments to Michigan's Business Corporation Act

By Justin G. Klimko

Introduction

During the previous three decades, the Michigan Business Corporation Act (the "BCA")[1] has been amended every few years. Additional amendments have now been introduced in the Michigan legislature. This package of amendments was developed by the Corporate Laws Committee of the Business Law Section of the State Bar of Michigan (the "Corporate Laws Committee"). The amendment bill was introduced in June 2017 as Senate Bill 442. At the end of October, it was passed unanimously by the Senate and referred to the House Committee on Commerce and Trade, where it was under consideration when this article was prepared. Futher action is expected prior to the end of 2017.

The amendments can be summarized as follows:

- They would permit shareholders and directors to deliver written consents to be effective in the future, even if the person delivering the consent is not a shareholder or director at the time the consent is executed.
- They would clarify the rules in Section 405 regarding remote participation in shareholders' meetings.
- They would provide rules to facilitate second-step mergers following tender offers without the need for shareholder approval under certain circumstances.
- They would permit designation of classes of "blank check" preferred stock, rather than restricting that designation to series of stock.
- They would amend several sections of the BCA applicable to professional corporations. The last amendment package, which became effective at the beginning of 2013, eliminated the Professional Service Corporation Act[2] as a separate act and instead brought those provisions into the body of the BCA as Chapter 2A.[3] Among other things, these amendments would clarify that entities may be shareholders in PCs if all their owners are properly licensed in the relevant professions.
- They would clarify the requirements for approval of a plan of conversion under which a non-corporate entity converts to a business corporation governed by the BCA.
- They would allow a board to amend a corporation's articles, without shareholder approval, to eliminate references to resident agents and registered offices. Current language permits such an amendment only to eliminate references to the corporation's *initial* resident agent or registered office.
- They would delete Section 784(2), which was rendered obsolete by previous amendments, and make other technical amendments.

Background

The latest amendments are part of the Corporate Laws Committee's continuing efforts to monitor the BCA to keep it up to date with developments in the corporate laws of other jurisdictions and the Model Business Corporation Act, as well as to reflect trends in corporate governance and regulation and occasionally to address the results of caselaw holdings. The BCA typically is amended on a three- to four-year cycle, with significant previous amendments effective in 1989, 1993, 1997, 2001, 2006, 2009, and 2013.

Specific Provisions

Written Consents with Future Effectiveness

Sections 407[4] and 525[5] of the BCA permit shareholders and directors to act by written consent rather than at a meeting. Shareholders may always act by unanimous written consent. Additionally, if authorized by the articles of incorporation, action may be taken if consents are delivered by holders of shares that would have sufficient votes to take the action at a meeting at which all shares entitled to vote on the action were present and voted.[6] Director action without a meeting may be taken only by unanimous written consent.

These sections would be amended to provide that written consents may be delivered for effectiveness at a future time even if the persons delivering the consents are not shareholders or directors at the time the consents are executed and delivered. This would occur most often in connection with a transaction involving a sale of a company or a new investment. The rules governing consents for shareholders would differ from those governing consents for directors.

Under proposed Section 407(4),[7] a person would be permitted to execute a shareholder consent that directs that the consent will take effect at a future time. The direction could be given through an agent or in some other manner, and the person would be required to designate a specific date or a specified future event (for example, a closing) when the consent would take effect. The date or event must occur not more than 60 days after the date the person provides the direction. The consent would be effective on the date or event specified only if the person is a shareholder on the record date applicable to the consent. The person would not be required to be a shareholder when the consent is executed or the direction is delivered. The direction could be revoked at any time before it becomes effective. Under Section 407(4), if the direction is not revoked, the future time specified would be considered both the effective time of the consent as well as the date of signature of the consent.

The BCA typically is amended on a three- to four-year cycle[.]

New Section 525(3)[8] would govern director consents with future effectiveness and would allow a person to execute a consent to an action of the board or a board committee that directs that the consent will take effect at a future time. As with shareholder consents, the direction could be given through an agent or in some other manner, and the person would be required to designate a specific date or a specified future event when the consent will take effect, which could not be more than 60 days after the date the person provides the direction. The consent would be effective on the date or event specified only if the person is a director at the future time specified, but the signer would not have to be a director on the date the consent is signed or the direction is given to the corporation. The direction would be revocable before it becomes effective and, if not revoked, the future time specified would be considered the time the consent takes effect.

The mechanics and time periods for consents with future effect are very similar for shareholders and directors, except status requirements. A shareholder consent would be effective if the signer is a shareholder on the record date applicable to the consent; he or she would not need to be a shareholder at the specified future time or action. In contrast, a director consent would require that the signer be a director at the future time or event specified in the direction. This reflects the difference in the way shareholder and director actions are taken. Director action is taken by directors in office on the date of the action. For shareholder action, however, the BCA (like other corporate statutes) uses the concept of a record date. This is because shares may change hands at any time, and so a rule is needed to determine who is entitled to vote on a given matter. A person who is a shareholder on a record date may cast a valid vote even if not a shareholder on the date of the meeting or action taken, and a person who acquires shares after a record date has no right to vote on the action in question absent a proxy from the record holder.[9]

Remote Participation

BCA Section 405[10] has long provided that shareholders may participate in a shareholders' meeting by conference telephone or other remote communication. Currently, all persons participating in the meeting must be able to communicate with the other participants, but this provision is ill-suited to online meetings of larger (especially publicly held) companies and would be eliminated by the amendments. Section 405 would continue to require that shareholders have a reasonable opportunity to participate in and vote at the meeting.

Remote participation would be permitted if authorized by the board of directors "in its sole discretion." This added language clarifies that remote participation is permitted as a convenience to a corporation in the conduct of meetings, but does not confer a right on shareholders to participate remotely. A board may choose not to permit remote participation.

Second-Step Mergers

Section 703a[11] would be amended to provide that in certain second-step mergers or share exchanges involving publicly held companies, shareholder approval is not required.

This would cover situations where a party to the transaction has completed an offer to purchase the corporation's shares (such as a tender offer) and as a result controls a sufficient number of shares to approve the merger or share exchange. The second-step transaction would give the offeror control of all shares. Under those circumstances, requiring a shareholder vote would be a needless formality, and so the amendments would allow the corporation to dispense with the time and expense of a shareholder meeting and proxy solicitation.

The new provisions anticipate that a merger or share exchange agreement would be created at the outset in tandem with an offer to purchase shares of the target corporation. This would enable publicly held corporations to enter into sale transactions in a more expedited fashion than if done in a straight merger or share exchange. A first-step tender offer could get cash into the hands of shareholders relatively quickly, and the second step could then be implemented to give the offeror 100 percent control of the corporation, so long as the remaining control were acquired on the same terms as the first-step offer.

A second-step transaction would not require a shareholder vote if the following conditions were met:

- The plan of merger or share exchange expressly permits or requires the second-step transaction to be made under the new statutory provisions, and requires that it be concluded as soon as practicable after the offeror has acquired control of sufficient shares as outlined below.
- A party to the transaction (or its parent) makes an offer to purchase, on the terms provided in the plan, all of the outstanding shares of the target that would be entitled to vote on the transaction.[12] The offer must remain open for at least 20 business days or any other period required under the tender offer rules in Section 14(e) of the Securities Exchange Act.
- The offer discloses the transaction will occur as soon as possible and that any shares not purchased pursuant to the offer will be acquired as set forth below. Additionally, if dissenters' rights apply to the second-step merger, the offer must disclose that and must include a copy of the sections of the BCA that provide dissenters' rights.
- The board recommends that shareholders tender their shares into the offer, unless the board determines that it should make no recommendation,[13] in which case the board must communicate the basis for its decision.
- The offeror purchases all shares that are properly tendered in the offer and not properly withdrawn.
- The offeror or its wholly owned subsidiary merges with or into the target corporation or acquires the target's remaining shares via the share exchange.
- The shares of the target described in the next sentence are collectively entitled to cast at least the minimum number of votes that would be required to approve the transaction at a meeting at which all shares entitled to vote were present and voted. The shares in question include those (i) purchased by the offeror pursuant to the offer, (ii) otherwise owned by the offeror or any of its parent or wholly owned subsidiaries, or (iii) subject to an agreement to be transferred, contributed or delivered to the offeror or any of its parent or wholly owned subsidiaries in exchange for stock or equity interests in the offeror, parent, or subsidiary.
- Each share of the target not purchased in the offer (other than shares owned by the target corporation or described in clauses (ii) and (iii) of the previous paragraph) is to be converted into or exchanged for the same amount and type of consideration (cash, securities or other) to be paid for each tendered share in the offer.

These amendments to Section 703a would be accompanied by the following corresponding changes:

- Section 707(1)(e)[14] would require a statement in a certificate of merger or share exchange that the plan of merger or share exchange was adopted in accordance with Section 703a(3) and that the conditions specified there have been satisfied
- Section 762[15] would provide dissenters' rights in connection with

Section 703a would be amended to provide that in certain second-step mergers or share exchanges involving publicly held companies, shareholder approval is not required.

such a second-step merger or share exchange if a shareholder vote would otherwise have been required. Shareholders would not be permitted to assert dissenters' rights in such a transaction if they tendered their shares in connection with the first-step offer.[16]

- Section 778(3)[17] would be amended to provide that shares acquired in the offer are not considered beneficially owned by the acquiror for purposes of Chapter 7A of the BCA,[18] unless the corporation determines otherwise by board resolution prior to the acquisition. This mechanism would allow the offer and second-step merger to proceed without the restrictions of Chapter 7A in a negotiated transaction, but potentially not in a hostile offer.

Conflicting language in the professional corporation provisions of the BCA currently casts doubt on whether entities may be shareholders of professional corporations.

Classes of "Blank Check" Preferred

BCA Section 302(3)[19] has long permitted a corporation's articles of incorporation to authorize series of "blank check" shares. This means that the board of directors may divide existing classes into series and may prescribe the relative rights and preferences of shares of the series, without the need for a shareholder vote to amend the articles.

The amendments would take this a step further by allowing for the authorization of blank check classes. This would allow the board to create new classes, within the limits on authorized shares contained in the articles, and designate the relative rights of the classes. Authority to designate blank check series within a class would be preserved, as it is currently.

The Section 302 amendments would also permit a board, by resolution, to eliminate a class or series of shares or change the relative rights of a class or series, so long there are then outstanding neither any shares of the class or series nor any rights to acquire or obligations to issue shares of the class or series.

Designation or elimination of a class or series of shares would require the filing of a certificate with the administrator setting forth the resolutions describing the action taken. Once filed, this would become an amendment to the articles of incorporation.

Entities as Shareholders of Professional Corporations

Conflicting language in the professional corporation provisions of the BCA currently casts doubt on whether entities may be shareholders of professional corporations. Section 283(1)[20] states that "1 or more licensed persons may form a professional corporation…," and the next subsection[21] provides that "[e]ach shareholder of a professional corporation must be a licensed person in 1 or more of the professional services provided by the professional corporation." Section 282(a)[22] defines "licensed person" to mean "an individual who is duly licensed or otherwise legally authorized to practice a professional service" and also specifically includes "an entity if all of its owners are licensed persons."

So far, so good. From this it seems that an entity may be a shareholder of a professional corporation. However, Section 288(1)[23] prohibits professional corporations from issuing shares "to anyone other than an *individual* who is licensed or otherwise legally authorized to provide" the services provided by the corporation. (Emphasis supplied.) Use of "individual" in this section appears to exclude entities and is inconsistent with the earlier provisions.

The amendments would resolve this inconsistency by amending Section 288(1) to prohibit professional corporations from issuing shares to anyone other than "a person that is eligible to be a shareholder…under Section 283(2)." Elimination of the word "individual" is intended to clarify that a PC may issue shares to an entity that qualifies as a licensed person under Section 283. Corresponding changes would be made to Section 283(2) to provide that PC shareholders may include "an entity that is directly or beneficially owned only by persons that are licensed persons in 1 or more of the professional services provided by the professional corporation."

Disqualification from Continuing as a Shareholder or Employee of a Professional Corporation

Section 286[24] of the BCA addresses when persons must terminate their relationship with a PC. This section provides that an officer, shareholder, agent or employee who becomes legally disqualified to provide the professional services provided by the corporation, or accepts employment that restricts or limits his or her authority to continue providing those professional services, must sever within a reasonable period all employment with and financial interests in the corporation.

This formulation creates ambiguity. First, it fails to account for the fact that a PC may be providing more than one licensed professional service. Does disqualification from *any* service provided by the PC require dissociation, or only disqualification from *all* services provided by the corporation? Second, it doesn't address the issue of entities. If an entity is a shareholder of a PC and one of the entity's owners becomes disqualified, what happens?

The amendments address both of these questions. As to the first, amended Section 286 would provide that a person must dissociate if no longer authorized to provide at least one of the professional services provided by the professional corporation. This language proved more difficult to draft than the Committee at first anticipated, and even as drafted may seem a little confusing. The intent of the amended language is that the person must dissociate only if he or she is authorized to provide none of the services provided by the corporation. If a PC provides multiple licensed services and one of the specified individuals becomes disqualified from providing one or more of the services, but remains eligible to provide one or more of the others, the owner would not be required to sever his or her connection.

As to the second question, if an entity is a shareholder and one of its owners becomes disqualified so that he or she is licensed to provide none of the professional service provided by the PC, that person would be required to dissociate from the PC. The entity could remain a shareholder if the person ceased to be an owner of the entity.

The amendments also recognize that there are some professions (e.g. public accounting)[25] where an entity itself must be licensed, and amended Section 282 would provide that such an entity qualifies as a "licensed person." Under amended Section 286, if that licensure was the basis for the entity being a PC shareholder and the entity became disqualified so that it could provide none of the PC's services, the entity would be required to sever its ties with the PC.[26]

Under new Section 286(2),[27] if a person became disqualified from being a shareholder of a professional corporation but within 90 days regained authorization to provide one of the professional services provided by the corporation, the person would not be required to sever his, her, or its connection with the PC

Rules for Conversion

Section 746[28] governs conversions of other types of business organizations, both foreign and domestic, into corporations governed by the BCA. That section requires that the conversion be permitted by the law governing the internal affairs of the converting entity, and that the requirements of that law be satisfied. It also requires adoption of a plan of conversion containing certain specific provisions and information. The Committee believed that it is unnecessary to impose these latter conditions, which might conflict with the law governing the converting entity, and so the amendments would delete them. So long as the converting entity complies with its governing law and files the necessary certificate of conversion and articles to be a domestic corporation, the conversion would be permitted. Some of the items currently required to be in the plan of conversion would have to be recited in the certificate of conversion.

Amending the Articles of Incorporation to Eliminate Reference to Resident Agents

BCA Section 611[29] has permitted a board of directors to amend a corporation's articles of incorporation without shareholder action for the purpose, among other things, of deleting the name and address of the corporation's initial resident agent or registered office. Limiting this to the *original* resident agent or registered office would be broadened by the amendments, so that a board could remove any reference to a resident agent or registered office so long as a statement is on file containing the name of the current resident agent and address of the current registered office.

Miscellaneous Corrections

The amendments also contain additional changes to various sections, including the following

- Section 762(2)(a)[30] makes dissenters' rights unavailable to holders of share listed on a "national securities exchange." The amendments would clarify the definition of this term to include the Nasdaq Global Market but not the Nasdaq Capital Market, formerly the Nasdaq Smallcap Market.

- Under Section 778(3),[31] certain shares acquired directly from a corporation or in a public offering by a corporation are not considered "outstanding or beneficially owned" for purposes of the restrictions of Chapter 7A. As a result, those shares are excluded from both numerator and denominator in determining percentage ownership. The amendments would delete the words "outstanding or," with the result that the shares would be excluded only from the numerator. The amendment would also expand this provision to cover shares acquired in a first-step offer as described above.
- Section 784(2)[32] would be deleted. This is purely a clean-up change. This section is an orphan that has no meaning following changes made in the 2013 amendments.
- Language would be added to several sections to authorize the administrator to provide certain notices by electronic transmission.

Conclusion

As noted above, the Corporate Laws Committee continually evaluates whether additional modifications to the BCA are appropriate to correct oversights or conflicts within the statute as well as to keep up with judicial decisions, trends in corporate practice, and developments in the laws of other states and the Model Act. Readers with suggestions for additional amendments should feel free to contact the author.

NOTES

1. 1972 PA 284, MCL 450.1101 *et seq*.
2. 1962 PA 192, formerly 450.221 *et seq*.
3. MCL 450.1281 et seq.
4. MCL 450.1407.
5. MCL 450.1525.
6. MCL 450.1407(1).
7. Proposed MCL 450.1407(4).
8. Proposed MCL 450.1525(3).
9. Note, too, that new Section 407(4) specifies that the future time designated in the direction would be deemed to be the date of signature of the consent. This would work in tandem with Section 407(1) (MCL 450.1407(1)), which provides that shareholder consents must be dated not more than ten days before the record date. *See* Section 412 (MCL 450.1412) for rules relating to fixing record dates.
10. MCL 450.1405.
11. MCL 450.1703a.
12. The offer may exclude shares owned by the target corporation itself or already owned by the offeror or certain affiliates.
13. The board may conclude that it should make no recommendation because of conflicts of interest, later-occurring events, contractual obligations or other special circumstances.
14. MCL 450.1707(1)(e).
15. MCL 451.1762.
16. *See* Section 765(2), MCL 450.1765(2).
17. MCL 450.1778(3). Other amendments to Section 778(3) are discussed in the description of Miscellaneous Corrections *infra*.
18. MCL 450.1776 *et seq*.
19. MCL 450.1302(3).
20. MCL 450.1283(1).
21. MCL 450.1283(2).
22. MCL 450.1282(a).
23. MCL 450.1288(1).
24. MCL 450.1286.
25. See MCL 339.728.
26. In such case, the entity still might qualify if all of its owners were qualified, but it is not uncommon for accounting firms to have owners who are not licensed in accounting. A special rule in BCA Section 284(5), MCL 450.1284(5), provides that a PC may engage in public accounting if more that 50% of its equity and voting rights are held by licensed individuals.
27. Proposed MCL 450.1286(2).
28. MCL 450.1746.
29. MCL 450.1611.
30. MCL 450.1762(2)(a).
31. MCL 450.1778(3).
32. MCL 450.1784(2).

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Internal Affairs Doctrine: A Fundamental Principle of Corporate Governance

By James C. Bruno and James H. Townsend

An October 2016 unpublished decision from the Michigan Court of Appeals may appear to call into question Michigan's recognition of the "internal affairs" doctrine ("IAD"). Long a bedrock principle of corporate law, the IAD provides that the internal affairs of a corporation (e.g., conflicts between shareholders of a corporation and its board of directors) will be governed by the laws of the state of incorporation.[1] The decision in *Madden v Avila*,[2] which passed over the IAD, offers an opportunity to review the internal affairs doctrine, explore how the doctrine is interpreted in Michigan and elsewhere, and consider its importance to corporate practice.

The plaintiff, in his capacity as a bankruptcy trustee for Energy Conversion Devices, Inc. ("EDC"), a Delaware corporation, alleged that former members of ECD's board of directors breached their fiduciary duties and duty of care when they approved several transactions on behalf of ECD.[3] Defendants moved for summary disposition on the basis that the claims were time-barred by the limitations period in Section 541a(4) of the Business Corporation Act ("BCA" MCL 450.1541a(4)), because the claims were filed more than two years after ECD discovered, or should have discovered, the claims.[4]

Plaintiffs argued, *inter alia*, that Section 541a(4) only applies to claims against directors of Michigan corporations and therefore could not bar plaintiff's claims on behalf of ECD because it was a Delaware corporation. The circuit court ruled in favor of the defendants, finding that Section 541a(4) applies to the plaintiff's claims, even though ECD was incorporated in Delaware.[5] On appeal, the court upheld the circuit court's ruling that the BCA applies to a Delaware corporation. The court noted that ECD operated its principal place of business in Michigan and that under Section 121 of the BCA (MCL 450.1121), the BCA "applies to every domestic corporation and to every foreign corporation which is authorized to or does transact business in this state except as otherwise provided in this act or by other law."[6]

The opinion then stated that it had not found any provision of the BCA or any other law that would make the BCA inapplicable to a Delaware corporation such as ECD.[7] The court did not discuss Section 1002 of the BCA, which codifies the internal affairs doctrine, and neither party raised the IAD.[8] Instead, the court employed the "interest analysis" conflicts of law approach, commonly used in tort law, in discussing what limitation law applies.[9] The court may have treated the case as sounding in tort and cited as authority for this approach *Hall v General Motors Corporation*, where the court balanced the interests of a foreign state against any Michigan interests that "mandate that Michigan law be applied, despite the foreign interest."[10] While it was not mentioned in *Hall*, 11 years later the IAD, a common law doctrine, made its way into Michigan statute, where it remains.

The court and the parties in *Madden* may have believed that the IAD did not apply because the case turned on whether the statute of limitations governing the alleged breaches of fiduciary duty and due care had expired.[11] Courts in New York and Delaware have held that the IAD applies only to substantive matters, and, given that statutes of limitation are generally deemed to be procedural, the IAD does not apply in such instances.[12] Other courts, however, have applied the IAD in statute of limitation cases, specifically, bankruptcy proceedings in Delaware and New Jersey.[13] Thus, the question of whether the IAD should govern in statute of limitations cases remains unsettled and deserved at least some treatment by the court and the parties in *Madden*.[14] Practitioners can benefit from a review of this foundational component of Michigan corporate law.

An October 2016 unpublished decision from the Michigan Court of Appeals may appear to call into question Michigan's recognition of the "internal affairs" doctrine ("IAD").

What Is the Internal Affairs Doctrine?

The IAD is a judge-made choice of law canon, which provides that disputes arising among the internal stakeholders of a corporation, specifically its shareholders, officers, and directors, shall be resolved according to the laws of the state where the entity was incorporated.[15] The Restatement (Second) of Conflict of Laws ("Restatement") lists the issues that commonly fall within the ambit of the IAD.[16] These include a lengthy list of matters related to the internal functions of a corporation that may affect the rights of shareholders, such as:

> Steps taken in the course of the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares, preemptive rights, the holding of directors' and shareholders' meetings, methods of voting including any requirement for cumulative voting, shareholders' rights to examine corporate records, charter and by-law amendments, mergers, consolidations and reorganizations and the reclassification of shares.[17]

The Restatement also includes issues that affect a corporation's creditors, such as "the issuance of bonds, the declaration and payment of dividends, loans by the corporation to directors, officers and shareholders, and the purchase and redemption by the corporation of outstanding shares of its own stock."[18] In addition, the IAD applies to both direct and shareholder derivative lawsuits.[19]

Rationales for IAD

The IAD began life in the mid-19th century as a means of preserving state territorial sovereignty over the regulation of business corporations, which at the time rarely operated across state lines.[20] In the late 1800's and early 20th century following the rise of mergers and national firms, the IAD became a basis for states competing for revenues derived from chartering corporations that operated in multiple states.[21]

Courts and commentators have set forth a range of policy goals and reasons to support this rule. The Supreme Court of Delaware, for example, noted that the IAD provides a single jurisdiction from which to draw the rules that will govern the rights and responsibilities among and between shareholders, officers, and directors.[22] The U.S. Supreme Court observed that states have an inherent interest in ensuring that investors in corporations founded under their laws enjoy the ability to hold those corporations accountable.[23] As the Supreme Court of Delaware opined, "the internal affairs doctrine protects the justified expectations of the parties with interests in the corporation."[24] In this way, the IAD respects the choice of law decision made by the incorporators and provides corporations and their shareholders certainty with respect to the laws that will govern their internal corporate functions.[25]

In addition, the Delaware Supreme Court has asserted that the IAD implicates constitutional protections found in the 5th and 14th Amendments and the Commerce Clause of the Constitution.[26] The court stated that subjecting foreign corporations to forum-state rules would create an "intolerable consequence to the corporate enterprise and its managers."[27] Corporations operating in multiple states have a right to know what laws will govern their behavior and denying them that knowledge violates their right to due process.[28] Finally, restricting the authority to regulate a corporation's internal affairs to the state of incorporation prevents forum state courts from interfering with the interstate commerce of businesses operating in multiple states.[29]

Internal vs. External Affairs

While the IAD enjoys wide acceptance in courts and legislatures across the U.S.,[30] the line that distinguishes internal and external affairs of a corporation is less clear. In setting forth the IAD, the Restatement limits its application, stating that "The local law of the state of incorporation will be applied ... except where, with respect to the particular issue, some other state has a more significant relationship ... to the parties and the transaction."[31] The Restatement goes on to exclude "the making of contracts, the commission of torts and the transfer of property" from coverage by the IAD.[32] In *Chrysler Corp v Ford Motor Co*, the court in the Eastern District of Michigan applied Michigan law to a case involving liability for pollution caused by a Pennsylvania corporation, reasoning that the alleged act was "not one of internal corporate governance but rather external liability."[33]

The commentary following Section 309 of the Restatement takes a pragmatic approach to distinguishing cases where the IAD should apply. Acts including the issuance of stock and declaration of dividends and other activities that "closely affect the organic structure or internal administration of the corporation" cannot be sensibly regulated under conflicting state laws, and therefore, the IAD generally should apply.[34] But when does a state's interest rise to the level that its laws should apply instead of those of the incorporating state? Courts and legislatures in states such as California and New York (discussed below) have created their own exceptions to the IAD by defining situations in which local law should apply. In general, these states have asserted a right to apply their own laws to the internal affairs of a corporation when critical public policies have been implicated in a case or when the interests of in-state stakeholders of a foreign corporation hang in the balance.[35] California and New York claim to be looking out for a broader set of interests held by people who might be classified as "stakeholders" rather than shareholders of a firm.[36]

Scholars have long debated who, if anyone, beyond shareholders and their corporate agents should be included under the umbrella of corporate law in general and the IAD in particular.[37] Beginning in the 1960's, corporate theorists began writing about "corporate stakeholders," which an early document from the Stanford Research Institute defined in extremely broad terms as "those groups without whose support the organization would cease to exist."[38]

In the ensuing half century, a veritable cottage industry has arisen around scholarly efforts to define "stakeholder" in a corporate context—all with very little success.[39] Traditionalists continue to view efforts by directors or officers to consider the concerns of anyone beyond shareholders as a violation of fiduciary duty. Meanwhile, some progressive advocates of an expansive view of what it means to be a corporate stakeholder assert that a corporation has a duty to look after "the welfare of all its constituents and for the well-being of the larger society in which it operates."[40] Commentators between these poles have yet to arrive at a satisfactory rule of thumb.[41] Despite the sometimes blurry line between shareholders and stakeholders, as we will see below, practitioners in selecting jurisdictions for litigation may want to consider how courts in potential venues have viewed this debate for clues about when they will and will not apply the IAD.

How Is the Internal Affairs Doctrine Expressed in the MBCA

The Model Business Corporation Act ("MBCA") provides for the internal affairs doctrine in §15.05.[42] It states, "This act does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state."[43] States generally adhere to the IAD and many, including Michigan,[44] have adopted the MBCA's model internal affairs language.[45]

States that have incorporated the MBCA's language have rarely challenged the strict interpretation of the IAD embraced by the Supreme Court of Delaware.[46] Areas generally viewed as off-limits to forum-state laws include: adoption of bylaws; the issuance, reclassification, and repurchase of corporate stock; the holding of directors' and shareholders' meetings; the declaration and payment of dividends and other distributions; charter amendments; mergers; consolidations; and reorganizations.[47] Some states, such as Louisiana and New Jersey, have not adopted this language, creating at least in theory the opportunity for their courts to disregard the IAD.[48] However, research turns up no cases in which these states have elected to do so.

While the IAD enjoys wide acceptance in courts and legislatures across the U.S., the line that distinguishes internal and external affairs of a corporation is less clear.

California and New York Find Exceptions to the Internal Affairs Doctrine

California and New York have adopted statutes that attempt to carve out exceptions to the IAD in cases involving non-publicly traded foreign corporations that meet certain thresholds of contact with the forum state. These provisions have generated significant controversy in legal and academic circles and triggered spirited rebukes from courts in Delaware.[49] Judges in California and New York have also recognized exceptions to the IAD even where the corporation in question did not meet requirements of these statutes.[50]

Enacted in 1977, California's so-called "long-arm statute," Section 2115 of the California Corporations Code, requires application of California corporate law to foreign corporations not traded on national securities exchanges if, (1) more than 50 percent of the corporation's voting shares are held by California residents and, (2) more than 50 percent of the corporation's business is conducted in California.[51] While not adopting the IAD as set forth in the MBCA, Section 2116 of the California statute does contain a provision that recognizes that the "law of the place of incorporation governs liability of directors to the corporation and its shareholders.[52] It is important to note that this provision covers only corporate directors and does not appear to affect corporate officers.[53]

Prior to the adoption of Section 2115, the California Court of Appeals had recognized an exception to the common law IAD with respect to the issue of cumulative voting.[54] Since its enactment, debate has simmered as to whether Section 2115 creates so-called "quasi-California" corporations or acts as a narrow exception to IAD in cases where the foreign corporation is heavily engaged with the forum state and its residents.[55] The California Assembly passed legislation in 2012 repealing Section 2115, but the measure stalled in committee in the State Senate[56] and the future prospects of the measure remain unclear.

California and New York have adopted statutes that attempt to carve out exceptions to the IAD in cases involving non-publicly traded foreign corporations that meet certain thresholds of contact with the forum state.

California courts have recognized the common law IAD. In *State Farm Mut Ins Co v Superior Court of Los Angeles*, the court ruled that the law of an insurance company's state of incorporation should apply because of the uncertainty that could be caused for shareholders and other insiders if the laws of more than one state applied to their internal activities.[57]

More recently, in *Lidow v Superior Court*, the California Court of Appeals, reviewing a series of cases dating back to the 1960s, attempted to define the kinds of "important state interests" that would trigger the application of Section 2115 and California corporate law to the internal affairs of a foreign corporation.[58] The case involved a CEO who contended that he had been wrongfully terminated in violation of public policy when his employer forced him to resign after he protested alleged unlawful acts by the company's audit firm. The court held that an ordinary dispute concerning a corporate officer's termination would fall under the IAD. In this situation however, an allegation of corporate retaliation against a CEO who was effectively a whistleblower required the application of California law because the case "goes beyond internal governance and touches upon broader public interest concerns that California has a vital interest in protecting."[59]

The court went on to distinguish situations that implicate the broader public interest and demand the use of California law, such as when a corporate actor places non-shareholders in harm's way or the soundness of the state's securities markets comes into question.[60] On the other hand, where the case involves "less vital state interests," such as disputes over promises to pay dividends or procedures governing derivative shareholder lawsuits, courts are more likely to apply the IAD.[61]

Whether upholding Section 2115 or identifying critical state interests, California courts have taken an expanded view of non-shareholders, who have interests that are potentially affected by the internal behavior of a corporation and at least sometimes need protection under local laws. A similar mindset appears to motivate courts in New York, which as far back as 1915 recognized circumstances in which it was proper to apply local law to the internal affairs of a foreign corporation.[62] Judge Benjamin Cardozo, then a member of the New York Court of Appeals, wrote that "when countless corporations, organized on paper in neighboring states, live and move and have their being in New York, a sound public policy demands that our Legislature be invested with this measure of control."[63]

New York's legislature accepted Judge Cardozo's invitation in 1962, when it enacted sections 1319-20 of the Business Corporation Act, later mirrored by California, which applied New York law to corporations that generate more than 50 percent of their business income in the state for three consecutive years.[64] Both federal and state courts in New York have subsequently applied New York law to foreign corporations that meet the thresholds in the statute.[65] Moreover, as in California, judges in New York have been inclined to apply New York law to the internal affairs of foreign corporations when the situation raises important public policy issues or interests of New York residents.[66] The Second Circuit and federal district courts in New York and Massachusetts have also refused to automatically apply the IAD.[67]

California and New York's interpretations of the IAD draw some support from the Restatement. While the Restatement specifies when the IAD should be applied,[68] it also recognizes "extremely rare" cases where a forum state has a more significant relationship with the parties or issues in a dispute than the state of incorporation and the IAD should not be applied.[69]

Michigan's View of the IAD

The Michigan Supreme Court in the 1940 case of *Wojtczak v American United Life Ins Co* refused to assert jurisdiction over a case dealing with the internal affairs of an Indiana corporation doing business in Michigan.[70] By declining jurisdiction, the court left the choice of law question open.[71] In subsequent years federal courts in Michigan have set aside the jurisdictional basis for the IAD and instead have viewed *Wojtczak* as a case in which the court had the power to hear the case but, in its discretion, chose not to for reasons of *forum non conveniens*.[72]

Michigan quietly codified the IAD by passing Public Act 402 of 2008.[73] Broad acceptance of the IAD in Michigan was evident when its codification was not viewed as a change in the law.[74]

Conclusion

The IAD was facially relevant in *Madden v Avila* because the plaintiffs alleged breaches of fiduciary duty and the duty of care, which are issues of corporate governance that courts routinely place under the domain of the IAD;[75] although whether the IAD should govern the application of a statute of limitations remains an unsettled question.[76] While not mentioned in *Madden v Avila*, the IAD's importance in the practice of corporate law in Michigan and around the U.S. requires that practitioners understand its relevance and are prepared to raise the IAD before the court when it may apply.

Practitioners may seek to fix the venue for disputes involving the internal affairs of the corporation by encouraging clients to adopt forum-selection bylaws. Recent decisions in Delaware Chancery Court[77] and in a federal district court in California[78] have upheld such provisions. In both instances, the court reasoned that the contractual nature of the corporation-shareholder relationship empowers a board of directors and shareholders to set the forum for litigation that implicates that relationship, in much the same way that two parties to a contract for sale of goods may agree on the forum for adjudicating disputes arising under that contract.[79] Practitioners may also consider a bylaw that requires the application of the statutes of limitations and statutes of repose of the state of incorporation to disputes regarding the internal affairs of the corporation.[80]

Despite the holding in *Madden v Avila*, the IAD remains on solid footing in Michigan, especially because of its codification in 2008.[81] Still, courts in California, New York, and potentially elsewhere, in balancing state interests under the Restatement, may deem it appropriate to depart from the IAD where (1) a foreign corporation has had particularly heavy contact with the forum state, or (2) the case raises important public policy issues or engages the interests of a broader set of stakeholders than just the holders of the corporation's shares.[82] California and New York have shown an inclination to champion those departures. Michigan caselaw, on the other hand, does not reveal a similar appetite to limit the IAD and apply Michigan law to the internal affairs of foreign corporations.[83]

NOTES

1. *Edgar v MITE Corp*, 457 US 624, 645 (1982); *Wojtczak v American United Life Ins Co*, 293 Mich 449, 292 NW 364 (1940).
2. No 326716, 2016 Mich App LEXIS 1942 (Oct 20, 2016) (unpublished).
3. *Madden* at *1.
4. *Id.* at *3.
5. *Id.* at *4.
6. *Id.* at *7.
7. *Id.* at *7.
8. MCL 450.2002(2).
9. *Madden* at *8.
10. 229 Mich App 580, 585 (1998).
11. *Madden*, WL 6138617 at *5.
12. *See Aboushanab v Janay*, No 06 Civ 13472 (AKH), 2007 U.S. Dist LEXIS 71278 at *12 n 2 (SDNY Sept 26, 2007) (noting that the internal affairs doctrine is not an exception to statute of limitations principles); *Baena v Woori Bank*, No 05 Civ 7018 (PKS), 2006 U.S. Dist LEXIS 74549 at *15-16 (SDNY Oct 11, 2006) (rejecting claim that Korean law should be applied under the internal affairs doctrine where the issue in the case turned on a statute of limitation); *Normal v Elkin*, No 06-005-JJF, 2007 U.S. Dist LEXIS 72725 at *9-10 (D Del Sept 26, 2007) (noting that the Delaware internal affairs doctrine applies only to substantive issues, and therefore because the "statute of limitations is a procedural issue .... the doctrine is not applicable").
13. *See Burtch v Dent (In re Circle Y),* 354 BR 349, 359 (Bankr D Del 2006), *Mervyn's, LLC v Lubert-Adler Group IV, LLC (In re Mervyn's Holdings, LLC)*, 426 BR 488, 502–03 (Bankr D Del 2010), and *U.S. Eagle Corp v Westphal (In re U.S. Eagle Corp)*, 484 BR 640, 654 (Bankr D NJ 2012) (citing the internal affairs doctrine, the court applied state of incorporation's statute of limitation).
14. Sean J. Bellew & David A. Felice, *Federalization Increases D & O Exposure*, Executive Counsel 24 (Feb./Mar. 2011).
15. *Edgar*, 457 US at 645 (1982).
16. Restatement (Second) of Conflict of Laws 302(2) & cmt a (Am. Law Inst. 1971).
17. *Id.*
18. *Id.*
19. *See Gallup v Caldwell*, 120 F2d 90, 93 (3d Cir 1941) (whether a person is a shareholder or other member of a corporation is determined by the law of the state of incorporation), *In re Atlantic Power Corp Sec*

Litig, 98 F Supp 3d 119 (D Mass 2015) (in deciding whether suit is direct or derivative, the court must look to the law of the state where the company was incorporated).

20. Frederick Tung, Before Competition: Origins of the Internal Affairs Doctrine, 32 J Corp L 33, 45 (2006).

21. *Id.* at 92.

22. *McDermott Inc v Lewis,* 531 A2d 206, 214 (Del Supr 1987).

23. *CTS Corp v Dynamics Corp of America*, 481 US 69, 91 (1987).

24. V*antagePoint Venture Partners 1996 v Examen, Inc*, 871 A2d 1108, 1113 (Del 2005).

25. *CTS Corp*, 481 US at 89-90.

26. US Const amends V, XIV, §1, US Const art I, §8, cl 3.

27. *McDermott Inc*, 531 A2d at 216.

28. *Id.*

29. *Edgar*, 457 US at 646.

30. The Internal Affairs Doctrine: Theoretical Justifications and Tentative Explanations for Its Continued Primacy, 115 Harv L Rev 1480 (2002)

31. Restatement (Second) Conflict of Laws, 309 (Am. Law Inst. 1971).

32. *Id.* at § 302, com E.

33. 972 F Supp 1097, 1102 (ED Mich 1997).

34. *Id.* at § 309, com c.

35. *Lidow v Superior Court*, 206 CalApp 4th 351, 362 (2012) (citing *Western Air Lines, Inc v Sobieski*, 191 Cal App 2d 399 (1961) and *Friese v Superior Court*, 134 Cal App 4th 693 (2005) (supporting the proposition that California courts are less likely to apply the IAD where vital interests of the citizenry are involved). *See Norlin Corp v Rooney, Pace, Inc*, 744 F2d 255, 261 (2d Cir 1984), *Greenspun v Lindley*, 330 NE2d 79, 81 (NY 1975) (upholding a NY statute, NY Bus Corp Law §§ 1319-1320, that governs internal affairs of foreign corporations).

36. Matt Stevens, *Internal Affairs Doctrine: California Versus Delaware in A Fight for the Right to Regulate Foreign Corporations*, 48 BC L Rev 1047, 1055 (2007) (citing the public policy rationale behind California's statute aimed at protecting California stakeholders of a Delaware corporation and similar aims expressed by then-New York Court of Appeals judge Benjamin Cardozo).

37. *See* Theresa A Gabaldon, *The Story of Pinocchio: Now I'm A Real Boy*, 45 BC L Rev 829, 842 (2004) (discussing the debate among scholars of corporate law and governance about whether non-shareholders should be considered stakeholders of the firm). The view that a for-profit corporation's primary purpose was to maximize shareholder returns dates back to the seminal "stockholder vs. stakeholder" holding in *Dodge v Ford Motor Co*, 204 Mich 459 (1919). Nonetheless, leading scholars then and ever since have debated whether "the interests of non-shareholder constituencies should be advanced by corporate fiduciaries in tandem with shareholders' interests." Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 Del J Corp L 649, 652 (2004).

38. Quoted in Samantha Miles, *Stakeholder: Essentially Contested or Just Confused?*, 108 S J Bus Ethics 285, 293 (2012).

39. *Id.*

40. *Id.*

41. *See* for example M.E. Clarkson, *A stakeholder framework for analyzing and evaluating corporate social performance*, Academy of Management Journal, 20(1), 92–118 (1995) and ME Clarkson, *Risk-based model of stakeholder theory*. Toronto: The Centre for Corporate Social Performance & Ethics (1994).

42. Model Bus. Corp. Act § 15.05 (1969) (Am. Bar Ass'n, amended 1973).

43. *Id.*

44. MCL 450.2002(2).

45. Tung, *supra* note 20 at 36. See also, The Internal Affairs Doctrine: Theoretical Justifications and Tentative Explanations for Its Continued Primacy, supra note 30 at 1480-81.

46. *McDermott*, 531 A2d at 216, *VantagePoint*, 871 A2d at 1108. *See* Tung, *supra* note 20, at 36.

47. Stevens, *supra* note 36, at 1065.

48. The Internal Affairs Doctrine: Theoretical Justifications and Tentative Explanations for Its Continued Primacy, *supra* note 30, at 1481.

49. Stevens, *supra* note 36, at 1047-51.

50. *See Stephens v National Distillers & Chem Corp,* No 91 CIV 2901 (JSM), 1996 U.S. Dist LEXIS 6915 at *15 (SDNY May 21, 1996) (supporting proposition that foreign corporation should be subject to NY law because "public policy concerns of New York State as embodied in the New York Insurance Law mandate a departure from the 'internal affairs' doctrine").

51. Cal Corp Code 2115(a), (b).

52. Cal Corp Code 2116.

53. Keith Paul Bishop, Officers And The Internal Affairs Doctrine, The National Law Review (Sep 5, 2015) http://www.natlawreview.com/article/officers-and-internal-affairs-doctrine.

54. *Western Air Lines, Inc v Sobieski*, 12 Cal Rptr 719, 728 (1961) ("issuance and sale of stock within a state other than that of its organization may be regulated in order to protect the residents and citizens of the former state"),

55. *See VantagePoint*, 871 A2d 1108, 1118 (Del 2005), (Delaware Supreme Court refused to recognize §2115 as an unconstitutional usurpation of the IAD), for an opposing view *Wilson v Louisiana-Pacific Res, Inc*, 138 Cal App 3d 216, 230-31 (1982) (California Court of Appeals required a Utah company to modify its charter to allow cumulative voting in order to protect California shareholders).

56. Adam R Moses, Haig Maghakian & Mark Vible, *Of Long Arms and Internal Affairs*, Corporate Counsel (Dec. 23, 2014) https://www.milbank.com/images/content/1/8/18692/Of-Long-Arms-and-Internal-Affairs-A-Moses-H-Maghakian-M-Vibl.pdf.

57. 8 Cal Rptr 3d at 63, 67(2003).

58. *Lidow*, 206 Cal. App. 4th at 362.

59. *Id.*

60. *Id.*

61. *Id.*

62. *See* Stevens, *supra* note 36 at 1055.

63. *Id.*

64. NY Bus Corp Law §§ 1319-1320. The 1961 version of this law applied New York law only to companies having either two-thirds of their shares owned by New York residents or two-thirds of their income "allocable to this state for franchise tax purposes." The law as it currently stands passed in 1962. *See* Robert S. Stevens, *New York Business Corporation Law of 1961*, 47 Cornell L Rev 141, 173 (1962).

65. *See, e.g., Norlin Corp v Rooney, Pace Inc*, 744 F2d 255, 261 (2d Cir 1984); *Stephens v National Distillers & Chem Corp*, No 91 CIV 2901 (JSM), 1996 U.S. Dist LEXIS 6915, at *14 (SDNY May 21, 1996); *Resolution Trust Corp v Gladstone*, 895 F Supp 356, 363 (D Mass 1995); *Greenspun v Lindley*, 330 NE2d 79, 81 (NY 1975).

66. *See Stephens*, No 91 CIV 2901 (JSM), 1996 U.S. Dist LEXIS 6915, at *15 (SDNY May 21, 1996) (supporting proposition that foreign corporations should be subject to NY law because "public policy concerns of New York State as embodied in the New York Insurance Law mandate a departure from the "internal affairs" doctrine).

67. *See Greenspun v Linley*, 330 NE2d at 81 (1975), *Resolution Trust Corp v Gladstone*, 895 F Supp at 363 (1995).

68. Restatement (Second) of Conflict of Laws § 302 cmt. a (1971).

69. *Id*, cmt g: "Among the factors that bear upon the question are (1) the nature and extent of the corporation's relationship to the state of incorporation, (2) the nature and extent of the corporation's relationship to the state whose local law is sought to be applied and (3) whether the act is of the sort discussed in Comment e—namely, one which cannot practicably be governed by the local law of more than one state."

70. 293 Mich 449 (1940).

71. Bruce Segal, Internal Affairs Doctrine – Rights and Duties of Shareholders, Directors, and Officers of Foreign Corporations Doing Business in Michigan, Mich Bus L J, Spring 2007 at 49-50.

72. *George S Hofmeister Family Trust, v FGH Indus, LLC*, No 06-CV-13984-DT, 2006 U.S. Dist LEXIS 90626, at *20-21 (ED Mich Dec 15, 2006) (citing with approval the *forum non conveniens* reasoning in *Lapides v Doner*, 248 F Supp 883 (ED Mich 1965)).

73. MCL 450.2002.

74. Justin G. Klimko, *New Amendments to Michigan Business Corporations Act*, Mich Bus LJ, Spring 2009 at 14.

75. Restatement (Second) Choice of Laws, 302(2) & cmt a.

76. For contradictory holdings, *see Aboushanab*, 2007 U.S. Dist LEXIS 71278 at *16 (IAD does not apply to procedural matters such as statutes of limitations) and *In re Circle Y,* 354 BR 349, 359 (IAD should apply in choosing the proper statute of limitations). For a review of recent cases, *see* Bellew & Felice, *supra* note, at 14.

77. *Boilermakers Local 154 Retirement Fund v Chevron Corp*, 73 A3d 934, 955 (Del Ch 2013).

78. *In re: CytRx Corp Stockholder Derivative Litig*, No CV 14-6414-GHK, 2015 U.S. Dist LEXIS 176966 at *11 (CD Cal Oct 30, 2015).

79. *See Boilermakers*, 73 A3d at 955 (shareholders' buying stock in a corporation agree to articles of incorporation that authorize a board to amend its bylaws) and *Id.* (adopting the reasoning used in *Boilermakers*).

80. Michigan's Business Corporation Act grants directors and shareholders broad latitude to enact any bylaw "for the regulation and management of the affairs of the corporation not inconsistent with law or the articles of incorporation." MCL 450.1231. Delaware's corporations law, Del Code Ann Tit 8, 109, is similar. Research of Michigan and Delaware law found no case addressing such a provision.

81. MCL 450.2002.

82. Rest 2d Conf of Laws, § 309.

83. *See* e.g., *George S Hofmeister Family Trust, v FGH Indus, LLC*, No 06-CV-13984-DT, 2006 U.S. Dist LEXIS 90626 at *20-21 (ED Mich Dec 15, 2006), *Lapides*, 248 F Supp 883, 886-887, *Wojtczak*, 293 Mich 449, 453-54.

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The Benefit Corporation Alternative

By Ronald P. Cheli and Jennifer E. Consiglio

Traditionally, in Michigan, and throughout the United States, "for-profit" corporations have operated under the premise that a corporation is organized and its business is carried on primarily for the profit of the shareholders.[1] Under that standard, the purpose of a corporation has been to maximize shareholder welfare and value. As such, for-profit corporations have not been empowered to pursue other goals, purposes, or constituencies.

In recent years, there has been a movement to allow formation of a for-profit corporation that pursues not only shareholder interests, but also purposes well beyond the traditional corporate standard. These entities are commonly called Benefit Corporations ("B-corporations"). In effect, B-corporations give businesses an additional option for conducting their business in the corporate form. If a corporation prefers to operate as a traditional for-profit corporation, it may simply choose that alternative when it is formed. If, however, a business wants to incorporate and operate under special rules that will allow it to promote shareholder, social and other permitted purposes, the corporation may, in jurisdictions where B-corporation legislation has been enacted, elect to conduct its business through the B-corporation format. The B-corporation format generally can be selected upon incorporation or after the corporation is formed.[2]

B-corporations are unique in that their governing statutes specifically direct them to pursue purposes that relate to society, the environment and other ventures related to social issues.[3] Accordingly, in jurisdictions where B-corporations are authorized, they provide for-profit corporations with a distinct alternative to operating under the traditional corporate standard. B-corporations are not eligible for incorporation as non-profit corporations, but rather, as a distinct form of business corporation.[4]

Since both traditional business corporations and B-corporations are for-profit corporations, they are governed, in part, by principles and precedents of general corporate law that have been developed over a substantial period of time. Accordingly, a long and established body of law exists which addresses for-profit corporate business activities. B-corporations, however, have unique and distinctive features (which in some cases are contrary to existing general corporate law). As such, B-corporations are governed not only by much of the existing general corporate law, but also by special statutory provisions that provide B-corporations with the authority and flexibility needed to accomplish their required and/or permitted purposes. In that regard, B-corporations must adhere to the special standards and procedures which compel these entities to pursue a socially-oriented purpose.

In the past, pursuit of such a socially-oriented purpose for a profit corporation would expose the corporation, and those persons affiliated with them (such as directors and officers), to claims those persons had breached their duty to the corporation and its shareholders. Such claims were founded on the basis that the appropriate sole standard of conduct for profit corporations was to maximize shareholder welfare and, by pursuing other goals, that standard was violated. With B-corporations, the standards of conduct for corporate action are much broader since B-corporations will have two or more corporate purposes. For example, B-corporations will still have to consider generating corporate profit for shareholders and, in addition, pursue the B-corporation's social and/or environmental goals.

In order for a corporation to conduct business in the form of a B-corporation, enabling legislation must be adopted by the jurisdiction in which it is formed. Model Benefit Corporation Legislation has also been created, led by B Lab Company, a prominent, national promoter of the B-corporation ("B Lab"), which provides a template for B-corporation legislation ("Model Act"). Maryland was the first state to adopt B-corporation legislation in 2010. At the time this article was written, 33 states, the District of Columbia, and Puerto Rico had also adopted similar legislation, and it is pending in in six other states.[5] While Michigan has not yet authorized use of B-corporations, legislation is being discussed which would, if enacted, authorize formation of B-corporations in this state.

Under the Model Act, B-corporations must have three fundamental elements: provision of a general public benefit; accountability; and transparency. A "general public benefit" is a material positive impact on society and the environment, taken as a whole, from the business and operations of the B-corporation, assessed taking into account the impacts of the B-corporation as reported against a third party standard.[6] Under the Model Act, each B-Corporation must have a purpose of creating general public benefit.[7] In addition to general public benefit, a B-corporation may elect to pursue one or more specific public benefit purposes that are permitted under the governing legislation and selected by the business (such as improving human health, promoting the arts, promoting science, restoring the environment, etc.).[8]

With respect to "accountability", the Model Act requires that the public benefit(s) provided by the B-corporation must be evaluated against standards established by a third party.[9] In order to meet this criterion, the measurement standard cannot be established by an entity that is controlled by the B-corporation.[10] Further, such a standard is one that must be a recognized standard for reporting a B-corporation's overall social and environmental performance of the business.[11] The Model Act provides that the third party standard must be comprehensive, in that it must assess not only performance of the entity, but also the effects of the business and its operations on a wide range of persons and interests, such as shareholders, employees, customers, community factors and the environment.[12] Commentators on the Model Act have stated that a B-corporation's preparation of an annual benefit report that assesses its performance against a third party standard provides important protection against the abuse of B-corporation status. For example, the commentators have expressed a desire to reduce situations where businesses claiming to be B-corporations are actually portraying themselves to be more socially and environmentally friendly than they actually are.[13]

The Model Act's "transparency" factor requires a B-corporation to prepare and periodically distribute a benefit report which contains significant information concerning the entity. The Model Act provides for annual publication of the report and several other requirements.[14] For example, the report must include a narrative description of the extent to which the B-corporation pursued general public benefit during the reporting period and the extent to which general public benefit was created.[15] Similar requirements apply for any specific public benefit adopted by the B-corporation.[16] The narrative description must also report on circumstances that have hindered the creation of public benefit and, in addition, the process and rationale for selecting or changing the third party standard used to prepare the annual report.[17]

The report must provide an assessment of the overall social and environmental performance of the B-corporation determined by taking into account the impacts of the B-corporation reported against a third party standard.[18] Application of the third party standard used in any report must be made in a manner that is consistent with the application of the standard used in prior benefit reports.[19] If an inconsistency exists in the application of the standard, the report must explain the reason(s) for inconsistent application of the standard. If there has been a change in a report's third party standard from the one used in the immediately preceding report, the reason for such a change must be explained in the report.[20] Third parties have established standards that vary by industry, applicable mission, and performance objectives. The Model Act does not require that the benefit report or the assessment of the B-corporation's performance be audited.[21] However, there are agencies available that offer a certification process, and the resulting certification can be mentioned by the B-corporation along with other data included in the B-corporation's published information.

The Model Act, also prescribes methods for delivery of the report.[22] In its current form, the Model Act would require the report to be distributed to each shareholder within 120 days after the end of the B-corporation's fiscal year or at the same time the B-corporation delivers any other annual report to its shareholders. Delivery by web posting is prescribed but, if a B-corporation does not have a web site, a copy of the report must be provided to any person that requests a copy.[23] The Model Act also proposes filing of the benefit report with a state agency.[24]

The Model Act addresses a wide range of persons who are associated with B-corporations. Some, such as shareholders, directors, and officers, are familiar from application of traditional corporate law. Others, such as

In recent years, there has been a movement to allow formation of a for-profit corporation that pursues not only shareholder interests, but also purposes well beyond the traditional corporate standard.

"Benefit Directors" and "Benefit Officers" are, under the Model Act, new and intended to assist the B-corporation in accomplishing its purposes.

The Model Act sets forth standards of conduct for directors. In discharging their duties, directors are required to consider the effect of any action or inaction of the B-corporation on many stakeholders. Those stakeholders include (but are not limited to): the B-corporation's shareholders; employees of the B-corporation, its subsidiaries and suppliers; the B-corporation's customers (as beneficiaries of the public benefit the B-corporation intends to provide); community and societal factors; the local and global environment; and the short and long term interests of the B-corporation, as well as the benefits that may accrue to the B-corporation from its long term plans.[25] The directors are not required to give priority to any of those factors.[26] However, those stakeholders' interests are particularly important to persons who fill directorship positions since B-corporations are new and it is uncertain how such interests will be interpreted over time.

The Model Act sets forth standards of conduct for directors. In discharging their duties, directors are required to consider the effect of any action or inaction of the B-corporation on many stakeholders.

Officers are also subject to standards of conduct under the Model Act. In that regard, an officer is required to consider the interests of stakeholders to the extent the officer has discretion with respect to a matter and the officer reasonably believes that the matter may have a material effect on the public benefit(s) the B-corporation is to provide.[27]

In addition, the Model Act provides for the discretionary appointment of a Benefit Director and a Benefit Officer. The same person may be selected to act in both capacities.[28] If appointed, a Benefit Director is required to prepare a compliance statement that will be inserted in the benefit report. The compliance statement reports on whether the B-corporation has acted in accordance with its required public benefit purpose(s) and whether directors and officers have met the standards of conduct set for them by statute (and if not, provide a description of the noncompliance items).[29] Under the Model Act, the Benefit Officer, if appointed, has the duty to prepare the B-corporation benefit report and has the powers and duties concerning creation of public benefits that are prescribed by the Bylaws and/or directors.[30]

The Model Act also contains provisions clarifying issues which relate to the unique nature of B-corporations. For example, the Model Act provides that neither a director nor an officer has a duty to any person that is a beneficiary of a public purpose which arises from the status of that person as a beneficiary.[31] As such, directors and/or officers do not have enforceable duties to mere stakeholders who are not shareholders. The Model Act also provides that, in general, a director or officer is not personally liable for money damages for: any action or inaction taken by that person as a director or officer (where the person was not interested in the matter); or where there has been a failure by the B-corporation to pursue or create a public benefit.[32] In addition, the Model Act contains specific language which unequivocally provides that the business judgment rule applies to protect directors and officers in carrying out their duties.[33]

The Model Act provides that, in general, no person may bring an action to assert a claim against the B-corporation or its directors or officers for: (1) failure to pursue or create public benefit described in the B-corporation's Articles of Incorporation; or (2) a violation of a duty or standard of conduct prescribed for a B-corporation under applicable legislation except in a "benefit enforcement proceeding" in limited circumstances.[34] In that regard, a benefit enforcement proceeding may be brought by: a direct suit by the B-corporation; or a derivative suit by shareholders who own two percent of any class or series of equity interests in the B-corporation, or persons who hold five percent or more of the outstanding equity interests in an entity of which the B-corporation is a subsidiary.[35]

In evaluating the protective provisions mentioned above, be advised that they apply only to actions, inactions and circumstances dealing with B-corporation matters. As such, those protective provisions are not available in claims involving breaches of duty which are outside the terms of the B-corporation statutes; or matters concerning breach of contract by directors, officers or the B-corporation.[36]

Since B-corporations are relatively new and they authorize the pursuit of more than one purpose, B-corporation legislation does, by its nature, expand the subjects which could create claims rooted in breach of duty. Without a significant body of case law analyzing B-corporation legislation and such duties, currently there is little guidance on the full spectrum of risk. As such, directors and officers might be more reluctant to make decisions concerning actions that require balancing of considerations for more than one purpose (such as maximizing corporate profit and remedying environmental contamination matters). However, some of that concern can be addressed by legislation. In that regard, it may be prudent for legislation to provide that: only shareholders with more substantial holdings of stock have standing to challenge the B-corporation's balancing of its corporate purposes; and the grant of injunctive relief will be the sole remedy for violations of B-corporation requirements. In addition, prospective B-corporations should, before incorporating, determine whether adequate directors' and officers' liability insurance coverage can be secured for the activities the B-corporation will undertake. Anecdotally, the authors have been told that directors' and officers' liability insurance policies generally should be available and bound in a substantially similar manner as for traditional for-profit corporations. However, we also understand from insurance industry contacts that many insurance companies and underwriters have had little to no experience pricing, issuing, or underwriting such policies and, with negligible loss history, may have difficulty or discomfort in doing so in the near future.

It should also be noted that the Model Act provides that a corporation can terminate its B-corporation status by taking appropriate action (even after the entity has been formed). In that regard, a corporation's status as a B-corporation can be terminated by deleting from its Articles of Incorporation any language that is otherwise required by the Model Act to be included in a B-corporation's Articles of Incorporation (such as the requirement to provide a general public benefit). However, in order to do so, the Model Act requires that the termination can only be accomplished by the affirmative vote of at least two thirds (2/3) of each class or series of stock entitled to vote.

The decision to select a B-corporation format may be motivated by a variety of factors. For example, if consumers vote with their wallets, and social impact investing grows, entrepreneurs may wish to convey to other persons that they operate in a way that is in the public interest or that the entity has an interest in purposes that extend beyond making a profit. Other businesses may want to associate with other similarly-motivated corporations in order to accomplish a common cause.

Some commentators argue that younger entrepreneurs and workers have a genuine interest in working, in harmony with their values, with mission-driven businesses that are concerned about their impact on society and the environment. Others note that the availability of the B-corporation option would allow a state to remain competitive in attracting business by allowing domestic profit corporations to choose a corporate format that is otherwise available in other jurisdictions.

Is B-corporation legislation coming to Michigan? Several factors point to adoption of the necessary legislation. Legal recognition of the B-corporation is proceeding rapidly through the United States, particularly when compared to that of the limited liability company ("LLC") which took more than 20 years to be recognized in every state. During the first almost seven years of the LLC's legal existence, only two states – first, Wyoming, and then Florida – had passed limited liability company legislation. During the same length of time, B-corporation legislation has been enacted in two-thirds of the states. It seems Michigan will not want to be left at a competitive disadvantage by failing to offer a form of business entity available in a majority of other jurisdictions.

Another reason it seems that B-corporation legislation will be adopted in Michigan is that Michigan companies are forging ahead with B-corporation principles even without the protection of legal recognition of the B-corporation or even a constituency statute[37]. In that regard, some Michigan companies have become B Lab-certified B-corporations. Such certification is intended to certify that these companies promote a socially and environmentally conscious public benefit and meet prescribed standards of accountability and transparency. These companies, primarily in Western Michigan and concentrated in Grand Rapids, include: Better Way Imports LLC, Cascade Engineering, Inc., Brewery Vivant, Bazzani Building Company, Catalyst Partners, The Gluten Free Bar, Essence Restaurant Group, Higher Grounds Trading Co, The Image Shoppe, Highland Group, FarmRaiser, LLC, 5 Lakes Energy LLC, and Next Door Photos.[38] We anticipate that these and other champions of the B-corporation, will increasingly demand the ability to legally incorporate mission-driven, public benefit corporations, and pressure Michigan lawmakers to "catch up" to expressly authorize them.

Is B-corporation legislation coming to Michigan? Several factors point to adoption of the necessary legislation.

Assuming the B-corporation will be recognized in Michigan, whether in the current legislative session or thereafter, what form will Michigan's legislation take? And when should we expect adoption?

The B-corporation statutes of most adopting jurisdictions follow the Model Act while Delaware has created its own legal framework for public benefit corporations.[39] B-corporation legislation so far proposed in Michigan, like the majority, has closely adhered to the Model Act. B-corporation legislation was first proposed in Michigan's House of Representatives in 2010 at a time when Michigan would have been one of the first states to adopt it. However, the legislation proposed in 2010 and in subsequent years, including 2011, 2013 and 2016, expired at the end of the applicable legislative session without progressing out of committee.

While proponents of B-corporation legislation in Michigan have touted the form as an innovative tool to attract new business and entrepreneurship to Michigan, and provide an opportunity for businesses to promote their mission-driven social enterprises, others have previously expressed concern and skepticism. There has been some concern that B-corporation legislation would create an environment in which businesses are judged and B-corporations are labeled as "good" and other for-profit businesses as "greedy" or "bad."[40] Additionally, some have been skeptical of B Lab's interest in the adoption of B-corporation statutes given that it stands to profit from the annual fees it charges, on a sliding scale based on a company's revenues, as the only third party providing for B-corporation certification. Some question the validity and usefulness of the B-corporation certification process itself and wonder if B Lab is identifying "good" companies or just providing "good marketing."[41]

These concerns were raised at a time, in 2012, when the B-corporation was in its infancy, with legislation adopted in only a handful of jurisdictions. As previously noted, it is a very different landscape in 2017 with adoption of B-corporation legislation in two-thirds of the United States. In addition, it should be noted that B-corporation certification is generally optional. Nevertheless, since the B-corporation was legally born in Maryland, to the date of this article, only a small fraction of the companies that have been established were B-corporations (2,221 according to B Lab[42]). This challenges the notion that the establishment of the B-corporation will translate into traditional for-profit corporations being perceived as selfish and socially irresponsible destroyers of the environment, or cause the extinction of the traditional for-profit corporation in the near future, if at all.

Sponsors of Michigan House Bills 5710 through 5713, introduced during the 2016-2017 legislative session, anticipate introducing B-corporation legislation in substantially the same form during the current 2017-2018 legislative session (the "Proposed Legislation")[43]. Such Proposed Legislation was drafted as Chapter 9A of the Michigan Business Corporation Act (the "MBCA"), with conforming revisions to other parts of the MBCA. The Proposed Legislation generally followed the Model Act with a few key differences based on the experiences of other jurisdictions that have adopted B-corporation legislation. Of course, the Proposed Legislation may be revised before it is re-introduced or at any time during the legislative process, or abandoned altogether.

One basic difference, and a significant area where states have diverged from the Model Act is the structure of the Board of Directors. As previously discussed, the Model Act permits B-corporations to appoint a specially designated Benefit Director,[44] who is independent from the B-corporation and has certain power and duties, which are aimed at promoting accountability.[45] It is a significant appointment.

A Benefit Director to a B-corporation must maintain independence while at the same time be involved enough in company activities to permit the Benefit Director to determine whether the B-corporation and its directors and officers are appropriately carrying out the B-corporation's missions and acting in accordance with their prescribed duties, and to author the required report. Concerns about requiring a Benefit Director include the ability of B-corporations to identify suitable candidates to provide oversight while attempting to successfully achieve a collective vision. It is the experience in Michigan and other jurisdictions that many socially-conscious enterprises, especially start-ups, are comprised of a small group of like-minded founders promoting shared values and missions. Finding an independent third party to act as a Benefit Director could be challenging and disruptive to the cohesiveness of the enterprise. Others have concluded that the Benefit Director designation is un-

One basic difference, and a significant area where states have diverged from the Model Act is the structure of the Board of Directors.

necessary. For these reasons, among others, Michigan's Proposed Legislation did not require or even provide for the designation of a Benefit Director, opting instead to promote accountability by emphasizing transparency and disclosure.[46]

Another difference between the Model Act and Michigan's Proposed Legislation is in the area of dissenters' rights. While the Model Act is silent, Michigan's Proposed Legislation expressly provided for the right of shareholders to exercise dissenters' rights and to receive payment of the fair market value of their outstanding shares in accordance with existing Section 762 of the MBCA when (a) a shareholder of a B-corporation votes against an amendment to a B-corporation's Articles of Incorporation terminating B-corporation status,[47] or (b) a shareholder of a non-B-corporation constituent of a plan of merger or share exchange votes against such a merger or share exchange in which the surviving entity will be a B-corporation[48]. As drafted, Michigan's Proposed Legislation did not provide for shareholder dissenters' rights with respect to an amendment to a company's Articles of Incorporation to create a B-corporation or change a B-corporation's stated purpose(s).[49]

Michigan's Proposed Legislation also diverged from the Model Act in the area of benefit enforcement proceedings in a couple of ways. Although in varying ways, both addressed the liability regime for B-corporation directors and officers and the enforcement of certain of their respective duties in benefit enforcement proceedings. They also limited the constituencies with standing to bring benefit enforcement proceedings against directors, officers and a B-corporation itself.

The Model Act specifically provides that benefit enforcement proceedings are the exclusive means of bringing actions to enforce the particular duties of directors and officers arising under the Model Act.[50] Therefore, under the Model Act, directors and officers are still subject to the full panoply of duties of directors and officers of traditional for-profit directors and officers under the corporate statute applicable to the B-corporation, and other applicable law. There was some ambiguity with respect to Michigan's Proposed Legislation. Some practitioners read Michigan's Proposed Legislation to exempt directors and officers of B-corporations from claims for breaches of duties under other chapters of the MBCA (e.g. MBCA Sections 541a and 489) because the language of Section 959(1) of the Proposed Legislation provides "the duties of directors and officers of a [B-corporation]…may be enforced only in a benefit enforcement proceeding…" Section 959(1) of the Proposed Legislation does not limit the duties to be enforced only to duties *arising under Chapter 9A*. Other practitioners find such a limit through the reading of the definition of "benefit enforcement proceeding" itself and the totality of Chapter 9A. Nevertheless, such ambiguity could be easily rectified with an amendment of Michigan's Proposed Legislation.

Michigan's Proposed Legislation with respect to benefit enforcement proceedings sought to better protect a B-corporation and its directors and officers from nuisance derivative suits than the Model Act. However, since the date of the Michigan House Bills 5710 through 5713, the Model Act has been amended to limit standing to bring a benefit enforcement proceeding to just the B-corporation, directly, and derivatively by its shareholders that own (individually or collectively), beneficially or of record at the time of the event or omission subject of the complaint, at least (a) two percent of the shares of a class or series outstanding, or (b) five percent of the outstanding equity interests of a subsidiary of the B-corporation.[51]

Standing to bring benefit enforcement proceedings under Michigan's Proposed Legislation (which, in this regard, was similar to earlier versions of the Model Act) was more expansive than the current Model Act in that it was also available to Directors of the B-corporation and any other person specified in the company's Articles of Incorporation or Bylaws. With respect to derivative actions for shareholders of a publicly-traded corporation, Michigan's Proposed Legislation required the lesser of two percent of the company's outstanding shares or shares with a market value of at least $2 million.[52] However, the Proposed Legislation was more limited with respect to shareholder derivative suits for private companies and required that shareholders own (individually or collectively) at least two percent of the company's outstanding shares.[53]

B-corporations provide a distinct alternative to traditional for-profit corporations. Prior to adoption of B-corporation legislation, for-profit corporations were required to conduct their operations primarily for the benefit of their shareholders. In recent years,

While Michigan has not yet adopted B-corporation legislation, this legislative momentum may bolster current efforts to promote its passage.

legislation permitting the formation of B-corporations, which by their nature permit a broader range of corporate purposes in consideration of a variety of social and environmental issues, has gained significant momentum across the United States. While Michigan has not yet adopted B-corporation legislation, this legislative momentum may bolster current efforts to promote its passage. In any event, it is advisable for practitioners in Michigan to learn the basic principles and nuances of the B-corporation form of entity. By doing so, the practitioner will both become familiar with entity formation developments and also be better prepared to advise B-corporations incorporated in other jurisdictions and, should they become a reality here, in Michigan.

NOTES

1. *Dodge v Ford Motor Co*, 204 Mich 459, 170 NW 668, 3 ALR 413 (1919)
2. Model Ben Corp Legis 103-104 (2017), B Lab Company accessed August 13, 2017 http://benefitcorp.net/attorneys/model-legislation.
3. Model Ben Corp Legis 102, 201(a), and 201(b) (Definitions of General public benefit and Specific public benefit)
4. Model Ben Corp Legis 103
5. B-corporation legislation has been enacted in Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, and West Virginia, and is pending in Alaska, Georgia, Iowa, Mississippi, New Mexico, and Oklahoma. "State by State Status of Legislation," B Lab Company, accessed August 13, 2017, http://benefitcorp.net/policymakers/state-by-state-status.
6. Model Ben Corp Legis 102
7. Model Ben Corp Legis 201(a)
8. Model Ben Corp Legis 201(a)
9. Model Ben Corp Legis 102 (General Public Benefit)
10. Model Ben Corp Legis 102 (Third Party Standard)
11. Model Ben Corp Legis 102 (Third Party Standard)
12. Model Ben Corp Legis 102 (Third Party Standard and 301(a)
13. Model Ben Corp Legis, Commentator's Comments on Third Party Standard
14. Model Ben Corp Legis 401(a)
15. Model Ben Corp Legis 401(a)1(i)
16. Model Ben Corp Legis 401(a)1(ii)
17. Model Ben Corp Legis 401(a)(iii) and (iv)
18. Model Ben Corp Legis 401(a)(2)
19. Model Ben Corp Legis 401(2)(i)
20. Model Ben Corp Legis 401(2)(ii)
21. Model Ben Corp Legis 401(c)
22. Model Ben Corp Legis 402(a)
23. Model Ben Corp Legis 402(b) and (c)
24. Model Ben Corp Legis 402(d)
25. Model Ben Corp Legis 301(a)(1)
26. Model Ben Corp Legis 301(a)(3)
27. Model Ben Corp Legis 303(a)
28. Model Ben Corp Legis 302(b)
29. Model Ben Corp Legis 304
30. Model Ben Corp Legis 302(c)
31. Model Ben Corp Legis 301(d) and 303(d)
32. Model Ben Corp Legis 301(c) and 303(c)
33. Model Ben Corp Legis 301(e) and 303(e)
34. Model Ben Corp Legis 305(a)(1) and (2)
35. Model Ben Corp Legis 305(a)
36. Model Ben Corp Legis 305, Commentator's Comment
37. Various states have adopted constituency statutes, born primarily as an anti-taker measure, that aim to permit corporate directors to consider interests other than shareholder interests/maximization of profit when making business decisions. (Edward S. Adams and John H. Matheson, A Statutory Model for Corporate Constituency Concerns, 49 Emory L J 1087 (2000), available at http://scholarship.law.umn.edu/faculty_articles/93.) Michigan has not enacted such legislation (though the Michigan Business Corporation Act does not prohibit directors from considering other interests so long as they comply with their fiduciary duty to act in the best interests of the corporation. (Cyril Moscow, Margo Rogers Lesser, and Stephen H. Schulman, Michigan Corporation Law & Practice, 7C-4 (2015 Supplement).)
38. "Find a B Corp," B Lab Company, accessed August 13, 2017, https://www.bcorporation.net/community/find-a-b-corp?search=&=Search+Companies&field_industry=&field_city=&field_state=Michigan&field_country=.
39. DGCL 361 *et seq*.
40. Sherri Welch, "Bills' implications worry business, Questions arise over creating benefit corporations," *Crains Detroit Business*, last updated June 7, 2012, accessed August 13, 2017, http://www.crainsdetroit.com/article/20120603/FREE/306039919/bills-implications-worry-business.
41. Welch, "Bills' implications worry business."
42. Homepage, B Lab Company, accessed August 13, 2017, https://www.bcorporation.net/.
43. Telephone conversation with a representative of the Office of Rep Christine Greig (Mich.), (August 1, 2017).
44. Model Ben Corp Legis 302. Model Ben Corp Legis 304 of the Model Act also permits the designation of a "Benefit Officer." Michigan's Proposed Legislation does not require or even provide for the designation of a Benefit officer. As the analysis of Benefit officers is very similar to that of Benefit directors, the authors did not include a discussion of Benefit officers.
45. Model Ben Corp Legis 302(c)
46. Michigan (State). Legislature. House of Representatives. Talent and Place Caucus. HB 5710 – 5713: Benefit Corporations, A bipartisan bill package of the Talent and Place Caucus, Revised 2016 Legislation, Section-by-Section Summary (with Key Changes Noted), 2016.
47. H.R. B. No. 5710, 953(4)(B), 2015-2016 Sess. (Mich. 2016).
48. H.R.B. No. 5710, 953 and 955
49. While the Talent and Place Caucus' HB 5710-5713 Summary notes that dissenters' rights would apply with respect to an amendment to a company's Articles of Incorporation to create a B-corporation, the authors read H. R. B. No. 5710, 953 to expressly provide

dissenters' rights only with respect to an amendment terminating B-corporation status.

50. Model Ben Corp Legis 305(a)(2).

51. Model Ben Corp Legis 305(c)

52. H.R. 5710, 959(B)(i)(B), (ii) and (iv)

53. H.R. 5710, 959(B)(i)(A).

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Disclaimers of Extra-Contractual Fraud Claims in M&A Transactions Under Delaware Law

By Robert J. Cambridge and Nicholas P. McElhinny

Purchase agreements, whether in the form of asset, stock, merger, or other similar agreements (each generically referred to as an "Agreement") are typically heavily negotiated documents derived from many hours of discussions, diligence, and negotiation among sophisticated parties and their advisors. One of the key features of this process, and of any Agreement, is ensuring the transfer of all relevant knowledge about the assets, liabilities, and operations of the business from the selling parties ("Seller") to the buying parties ("Buyer").

Ideally, this process would result in a complete transfer of all relevant information: Seller would have and make available all such information; Buyer would fully evaluate it and understand exactly what it is buying; and the parties could precisely draft an Agreement without the need to worry about or hedge against undisclosed matters, misunderstandings, or misrepresentations. In reality, the process often falls short for a variety of reasons, such as Seller's representatives being overburdened or historical administrative sloppiness (not to mention occasional outright fraudsters); Sellers may provide incomplete, untimely, or ineffective disclosure; Buyer is often willing to move forward with the transaction based on a gut feeling rather than actual knowledge and understanding of the business it is acquiring; and the parties negotiate Agreements to deal with this imperfect process by assigning risk based on general representations and warranties, with only partial consideration given to actual relevance or facts.

To manage the risks inherent in this process, Buyer and Seller typically negotiate parameters for the remedies available in the event that Seller's representations and warranties are inaccurate or contain misrepresentations about the business. This typically takes the form of an indemnification provision, pursuant to which Buyer may recover some or all of the consideration paid for the business in the event Seller's representations and warranties are inaccurate. However, Seller will often be able to limit this exposure by negotiating a cap on its indemnification obligation at an amount less than the entire consideration it anticipates receiving in the transaction (a "cap"), and Seller is also often able to get Buyer to bear at least some initial cost for minor inaccuracies until the damage to Buyer exceeds some minimum threshold (a "basket"). A variety of factors—market forces, relative bargaining power, disclosures about risks/liabilities—come into play in negotiating these indemnifications, baskets, and caps, but, to one extent or another, they typically find their way into an Agreement.

After these extensive negotiations, one might be tempted to think that Buyer and Seller have considered and negotiated everything important into the Agreement. Despite this, Buyers sometimes find themselves in a position post-closing in which they are no longer satisfied with the Agreement, particularly if their remedies are limited. In an attempt to escape these constraints, some Buyers assert fraud on the part of Sellers, which claims are often carved-out from the indemnifications, baskets, and caps agreed to in the Agreement. These Buyers will often allege that the situation that led to their dissatisfaction with the deal was known or should have been known to Seller but was misstated, undisclosed, or even actively concealed. In making this case, Buyers may claim that they relied on misstatements or inaccuracies contained in diligence materials, representations, warranties, or statements other than those addressed by or contained in the Agreement.

In response to these types of challenges, Sellers have looked to various clauses in their Agreements to argue that Buyers do not have the right to pursue such alleged frauds in an attempt to revise the deal after the fact, particularly those clauses that, in some form, state that: Seller is making no additional representations other than those expressly set forth in the Agreement; Buyer conducted its own independent investigation and did not rely upon any representation or warranty not contained in the Agreement; and the Agreement and the documents incorporated by reference form the entire agreement among the parties.

As these arguments have been litigated many times in Delaware courts due to the common practice of using Delaware law to govern Agreements, this article looks at Delaware law with respect to the interplay of these clauses with Buyers' fraud claims and common drafting suggestions in connection with the same. Special consideration must be given, however, to the body of law that will govern the actual Agreement, as many jurisdictions differ from Delaware in how fraud claims may be limited (if at all).[1] Indeed, Michigan courts have held that when an integration clause is present, extrinsic evidence is generally admissible to prove fraud that would invalidate the integration clause itself or the entire contract, but not to contradict or vary the terms of the Agreement.[2] Accordingly, Michigan courts have permitted reliance on pre-contractual representations of fact to support claims for fraudulent inducement despite integration clauses.[3]

Requirements Under Delaware Law to Disclaim Extra-Contractual Fraud

In looking to avoid an assertion of fraud, Sellers look to Delaware courts to adhere to the concept of contractual freedom: generally, if parties voluntarily agree to a binding contract, Delaware law will respect such agreements absent "a strong showing that dishonoring the contract is required to vindicate a public policy interest even stronger than freedom of contract."[4] Buyers, on the other hand, look to Delaware's strong aversion to insulating fraud, arguing that it provides such a stronger public policy interest.[5] Recognizing these competing policies, a series of Delaware cases has clarified the circumstances under which it will uphold disclaimers of extra-contractual fraud, reasoning that to fail to enforce such disclaimers is to sanction Buyer's own fraudulent conduct in representing to Seller that it was relying only on contractual representations and that no other representations had been made.[6]

In 2001, in *Great Lakes Chem Corp v Pharmacia Corp*, 788 A2d 544 (Del Ch 2001), the Delaware Court of Chancery held that disclaimers of extra-contractual fraud claims were permitted where "two highly sophisticated parties, assisted by experienced legal counsel entered into carefully negotiated disclaimer language after months of extensive due diligence."[7] The disclaimer language at issue was extensively negotiated and contained an express acknowledgement by Buyer that Seller would not incur liability related to any information outside of the Agreement. Moreover, it contained an exclusive representations clause disclaiming any representation or warranty by Seller other than those specifically set forth in the Agreement. The court held that the parties "explicitly allocated their risks and obligations in the [p]urchase [a]greement" and that "a party to such a contract who later claims fraud is not in the same position—and does not have the same need for protection—as unsophisticated parties who enter into…contracts having boilerplate disclaimers that were not negotiated."[8] Accordingly, pursuant to *Great Lakes*, key considerations in upholding a disclaimer of extra-contractual fraud are the sophistication of the parties, whether the clause is explicit, and whether the clause was negotiated between the parties.[9]

ABRY Partners—Seminal Decision for Anti-Reliance Clauses Under Delaware Law

After *Great Lakes*, a line of cases continued the trend of upholding disclaimers of extra-contractual fraud where sophisticated parties conduct extensive due diligence and negotiate explicit disclaimer language.[10] In 2006, however, the Court of Chancery reexamined a Buyer's ability to disclaim extra-contractual fraud claims in *ABRY Partners V, LP v F&W Acquisition LLC,* 891 A2d 1032 (Del Ch 2006). In *ABRY*, Buyer purchased a business and then claimed that it had been defrauded by Seller's manipulation of company financials and omissions about operational problems.[11]

Under the terms of the Agreement at issue, ABRY's "sole and exclusive remedy" was to pursue an indemnification claim.[12] Buyer argued that the Agreement's exclusive remedy provision only applied to claims based on a breach of contract, not fraud.[13] The court disagreed, noting that the indemnification provision that provided the exclusive remedy specified that it was the remedy for any claim arising due to any "*inaccuracy, misrepresentation, breach of,* default in, or failure to perform *any of the representations, warranties or covenants*."[14] Since "misrepresentation," in particular, is commonly treated as

> After these extensive negotiations, one might be tempted to think that Buyer and Seller have considered and negotiated everything important into the Agreement.

Delaware law does not require specific wording in an anti-reliance clause[.]

including and broader than fraud, the court found no reason to treat fraud as not included by the indemnification and exclusive remedies clauses, so, absent some over-arching public policy against fraud, Buyer could only look to the agreement's indemnification for its remedy.[15]

Buyer then argued that public policy would not permit Seller to benefit from the alleged fraud perpetrated by Seller, regardless of the Agreement's terms.[16] The court disagreed, noting that Delaware law permitted "sophisticated parties to negotiated commercial contracts" to agree that they "may not reasonably rely on information that they contractually agreed did not form a part of the basis for their decision to contract."[17] Further, the court held that a party "cannot promise, in a clear integration clause of a negotiated agreement, that it will not rely on promises and representations outside of the agreement" and then turn around and do so in a fraud claim.[18] Doing so would simply permit the substitution of one lie (the alleged representations and warranties not evident in the agreement) for another (the promise that a party had not relied on any representations and warranties not found in the Agreement).[19]

However, the court stated that Delaware law will only enforce such provisions if they clearly state a party's disclaimer of reliance on any matters outside of the scope of the Agreement;[20] otherwise, "murky integration clauses, or standard integration clauses without explicit anti-reliance representations, will not relieve a party of its oral and extra-contractual fraudulent representations."[21] In particular, an integration clause must contain "language that ... can be said to add up to a clear anti-reliance clause by which the [Buyer] has contractually promised that it did not rely upon statements outside the contract's four corners in deciding to sign the contract."[22] The failure to "include unambiguous anti-reliance language" from Buyer means that Seller will not be able to preclude claims for fraud based on representations and warranties outside of the Agreement itself.[23]

Recent Developments in Delaware Law

In *Prairie Capital III, LP v Double E Holding Corp,* 132 A3d 35 (Del Ch 2015), the Delaware Court of Chancery again revisited issues with respect to anti-reliance clauses, including a party's ability to disclaim fraud based on extra-contractual omissions. *Prairie Capital* developed from the sale of stock of a portfolio company by a private equity firm. Buyer in the transaction alleged fraud against the selling stockholders and certain executive officers of the target company on the basis that they made contractual and extra-contractual misrepresentations and omissions relating to, among other things, the target company's financial statements.

The Agreement in *Prairie Capital* contained a provision in which Buyer acknowledged that (a) it had conducted an independent investigation of the financial condition, operations, assets, liabilities, and properties of the target company; (b) it had relied on the results of such investigation and the representations and warranties expressly set forth in the Agreement; and (c) it understood that all other representations were disclaimed.[24] The Agreement further contained a standard integration clause that expressly provided that the Agreement set forth the entire understanding of the parties with respect to the transaction and superseded all other agreements, representations, and statements made in connection with negotiating the terms of the Agreement.[25]

Although the exclusive representations clause was not framed negatively (i.e., that Buyer *did not* rely on extra-contractual representations), the court in *Prairie Capital* held that it was nonetheless sufficient. Specifically, the court held that a Buyer's affirmative representation that it only relied on the representations and warranties set forth in the Agreement clearly "establishes the universe of information on which the [Buyer] relied."[26] Delaware law does not require specific wording in an anti-reliance clause; "language is sufficiently powerful to reach the same end by multiple means, and drafters can use any of them to identify with sufficient clarity the universe of information on which the contracting parties relied."[27] The court in *Prairie Capital* held that the exclusive representations clause, together with the integration clause, added up to a clear anti-reliance clause, despite being framed affirmatively.[28]

The court next turned to the issue of whether an anti-reliance clause that does not expressly mention omissions or the accuracy or completeness of information could disclaim fraud claims based upon extra-contractual omissions or concealment. The Delaware Court of Chancery had previously opined on this issue in *Transdigm, Inc v Alcoa Global Fas-*

teners Inc, No 7135-VCP, 2013 Del Ch LEXIS 137 (May 29, 2013). While the Agreement in *Transdigm* contained an anti-reliance clause in which Buyer expressly disclaimed reliance upon "any express or implied representations or warranties of any nature . . . except as expressly set forth in [the] Agreement,"[29] the court held that Buyer had preserved its rights to bring a fraud claim based on extra-contractual omissions because the anti-reliance clause did not contain an acknowledgement from Buyer that Seller was not making any "representation as to the *accuracy or completeness* of the information it provided . . . or as to extra-contractual *omissions*."[30]

Though the anti-reliance clause in *Prairie Capital* was similar to that in *Transdigm*, the court held that the wording of such anti-reliance clause "bar[s] not only fraud claims based on extra-contractual representations but also fraud claims based on extra-contractual omissions."[31] The court further held that "[t]o the extent *Transdigm* suggests that an agreement must use a magic word like 'omissions,' then [the court] respectfully disagree[s] with that interpretation."[32] Any other interpretation would render anti-reliance clauses ineffective.[33] Until the Delaware Supreme Court resolves this split between the lower courts, practitioners representing Sellers are urged to continue to draft anti-reliance clauses to include an express disclaimer from Buyer as to omissions and the accuracy or completeness of information received in order to be certain that the parties have properly waived fraud claims based on extra-contractual omissions.

In *FdG Logistics LLC v A&R Logistics Holdings, Inc*, 131 A3d 842 (Del Ch 2016), the Delaware Court of Chancery held that an integration clause in the parties' merger agreement did not preclude an allegation of fraud by Buyer against Sellers. Buyer alleged that Sellers had engaged in "an extensive series of illegal and improper activities that were concealed from [buyer] during pre-merger due diligence,"[34] and argued that these pre-merger misrepresentations and omissions formed the basis for a claim of common law fraud;[35] Sellers responded that since such matters were not part of the Agreement, Buyer could not have justifiably relied on them in entering into the Agreement.[36]

Seller's response was premised on the Agreement's exclusive representations and integration clauses. The exclusive representations clause stated that the only representations and warranties made by Seller were those contained in the Agreement, and it expressly disclaimed any representation or warranty based on any projections, estimates, or budgets or any other information made available to Buyer that was not expressly within a representation or warranty in the Agreement.[37] The integration clause stated that the Agreement and certain specified documents "contain the entire agreement between the Parties and supersede any prior understandings, agreements or representations by or between the Parties, written or oral, which may have related to the subject matter hereof in any way."[38]

The court found that the clauses in this merger agreement did not operate to preclude Buyer's assertion of fraud because the exclusive representations and integration clauses did not include "any affirmative expression by Buyer of (1) specifically what it was relying on when it decided to enter the Merger Agreement, or (2) that it is was not relying on any representations made outside of the Merger Agreement."[39] Delaware courts will not bar assertions of fraud based on representations not contained in an Agreement "unless that contracting party unambiguously disclaims reliance on such statements," which "must come from the point of view of the aggrieved party (or all parties to the contract) to ensure the preclusion of fraud claims for extra-contractual statements…."[40] As the exclusive representations clause in the Agreement was a statement by the Company, not Buyer, and the integration clause did not include any such unambiguous statement, they did not preclude Buyer's fraud claim.

Oftentimes, Sellers try to avoid extra-contractual fraud claims through the use of generic integration or exclusive representations clauses.

In *IAC Search, LLC v Conversant, LLC*, No 11774-CB, 2016 Del Ch 176 (Nov 30, 2016), the Delaware Court of Chancery reaffirmed its holding in *FdG Logistics*, as originally held in *ABRY*, that "in order to bar fraud claims, a disclaimer of reliance 'must come from the point of view of the aggrieved party,' meaning that it must come from the buyer who is asserting the fraud claim."[41]

IAC Search arose from the purchase of six subsidiaries of Seller through a stock and asset purchase agreement. Buyer alleged that Seller fraudulently induced it to overpay for one of the subsidiaries by providing false information regarding the subsidiary's advertising sales. Buyer's claim was based upon misrepresentations contained in documents placed in an electronic data room and in response to certain diligence requests during the diligence period rather than the express representations set forth in the Agreement.

The court noted that three provisions contained in the Agreement were relevant to its analysis: First, the Agreement contained an express disclaimer by Seller of any representation or warranty not contained in the Agreement.[42] Second, the Agreement contained an acknowledgment (referred to as the "Acknowledgement Clause") from Buyer that (a) it was a sophisticated purchaser and had conducted an independent investigation and analysis of the transaction, and (b) it understood that Seller was not making any representation or warranty with respect to any data rooms, management presentations, diligence materials or financial projections or forecasts unless the same was contained in the Agreement.[43] Finally, the Agreement contained a standard integration clause expressly providing that the Agreement and certain other specified documents constituted the entire understanding and agreement of the parties and superseded all prior agreements, representations and statements made with respect to the subject matter of the Agreement.[44]

From a Buyer's perspective, special attention should be given to these provisions early in negotiations, particularly since recent trends indicate that the use of anti-reliance clauses is now relatively common.

The court held that "[a]n assertion from the *Seller* 'of what it was and was not representing and warranting' is not sufficient given [Delaware's] abhorrence of fraud."[45] Accordingly, Seller's disclaimer of extra-contractual representations was not, on its own, enough to properly bar fraud claims. That, however, was accomplished through the Acknowledgement Clause and the integration clause. Buyer expressly acknowledged in the Acknowledgement Clause that Seller was not "'making, directly or indirectly, any representation or warranty' with respect to any information it received in due diligence 'unless such information [was] expressly included in a representation and warranty' in the Agreement." Buyer, therefore, contractually agreed to the exact "universe of information on which [it] relied and did not rely when it entered into the Agreement."[46]

In comparing the provisions from *IAC Search* with those in *ABRY*, the court noted that the *ABRY* Agreement contained additional language in which Buyer released Seller from liability with respect to Buyer's reliance on extra-contractual information set forth in data rooms and management presentations.[47] Buyer in *IAC Search* argued that because of this missing information, the Acknowledgement Clause failed to meet the standard to bar extra-contractual fraud claims. Notwithstanding, the court held that while the release language would have certainly reinforced the limiting effect of the anti-reliance clause, its omission is not fatal; "the combined effect of the Buyer's Acknowledgement Clause and the integration clause…nonetheless add up…to a clear anti-reliance clause to bar fraud claims based on extra-contractual statements made during due diligence."[48] The court reasoned that "the integration clause define[d] the universe of writings reflecting the terms of [the] agreement, and the Buyer's Acknowledgement Clause explains in clear terms from the perspective of the Buyer the universe of due diligence information on which the Buyer did and did not rely when it entered into the Agreement."[49]

Practical Considerations and Drafting Points to Disclaim Extra-Contractual Fraud Under Delaware Law

Delaware law is clear—despite its strong abhorrence of fraud, sophisticated parties in commercial transactions are permitted to negotiate and agree to the universe of documents, information, and representations relied upon in entering into the Agreement. "A party cannot promise…that it will not rely on promises and representations outside of the agreement and then shirk its own bargain… ."[50] To do so would sanction Buyer's own fraudulent conduct.[51]

However, to properly protect against abuses of fraud, Delaware courts only uphold disclaimers of fraud based upon extra-contractual statements and information if Buyer clearly and unambiguously disclaims reliance on the same or, in the alternative, affirmatively states what it relied upon in entering into the Agreement. Absent this clear and unambiguous language from Buyer, Buyer may be deemed to preserve its ability to make an extra-contractual fraud claim. Moreover, through *Transdigm*, Delaware courts have at times required additional language as to the accuracy or completeness of information provided to disclaim fraud based upon concealment or omission rather than misstatements.[52]

Oftentimes, Sellers try to avoid extra-contractual fraud claims through the use of generic integration or exclusive representations clauses.[53] While such clauses otherwise have their purposes, it is clear that they do not properly disclaim extra-contractual fraud claims under Delaware law as they are not generally drafted from a Buyer's perspective and frequently lack (a) an acknowledgement from Buyer that it is a sophisticated party and that it had conducted its own independent investigation; (b) a clear and unambiguous disclaimer of reliance from Buyer of any representation, warranty, statement or other information or document of any kind other than those representations and warranties expressly provided in the Agreement; (c) an express acknowledgement from Buyer that the only representations and warranties made by Seller are those contained in the Agreement; and (d) an express disclaimer of reliance on omissions as well as the accuracy or completeness of any representation, warranty, statement, or other information or document other than those representations and warranties expressly provided in the Agreement.

From a Buyer's perspective, special attention should be given to these provisions early in negotiations, particularly since recent trends indicate that the use of anti-reliance clauses is now relatively common.[54] A Buyer agreeing to an anti-reliance clause should be mindful of its potentially limiting effects and must carefully scrutinize the representations and warranties contained in the Agreement to ensure they capture those items that Buyer truly relied upon in connection with the transaction. Finally, if Buyer relies on any representation or warranty contained in a document or statement that may otherwise fall outside of the Agreement, such document or statement should be expressly listed as something relied upon in the anti-reliance clause.

NOTES

1. *See* Wilson Chu and Jessica Pearlman, Practical Law Corporate & Securities, *Disclaimers of Reliance in Private M&A Deals Chart,* http://www.practicallaw.com (accessed July 27, 2017) ("for example, in California (*Danzig v Jack Grynberg & Assocs*, 208 Cal Rptr 336, 342 (Ct App 1984)), Massachusetts (*Sweeney v DeLuca*, No 04-2338, 2006 Mass Super LEXIS 147, at *5–6 (Mar. 16, 2006)) and Nevada (*Blanchard v Blanchard*, 839 P2d 1320, 1322–23 (Nev 1992))").
2. *See UAW-GM Human Res Ctr v KSL Recreation Corp*, 228 Mich App 486, 503, 579 NW2d 411 (1998).
3. *See, e.g.*, *Johnny's-Livonia Inc v. Laurel Park Retail Props*, No 320430, 2015 Mich App LEXIS 1027, at *3-4 (May 19, 2015) (unpublished).
4. *Libeau v Fox*, 880 A2d 1049, 1056-57 (Del Ch 2005), *aff'd in pertinent part*, 892 A2d 1068 (Del Ch Jan 24, 2006).
5. *See, e.g.*, *ABRY Partners V, LPl v F&W Acquisition LLC*, 891 A2d 1032, 1036 (Del Ch 2006).
6. *ABRY* at 1057.
7. *Great Lakes* at 555; *But see Norton v Poplos*, 443 A2d 1 (Del 1982) (holding that a boilerplate unnegotiated disclaimer was not sufficient to bar fraud claims).
8. *Great Lakes* at 555.
9. *See also Kronenberg v Katz*, 872 A2d 568, 593 (Del Ch 2004) ("Because Delaware's public policy is intolerant of fraud, the intent to preclude reliance on extra-contractual statements must emerge clearly and unambiguously from the contract.")
10. *See, e.g.*, *H-M Wexford LLC v Encorp Inc,* 832 A2d 129 (Del Ch 2003) (Where an Agreement was entered into between sophisticated parties after extensive due diligence, an integration clause expressly disclaiming representations, warranties, covenants or undertakings other than those set forth in the Agreement foreclosed the ability of Buyer to use such extra-contractual representations or warranties as a basis for a breach of the Agreement.)
11. *ABRY,* 891 A2d at 1038-40.
12. *Id.* at 1035.
13. *Id.* at 1053.
14. *Id.* at 1044.
15. *Id.* at 1054-55.
16. *Id.* at 1035.
17. *Id.* at 1057 (quoting *H-M Wexford LLC v Encorp Inc*, 832 A2d at 142 n 18 (Del Ch 2003)).
18. *Id.* at 1057.
19. *Id.* at 1058.
20. *Id.*
21. *Id.* at 1059.
22. *Id.*
23. *Id.*
24. *Prairie Capital*, 132 A3d at 55.
25. *Id.*
26. *Id.* at 51.
27. *Id.*
28. *Id.* (citing *Kronenberg*, 872 A2d at 593).
29. Transdigm at *7
30. *Id.* at *8 (emphasis added)
31. *Prairie Capital*, 132 A3d at 53.
32. *Id.* at 54
33. *Id.*
34. *FdG Logistics LLC*, 131 A3d at 850.
35. *Id.* at 857.
36. *Id.*
37. *Id.* at 858.
38. *Id.*
39. *Id.* at 860.
40. *Id.*
41. *IAC Search* at *6 (citing *FdG Logistics LLC*, 131 A3d at 860).
42. *IAC Search* at *5.
43. *Id.*
44. *Id.*
45. *Id.* at *6 (citing *FdG Logistics LLC*, 131 A3d at 860 (emphasis in original)).
46. *Id.* at *6.
47. The following release was contained in *ABRY* but not in *IAC Search*: ". . . neither the Company nor the Selling Stockholder shall have or be subject to any liability to Acquiror or any other person resulting from the distribution to Acquiror, or Acquiror's use of or reliance on, any such information or any information, documents or material made available to Acquiror in any "data rooms," "virtual data rooms," management presentations or in any other form in expectation of,

or in connection with the transactions contemplated hereby." *See ABRY*, 891 A2d at 1041.

48. *IAC Search* at *7.

49. *Id.*

50. *ABRY,* 891 A2d at 1058.

51. *Id.*

52. *See Transdigm* at *8; *but see Prairie* Capital, 132 A3d at 54.

53. A standard integration clause generally provides: "This Agreement, which includes the exhibits [hereto], constitutes the entire agreement and understanding of the parties hereto with respect to the subject matter hereof and supersedes all prior or contemporaneous agreements, understandings, inducements, or conditions, oral or written, express or implied." *Kronenberg*, 872 A2d at 593.

A standard exclusive representations clause generally provides: "Except for the representations and warranties contained in [Article III] (as modified by the disclosure schedules), none of seller, the company or any other person has made or makes any other express or implied representation or warranty, either written or oral, on behalf of seller or the company." *ABA 2013 Private Target Mergers & Acquisitions Deal Points Study*, http://apps.americanbar.org/dch/committee.cfm?com=CL560003, slide 79 (accessed July 27, 2017).

54. According to the ABA's 2015 Private Target Mergers & Acquisitions Deal Points Study, 40% of the deals subject to the study (those completed in 2014) contained an express anti-reliance provision (compared to 43% of the deals completed in 2012 and 33% of the deals completed in 2010.) *See ABA 2015 Private Target Mergers & Acquisitions Deal Points Study,* http://apps.americanbar.org/dch/committee.cfm?com=cl560003, slide 66 (accessed July 27, 2017). According to the ABA's 2016 Strategic Buyer / Public Target M&A Deal Points Study, 36% of the deals subject to the study (those completed in 2015) contained an express anti-reliance provision (compared to 26% in 2014 and 28% in 2013). *See ABA 2016 Strategic Buyer / Public Target M&A Deal Points Study*, slide 109 (accessed July 22, 2017).

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Dispute with Minority Shareholder May Be Resolved by Cash-Out Merger

By Bruce W. Haffey

Sometimes a shareholder is simply out of step with the rest. Despite efforts on all sides to resolve the issues, problems may fester and the business may suffer.

Shareholders may work well together for many years, but over time their relationships may change. What were once equally valuable contributors to the business may be no longer. Compensation and profit-distribution structures that once were fair and appropriate may no longer reflect the time, effort, and value contributed by the shareholders. Retirement and buy-out arrangements that may have made sense for a start-up business may not make sense for an established thriving business. Yet one or more shareholders may not be willing to agree to new arrangements that reflect the current reality.

What was once a well-established vision for the company may no longer be universally endorsed. Certain shareholders may desire to grow and expand the business or pursue new opportunities, whereas others may be getting older and may be more risk averse or may want to begin to work less, looking forward to retirement. A strategic growth plan supported by the majority may be frustrated by one or more minority shareholders who undermine the process.

A long-term plan to transition the business to the next generation of family members may no longer be desirable for a shareholder whose children did not become active in the business. Perhaps for reasons entirely unrelated to the business, a shareholder may become grumpy, bitter or cynical, and may generally make life miserable for his or her colleagues, and the business may suffer as a result.

To resolve such a situation the parties may look to the corporation's organizational documents and shareholder agreements. Supermajority voting requirements may enable a minority shareholder to frustrate the will of the majority. Changes to compensation or profit shares set forth in contracts may require negotiation and agreement by the parties, including those negatively affected, which may be difficult or impossible to achieve.

Shareholder agreements may not provide a buy-sell triggering mechanism based solely upon a minority shareholder's interests or opinions being out of alignment with the majority. A buy-out trigger based on termination of employment may not be effective if the shareholder's employment agreement requires good cause for termination. Simply having a difference of opinion regarding policy or action proposed by the majority is unlikely to constitute good cause for termination.

Problems may fester as a result, competing factions may develop, or shareholders, directors, officers, and employees may become distracted or try to avoid each other, which may lead to the decline of the business, or failure to thrive, to the disadvantage of all shareholders.

In such a case, a "cash-out" merger may allow the parties to separate on fair, reasonable terms, letting the majority shareholders continue to operate the business while cashing out a minority shareholder. A cash-out merger, sometimes referred to as a squeeze-out merger or freeze-out merger, is one in which the existing corporation is merged with another corporation, the majority shareholders receive shares of stock of the surviving corporation, but one or more shareholders receive only cash or other property and are thereby eliminated as shareholders.

A plan of merger must be adopted by the boards of directors and, subject to certain exceptions, the shareholders of the constituent corporations. The plan of merger must specify the basis on which the shares of each corporation will be converted into shares, bonds or securities of the surviving corporation, or into cash or other consideration.[1] Other consideration may include shares, bonds, rights or other property or securities of a corporation not a party to the merger.[2] The plan of merger may provide for different forms of consideration for different shareholders, even for shareholders of the same class.[3]

The vote of the shareholders of the surviving corporation to approve the plan of merger is not required if its articles of incorporation will not be amended and each shareholder of the surviving corporation will hold, after the merger, the same number, class, and series of shares as owned prior to the merger.[4] This would not be the case in a cash-out merger, and therefore, a shareholder vote is required.

If a shareholder disagrees with the consideration payable for his or her shares under a plan of merger, the shareholder is generally entitled to dissent from the merger and obtain payment of the fair value of his or her shares.[5] A shareholder is entitled to dissenters' rights in a merger in which shareholder approval is required,[6] except in a case in which the consideration for the shareholder's shares is limited to cash or shares traded on a national securities exchange.[7] Even if not required by statute, dissenters' rights may be granted in the articles of incorporation, bylaws, or resolution of the board of directors.[8]

A plan of merger must be adopted by the boards of directors and, subject to certain exceptions, the shareholders of the constituent corporations.

The Michigan Business Corporation Act (the "Act")[9] prescribes a detailed procedure for the exercise of dissenters' rights, including required notices to the shareholders by the constituent corporations and by shareholders intending to exercise their dissenters' rights, and the process of determining the fair value of a shareholder's shares. Fair value is the value of the shares immediately before the merger, excluding any appreciation or depreciation in anticipation of the merger unless exclusion would be inequitable.[10] Minority share discounts do not apply.[11]

Stock Transfer Restrictions Do Not Apply to Cash-Out Mergers

A minority shareholder who desires to contest a cash-out merger has limited options. Shareholders have argued that a restriction on the sale or transfer of shares in a shareholder agreement applies to a merger. Such an argument has been rejected in several states. In the Delaware case of *Shields v Shields*,[12] majority shareholders of a second-generation family owned corporation sought to avoid the punitive effects of a long-standing shareholder agreement providing for a book value buy-out by engaging in a merger in which the corporation was merged into a new corporation, which was structured to have more reasonable buy-out terms. There was no squeeze out, ownership of the new corporation was identical to the old and the same buy-sell terms were available to all, but the minority shareholder asserted an option to purchase the majority shareholders' shares under the old corporation's shareholder agreement. The plaintiff claimed that the merger constituted a sale or disposition of shares within the meaning of the shareholder agreement, which provided an option to purchase a shareholder's shares "[i]n the event any party desires to sell, give, pledge, dispose of by will, gift in trust or in any manner otherwise dispose of his or her stock holdings in the Company."[13]

The court held that the statutory conversion of shares in the merger was not a sale, transfer, or exchange within the meaning of the shareholder agreement because the merger was not an act by the stockholders that the shareholder agreement sought to restrict; it was a corporate act, even though it required the approval of the shareholders. The merger was not a transfer of stock but a transmutation of the stock by operation of law.

A similar result was held in the Pennsylvania case of *Seven Springs Farm, Inc v Croker*.[14] In that case the stock of a family business was held in equal shares by three families, all of whom were descendants of the company founders. Two families desired to sell the business, entered into a merger agreement with an unrelated third party, and sought a declaratory judgment that the parties' buy-sell agreement did not trigger an option by the third family group to purchase the shares of the majority shareholders. The Pennsylvania Supreme Court cited *Shields* in holding that a merger was a corporate act, not a stockholder act, that the conversion of shares in a merger did not constitute a sale or transfer by a shareholder, and therefore that the restrictions of the buy-sell agreement did not apply. The court also noted that if the shareholders had intended to prohibit corporate actions like mergers, they could have drafted the buy-sell agreement or other corporate documents to do so.

Dissenters' Rights Are an Exclusive Remedy Absent Unlawful or Fraudulent Conduct

A shareholder may also argue that a merger is void for lack of a business purpose, or that the merger is a breach of fiduciary duties or unlawful act by the board of directors or majority shareholders of the corporation. Under the Act, however, a shareholder entitled to dissent from a merger transaction may not challenge the merger itself unless the merger is unlawful or fraudulent with respect to the minority shareholder.[15] Therefore, absent fraud or unlawful action a shareholder's sole recourse in response to a cash-out merger is to exercise his or her dissenters' rights and receive the fair value of his or her shares.

The exclusivity of the appraisal remedy was tested in the Michigan case of *Krieger v Gast*.[16] In that case, Krieger, a minority shareholder, was squeezed out in a cash-out merger and did not exercise his dissenters' rights. He was instead paid cash pursuant to the plan of merger. Roughly a year and a half later, the corporation was sold, and the majority shareholders received more than twice the amount Krieger received in the merger. Krieger sought to challenge the merger on grounds of fraud and breach of fiduciary duty.

A threshold issue was whether dissenters' rights were the exclusive remedy, since Krieger did not exercise it. Prior to the 1989 amendments to the Act, the shareholder must have exercised dissenters' rights for it to be the exclusive remedy.

Under the amended statute, dissenters' rights are the exclusive remedy (absent fraud or unlawful conduct) for a shareholder entitled to them in a merger in which shareholder approval is required by statute or the articles of incorporation and the shareholder is entitled to vote.[17] Krieger argued that this did not apply because this was a cash-out merger, so the right to dissent was not granted by statute or the articles of incorporation, but it was granted by the board resolutions adopting the plan of merger. Krieger argued that Section 762(4) of the Act applied, which stated that where the dissenter's rights were granted by board resolution they were the exclusive remedy only if exercised.[18]

The court acknowledged the ambiguity of the statute and the reasonableness of the construction of the statute proffered by both parties, but it ruled against Krieger. Because Krieger was entitled to dissenters' rights, they were his exclusive remedy even though he did not exercise them, absent fraud or unlawful conduct.

This led the court to consider the types of conduct that might be challenged as fraudulent or unlawful. Krieger alleged that the defendants engaged in a plan or conspiracy to squeeze out the minority shareholders at an unfairly low price so as to enrich themselves in a subsequent sale of the business.

The court found it to be an issue of first impression in Michigan as to what type of conduct might be challenged as fraudulent or unlawful within the meaning of the statute so as to avoid the exclusivity of dissenters' rights, and it looked to cases in Delaware and other states for instruction. Despite some variations in wording the court did not find there to be a significant difference between the scope of the appraisal remedy in the various states. The court concluded that fraud or unlawful conduct might include acts of self-dealing, deliberate waste of corporate assets, or breach of fiduciary duty. However, the court held that mere general allegations were insufficient and that specific acts of misconduct must be pled. The court further held that a claim that is in essence merely a dispute about price should be dismissed because the statutory appraisal remedy is sufficient.

Krieger alleged the failure to include relevant financial information in the notice of shareholder meeting and the engagement of an investment banking firm to further the ultimate plan of the majority shareholders to undertake an initial public offering of stock or to sell the business constituted fraud or unlawful conduct within the meaning of the Act. The court held that these allegations were sufficiently specific to state claims for fraud or unlawful conduct and remanded the case for further proceedings.

In the subsequent proceedings,[19] the court held that the failure to include financial information in the initial notice of shareholder meeting did not constitute a breach of fiduciary duty or unlawful conduct since the Act specifies the information to be included in such notice and provides for the disclosure of financial information later in the prescribed statutory dissenters' rights process. The court further held that Krieger's various allegations were insufficient as a matter of law to constitute fraud or unlawful conduct and dismissed the case.

Subsequent cases have provided further instruction on the scope of conduct that might be considered fraudulent or unlawful. In the case of *Irish v Natural Gas Compression Sys, Inc*,[20] the plaintiff was a founding director and shareholder of the defendant corporation and was squeezed out in a merger. The plaintiff claimed he did not receive notice of the shareholder meeting so he was unable

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to vote against the merger. He returned the check tendered to him for his shares, stating that he thought the action was illegal and oppressive, but he did not take any action to exercise his dissenters' rights. Almost three years later, the plaintiff sued alleging shareholder oppression and seeking equitable relief.

The court held that the plaintiff had dissenters' rights and failed to exercise them. The court stated that dissenters' rights were the exclusive remedy, as the action was essentially a dispute about price, and that the plaintiff had made no showing of unlawful or fraudulent conduct. The court said there was no breach of contract, and the court was not troubled by the lack of notice of the shareholder meeting because the votes in favor of the merger were sufficient regardless of whether plaintiff was present to vote against the action. The court further held that plaintiff had no standing to assert a shareholder oppression claim as he was not a shareholder at the time of filing, having been squeezed out in the merger, and that his claim was barred by a two-year statute of limitations.

In the New Mexico case of *McMinn v MBF Operating Acquisition Corp*,[21] a minority shareholder in a closely held corporation was squeezed out in a merger. McMinn was one of three equal founding shareholders of the business but was subsequently appointed to the state public regulation commission. He resigned as an employee but continued to own shares of stock, placing them in a blind trust. The trustee sought to have the corporation institute a dividend policy, which was rejected. The trustee complained that the corporation and majority shareholders were engaged in oppressive conduct and self-dealing, including the payment of excessive compensation, thereby denying McMinn's right to one third of the profits.

The majority shareholders decided it was necessary to separate from McMinn and undertook a squeeze-out merger. The consideration offered for McMinn's shares was based upon a third-party valuation, but the third party had no valuation expertise. The trustee objected to the merger, and asserted that the action was unlawful and the valuation deliberately undervalued, but did not formally exercise dissenters' rights. The trust subsequently filed suit and alleged breach of fiduciary duty, oppression, and tort.

The trial court found in favor of McMinn for breach of fiduciary duty, but the New Mexico Court of Appeals reversed, stating that McMinn's exclusive remedy was his statutory appraisal right. The Court of Appeals also found that McMinn's claims did not constitute fraud or unlawful conduct.

The New Mexico Supreme Court reversed. The court first considered whether statutory appraisal rights were the exclusive remedy. The court stated that New Mexico's appraisal statute appears to be designed to address arm's-length merger transactions between unrelated parties and does not seem to contemplate a squeeze out of a minority shareholder by the majority in a closely held company. The court stated that the appraisal remedy should not be used to circumvent close scrutiny of related party transactions or breaches of fiduciary duty. The court stated further that if statutory appraisal was the exclusive remedy, the claims of self-dealing, payment of excessive salaries, and failure to pay plaintiff his share of profits would constitute fraudulent or unlawful conduct that would not be foreclosed by the appraisal remedy.

In reaching this conclusion, the court stated that nothing in the appraisal statute indicates that shareholders squeezed out in a merger cannot pursue claims based upon conduct prior to the merger itself, and that claims challenging wrongful behavior other than incorrect, accounting–type share valuation should not be forced into the appraisal remedy.

In a recent Michigan Court of Appeals case, *In re Caraco Pharm Labs S'holder Litig*,[22] minority shareholders were squeezed out in a merger. Approximately 75.8 percent of Caraco's stock was owned by related parties Sun Pharmaceutical Laboratories, Ltd. ("Sun"), the controlling shareholder of Sun and a wholly-owned subsidiary of Sun. The majority shareholders desired to take the company private.

Sun announced a plan on December 3, 2010, to purchase the shares they did not already own for $4.75 per share. Caraco appointed an independent committee to evaluate the proposal. Shortly thereafter, Sun announced that an important distribution and marketing agreement with Caraco would cease in approximately two years. In January 2011, Caraco announced that it would be unable to meet previous forecasts to restart production of certain drugs by the end of the year.

In February 2011, based on the recommendation of the independent committee, Caraco entered into a merger agreement in which minority shareholders would be cashed out at a value of $5.25 per share. In April 2011, the minority shareholders filed suit against Caraco, the majority shareholders, and certain individuals, including the members of the independent committee. The claims alleged that the transaction was not procedurally or financially fair to the minority shareholders, and that the majority shareholders and other defendants breached their fiduciary duties to the minority shareholders or aided and abetted the breach of fiduciary duties. Plaintiffs alleged there was a scheme to devalue the stock of Caraco prior to the merger and there was a failure to disclose material facts prior to consummation of the merger. The merger was consummated in June 2011, and the minority shareholders did not exercise their dissenters' rights.

Defendants cited the *Krieger* case in arguing that the plaintiffs' claims were fundamentally no more than a dispute about the price paid for their shares of Caraco stock, and that plaintiffs failed to show fraudulent or unlawful conduct so their exclusive remedy was dissenters' rights.

The court disagreed, noting the distinction made in the *Krieger* case between conduct that is related to and has a substantial impact on price but establishes an independent claim of breach of fiduciary duty and mere judgmental factors of valuation. The court held that the plaintiffs in *Caraco* had alleged sufficient facts in support of a scheme to artificially depress the value prior to the merger to support a claim of breach of fiduciary duty so that dissenters' rights were not the exclusive remedy. Accordingly, the court reversed the trial court order of summary disposition for the defendants.

Survival of Shareholder Agreements and Other Contracts

In a closely-held corporation, arrangements between the corporation and its shareholders may include terms covering employment, compensation and bonuses, restrictions on compensation, employee benefits, employment or ownership opportunities for children or other family members, leases or licenses of real or personal property, or other arrangements. It remains unclear to what extent the majority shareholders would be able to sever all such relationships by reason of a squeeze-out merger that eliminates a minority shareholder.

As a function of the merger statute, in a merger, the merged corporation ceases to exist, but its assets and obligations survive and become assets and obligations of the surviving corporation.[23] Generally, contracts of the merged corporation survive and become contracts of the survivor.

However, the *Shields* case held that rights of first refusal and options to purchase shares of stock of a merged corporation do not survive the merger.[24] Such rights are inherently connected to the ownership of stock of the merged corporation and do not survive a merger in which stock ownership terminates. In the *Shields* case, the minority shareholders sought to exercise options to purchase stock of the majority shareholders under a premerger shareholder agreement. The *Shields* court reasoned that the event asserted by the minority shareholders to trigger the option to purchase was the merger, that the stock of the merged corporation ceased to exist by reason of the merger, and that therefore

> [t]he subject matter of the stockholders' agreement thus vanishes… . The merger…legally moots the terms of a restriction on transfer of the stock of a disappearing corporation.

The court further noted "here the effect of the merger was not so much the abolishment of a contract right but the mooting of it, since as a result of the merger the stock to which the right related disappeared by operation of law."

Based on the *Shields* case, notwithstanding the general rule of successor liability in a merger, contracts imposing restrictions on the transfer of shares, or providing options rights or rights of first refusal related to the shares of a merged corporation, are rendered void by reason of the merger.

Cases shed little light on whether other arrangements between a cashed-out shareholder and the corporation or the other shareholders survive a squeeze-out merger. It seems less likely such arrangements would be rendered void as the subject matter would not necessarily disappear.

Consider, for example, an employment agreement. If the employment agreement permitted termination at will, there would of course be no issue since the survivor could terminate the shareholder's employment even if the employment agreement survived. If employment may be terminated only for

> The merger statute provides a clear path to eliminating the minority shareholder, while ensuring fair consideration for his or her shares.

cause, survival of the agreement is a more problematic issue.

Certainly an employment agreement with an employee other than a squeezed out shareholder would survive the merger. An employment agreement with a squeezed out shareholder should also survive the merger unless his or her employment is deemed to be part of or fundamentally connected to his or her shareholder status, so that upon the termination of his or her stock ownership the employment is rendered moot.

Shareholder oppression provisions of the Act recognize the premise that a shareholder's interests as a shareholder may include employment and compensation.[25] It may be reasonable to assume that in many closely-held corporations the intent of the parties is that a shareholder's right to employment is a function of his continued status as a shareholder. But the successor liability provisions of the Act do not distinguish between large or small, or closely-held or widely-held corporations. Extrinsic evidence of the parties' intent regarding the linkage between ownership and employment may be relevant.

Other arrangements seem designed to protect one's status as a shareholder, such as restrictions on salaries or compensation to certain shareholders, or shareholders generally, or restrictions against related-party transactions, in order to protect against the dissipation of profit that would otherwise be available for distribution to the shareholders. It would seem reasonable that such restrictions would terminate upon the termination of one's status as a shareholder, but there is no clear guidance under the statute or caselaw.

Other arrangements such as real and personal property leases and licenses seem more remote from a minority shareholder's stock ownership. Moreover, the real or personal property that is the subject of such a lease or license would have value that would not be included in the consideration received for the corporate stock. Therefore, such arrangements seem less likely to be rendered moot by a merger.

Where a dispute between majority and minority shareholders is having a negative effect on the business, and corporate organizational documents do not provide a solution, a cash-out merger may be an effective technique to resolve the dispute. The merger statute provides a clear path to eliminating the minority shareholder, while ensuring fair consideration for his or her shares. It may not, however, resolve all of the issues inherent in the complex relationships among a corporation and its shareholders. All of these complex relationships should be carefully considered before engaging in such a transaction.

NOTES

1. MCL 450.1701(2)(c).
2. *Id.*
3. MCL 450.1703a(2)(g).
4. MCL 450.1703a(2)(e).
5. MCL 450.1762(1).
6. MCL 450.1762(1)(a).
7. MCL 450.1762(2)(b).
8. MCL 450.1762(1)(g).
9. MCL 450.1101 *et seq.*
10. MCL 450.1761(d).
11. *Irvine Co v Smith*, unpublished opinion of the Oakland County Circuit Court, issued June 25, 1990 (Docket No. 83-270011-CZ); Mich. Corp. L. & Prac. 7.17.
12. *Shields v Shields*, 498 A2d 161 (Del Ch 1985).
13. *Id.*
14. *Seven Springs Farm, Inc v Croker*, 569 Pa 202, 801 A2d 1212 (2002).
15. MCL 450.1762(3).
16. *Krieger v Gast*, 122 F Supp 2d 836 (WD Mich 2000).
17. MCL 450.1762(3).
18. MCL 450.1763(4).
19. *Krieger v Gast*, 179 F Supp 2d 762 (WD Mich 2001).
20. *Irish v Natural Gas Compression Sys, Inc*, No 266021, 2006 Mich App LEXIS 2229 (July 18, 2006) (unpublished).
21. *McMinn v MBF Operating Acquisition Corp*, 142 NM 160, 164 P3d 41 (2007).
22. *In re Caraco Pharm Labs S'holder Litig*, No 329933, 2017 Mich App LEXIS 929 (June 13, 2017) (unpublished).
23. MCL 450.1724.
24. *Shields*, 498 A2d 161.
25. MCL 450.1889.

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Instead of Olmstead *and* Albright: *Why Michigan Courts Will Continue to Protect SMLLCs Against the Member's "Outside" Judgment Creditors*

By Michael J. Willis and Samuel R. Gilbertson

Introduction

When a Colorado bankruptcy court ruled that a member of a single-member limited liability company ("SMLLC") could lose his membership to a judgment creditor in the case *In re Albright*, 291 BR 538 (Bankr D Colo 2003), many business counselors inferred that decision to be the "writing on the wall" spelling the end of the conceptual protection of a single member's rights against outside creditors.[1] Those skeptical of the SMLLC's protection redoubled their forewarnings after the decision handed down by the Supreme Court of Florida in the case *Olmstead v Federal Trade Comm'n*, 44 So 3d 76 (Fla 2010), in which the Court ruled that a charging order was not the exclusive statutory remedy provided to a judgment creditor of a member of a SMLLC.[2] However, this article intends to show why the protection of Michigan SMLLCs should be in no way threatened by this new trend of courts allowing judgment creditors unbridled access to a single member's membership rights, because of these three reasons: (1) the distinction made by the courts in *Albright* and *Olmstead* when comparing the liability of multiple members versus that of single members is unfounded and incorrect, (2) the response to *Albright* and *Olmstead* by their respective state legislatures proves the rulings were not aligned with legislative intent, and (3) the Michigan LLC Act contains an additional shield of protection against judgment creditors for SMLLCs. The opinion on the protections from outside creditors of a member of a SMLLC in this article expands on those published by one of the co-authors herein in the *Michigan Business Law Journal* in the spring of 2009.[3]

The issue addressed in *Olmstead* was whether a charging order was the sole remedy for a judgment creditor if the debtor is the lone member of an LLC.[4] Olmstead was sued by the FTC for unfair and deceptive trade practices after he was caught running an elaborate credit card scam that garnered so much profit that the FTC was eventually able to obtain a judgment of over $10 million, as well as all of Olmstead's right, title, and interest in his SMLLCs.[5] In coming to this judgment, the Supreme Court of Florida followed the rationale of the Colorado bankruptcy court in *Albright*, which had held that a charging order was not the exclusive remedy when a creditor sought to recover from the member of an SMLLC; it was only exclusive against a debtor of a member of a multiple-member LLC.[6] Citing *Albright's* assertion that the original purpose of a charging order was to prevent members of an LLC from being forced into an unwanted alliance with a creditor, the court in *Olmstead* reasoned that "the charging order limitation serves no purpose in a SMLLC because there are no other parties' interests affected."[7] Thus, because there was no third-party member to protect from an intrusion into the LLC, the Supreme Court of Florida found it inequitable to protect the single member possessing the economic and voting interests in the LLC from losing those membership rights to an outside creditor.[8]

The ruling in *Olmstead* was also based on the absence of exclusive remedy language within Florida's LLC statutes. Unlike Florida's partnership statutes, which included express language that a charging order was the exclusive remedy for a creditor,[9] Florida's LLC statutes did not include any mention of whether a charging order was the exclusive remedy.[10] Accordingly, the court reasoned that the legislature must not have intended to make the charging order the exclusive remedy against a member's interest in a SMLLC because there was "no express provision" barring other recovery beyond the charging order.[11] However, in the opinion of these authors, the court's analysis of the "unnecessary" protection for a single member and its reliance on the non-exclusive language within the statute were both erroneous.

The Fictitious Distinction Between Multi-Member and Single-Member Liability

Both *Olmstead* and *Albright* followed the same logic in exposing the SMLLC to outside creditors of a member: there were no vulnerable third-party members needing protection from a creditor forcing his way into the LLC as an equal member.[12] Since a single member has sole claim to right, title, and interest in the LLC and can freely assign that interest, the two courts ruled that a judgment creditor should not have less extensive rights to the LLC than the debtor himself.[13] Thus, the courts in both cases based their decisions on the theory that there were no other members who would be adversely affected and the judgment creditor should have more extensive rights than the debtor.[14]

Thus, the courts in both cases based their decisions on the theory that there were no other members who would be adversely affected and the judgment creditor should have more extensive rights than the debtor.

However, there is an inherent fallacy in determining a charging order's validity based on the mere number of members that compose an LLC: other members are not the only third parties in need of protection from unwanted involvement.[15] It is crucial to note that the charging order also protects the entity's other creditors and participants who depend upon the viability and security of engaging in business with an LLC, regardless of its number of members. Presumably, the business assets of an LLC are dedicated to the purposes of its operations; thus, the limited liability to creditors also appeals to those entities doing business with the LLC. The entities know that company assets will first be applied to their creditor claims on the LLC rather than be used to satisfy the creditors of an individual owner. By removing the exclusivity of the charging order, the entities that would normally assist an LLC in its venture may now be reluctant to do so, because it could wind up last in a long line of personal creditors of the LLC member trying to recover assets. Thus, a charging order—regardless of the number of members—serves to balance the interest of the judgment creditor with the interest of the venture to be able to use its assets for its operations without interference by an owner's creditor.[16]

Imagine the following scenario:[17] an SMLLC joins as the general partner of a venture that is organized as a limited partnership. Lenders flock to back the LLC based on the owner's history of creating profit from similar ventures. However, she makes an ill-advised personal decision that results in a lawsuit and a subsequent judgment against her assets. If the charging order was not the exclusive remedy for creditors, consider the ramifications to the limited partnership venture now subject to different ownership—possibly even to an entity with no experience or credibility in that field. The venture would likely lose its financial backing, or worse: it could be completely shut down by the new general partner. Thus, the mere number of members within the LLC should not be the deciding factor in whether a charging order is the appropriate remedy. Relying on the "no other member" rationale merely gave the Florida Supreme Court a reason to effectively write in its own equitable intent into the LLC statute.

This judicial re-writing is especially evidenced by the fact that the same Florida LLC statutes that did not explicitly define a charging order as the exclusive remedy also made *no distinction regarding the number of members in the LLC*.[18] In other words, there is no explanation for not also ruling that the absence of "exclusive remedy" language in the statutes applies to multi-member LLCs as well, because there was no explicit mention of the charging order being the exclusive remedy.[19] If the remedies provided under the LLC Act are inapplicable because of the absence of the "exclusive remedy" phrase, the same logic must apply to multi-member LLCs based on the lack of specific language regarding the number of members; consequently, the assets of all LLCs would become vulnerable to every member's personal creditors.[20] The court's reliance on the number of members within the LLC and the absence of exclusive remedy language seems misguided at best.

The Legislative Response to *Albright* and *Olmstead*

Both Colorado and Florida's state legislatures apparently shared the same opinion as these authors; the legislatures revised their LLC statutes after the court decisions in their respective states.

After *Albright* opened the door for judgment creditors to assume the rights and membership of a single-member debtor, the

Colorado Legislature revised its LLC Act just a few years later. Interestingly, it rewrote Colo Rev Stat 7-80-702(1) to state that without the consent of the single-member, an assignee or transferee is only entitled to receive the share of profits or other compensation by way of income to which the member would otherwise be entitled.[21] The statute also clarifies that the assignee or transferee has no right to participate in the management of the business and activities of the LLC or to become a member.[22] Thus, Colorado's revised statute currently provides significantly more outside creditor protection to the member of a SMLLC than its predecessor, which ambiguously required the unanimous consent of "other members" without addressing the single-member situation.[23]

Similarly, the Florida Legislature revised Fla. Stat. 608.433 in response to the *Olmstead* decision.[24] That statute had formerly stated that an assignee or transferee could assume membership or control with the consent of all the members of the LLC.[25] The court in *Olmstead* seemed to infer from the statute that "the approval of all members" inherently suggested that the statute applies to LLCs with multiple members and not to SMLLCs.[26]

However, the Florida Legislature revised the statute to specifically state that "in the case of an LLC having only one member, the exclusive remedies available to a judgment creditor as to the debtor's interest are a charging order or a charging order followed by a foreclosure sale."[27] While the Legislature stopped short of making the charging order the sole remedy, this amendment reined in on the unrestrained access to all rights and membership of a single member debtor that was granted in *Olmstead*. The revised Florida statute only allows for a foreclosure sale of the member's interest in the limited liability company if the judgment creditor can make a showing to the court that distributions under a charging order will not satisfy the judgment within a reasonable time.[28] Subsequent to the statutory revisions, the United States District Court for the Southern District of Florida confirmed that the holding in *Olmstead* has been superseded by statute.[29]

Thus, both Colorado and Florida took significant steps to reestablish protection for the single member after their respective courts allowed uninhibited access by judgment creditors against SMLLCs. And yet, the revised statutes still do not provide as strong of a shield for SMLLCs as the protection that is embodied in Michigan law.

The Additional Shield of Protection Found in Michigan's Legislation

In 1997, Michigan amended its LLC Act to specifically reference SMLLCs. Prior to that amendment, its charging-order statute ambiguously required the consent of "other members" before an assignee could become a member. This language was similar to that found in the Colorado and Florida statutes before those states made their respective amendments. Now, MCL 450.4506(1) addresses how an assignee becomes a member of an LLC:

> Unless otherwise provided in an operating agreement, an assignee of a membership interest in a limited liability company having more than 1 member may become a member only upon a unanimous vote of the members entitled to vote. *An assignee of a membership interest in a limited liability company having 1 member may become a member in accordance with the terms of the agreement between the member and the assignee.* (italics added)

Unlike the original statutes in Colorado and Florida that were analyzed by the courts in *Albright* and *Olmstead*, respectively, the statute above specifically addresses the assignment of membership interest in a SMLLC. By clarifying that the single member *must consent* to an assignee becoming a member, the Michigan statute explicitly contains a seemingly impenetrable layer of protection for SMLLCs.[30] Unless the debtor member actually agrees to allow the judgment creditor to assume membership rights, those rights may not be forcibly assigned by a Michigan court.

Additionally, MCL 450.4507(6) includes the exclusive language that was missing in the original Colorado and Florida statutes. It states, "This section provides the exclusive remedy by which a judgment creditor of a member may satisfy a judgment out of the member's membership interest in a limited liability company."[31] Notably, the courts in *Albright* and *Olmstead* both based their holdings in part on the absence of exclusive language in the statutes. Because this exclusive language is plainly stated in the Michigan statute, a court would have no opportunity

The *Albright* and *Olmstead* decisions should not cause concern for the viability of SMLLCs in Michigan.

to expand the available remedies for a judgment creditor.

Therefore, Michigan courts cannot follow in the footprints of the courts in *Albright* and *Olmstead*, because the Legislature has clearly provided that (1) a single member must consent to an assignee becoming a member,[32] and (2) a charging order is the exclusive remedy for judgment creditors against an LLC.[33] This language establishes an additional shield of protection beyond both Florida's LLC statute, which still allows for foreclosure if a charging order is proven inadequate, and Colorado's LLC statute, which does not specifically define a charging order as the "exclusive" remedy.

The only Michigan case on point affirms the validity of this interpretation of Michigan's LLC statutes. In April of 2015, the bankruptcy court for the Eastern District of Michigan ruled in the case *In re Dzierzawski* that the statutes "draw no distinction between single-member LLCs and multiple-member LLCs."[34] The bankruptcy court predicted "with a high degree of confidence" that the Supreme Court of Michigan or any other non-bankruptcy court would hold that "the Michigan charging-order statute and its limitations on creditor remedies does apply to single-member LLCs just as it applies to all other LLCs."[35] The court concluded by maintaining that there was "nothing whatsoever" in the statutes that indicated the limitation did not include single-member LLCs, stating that the statute was "unambiguous on this point."[36] Therefore, the only decision made by a court in Michigan on this issue as of the time of this writing confirms that a charging order is the exclusive remedy for a judgment creditor against a member of a SMLLC.

Conclusion

The *Albright* and *Olmstead* decisions should not cause concern for the viability of SMLLCs in Michigan. Not only did Colorado and Florida negate those rulings by revising their respective statutes to reinstate protection for SMLLCs, but Michigan already offers strong legislative protection. Michigan's statutes are clear: without the consent of the member, a judgment creditor of a member may not assume his membership rights in the company and has a charging order as its exclusive remedy.

Furthermore, the only caselaw in Michigan on this issue affirms that members of SMLLCs are as equally protected against judgment creditors as are members of multiple-member LLCs. Michigan rightfully recognizes that there is significant incentive to protecting the membership rights of a single member in a SMLLC, because a SMLLC still has liability to those with whom it enters into business endeavors and partnerships.

As this article has sought to establish, (1) there is no worthwhile distinction for purposes of liability of a SMLLC for the personal debts of a member between the number of members in an LLC, (2) the legislative response to *Albright* and *Olmstead* clearly manifests that members of SMLLCs were meant to be protected from the member's judgment creditors, and (3) Michigan has specifically inserted statutory provisions to affirm the exclusive nature of a charging order as the only remedy for the outside creditor of a member against *any* LLC. Therefore, under Michigan law, creditors will not be allowed to use a judgment claim to seize the membership rights and assets of an SMLLC without the consent of its member.

NOTES

1. Adkisson & Riser, Asset Protection: Concepts & Strategies For Protecting Your Wealth 219 (2004). Adkisson & Riser, Single Member LLCs http://www.assetprotectionbook.com/singlememberllc.htm (accessed August 1, 2014). Rutledge & Geu, The Albright Decision—Why An SMLLC Is Not An Appropriate Asset Protection Vehicle, 5 BUS ENTITIES 16 (Sept/Oct 2003).

2. Gardner F. Davis, Single-Member LLC Will Not Shield Debtor's Assets From Judgment Creditor, 29-OCT Am Bankr Inst J 52.

3. *See* Michael J. Willis, Single-Member LLCs v. the Member's Judgment Creditor: How Strong is the Shield? 29 MI Bus LJ 33 (2009).

4. *FTC v Olmstead*, 528 F3d 1310, 1311-12 (11 Cir 2008).

5. *Olmstead*, 44 So 3d at 77.

6. *Id.* at 81, see also *In re Albright*, 291 BR 538, 540 (Bankr D Colo 2003).

7. *Id.*

8. *Id.* at 83.

9. Florida Revised Uniform Partnership Act, 620.81001-.9902, Fla Stat (2008).

10. Fla Stat 608.433(4).

11. *Olmstead*, 44 So 3d at 81-82.

12. *Id.* at 82-83, *In re Albright*, 291 BR at 542.

13. *Olmstead,* 44 So 3d at 82-83.

14. *Id.*

15. Geu, Rutledge, & DeBruyn, To Be or Not To Be Exclusive: Statutory Construction of the Charging Order in the Single Member LLC, 9 DePaul Bus & Com LJ 83, 99 (2010).

16. *Id.* at 85.

17. *See generally* Geu, *supra* at 99 (explaining the ramifications of removing limited liability protection for a SMLLC).

18. Fla Stat 608.433(4).

19. *Olmstead*, 44 So 3d at 84 (Lewis, J., dissenting).

20. *Id.*

21. Colo Rev Stat 7-80-702(1).

22. *Id.*

23. *See Albright* at 540. The court in *Albright* appeared to base its decision on the specific reference in the original statute to the required consent of other members (of which there were none).

24. *Regions Bank v Hyman*, No 8:09-CV-1841-T-17MAP, 2015 U.S. Dist LEXIS 55011 at *20 (MD Fla Apr 27, 2015). "In response to *Olmstead, supra*, the Legislature amended Sec. 608.433, *Fla. Stat.* to clarify the exclusive remedies available to a judgment creditor as to a judgment debtor's interest in an LLC: a charging order, or a charging order followed by a foreclosure sale."

25. *Id.*

26. *Olmstead*, 44 So 3d at 81.

27. Fla Stat 605.0503(4) (2014).

28. *Id.*

29. *Rodriguez v Pasat Roofing, Inc,* No 13-62018-CIV, 2014 US Dist LEXIS 188933 (SD Fla Sept 29, 2014).

30. Willis, *supra* at 34 (explaining Michigan's extraordinary statutory protection for single-member LLC's).

31. MCL 450.4507(6).

32. MCL 450.4506(1).

33. MCL 450.4507(6).

34. *In re Dzierzawski*, 528 BR 397, 413 (ED Mich 2015).

35. *Id.*

36. *Id.* at 414.

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Permissibility of E-Shares Under Michigan Law

By Candice Moore

E-shares…what are they? They are uncertificated (or book entry) shares—right? Companies who issue them say: wrong! They are shares represented by an actual certificate, which happens to be in electronic form. The service providers who assist corporations in issuing electronic certificates will generally establish an account for each shareholder to assist in viewing and tracking their security holdings, accessing financial and other information about the corporation and even provide any applicable vesting schedule.[1] So a shareholder would log into an account to access and view their electronic stock certificate.

There is a growing trend among tech and emerging companies to issue electronic share certificates, instead of paper certificates. Many companies find the electronic certificate option appealing because of certain legal and practical benefits, such as: (1) having the ability to virtually eliminate the issue of lost or stolen certificates because the stock certificates would be maintained on an online account (and not in the hands of people who may misplace them); (2) having a central storage location for all certificates greatly simplifies any due diligence or auditing process; (3) ensuring that the issuing corporation is notified of any attempted sale or transfer; and (4) having the ability to maintain or update certificates for any stock splits, stock dividends, partial sales or partial transfers.

Is this trend, however, even permissible under Michigan law? Or said another way — are e-shares, from a legal perspective, really just uncertificated shares? The answer to the first question is likely yes, and the answer to the second question is probably not. While no court has ruled on the subject, it appears that under Michigan law electronic share certificates meet all of the legal requirements of paper stock certificates. Additionally, there is nothing precluding a company from using an electronic version of a certificate. In fact, there is legislation in Michigan that would support the use of an electronic version of a certificate over a paper version.[2] Under the Michigan Uniform Commercial Code (the "Michigan UCC"), on the other hand, it is not so clear that an electronic share certificate will be treated as a certificated security. Nonetheless, the Michigan UCC allows multiple ways for a secured party to perfect its lien on the applicable shares.

Section 336 of the Michigan Business Corporation Act (the "MBCA") clearly provides that "[u]nless the articles of incorporation or bylaws provide otherwise, the board may authorize the issuance of some or all of the shares of any or all of its classes or series *without certificates*."[3] So, the question here is not whether uncertificated (or book entry) shares are permissible under Michigan law. Rather, the question is whether an electronic form of a share certificate may be treated as shares having a certificate (i.e., as certificated shares).

This article is a discussion of (1) the purpose of a stock certificate, (2) a quick overview of the differences between uncertificated and certificated shares, (3) the legal requirements of a stock certificate under Michigan law, (4) other statutes in furtherance of electronic stock certificates, (5) transfer restrictions with respect to electronic stock certificates, and (6) an overview on perfecting a security interest in an electronic stock certificate.

What's the Big Deal Anyway–Purpose of a Stock Certificate

It is well settled that stock certificates are not stock. "They are merely evidence of the existence and ownership of stock."[4] And even though a stock certificate is only a representation of the obligation of the issuer with respect to its shares of stock, it is an important document that helps with the sale and transfer of the stock. Additionally, a corporation is generally forbidden from denying the information provided on a stock certificate.[5]

Even though the MBCA provides that a corporation may or may not issue stock certificates, at the discretion of a corporation's board of directors, once it decides the shares will be certificated, all shareholders are entitled to receive a stock certificate. So, for a smaller emerging corporation wanting to go paperless with its certificates, it becomes important to know whether a share issued with an electronic certificate may be deemed a certificated share under Michigan law.

Difference Between Uncertificated (Book Entry) Shares and Certificated Shares

Taking a step back, let us discuss the difference between uncertificated (book entry) shares and shares represented by a certificate, regardless of whether the certificate is paper or electronic.

- Uncertificated shares are shares issued without a certificate. They may also be called "book-entry" shares because they are tracked on the books of the corporation. Generally, the corporation, the corporation's transfer agent, or a broker-dealer provides evidence of ownership of the corporation to the owner of the shares through an account statement or periodic updates.
- Certificated shares, on the other hand, are shares issued with a certificate (traditionally that has been a paper stock certificate). There is power in the paper, in that whoever holds the certificate has physical evidence of ownership of shares in the corporation (we will get into the question of possession of an electronic certificate later). The only difference between paper and electronic certificates is that electronic certificates are represented electronically rather than on paper.

Stock Certificate Legal Requirements

The MBCA mandates certain requirements of a "stock certificate." Section 331 of the MBCA provides that a stock certificate must be "signed by the chairperson of the board, vice-chairperson of the board, president or a vice-president and which also *may* be signed by another officer of the corporation."[6] Further, Section 332 of the MBCA provides that the signatures of the officers may be facsimiles. Therefore, a facsimile or electronic signature may be applied to an electronic certificate and be considered properly endorsed.

Section 332(1) of the MBCA further requires a stock certificate to expressly state upon its face all of the following:

1. The fact that the corporation is formed under the laws of Michigan.
2. The name of the person to whom the shares are issued.
3. The number and class of shares and the designation of the series, if any, which the certificate represents.

Furthermore, if any of the following conditions apply, then a stock certificate must provide the applicable additional information.

1. If the corporation is authorized to issue more than one class or series or stock, then the stock certificate must set forth on its face or back (or state on its face or back that the corporation will furnish to a shareholder upon request and without charge) a full statement of the designation, relative rights, preferences, and limitations applicable to the class or series of shares and the authority of the board to designate and prescribe the relative rights, preferences, and limitations of other series.[7]
2. If there are any transfer restrictions with respect to the shares, then the transfer restrictions must be "noted conspicuously on the face or back of the instrument or on the information statement" provided to the shareholder if the shares are uncertificated.[8]
3. If there is a desire to ensure that a proxy remains irrevocable with respect to any future purchaser of the shares, then the existence of the proxy and its irrevocability must be "noted conspicuously on the face or back of the certificate representing the shares."[9]

Various service providers that offer the ability to issue electronic certificates to corporations provide that all of the above may easily be implemented on the face of an electronic certificate. In fact, doing so appears to be no more complicated than just modifying and editing the text and graphics of the certificate. More importantly, and what is not required or provided in the MBCA, there is no requirement that a certificate be in tangible paper form nor is there a prohibition against the use of an electronic form. Accordingly, based on the MBCA, it does not appear that there is anything special about electronic certificates that would prevent them from being considered as representing certificated shares.

There is a growing trend among tech and emerging companies to issue electronic share certificates, instead of paper certificates.

Other Statutes in Furtherance of Electronic Certificates

Michigan adopted the Uniform Electronic Transactions Act (the "UETA") on October 16, 2000, which provides the terms and conditions under which information and signatures can be transmitted, received, and stored electronically. Effectively, the UETA establishes the legal equivalence of electronic records and electronic signatures to tangible/paper records and manual signatures.

Section 4 of the UETA provides that the "act applies to any electronic record or electronic signature created, generated, sent, communicated, received, or stored on or after the effective date" of the Act.[10] Section 7 of the UETA provides the following guidance with respect to the legal effect of electronic records and signatures:

> More importantly, and what is not required or provided in the MBCA, there is no requirement that a certificate be in tangible paper form nor is there a prohibition against the use of an electronic form.

1. A record or signature shall not be denied legal effect or enforceability solely because it is in electronic form.
2. A contract shall not be denied legal effect or enforceability solely because an electronic record was used in its formation.
3. If a law requires a record to be in writing, an electronic record satisfies the law.
4. If a law requires a signature, an electronic signature satisfies the law.[11]

The broad provisions contained in the sections referenced above demonstrates the Michigan legislature's intent to reform laws to match the realities of today and to validate and legitimize electronic versions of legal documents and signatures. Thus, the adoption of the UETA further supports the notion that an electronic version of a certificate should be deemed to have the same legal effect as a paper certificate under Michigan law.

Section 3 of the UETA, however, expressly provides that except for certain unrelated Michigan UCC provisions (i.e., Article 2 (sales) and 2A (leases)), it does not apply to the Michigan UCC. Thus, even though the UETA may be seen to support the use of electronic stock certificates from a general corporate perspective, the UETA cannot be used to support any Michigan UCC perfection argument (as further discussed below).

Enforcing Transfer Restrictions

Now we turn to the question of whether transfer restrictions may be enforceable on electronic stock certificates. It appears that the answer is "Yes" under Section 204 of the Michigan UCC, which provides that:

> [a] restriction on transfer of a security imposed by the issuer, even though otherwise lawful, is ineffective against a person without knowledge of the restriction unless:
>
> (a) The security is certificated and the restriction is noted conspicuously on the certificate.
>
> (b) The security is uncertificated and the registered owner has been notified of the restriction.[12]

Service providers who offer the ability to issue electronic certificates to corporations should be capable of putting the transfer restriction conspicuously on the face or back of the certificate, thereby complying with this requirement. Further, in the e-mail or other communication sent out to the shareholder regarding the electronic certificate held on account for the holder, a statement about the transfer restriction could be made. The service provider of the corporation or transfer agent could ensure the holder actually knew about the restrictions through click-wrap agreements prior to reviewing the certificate or by providing notices to any and all registered owners of the security via e-mail or posted on the account where the certificate is located, thereby permitting the transfer restriction to be enforceable against such person(s).

Perfecting Security Interest in e-Shares

Moving on to the last question at hand, and probably the most challenging to conceptualize – how can a secured party perfect its security interest in the shares held by a shareholder if the holder has an electronic stock certificate?

Article 9 of the Michigan UCC provides that "[e]xcept as otherwise provided . . . a security interest is perfected if it has attached and all of the applicable requirements for perfection in Sections 9310 through 9316 [of the Michigan UCC] have been satisfied."[13] Therefore, perfecting a security interest in collateral requires (1) attachment and (2) the ability to meet certain other requirements for perfection.

Attachment and Certain Other Perfection Requirements

Pursuant to Section 9203(1) of the Michigan UCC, attachment generally occurs when the security interest "becomes enforceable against the debtor with respect to the collateral."[14] Section 9203(2) of the Michigan UCC further provides that a security interest will become enforceable against the debtor and any third party with respect to shares of stock when (1) value is given; (2) the debtor has rights in the stock or an ability to transfer it; and (3) when one or more of the following conditions are met: (a) the debtor has authenticated a security agreement covering the applicable stock; (b) the collateral is *not* a certificated security and is in the possession of the secured party under Section 9313 pursuant to the debtor's security agreement; (c) the collateral *is* a certificated security in registered form, and the security certificate has been delivered to the secured party under Section 8301 pursuant to the debtor's security agreement; and/or (d) the secured party has control under Section 9106 (regarding control of investment property) pursuant to the debtor's security agreement.[15]

With respect to the other requirements for perfection of a security interest in stock, a secured party could satisfy its perfection requirements by either filing a financing statement, obtaining possession or delivery of the security, or obtaining control of the security. These perfection options appear to be the same regardless of whether the stock is in electronic or paper form.

Perfection by Filing:

A secured party may perfect a security interest in certificated or uncertificated securities by filing a financing statement.[16] The filing of a financing statement is not required, but optional at the secured party's election. With respect to certificated securities, however, the customary method to perfect a security interest is for the secured party to take possession of the certificate itself.

Perfection by Delivery (Possession):

A secured party may perfect a security interest in certificated or uncertificated securities by taking delivery of the securities under Section 8301.[17] Additionally, a "security interest in a certificated security in registered form is perfected by delivery when delivery of the certificated security occurs under Section 8301 and remains perfected by delivery until the debtor obtains possession of the security certificate."[18] Furthermore, if "a person acknowledges that it holds possession for the secured party's benefit, the acknowledgment is effective under … Section 8301(1), even if the acknowledgment violates the rights of a debtor, and unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the secured party and is not required to confirm the acknowledgment to another person."[19]

Section 8301 provides the following guidance in taking delivery of a certificated or uncertificated stock certificate:[20]

> (1) Delivery of a certificated security to a purchaser occurs when 1 of the following occurs:
>
> (a) The purchaser acquires possession of the security certificate.
>
> (b) Another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser.
>
> (c) A securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and is (i) registered in the name of the purchaser, (ii) payable to the order of the purchaser, or (iii) specially indorsed to the purchaser by an effective indorsement and has not been endorsed to the securities intermediary or in blank.
>
> (2) Delivery of an uncertificated security to a purchaser occurs when either of the following occurs:
>
> (a) The issuer registers the purchaser as the registered owner, upon original issue or registration of transfer.
>
> (b) Another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser.

In the comments to Section 8301 of the Michigan UCC, the commentators provide that subsection 1(a) requires physical possession of certificates, and subsections (1)(b) and (1)(c) specify the circumstances in which delivery to a purchaser can occur although the certificate is in the possession of a person other than the purchaser. With respect to an electronic certificate, clearly physical possession cannot take place; however, one could

With respect to an electronic certificate, clearly physical possession cannot take place; however, one could argue that "another person" or a securities intermediary could acquire possession on behalf of the shareholder.

Nothing in the MBCA or the Michigan UCC appears to prohibit or restrict the use of electronic stock certificates.

argue that "another person" or a securities intermediary could acquire possession on behalf of the shareholder. One could argue that since the commentators to the Michigan UCC expressly mentioned that physical possession was required for subsection (1)(a), but did not make the same express statement with respect to subsections (1)(b) and (1)(c) to Section 8301 of the Michigan UCC, that "physical" possession was not intended for other third parties. Service providers who assist corporations in issuing electronic certificates will maintain the electronic certificate on an online account on behalf of the shareholder that is stored on the service provider's data systems, which is viewable through a dashboard or by logging in to the applicable account. In this context, the service provider maintaining the certificate can be seen to have possession of the certificate via its data systems (regardless of whether it is stored on a hard drive or in the cloud). So, one could argue that since the service provider maintains the certificate on behalf of the shareholder, the shareholder has legal "possession" of the electronic certificate.

A counterargument would point to the fact that a person must maintain *physical* possession of the certificate under Section 8301(1), and that the commentators intended *physical* possession with respect to subsections (1)(b) and (1)(c) in addition to (1)(a) because subsections (1)(b) and (1)(c) are meant to be extensions of (1)(a). So, in this context, since an electronic version of a stock certificate could never be physically possessed, some may argue that an electronic stock certificate would not be seen as a "certificated" security for purposes of the Michigan UCC, and would rather be deemed an uncertificated security. On the other hand, however, Article 8 of the Michigan UCC defines a "certificated security" as "a security that is represented by a certificate."[21] The definition merely requires a certificate – and not specifically a paper certificate.

Even if an electronic stock certificate is deemed to be an uncertificated security under the Michigan UCC, Section 8301(2) of the Michigan UCC provides that "delivery" may still occur when a purchaser becomes the registered owner of the uncertificated security, either upon original issue or registration of transfer. The service provider, working with the corporation or the appropriate shareholder, as applicable, should be able to change the name of the registered owner the securities using the online securities management account. With that, regardless of whether the electronic certificate is considered "uncertificated" or "certificated," a shareholder or later purchaser (or creditor) should be able to obtain legal "possession" of the security upon being named the registered owner on the account.

In summary, even though it is unclear as to whether the Michigan UCC would deem an electronic stock certificate as a certificated security (regardless of how the security may be deemed under the MBCA), a shareholder (or a third party on behalf of the shareholder) may "deliver" the electronic stock certificates to a later third party or creditor for perfection purposes of the Michigan UCC. Based on the foregoing, delivery equals possession, and possession leads to perfection. Therefore, a secured party may perfect its interest in stock represented by an electronic stock certificate by "possession" of the electronic stock certificate.

Perfection by Control:

The final way to perfect a security interest in the stock represented by a stock certificate is to achieve control. "A person has control of a certificated security, uncertificated security, or security entitlement as provided in Section 8106."[22]

Section 8106 provides: [23]

(2) A purchaser has "control" of a *certificated security* in registered form if the certificated security is *delivered* to the purchaser and if either of the following applies:

(a) The certificate is indorsed to the purchaser or in blank by an effective indorsement.

(b) The certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(3) A purchaser has "control" of an *uncertificated security* if either of the following applies:

(a) The uncertificated security is *delivered* to the purchaser.

(b) The issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

Effectively, if delivery occurs, then the secured party would have the functional equivalent of possession, which constitutes control. As discussed previously, a secured party can obtain delivery of an electronic stock certificate, even if for purposes of the Michigan UCC it is considered an uncertificated security. Thus, a secured party may obtain control of the electronic stock certificate.

Perfection Summary

In summary, perfecting a security interest in the stock represented by an electronic certificate could be made by transferring the certificate from the record holder's account to an account created for the person or organization that will control the security as collateral. Or, the parties could enter into a pledge or security agreement, and the secured party could file a financing statement to perfect its interest.

Summary

In conclusion, while no court has ruled on the subject, the use of electronic stock certificates appears to be legally permissible under Michigan law as the equivalent of traditional paper stock certificates. Nothing in the MBCA or the Michigan UCC appears to prohibit or restrict the use of electronic stock certificates. In addition, Michigan's UETA supports the use of electronic stock certificates with its support of electronic documents and electronic signatures as legal equivalences to paper forms. Even though it is unclear as to how the Michigan UCC will treat the electronic stock certificates (whether they will be considered certificated or uncertificated securities), the Michigan UCC will nonetheless provide multiple ways for a secured party to perfect its security interest in the shares of stock represented by such a certificate.

NOTES

1. Service providers such as https://www.capshare.com/, https://www.shoobx.com, and https://esharesinc.com/ assist corporations in issuing electronic stock certificates.
2. MCL 450.837.
3. MCL 450.1336 (emphasis added).
4. *Fuller v Bassett's Estate*, 246 Mich 440, 451-52, 224 NW 639 (1929).
5. *Culp v First Commercial Sav Bank*, 288 Mich 646, 647, 286 NW 113 (1939). *Turner v J & J Slavik*, No 313936, 2014 Mich App LEXIS 673 at *11 (Apr 15, 2014) (unpublished).
6. MCL 450.1331.
7. MCL 450.1332(2).
8. MCL 450.1472.
9. MCL 450.1423.
10. MCL 450.834.
11. MCL 450.837.
12. MCL 440.8204 .
13. MCL 440.9308(1).
14. MCL 440.9203(1).
15. MCL 440.9203(2).
16. MCL 440.9310.
17. MCL 440.9313(1) and 440.8301.
18. MCL 440.9313(5).
19. MCL 440.9313(7).
20. MCL 440.8301.
21. MCL 440.8102.
22. MCL 440.9106.
23. MCL 440.8106 (emphasis added).

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Case Digests

Sandusky Wellness Ctr, LLC v ASD Specialty Healthcare, Inc, 863 F3d 460 (6th Cir 2017)

Defendant, ASD Specialty Health Care, a pharmaceutical distributor, sent a one-page fax advertising a drug to 53,503 physicians. Only 75 percent of these faxes were successfully transmitted. Sandusky Wellness Center, a chiropractic clinic, claimed to have received this "junk fax" and filed a lawsuit for the annoyance. Sandusky alleged that the defendant violated the Telephone Consumer Protection Act ("TCPA"), 47 USC 227, by sending an unsolicited fax advertisement lacking a proper opt-out notice, and it sought to certify a putative class of all the drug fax recipients. The district court denied the motion for class certification.

Per the TCPA, a fax is considered unsolicited if it is sent without "prior express invitation or permission" to receive it. 47 USC 227(a)(5). Federal Communications Commission (FCC) was created by Congress to implement the requirements of the TCPA. The FCC later promulgated a rule requiring opt-out notices on solicited faxes, known as the "Solicited Fax Rule." 47 CFR 64.1200(a)(4)(iv). Fax senders faced a $500 fine for each fax sent that violated the TCPA or any FCC rule. The fine could be increased to $1,500 per fax for willful violations. 47 USC 227(b)(3).

There was some confusion and concern from businesses of: 1) whether solicited faxes were also in violation of the rules, and 2) whether the FCC had statutory authority on this issue as it was a private cause of action. The FCC granted some retroactive waivers of liability, exempting them from compliance with the Rule during a certain timeframe due to the confusion over its applicability.

The court found that the district court did not abuse its discretion in the denial of class certification. The court affirmed the district court's holding that the questions of consent presented an individualized issue, not a class action.

Hemlock Semiconductor Operations LLC v SolarWorld Indus Sachsen GmbH, 867 F3d 692 (6th Cir 2017)

Hemlock Semiconductor Operations, LLC ("Hemlock") and SolarWorld Industries Sachsen GmbH ("Sachsen") make components of solar-power products. They entered into a number of long-term supply agreements ("LTAs") agreeing for Hemlock in Michigan to supply Sachsen in Germany with a set quantity of polysilicon at fixed prices.

A few years into the LTAs, the Chinese government began subsidizing its national production of polysilicon and the price plummeted. Due to the pricing, Hemlock and Sachsen entered into a temporary agreement for a year to lower it. After the price went back up, the parties attempted to negotiate again. They were unable to reach any sort of agreement. In the year to follow, Sachsen failed to purchase the stated amount in the LTAs.

Hemlock filed a complaint in 2013 for the full amount due under the liquidated damaged provision in the LTAs. Sachsen asserted a number of affirmative defenses, including illegality, commercial impracticability, and frustration of purpose. The district court granted Hemlock's motion for summary judgment and ordered Sachsen to pay the full amount of damages. Sachsen appealed the district court's decision to deny the illegality defense and to reconsider the grant of summary judgment.

The court found that in order to establish the illegality defense under a European Union regulation, Sachsen would have to prove that the contract imposed a direct or indirect obligation to purchase more than 80 percent of its requirement for polysilicon from Hemlock, a single seller. The court affirmed the district court's decision to strike the defense, adding that even if Sachsen proved that more than 80 percent of its polysilicon was purchased from Hemlock, they were also required to prove that Hemlock possessed more than 15 percent share of the market for polysilicon. The court also went through the other affirmative defenses raised and affirmed the judgment of the district court.

Sunshine Heifers, LLC v Citizens First Bank (In re Purdy), 870 F3d 436 (6th Cir 2017)

Lee Purdy operated a dairy farm in Barren County, Kentucky. In 2008, Purdy entered into a loan with Citizens First Bank ("CFB") using his dairy cattle as collateral. He refinanced in 2009, and signed an "Agricultural Security Agreement" in exchange for additional principal of over $400,000. Within the security agreement, Purdy granted CFB a purchase money security interest in all of his equipment, farm products, and livestock. After Purdy refinanced his loan with CFB, he decided to increase the size of his dairy cattle herd. He contacted Jeff Blevins of Sunshine about leasing the additional cattle. Sunshine agreed and they entered into a contract involving the additional cattle. The terms of the contract required Purdy to apply Sunshine's brand and a yellow ear tag to their cows. To differentiate the cattle, Purdy applied a white ear tag to the cattle covered by CFB's security interest.

After some tough times in 2012, with the price of cattle feed rising and milk production becoming less profitable, Purdy began to sell off some cattle at a faster rate. On November 29, 2012, Purdy filed a voluntary petition for Chapter 12 bankruptcy relief. The bankruptcy court quickly issued an automatic stay, preventing the removal of any assets from the farm. CFB and Sunshine inspected there were 389 cattle still on the farm, majority of which had white ear tags and Sunshine's brand, and 99 only had white ear tags.

CFB argued that Purdy owned all of the cattle and therefore they were covered by the bank's perfected purchase money security interest. Sunshine argued that it maintained ownership of the cattle and that Purdy only held a lease interest. The bankruptcy court held that CFB perfected liens attached to all cows on Purdy's farm on the date the Petition was filed. The bank later foreclosed on the heard and CFB auctioned the cattle. The bankruptcy trustee awarded the proceeds to CFB and applied it toward Purdy's outstanding debt. Sunshine appealed after the auction sale.

The Court of Appeals found that the bankruptcy court thoroughly reviewed and considered all relevant facts, and its application of the law to the facts was not erroneous. The court affirmed that all of the proceeds of the bankruptcy auction, less than the Trustee's fee, are the property of CFB.

Retail Works Funding LLC v Tubby's Sub Shops, No 332453, 2017 Mich App LEXIS 1392 (Aug 31, 2017) (unpublished)

Just Baked was bakery retail chain that owned several retail stores and franchised additional stores in Michigan. In 2015, Retail Works Funding LLC ("Retail Works") obtained a judgment against Just Baked for over $180,000. Defendants alleged that Tubby's is in the business of franchising independent businesses selling sandwiches and other related food. The defendants organized JB Development for the purpose of purchasing the Just Baked service mark for $4,000. Just Baked, quickly closed most of its retail stores after the purchase of the service mark. Tubby's planned to carry Just Baked products in its retail stores. Retail Works filed a complaint against the defendants asserting that they were liable to pay the money judgment it obtained against Just Baked.

Retail Works relied on the theories of alter ego/successor liability. The plaintiffs claimed that JB Development was simply holding company for Tubby's, who failed to pay fair consideration for Just Bake's assets, failed to provide the debt owed to plaintiff in the sale and merely continued Just Baked as Tubby's. Retail Works also claimed that the defendants were unjustly enriched by only taking the assets of value and leaving the debt owed. The trial court granted defendants' motion for summary disposition, concluding that the defendants could not be held liable for plaintiff's judgment because JB Development only purchased a single asset from Just Baked. Further, defendants purchased the service mark at a price above fair-market value and were therefore not unjustly enriched. Plaintiff's appealed.

Concluding that plaintiff abandoned any claim of error as to the applicability of any exception but the continuity of the enterprise exception, the court affirmed summary disposition for defendants on plaintiff's alter ego/successor liability claim. It also held that plaintiff's unjust enrichment claim lacked any arguable legal merit and thus, affirmed the trial court's award of sanctions.

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DATE	TIME	LOCATION
March 1, 2018	3:30 p.m.	Lansing, MI

Business Boot Camp II

DATE	LOCATION
January 29, 2018	Plymouth, MI