STATE BAR OF MICHIGAN
BLS
BUSINESS LAW SECTION

The Michigan Business Law JOURNAL

Volume 37
Issue 1
Spring 2017

CONTENTS

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STATE BAR OF MICHIGAN

Published by THE BUSINESS LAW SECTION, State Bar of Michigan

The editorial staff of the *Michigan Business Law Journal* welcomes suggested business law topics of general interest to the Section members, which may be the subject of future articles. Proposed business law topics may be submitted through the Publications Director, D. Richard McDonald, *The Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, Michigan 48304, (248) 203-0859, drmcdonald@dykema.com, or through 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://connect.michbar.org/businesslaw/newsletter.

Each issue of the *Michigan Business Law Journal* has a different primary, legal theme focused on articles related to one of the standing committees of the Business Law Section, although we welcome articles concerning any business law related topic for any issue. The 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
Fall 2017	Corporate Laws Committee	July 31, 2017
Spring 2018	Debtor/Creditors Rights Committee	November 30, 2017
Summer 2018	Nonprofit Corporations Committee	March 31, 2018
Fall 2018	Uniform Commercial Code Committee	July 31, 2018

ADVERTISING

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

MISSION STATEMENT

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

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

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

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

From the Desk of the Chairperson

By Judy B. Calton

The 21st Century Practice Task Force Report

In 2015, the State Bar of Michigan established the 21st Century Practice Task Force to take an in-depth look at how legal services are administered and make recommendations to reinvent the administration of justice to address the problems the Task Force identified. The Task Force's report, *Envisioning A New Future Today*, is available at www.michbar.org/21stCenturyTaskForce. In summary, the report identifies five key problems, the vision of how to address the problems, and elements of how to achieve the vision. Everyone is encouraged to read the report and to be inspired on implementation of the report's recommendations.

One of the Task Force visions is for more practical legal education, both for new lawyers entering practice and for experienced lawyers facing new challenges. The State Bar of Michigan is encouraged to create training aids to support Michigan lawyers' professional competence.

ICLE's Competency Maps

Michigan's Institute of Continuing Legal Education ("ICLE") is working on that goal by, among other things, developing online task-oriented and goal-oriented learning resources. One particular initiative, which will support that effort, is the creation of "competency maps." A competency map will be a useful guide for lawyers entering into a particular practice area, containing a list of the tasks a lawyer needs to be able to do to practice competently in that area. The maps are geared to Michigan practice and do not attempt to cover the more specialized areas of a particular practice. When finalized, the maps will be used to enhance (and help users find) the practical resources provided by the Section and ICLE and will be available to practitioners as a guide.

The Section Partners With ICLE

The Business Law Section is pleased to be partnering with ICLE staff attorneys to create a Transactional Business Practice Map. The ICLE project lead is Mary Hiniker. As a first step, ICLE created a draft outline of transactional practice areas and tasks based on research and consultation with ICLE speakers and authors on transactional issues.

Second, a diverse group of Section members throughout the state from firms of varying sizes volunteered to work with ICLE to develop and refine the maps. These volunteers will hold a series of conference calls with ICLE staff to refine the map. Finally more Section members with transactional practice experience will comment upon and proof the draft competency map before finalization.

Thanks to the volunteers! It is hoped this competency mapping effort serves as a model for the future.

Future Innovative Legal Training

The Section hopes to partner with ICLE on other competency maps and develop other innovative means of legal training. If you have ideas for other innovative means of delivering legal training or the particular training that would be useful to you, we welcome your ideas. Please contact me at jcalton@honigman.com or Ms. Hiniker at mhiniker@umich.edu.

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By Julia Dale

A Transportation Revolution

It was May 2015, and I found myself attending a conference in Savannah, Georgia, one of the most charming of southern cities. The architecture and Spanish moss alone are reasons enough to visit. Two days into the conference, attendees were shepherded onto buses for a dinner offsite at the historic Fort Jackson. Watching the charter buses drive off with a promise to return in four hours, I quickly realized I'd underestimated the hazards of a late spring evening in the Deep South.

Dinnertime passed and a handful of us were gathered at the top of the Fort looking out over the Savannah River and trying to escape the swarms of mosquitoes making their attack. I was certain that if I didn't succumb to the buzzing pests, the heat (88 degrees) and oppressive humidity would do me in. As we took turns complaining about the late return of the buses one of my more traveled companions pulled out his cell phone and said, "*What about Uber?*"

He logged into the app and twenty minutes later all six of us crept down the stairs, out the old fort, and down the long drive that led to the main road. We were determined to let no one intercept our ride. An older-model, dark-colored minivan met us on the dirt road. I'm sure there were French fries and fruit snacks buried between the seats, but it didn't matter, the air conditioning worked and this was our ticket out. We piled into that van like clowns into a clown car, thanking the driver (who'd probably just put his kids to bed) and exclaiming our good fortune.

There is a revolution occurring in the transportation industry, and while we are not riding around in flying vehicles, all the talk of transportation network companies (TNCs) and driverless vehicles leads one to believe that it might not be that far off.

In September 2013, the California Public Utilities Commission (CPUC) became the first to address the burgeoning TNC industry and adopt rules and regulations for this new method of transportation.[1] At the time, the CPUC defined a TNC "as an organization whether a corporation, partnership, sole proprietor, or other form, operating in California that provides prearranged transportations services for compensation using an online-enabled application (app) or platform to connect passengers with drivers using their personal vehicles."[2] These rules included the following requirements for obtaining a permit to operate from the CPUC: not less than a $1 million commercial liability insurance policy; criminal background checks; a zero tolerance policy for drug or alcohol use; driver record checks; nondiscrimination policies; visible signage; a driver training program; and vehicle inspections.[3] With this action, California laid the groundwork for similar discussion across the country addressing concerns of public safety for riders and drivers with companies like Uber and Lyft.

At the end of 2016, fourteen states enacted TNC legislation[4] bringing the total number of states recognizing this new category of transportation to forty-two.

Michigan joined these ranks on December 21, 2016, when Governor Snyder signed a package of five bills (House Bills 4637, 4639, 4640, 4641 and Senate Bill 392), ushering in a new perspective and a revolution in transportation.

Uber advertises itself as a "global platform offering safe, affordable and reliable rides with the tap of a button," boasting availability in more than 400 cities and 70 countries, and providing in excess of two billion rides to date.[5] Not to be outdone, Lyft, the other major player in this arena, offers services in more than 200 cities within the United States.[6] In July 2016, there were 5.1 million combined downloads of the Uber and Lyft apps in the United States.[7] Both have made their way to Michigan and now have a framework under which to operate.

When Governor Snyder signed these bills, he not only established a framework under which TNCs might operate but also leveled the playing field for the limousine and taxi industries in this changing space.[8]

A synopsis of Public Act 345 of 2016[9] is provided below as it provides the framework for the regulation of TNCs, taxicabs, and certain limousines in this state.

House Bill 4637, now Public Act 345 of 2016, the Limousine, Taxicab, and Transportation Network Company Act (the "Act") took effect on March 21, 2017 and established the Department of Licensing and Regulatory Affairs (LARA) as the agency charged with administering the Act. LARA may promulgate rules to administer the Act under the Administrative Procedures Act of 1969, 1969 PA 306, MCL 24.201-.328.[10]

Within this legislation are many definitions making clear the varied services and persons regulated by the Act, here are a few of those key definitions.[11]

- **Limousine** means a self-propelled motor vehicle used in the carrying of passengers and the baggage of the passengers for hire with a seating capacity of 8 passengers or fewer, including the driver. Limousine does not include a commercial vehicle.[12]
- **Limousine carrier** means a person who, either directly or through any device, dispatch system, or arrangement, holds himself or herself out to the public as willing to transport passengers for hire by limousine.[13]
- **Limousine driver** means an individual who uses a limousine to provide transportation services to potential passengers.[14]
- **Person** means an individual, sole proprietorship, partnership, corporation, associ-

ation, or other legal entity.[15]

- **Taxicab** means a motor vehicle with a seating capacity of 8 passengers or fewer, including the driver, that is equipped with a roof light and that carries passengers for a fee usually determined by the distance traveled. Taxicab does not include a commercial vehicle.[16]
- **Taxicab carrier** means a person who either directly or through any device, dispatch system, or arrangement, holds himself or herself out to the public as willing to transport passengers for hire by taxicab.[17]
- **Taxicab driver** means an individual who uses a taxicab to provide transportation services to potential passengers.[18]
- **Transportation network company** means a person operating in this state that uses a digital network to connect transportation network company riders to transportation network company drivers who provide transportation network company prearranged rides. Transportation network company does not include a taxi service, transportation service through a transportation broker, ridesharing agreement, or transportation service using fixed routes at regular intervals.[19]
- **Transportation network company driver** means an individual who satisfies the following: (i) receives connections to potential passengers and related services from a transportation network company in exchange for a payment of a fee to the transportation network company; and (ii) uses a personal vehicle to offer or provide transportation network company prearranged rides to transportation network company riders upon connection through a digital network controlled by a transportation network company in return for compensation or payment of a fee.[20]

Effective March 21, 2017, a limousine carrier, taxicab carrier, or transportation network company shall not operate in this state without first registering with LARA under the Act.[21] The application for registration will be available online prior to March 21; a paper application (on a form provided by LARA) will also be available. An application fee and a registration fee must accompany the completed application for registration. The fees are determined by the number of vehicles the applicant registers. Registrations expire annually on August 31.[22]

# of Vehicles	Application Fee	Annual Registration Fee	Total
1	$25.00	$100.00	$125.00
2	$25.00	$150.00	$175.00
3	$25.00	$200.00	$225.00
4	$25.00	$250.00	$275.00
5	$25.00	$300.00	$325.00
6	$25.00	$350.00	$375.00
7	$25.00	$400.00	$425.00
8	$25.00	$450.00	$475.00
9	$25.00	$500.00	$525.00
10	$25.00	$550.00	$575.00
11-25	$50.00	$1,000.00	$1,050.00
26-100	$100.00	$2,500.00	$2,600.00
101-500	$100.00	$5,000.00	$5,100.00
501-1000	$100.00	$10,000.00	$10,100.00
1001 or more	$100.00	$30,000.00	$30,100.00

The fee structure is as follows:[23]

The Act also provides that three years after the effect date of the Act, LARA "shall cease to impose the fees."[24]

The application for registration must also include, proof of satisfactory compliance of all insurance requirements; the type of business entity; relevant articles, if a foreign entity a Certificate of Authority authorized to do business in Michigan, or if registered at the county level a copy of its certificate of conducting business under an assumed name or certificate of co-partnership; contact information for the applicant; the number of vehicles the applicant operates; and, if applicable, proof the applicant has satisfied any disciplinary action.[25] Under the Act, all limousine carrier, taxicab carrier, and transportation network companies must also provide an annual statement regarding insurance coverage requirements.[26]

Prior to individuals operating a limo, taxicab, or TNC vehicle, they must first submit an application to either the carrier or TNC. It is the responsibility of the carrier or TNC to annually conduct (either themselves or via a third party) a criminal background check of the applicant. The check "shall include a search of all of the following: a multistate or multijurisdiction criminal record locator or similar commercial nationwide database with validation; the national sex offender registry database; and annually obtain and review a driving history research report for the applicant."[27]

LARA has the authority to audit the records of a registrant under the Act, but not more than two times per year. This includes an audit of driver applications and background records. The Act also designates several types of records as nonpublic records if produced for an audit and they meet certain other requirements.[28]

There are a host of reasons an individual may not be allowed to operate a limousine, taxicab, or TNC, among them are certain violations on their driving record, certain felony convictions in the five years leading to the date of the application, being listed on the national sex offender registry, and being under 19 years of age.[29]

A limousine carrier, taxicab carrier, TNC, or an officer or agent of any of the three who requires or knowingly permits a driver to drive or operate a limo, taxicab, or personal vehicle in violation of this Act, or a rule or order promulgated or issued under this Act is guilty of a misdemeanor punishable by a fine of not more than $1000 per violation or imprisonment for not more than 90 days or both. LARA may also assess a fine against a person who violates the act that covers the actual cost to the department of the investigation and enforcement of the violations, including attorney fees.[30]

Other requirements under the Act include:

- Mechanical inspections for any vehicles five years old or older.
- Consistent and distinctive signage/emblem (approved by LARA).
- Zero tolerance policy addressing the use of drugs and alcohol as it relates to providing rides for passengers.
- Nondiscrimination policy with regard to passengers and potential passengers.
- For limousine carriers bodily injury and property damage liability insurance with a minimum combined single limit of $1 million for all persons injured or for property damage.
- For taxicab carriers bodily injury and property damage liability insurance with a minimum combined single limit of $300,000 for all persons injured or for property damage.
- When a TNC driver does not have a passenger in their vehicle, they must have residual third-party liability insurance in the amount of at least $50,000 per person for death or bodily injury, $100,000 per incident for death or bodily injury, and $25,000 for property damage.
- When a TNC driver has a passenger in their vehicle, they must maintain residual third-party liability insurance with a minimum combined single limit of $1 million for all bodily injury or property damage.

It is important to note that this Act provides for registration and not licensure. As such, LARA's role is limited with regard to enforcement. A violation of the Act or the rules promulgated or order promulgated or issued under this Act may result in the denial of a registration or a renewal of registration. The Department of the Attorney General or the local prosecuting attorney may initiate appropriate criminal proceedings, and LARA (or any other person) may bring an action in circuit court in a county in which the limousine carrier, taxicab carrier, or TNC has solicited or sold its service to enforce compliance with this Act.

The director of LARA (or their designee) may order a carrier or TNC to cease and desist from a violation of this Act, a rule promulgated under this Act, or an order issued under this Act. The carrier or TNC may request a hearing before the department if the carrier or TNC files a written request for a hearing no later than thirty days after the effective date of the cease and desist order.[31]

The Limousine, Taxicab, and Transportation Network Company Act, will be administered through the Commercial Licensing Division within the Corporations, Securities & Commercial Licensing Bureau of LARA. Questions regarding the program may be directed to the Commercial Licensing Division at (517) 241-9221. More information is available online at www.michigan.gov/tnc.

NOTES

1. California Public Utilities Commission (CPUC) Press Release dated September 19, 2013 concerning the establishment of rules for Transportation Network Companies. Accessed January 19. *See* http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M077/K132/77132276.PDF.

2. CPUC Decision adopting rules and regulations to protect public safety while allowing new entrants to the transportation industry. Accessed January 19. *See* http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M077/K112/77112285.PDF.

3. *Id.*

4. Property Casualty Insurers Association of America. 2016. "Transportation Network Companies." Accessed January 19. *See* http://www.pciaa.net/industry-issues/transportation-network-companies.

5. Uber. 2016. *See* https://www.uber.com/business/.

6. Lyft. 2016. *See* https://www.lyft.com/cities.

7. Sonders, Mike. 2016. "Uber vs Lyft" *SurveyMonkey Intelligence blog*, August 26. https://www.surveymonkey.com/business/intelligence/uber-statistics/.

8. Governor Rick Snyder Press Release dated December 21, 2016 concerning recently signed legislation. Accessed January 19. *See* http://www.michigan.gov/snyder/0,4668,7-277-57577_57657-400530--,00.html.

9. This Act repeals the Limousine Transportation Act, 1990 PA 271, MCL 257.1901 to 257.1939.

10. 2016 PA 345, Section 3.

11. *See also* Public Act 348 of 2016, Section 6 (3)(i-k) which amends the Michigan Vehicle Code to specify that "chauffeur" does not include a limousine, taxicab, or TNC driver and "commercial vehicle" does not include a limousine operated by a limousine driver, a taxicab operated by a taxicab driver, or a personal vehicle operated by a TNC driver which means that they are not required to obtain a chauffeur license. This bill also takes effect on March 21, 2017.

12. There are additional exclusions to the definition of limousine under this Act. *See* Section 2(d)(i-vii).

13. 2016 PA 345, § 2(e).

14. *Id.*, § 2(f).

15. *Id.*, § 2(g).

16. *Id.*, §2(i).

17. *Id.* § 2(j).

18. *Id.* § 2(k).

19. *Id.* § 2(m).

20. *Id.* § 2(n).

21. *Id.* § 4.

22. *Id.* § 4(6).

23. *Id.* § 4(2) and (3)

24. *Id.* § 4 (11).

25. *Id.* § 5.

26. *Id.* § 5.

27. *Id.* § 7(1)(a).

28. *Id.* § 9.

29. *Id.* § 7(2)(a-g).

30. *Id.* § 49 (1) and (2).

31. *Id.* § 53 (1) and (2).

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IRS Organization Changes and a Hard-Hitting Tax Court Case

IRS Reorganizes—Again

The IRS has implemented further organizational changes in the examination division. This is particularly true of LB&I (Large Business and International).

Some of the structural changes include the elimination of industry designations and a move to issue-based examinations. LB&I audit examination will now be based on perceived compliance risk. The determination will be based upon the utilization of data analytics and specified staff to "issue spot." These self-described streamlined audits will quickly target specific areas of IRS enforcement. Agents will move quickly with rapid and focused Information Document Requests or IDR's. Expect the quick or even preemptive use of IRS summons authority or even quickly closed "unagreed" examinations.

IRS Publication 5125 provides specific information. Taxpayers and their representatives should consult this publication upon receipt of an IRS examination notice as it sets forth the procedural IRS playbook. An important note is that an LB&I examination could have multiple agents with each agent examining a discreet area of examination such as research tax credits, employment taxes, or international issues with each agent issuing separate IDR's.

An additional important factor will be the agents' push at the earliest stages of the examination for the client to agree and execute an "Acknowledgement of Facts," IRM Exh 4.46; 4-3. This form is an attempt by the IRS to get the taxpayer to effectively stipulate factual issues. Unsuspecting taxpayers or their representative can unwittingly concede important factual issues with legal implications.

The IRS is also instituting "campaigns" to alter taxpayer behavior. These campaigns will be a precursor of future IRS examination activity. The IRS will essentially focus on "strategic" issues designed to change taxpayer behavior. This is a process that will roll out over a period of years. Expect a lot of focus on rules of charitable giving or documenting business expenses.

Taxpayers would be well-advised to specifically ask their tax advisor about employing any "tax saving products" if the IRS has published any enforcement guidance regarding the product. Taxpayers should enquire if they are employing a tactic or product that the IRS is going to greatly target for examination or effectively litigate. The IRS will enquire what actions the taxpayer took before signing off on the tax strategy for penalty application purposes.

Partnership Audit Changes

Partnership examination rules have undergone significant changes. The Bipartisan Budget Act of 2015 (BBA) will apply to any entity classified for federal income tax purposes that is required to file a federal income tax return. The major impact is the liability and responsibility for payment of determined audit adjustments to the partnership. Careful attention to upcoming guidance is essential for any business lawyer.

There is an opt-out provision for partnerships of 100 or fewer Schedule K-1 forms in a taxable year. The opt-out must be elected annually on the partnership's timely filed tax return, and the partnership must notify each partner of the election.

This new approach can have a profound impact on partnership economies. The economic cost of an examination is effectively borne by the persons who are partners in the year of the audit adjustment rather than the partners in the review year. Furthermore, included partners will no longer have a partner level penalty defense. Careful clarity in partnership agreements will be required to address the potential economic consequences of the tax law change.

Document, Document, Document…

A recent Tax Court holding highlights the importance of contemporaneous written acknowledgement of a charitable donation. In *15 W 17th St, LLC v Commissioner*, 147 TC No 19 (2016), a divided Tax Court upheld the disallowance of a $64 million deduction for failure to secure a contemporaneous acknowledgement under IRS 170(f)(8)(D) for the charitable contribution.

This case involved the donation of a conservation easement—never an IRS favorite. While the charity acknowledged receipt of the easement, the letter did not state if the donee had provided any goods or services to the taxpayer, or if the donee had otherwise given the taxpayer anything of value in exchange for the easement. There is an exception to the requirement if the donee files a return or a form in accordance with IRS Regs. While the donee filed an amended Form 990 acknowledging the gift, the Tax Court held that since the IRS never issued final regulations, this particular donee could not rely on the statutory exception to the contemporaneous written acknowledgement requirement. Applying a strict compliance standard, the charitable deduction was disallowed.

This case is a painful reminder that strict statutory requirements must be understood and followed or the taxpayer runs a significant risk of disallowance with the inevitable professional liability repercussions.

IRS Budget Woes

I have written in the past columns about the practical impacts for taxpayers and practitioners of repeated IRS budget cuts. Recently there was an announcement that the IRS will not be issuing any guidance such as revenue procedures and revenue rulings except routine administered guidance "for a while."

Recently Released

FY 2016 statistics released by IRS Criminal Investigation provide tangible proof of IRS budget cuts. The number of investigations initiated has dropped to 3,395 from 4,297 just two years ago. The percentage of those convicted (plea or guilty verdict) remains well over 90 percent, and those sentenced to prison remains at about 80 percent with the average prison sentence being 41 months.

Given the pressure on resources, there has never been a better time for taxpayers to consider a voluntary disclosure to avoid potential criminal prosecution. Taxpayers and their advisors should consult with experienced tax controversy lawyers when considering such an approach.

Is the U.S. a tax haven? Don't laugh. A recent EU report declares as much. Citing the decentralized U.S. system of LLCs, shell companies, and anonymous ownership, there is a growing concern about a U.S. double standard. There are significant demands by U.S. authority for information with a perceived lack of reciprocity.

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Compliance 2017: Looking Forward – Looking Back

A new year is always a good time to take stock of where you are as well as planning for the future. In the tech world, change is a constant, and a new administration adds uncertainty. While looking forward, however, never neglect to check your company's compliance with existing laws and regulations.

This column touches on three areas that are sometimes forgotten but which can cause significant trouble if the rules are ignored. These involve software and data licensing compliance, telephone marketing, and antitrust aspects of licensing. At the end, I note some contracting trends related to technology that you may come across.

Software and Data Licensing

In the days of subscription-based software and data licensing, it is sometimes easy to forget that the copying and use of unlicensed software is illegal. A number of companies and industry groups, such as the Business Software Alliance (BSA),[1] still actively police proper licensing of software and act against potential illegal copying and use. Remember that your software licenses are usually limited by the number of computers on which the software can be installed and restrict sharing of that software. A prior column also touched on this issue.[2]

Here are some of the points to remember:

- Document your licenses and make sure someone in the organization tracks both licenses and subscriptions of software and data.
- Establish a benchmark for installed software and make sure that all installed software is properly licensed.
- The person responsible for licensing compliance should periodically audit usage. There are many automated tools that will do this for you. (Note: I do not recommend any "free" tools offered by those groups that enforce compliance.)
- Company policies should be clear that only software licensed by the company should be installed on company computers, and that the installation of any other software or unlicensed software is against company policy.

If the BSA does come knocking, contact someone that knows how to address the issues. Most investigations are prompted by tips from disgruntled or terminated employees, so the entity contacting your company already knows a lot about your company and its use of software. Do not start deleting unlicensed software!

Telephone Solicitations

Robocalls are not new, but they are getting more prevalent. Congress originally enacted the Telephone Consumer Protection Act[3] ("TCPA") in 1991. The law does not apply just to traditional telephone marketing but has a broader application, including text messages. One of the key provisions is the requirement of express, advance consumer consent for any automated calls or texts. That is why you are asked (by those that understand the law) to consent to receiving these messages. Violations are punishable with fines of a minimum of $500 per offending call or text, and can be trebled if willfulness is found.

The Federal Communications Commission recently provided detailed guidance as to permissible and proscribed practices.[4] Businesses also need to understand that their engagement of a third-party firm to make calls or texts on their behalf will not insulate them from liability. If the third-party firm violates the TCPA on behalf of a client, the client is responsible for the consumer damages. Unlike many similar laws, consumers have a private right of action to sue companies directly and to recover damages even if such consumers are neither deceived nor defrauded in any way.

Warning: On a closing note, remember that the calls you may get from "Card Services" or "National Student Loan" or others promising to lower your interest rate or help consolidate debt at lower rates not only violate this law, but they are likely scammers. Hang up. Do not give them information even if they sound like they are from Visa or MasterCard. They aren't.

Antitrust Guidelines for the Licensing of Intellectual Property

Antitrust? Does it exist anymore? Of course it does, and the FTC recently reminded the industry that there are competition considerations involved in the licensing of intellectual property.[5] The guidelines[6] update prior guidance from the U.S. Department of Justice and the FTC, and reaffirm that the FTC recognizes that there are good reasons for restrictions in licensing, but also that the same statutory principles apply to the competition analysis.

Contracting Trends

I have been seeing a strong trend by companies that require their vendors to have business continuity and disaster recovery plans in place and available for inspection.[7] If the vendor is critical to the operations of the buyer, the buyer has a vested interest in making sure that the seller can recover from a business interruption and continue production.

A second trend that has become almost standard is the requirement that the vendor have in place information security and privacy systems and policies to protect any data that is being provided by the buyer. The buyer will usually demand that the vendor make these plans and policies available if requested and may even demand that the seller be certified in its information security protocols or meet objective standards (such as ISO 27001).

Conclusions

Just because the technology legal landscape is changing quickly, don't forget existing obligations under current law. Also anticipate that your business partners will want your company to be proactive in protecting against technology and other threats.

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NOTES

1. www.bsa.org.

2. Technology Corner, *Licensing Watchdogs Get Tough,* MI Bus LJ (Spring 2005), by Michael S. Khoury.

3. 47 USC 609, et seq. See also, Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991, https://www.fcc.gov/document/telephone-consumer-protection-act-1991.

4. https://www.fcc.gov/document/tcpa-omnibus-declaratory-ruling-and-order.

5. Department of Justice and Federal Trade Commission's Update to the Antitrust Guidelines for the Licensing of Intellectual Property, https://www.justice.gov/atr/guidelines-and-policy-statements-0/2017-update-antitrust-guidelines-licensing-intellectual-property.

6. https://www.justice.gov/atr/IPguidelines/download.

7. For additional background, see Technology Corner, *Business Continuity Planning,* MI Bus LJ (Spring 2008) by Michael S. Khoury.

Pransky's Finding for Finders—Michigan Investors, Not So Much

By Shane B. Hansen, Cyril Moscow, and Hugh H. Makens

In *Pransky v Falcon Group, Inc*[1] the Michigan Court of Appeals held that a "finder"[2] as defined in Michigan's Uniform Securities Act (2002) ("*MUSA*" or "*Securities Act*")[3] was not required to be registered with and regulated by the State of Michigan. In a strenuous effort to discern or impute legislative intent, the opinion resolved a commercial dispute in favor of an unregistered business intermediary acting as a "finder" but in doing so unnecessarily tore a hole in the MUSA's regime for protecting Michigan investors. This case commentary does not defend inartful legislative craftsmanship but does offer an alternate statutory interpretation that could have avoided the collateral damage to Michigan investors, as well as Michigan businesses seeking to raise start-up and growth capital.[4] Judicial, legislative or administrative stitching is urgently needed to fix this hole in the MUSA's protective regime.

Pransky's Basic Facts

The *Pransky* case involved a commercial dispute between an entrepreneur, Jaime Pransky ("*Ms. Pransky*"), who intended to open and operate a health and wellness spa in her home state of Vermont. Ms. Pransky entered into a business consulting arrangement with a Michigan business intermediary, Falcon Group, Inc. ("*Falcon Group*"), that was, among other things, to advise and assist her in obtaining funding or commercial financing for her proposed health spa.[5] Ms. Pransky paid Falcon Group a $20,000 deposit toward an agreed $50,000 non-refundable retainer and agreed to pay additional amounts contingent upon the amount of funds the intermediary helped raise (i.e., transaction-based compensation or, more commonly, a commission). The desired funding could come from a variety of sources such as prospective investors, commercial lenders, or acquirors. Several months after signing the consulting agreement, Ms. Pransky became dissatisfied with Falcon Group's services and demanded the return of her deposit, and Falcon Group refused. In the resulting lawsuit, among other things, Ms. Pransky alleged that Falcon Group's activities would have required it to be Michigan-registered as a "broker-dealer" under the MUSA, and, since it was not registered, the consulting agreement was illegal and void *ab initio*, and the deposit should therefore be refunded.

The trial court granted Falcon Group's motion for summary judgment. The trial court stated that "the agreement unambiguously required Falcon Group to perform services that fell within the definition of a finder under the Securities Act," but it determined that the MUSA did not require a finder to be registered.[6] Further, "because the consulting agreement did not require Falcon Group to 'have any meaningful role in effecting the actual transaction,'[7] the court determined that *the agreement did not require* Falcon Group to act as an agent or broker-dealer."[8] Because the trial court dismissed the case on summary judgment, there was no evidence adduced at a trial whether, in fact, Falcon Group's activities went beyond merely an "introduction" or whether Falcon Group's performance to date had satisfied its contractual obligations to Ms. Pransky.[9]

After its *de novo* review, the Michigan Court of Appeals sided with the trial court and found in favor of the finder:

> Examining the [MUSA] scheme as a whole and construing it according to its plain language, we conclude that the Legislature intended to differentiate finders from broker-dealers, agents, and investment advisors [*sic*]. Because *the Legislature chose not to include finders within the definition of a broker-dealer (or any other category)* and chose not to specifically require finders to register, a finder will not have to register *as long as the finder constrains his or her activities to those stated under MCL 451.2102(i)*. A person serving as a finder whose activities go beyond those described under MCL 451.2102(i), however, must

> register as an agent, broker-dealer, or investment advisor [*sic*], as the case may be. Further, the finder may avoid having to *register under multiple categories* by registering as a broker-dealer. (Emphasis added.)[10]

The *Pransky* opinion analyzes the definition of a "broker-dealer" and cites various authorities, some notably inconsistent, for the proposition that "effecting" requires "something more" than the activities defining a finder, stating:

> Moreover, it is not enough that the person's business involves transactions in securities in any way; the person's business must be one "effecting" transactions in securities. MCL 451.2102(d). The verb "effect" suggests *something stronger than tangential involvement* in the transfer of securities; rather, the person's business must *involve bringing about or accomplishing* the transactions in securities. *See* 5 *Oxford English Dictionary* (2d ed, 1991 rev) (defining the verb to mean "*[t]o bring about (an event, a result*); to accomplish (an intention, a desire)"). As one foreign court has explained, a broker-dealer is a *person who participates* in the transaction by *effectuating* the trade—that is, by performing *any function* in connection with *processing* the transaction. *See Overstock.com, Inc v Goldman Sachs & Co*, 231 Cal App 4th 513, 530-533; 180 Cal Rptr 3d 269 (2014) (examining the meaning of the terms "effect" and "effecting" as used in California's securities laws and specifically referring to the definition of "broker-dealer," which is the same as this state's definition); *see also Legacy Resources, Inc v Liberty Pioneer Energy Source, Inc,* 2013 Utah 76, ¶¶ 21-28; 322 P3d 683, 688-690 (2013) (construing the definition of "broker" under Utah's securities laws and holding that "one who is engaged in the business of 'effecting' a securities transaction is one who is *involved in 'bring[ing it] about; mak[ing it] happen, caus[ing] or accomplish[ing it]*'") (citation omitted) (alterations in original); *Indus Partners, LLC v Intelligroup, Inc,* 77 Mass App 793, 796-798; 934 NE2d 264 (2010) (stating that a person effects transactions in securities *when he or she participates* in the transaction *at key points* in the chain of distribution); *In re Slatkin*, 525 F3d 805, 817 (CA 9, 2008) (examining federal securities law and stating that the operative term, "*effecting," means to bring about or make happen*). With regard to persons who find investors for securities, some courts have held that whether a *person actively—as opposed to passively—solicits investors* for securities is a factor to consider when determining whether that person's activities fall within the definition of a broker-dealer. *See Legacy Resources*, 2013 Utah 76 at ¶ 21; 322 P3d at 688. Other courts have held that the activities of a finder fall under the definition of "broker-dealer." *See Black Diamond Fund, LLLP v Joseph*, 211 P3d 727, 734 [*177] (Colo App, 2009) ("*Individuals who solicit investors* by phone and in person, and *who distribute documents* and prepare and *distribute sales circulars* in the hope that potential investors will deposit money in the account, are seeking to effect securities transactions."). But this Court must be careful when considering whether the definition of "broker-dealer" necessarily includes the activities of finders because, unlike other jurisdictions, our Legislature has specifically addressed the activities of finders within our Securities Act. (Emphasis added; footnotes omitted.)[11]

Judicial, legislative, or administrative stitching is urgently needed to fix this hole in the MUSA's protective regime.

The opinion's last admonition, quoted above, is where the court's reasoning unnecessarily diverges from broader public policy considerations. Respectfully, the *Pransky* opinion's seemingly exhaustive postulations of legislative constructions overlooked a harmonizing view that would have protected Michigan investors and Michigan capital-raising companies alike—that the limited activities of a finder already come within the MUSA's broad definitions of *both* a "broker-dealer"[12] *and* an "investment adviser."[13] This view could have avoided *Pransky*'s creating a gap in the MUSA's investor protection regime.

Viewed in this light, the MUSA does not need to prescribe *which* of these two types of securities registration is required with respect to finder-related activities—the type of required registration is based upon the activities actually performed and, importantly, the type of compensation to be received for the intermediary's services.[14] While one might quibble with the legislative draftsman's rep-

etition of the same finder-related provisions in both MUSA sections 413 and 502(2), the legislative intent in doubling down on these provisions demonstrates that these investor protections are important and apply to both registration types. Rather than define a finder registration category, the MUSA's use of the term "finder" can be viewed instead as prescribing the circumstances under which specific investor protections are to be applied by either a broker-dealer or investment adviser.

As quoted from the *Pransky* opinion above, many courts, as well as the SEC staff,[15] see a finder's "participation" in a securities transaction by soliciting or making an introduction of a prospective investor to a securities issuer as a "key point" in the offering and sales process—no introduction, no sale. When soliciting a prospective investor a finder is giving, at a minimum, general advice to at least consider the investment opportunity—and commonly more. In the view of the SEC staff, it is unrealistic to believe that a "mere" passive introduction is all that is made in view of the transaction-based compensation incentive to be received by the finder only upon a successful sale—the SEC staff refers to this as a "salesman's stake" in the outcome.[16] A finder's "introduction" will be compensated (hence "engaged in the business"). A finder has every incentive to encourage and induce a prospective investor to buy the proffered securities, leading to potentially abusive and unlawful sales practices that are prohibited by the MUSA, which is the public policy rationale for registration and even modest regulation.

The *Pransky* opinion recites the MUSA's public policy underpinnings:

> Michigan's Legislature enacted the Securities Act to protect the public from fraud and deception in the issuance, sale, and exchange of securities [*citation omitted*.] It accomplished this in significant part by limiting the types of securities that may be offered and sold and by prohibiting certain practices involved with the offer and sale of securities. *See* MCL 451.2301 (prohibiting persons from offering or selling a security in Michigan unless the security meets certain criteria); MCL 451.2501 (prohibiting persons from directly or indirectly engaging in schemes or practices to defraud or making misrepresentations in connection with the offer, sale, or purchase of a security). However, it also chose to *protect the public by regulating the persons who are involved with the offer and sale of securities*. *See* MCL 451.2401 to MCL 451.2413. In particular, the Legislature prohibited a person from transacting business in this state as a broker-dealer, agent, or investment advisor [*sic*] *unless he or she is registered as a broker-dealer, agent, or investment advisor* [*sic*] under the act. *See* MCL 451.2401(1); MCL 451.2402(1); MCL 451.2403(1). (Emphasis added).[17]

In concluding that a finder need not be MUSA-registered, the *Pransky* opinion renders nugatory the investor protections in MUSA section 413 (applicable to a broker-dealer) and section 502(2) (applicable to an investment adviser) unless a particular finder happens to be registered as such. Registration serves a number of prophylactic purposes, most notably by screening "bad actors" from engaging in activities giving them ready access to other people's money. Prospective investors can better protect themselves from an unregistered fraudster or even a registered finder having one or more investor complaints when basic registration information is publicly available.[18] The MUSA's comprehensive securities-related registration regime was designed to help *prevent* such an outcome, not just retrospectively *try* to provide a remedy to recover lost money.

In concluding that no type of registration of finders is required under the MUSA, the opinion opens the door for fraudsters and other "bad actors"—some of whom could have been barred from the securities, banking, or other regulated industries—to offer, sell, and be compensated for capital-raising securities transactions. Without any form of registration under the MUSA, Michigan investors and capital-raising businesses have no ability to check the background, credentials, or authenticity of a finder asking for their money—either to raise capital or to invest their capital.[19] Moreover, when investor complaints are received, the Corporations, Securities, and Commercial Licensing Bureau of the Michigan Department of Licensing and Regulatory Affairs ("*Bureau*") has no information about a finder or its associated persons, which makes it far more difficult to promptly investigate the matter.

Lest the regulation of a finder under the MUSA seem unduly burdensome, bear in mind that the MUSA's designated adminis-

In concluding that no type of registration of finders is required under the MUSA, the opinion opens the door for fraudsters and other "bad actors" … to offer, sell, and be compensated for capital-raising securities transactions.

trator, presently the Bureau,[20] has always had the statutory authority to adopt and amend rules necessary or appropriate to carry out the MUSA. Specifically, section 605 of the MUSA[21] provides in relevant part:

> (1) The administrator may do any of the following:
>
> (a) Issue forms and orders and, after notice and comment, may adopt and amend rules necessary or appropriate to carry out this act, and may repeal rules, including rules and forms governing registration statements, applications, notice filings, reports, and other records.
>
> * * *
>
> (c) By rule, classify securities, persons, and transactions and adopt different requirements for different classes.

Indeed, under Michigan's prior blue sky law[22] the Bureau's predecessor agency adapted and adopted a simplified version of investment adviser registration using Form ADV and supporting forms to serve as a finder's application for registration, as further discussed below.

To be sure, Michigan businesses need simple, safe, and cost-effective ways of raising capital, but those objectives could be accomplished (as had been done under the 1964 Act) without eliminating all regulatory oversight and resulting accountability for a finder. Other states, like California and Texas, have created simplified "broker-dealer lite" registration or notice-filing regimes to put a finder "on the radar" without imposing unduly burdensome regulatory requirements. *Pransky's* investor protection gap could yet be fixed by the Michigan Legislature by amending the MUSA in a manner similar to California.[23] Texas has implemented a simplified regime by administrative rule.[24]

Other states, like California and Texas, have created simplified "broker-dealer lite" registration or notice-filing regimes to put a finder "on the radar" without imposing unduly burdensome regulatory requirements.

In sorting out the MUSA's activities-based definitions of "finder," "broker-dealer," and "investment adviser," some regulatory history may be helpful.

Michigan's History of Finder Registration

The MUSA's definition of a finder is identical in substance to its predecessor in section 401(i) of the 1964 Act.[25] The finder-related provisions in the 1964 Act had an irregular birth. To address various issues in exemptions and enforcement, in 1974 the MUSA's then administrator, the Michigan Corporation and Securities Bureau (a predecessor of the current agency), sought a series of amendments to the 1964 Act. Extensive negotiation of the amendments between the Bureau and representatives of the Business Law Section of the State Bar of Michigan followed. In 1975, proposed amendments were introduced in the Michigan Legislature. The amendments did not receive legislative action until 1978. In the late stages of the 1978 legislative consideration, a lawyer active in merger transactions presented finder provisions to the Michigan Senate committee considering the legislation providing that intermediaries in merger transactions, like his clients, would avoid registration as broker-dealers. The Michigan Legislative Service Bureau then prepared the provisions that found their way into the bill that became 1978 PA 481 ("*1978 Amendments*").

By way of context, for many preceding years the regulation of financial intermediaries who participated in the sale of securities under various circumstances had been an ill-defined and troublesome part of securities regulation.[26] Typically, the issue was framed as whether finders in securities placements or mergers have to register as brokers under federal or state securities laws. There had been related, but less pressing, questions as to whether finders should register as agents or investment advisers. The hurriedly prepared 1978 amendments added several provisions to deal with finders and, somewhat oddly,[27] included finders in the definition of investment advisers in section 401(f)[28] by stating, "[a]ny person who acts as a finder in conjunction with the offer, sale, or purchase of a security or commodity," repeating part of the definition of finder. The 1978 amendments went on to exclude from the definitions of "agent" and "broker-dealer" "a person acting solely as a finder and registered pursuant to this Act or acting as a finder under a transaction exempt pursuant to section 402(v)(19)." Section 102(a)(c)[29] provided that it was unlawful for any investment adviser acting as a finder to engage in the activities now proscribed by MUSA sections 413 and 502(2).

In response to classifying a finder as a category of an investment adviser, the 1964 Act's administrator adopted a modified form of investment adviser registration form ADV providing for the registration of organizations and individuals as an investment adviser. If an organization registered, none of its employees were required to register. In prac-

tice, only a limited number of organizations registered as such, primarily the financial services affiliates of several national accounting firms. By 1993, only ten registrations as finders were in effect. No current record of historically registered finders has been maintained by the MUSA's current administrator.

In 2002, House Bill 6338 was introduced to make Michigan the first state to adopt the recently approved model Uniform Securities Act (2002) ("*2002 Model Act*").[30] Since the 2002 Model Act did not contain finder-related provisions, Michigan's administrator drafted additions that would incorporate Michigan's then existing regulatory regime. By incorporating the 1964 Act's language, the administrator intended to move regulation from the investment adviser category to the more seemingly appropriate broker-dealer category in which finder issues were previously considered. Accordingly and to harmonize the registration schemes, the new MUSA's definition of investment adviser expressly excludes "a finder registered as a broker-dealer under this Act."[31] Similarly, the MUSA's definition of agent provides that "the term does not include a person acting solely as a finder and registered as a broker-dealer under this Act or acting as a finder in a transaction exempt under section 202(1)(r)."[32] The cross-references to section 402(b)(9) in the predecessor act and 202(1)(r) in the MUSA refer to a transactional exemption from registration for merger and acquisitions transactions.[33] Attempts to adopt the Uniform Act in 2002 and 2006 were unsuccessful for reasons unrelated to the finder issue. Eventually, the MUSA was enacted as Public Act 551 of 2008, effective October 1, 2009.

There is no known record of the reasoning of the 1964 Act's administrator in 2002 in its grafting the language regarding a finder from the 1964 Act into the new MUSA. The 1964 Act had included a finder in the definition of an investment adviser, but the MUSA does not specifically include a finder in the definition of a broker-dealer. This difference appears to have strongly influenced the *Pransky* court which stated:

> There is no reasonable interpretation of this statutory scheme that leads to the conclusion that the Legislature intended to require finders to register as broker-dealers in every case. In order to reach *Pransky*'s desired result, we would have to assume that the Legislature intended to include finders within the definition of "broker-dealer" or intended to require finders to register as broker-dealers, but forgot to include either provision in the statutory scheme.[34]

Concluding Observations

We believe the court erred when it did not consider the most likely reason that the broker-dealer definition does not expressly include the term "finder," namely that a finder's activities fit within the "broker-dealer" definition (and, as noted above, the "investment adviser" definition) and that therefore its express inclusion is not necessary. This view has been expressed by the SEC with respect to the similar language in the Securities Exchange Act of 1934.[35] In light of caselaw cited from other jurisdictions, we believe a better approach to the issue in the *Pransky* case would be to ask why there is *not an express exclusion* from the broker-dealer definition *if finder activities were not to be covered* by the definition. In addition, MUSA encourages state and federal uniformity in administering securities statutes (section 608) which suggest deference to SEC interpretations. MUSA Section 608(2)(b) directs the administrator to take into consideration specified policies including, "maximizing uniformity in *federal* and state regulatory standards."[36] While the *Pransky* court looked to other state jurisdictions[37], it neglected to look at federal caselaw interpreting "broker" as similarly defined in the Securities Exchange Act.

The answer to the court's unrealistic argument that requiring registration of finders as broker-dealers would make the finder subject to even more regulation than a broker-dealer[38] is that the problem had been handled administratively under the 1964 Act with the rules and forms then in use.

The *Pransky* court analyzed the issue before it as a matter of discerning legislative intent. Having worked on complex technical legislation, we have observed that legislative attention to nuances in a statute usually does not exist. In the case of MUSA, it is unlikely that anyone in the legislature or on the legislative staff had more than a vague understanding of securities regulation or had any understanding of how the old finder provision should be folded into the statute.

The regulation of finders has been debated for many years. The *Pransky* court framed the argument as whether the finder definition automatically required registration as

In the case of MUSA, it is unlikely that anyone in the legislature or on the legislative staff had more than a vague understanding of securities regulation or had any understanding of how the old finder provision should be folded into the statute.

a broker-dealer. Although courts generally have agreed with the SEC's position that finder activities require registration, courts occasionally have held otherwise.[39] Until California adopted a finder provision for local financings in 2015,[40] Michigan was the only state to have a statutory finder scheme.

Finally, the *Pransky* court cautions in footnote 15, "The better course of action would be for finders acting pursuant to similar contracts to protect themselves by registering, at the very least, as broker-dealers; the line between a finder's activities and that of a broker-dealer, agent, or investment advisor [*sic*] is a thin one and persons acting under such contracts without being registered are inviting litigation." We would add the cautionary point that the SEC staff and many, if not all, other states would reach a different conclusion than *Pransky*, and that many capital-raising securities transactions cross state lines.

Stitching Michigan's Seamless Web of Investor Protection

In finding for finders we believe the *Pransky* court misread the MUSA, as informed by both its public policy underpinnings and historical context, and erroneously inferred a legislative intent to deregulate finders where we see no such intent. In doing so, the court unnecessarily tore a hole in the MUSA's investor protection regime. The error can and should be corrected by the Michigan Supreme Court, legislative amendments to the MUSA, or by agency rulemaking.[41]

NOTES

1. *Pransky v Falcon Group, Inc*, 311 Mich App 164, 874 NW2d 367 (2015); leave to appeal denied, *Pransky v Falcon Group, Inc*, 499 Mich 908, 877 NW2d 721 (2016).

2. "'Finder' means a person who, for consideration, participates in the offer to sell, sale, or purchase of securities by locating, introducing, or referring potential purchasers or sellers. Finder does not include a person whose actions are solely incidental to a transaction exempt pursuant to section 202(1)(r)." The administrator may by rule or order exclude other persons from this definition. MUSA section 102(i), MCL 451.2102(i).

3. 2008 PA 551, MCL 451.2101-.2703, eff. Oct 1, 2009.

4. The role and regulation under federal and state securities laws of an intermediary in capital-raising transactions is fundamentally different than in the context of a merger, acquisition, or business sale among parties actively involved in controlling or running a business. *See* Hansen, *Simplifying Securities Regulation of M&A Brokers*, 34 Mich BLJ (Spring 2014) available at https://higherlogicdownload.s3.amazonaws.com/MICHBAR/ebd9d274-5344-4c99-8e26-d13f998c7236/UploadedImages/pdfs/journal/MBLJ_Spring14.pdf#page=23; *see also* Yadley, *Notable By Their Absence: Finders and Other Financial Intermediaries in Small Business Capital Formation*, US Securities and Exchange Commission Advisory Committee On Small And Emerging Businesses, June 3, 2015 available at https://www.sec.gov/info/smallbus/acsec/finders-and-other-financial-intermediaries-yadley.pdf ; Task Force on Private Placement Broker-Dealers, ABA Section of Business Law, *Report and Recommendations*, 60 Bus Law 959 (2005) ("ABA Task Force Report") available at https://www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf.

5. The record does not indicate how a Vermont resident came through interstate commerce to contract with a Michigan business intermediary to raise capital for a new venture to be operated in Vermont, or why parallel statutory claims under both federal and Vermont securities laws were not also raised in this case's pleadings.

6. The MUSA's jurisdiction and scope is activities-based. It is unclear why the activities actually performed were not assessed to determine whether those activities came within the MUSA's jurisdiction.

7. On its face, the case's posture and outcome *might* suggest that an unregistered capital-raising intermediary could narrowly define the scope of its contractual engagement, accept a large advance fee payment in anticipation of broader services to be actually performed, and thereby *apparently* contract-away the MUSA's investor protection regime—perhaps not the best public policy outcome.

8. *Pransky* at 172.

9. Such services could have included, for example, participating in discussions or negotiations and distributing information to prospective investors about a securities issuer seeking investors—services that go beyond a "mere introduction" and, in fact, operate as key steps in starting and facilitating a securities transaction. See the factual analysis applied by courts in other jurisdictions below.

10. The MUSA's registration categories are not overlapping; the investment-related activities defining an "investment adviser" in MUSA section 102a(e), MCL 451.2102a(e), exclude the activities of a "broker-dealer" "that does not receive *special compensation* for the investment advice". These definitions track with similar definitions under the federal Investment Advisers Act of 1940, as amended ("*Advisers Act*"), and concept of "special compensation" has been construed under federal securities laws. Thus, the type of compensation paid, or to be paid, for investment-related services is an important factor in the MUSA's treatment of these regulated activities.

11. *Pransky* at 175.

12. MUSA section 102(d), MCL 451.2102(d); *see also* MUSA section 401, MCL 451.2401, *Broker-dealer registration; requirements; exemptions; limitation on employment or association; employment or association with certain individuals prohibited; rule or order*; and more specifically, MUSA section 413, MCL 451.2413, *Broker-dealer acting as finder; prohibited conduct*.

13. MUSA section 102a(e), MCL 451.2102a(e); *see also* MUSA section 403, MCL 451.2403, *Investment advisor registration; requirements; exemptions; employment or association with certain individuals prohibited; exception*; and more specifically MUSA section 502(2), MCL 451.2502(2), *Investment advice or publications; prohibited conduct; rule or order*.

14. *See* note 10.

15. If engaged in interstate commerce, "broker" registration with the SEC would be required under the Securities Exchange Act of 1934 ("*Exchange Act*"). *See* SEC *Guide to Broker-Dealer Registration* for guidance and various examples of "broker" status at http://www.sec.gov/divisions/marketreg/bdguide.htm#II.

16. See the reasoning of the Securities and Exchange Commission ("*SEC*") staff in denying a law

firm's requested no-action letter to receive a referral fee (i.e., transaction-based compensation) for introducing its capital-raising business clients to prospective investor clients in *Brumberg, Mackey & Wall, P.L.C.*, 2010 SEC No-Act. LEXIS 406 (May 17, 2010). See also comments by an SEC staff attorney, Kristina Fausti, expressing the staff's views at the 2008 *SEC Government-Business Forum on Small Business Capital Formation* available at https://www.sec.gov/info/smallbus/sbforumtrans-112008.pdf.

17. *Pransky* at 173.

18. The background and regulatory history of a registered broker-dealer may be confirmed on FINRA BrokerCheck website (https://brokercheck.finra.org/); similarly, the Investment Adviser Public Disclosure website (https://adviserinfo.sec.gov/IAPD/default.aspx) provides substantially the same information about registered investment advisers.

19. *See* note 18.

20. *See* Executive Reorganization Order No. 2012-6, compiled at MCL 445.2034, for the transfer of the Securities Division of the Office of Financial and Insurance Regulation to the Department of Licensing and Regulatory Affairs.

21. *See* MUSA section 605, MCL 451.2605, *Forms; orders; rules; financial statement; interpretative opinions; conduct of hearing*.

22. Uniform Securities Act, 1964 PA 265, MCL 451.501-.818, as amended, eff. from Jan 1, 1965 to Sept 30, 2009 ("*1964 Act*").

23. *See* section 25201.1, *Broker-dealers: exemptions: finders*, Corporate Securities Law of 1968, added by Laws 2015, Ch. 743, A.B. 667, eff. Oct 10, 2015.

24. *See* title 7, part VII, Texas State Securities Board Rules, section 115.11, *Finder registration and activities*.

25. MCL 451.801(i).

26. *See* generally, Poser, *Broker-Dealer Law and Regulation*, Section 502[D]; ABA Task Force Report; L. Lerner and E. Rohrer, *Private Placement Brokers – State of Play Two Years Later*, Business Law Today (December 5, 2015).

27. Oddly because, unlike a broker-dealer or its agent, an investment adviser is not viewed as a salesman and, instead, has long been deemed by caselaw to be a fiduciary with respect to its clients.

28. MCL 451.801(f).

29. MCL 451.102(a)(c).

30. Uniform Law Commission (ULC, also known as the National Conference of Commissioners on Uniform State Laws) website at: http://www.uniformlaws.org/Act.aspx?title=Securities%20Act.

31. MUSA section 102(e)(ix), MCL 451.2102a(e)(ix), *Definitions; I.* Similarly, it excludes a broker-dealer that does not receive "special compensation" for its investment advice; see note 10.

32. MUSA section 102(b), MCL 451.2102(b), *Definitions; A to G*.

33. MUSA section 202(1)(r), MCL 451.2202(1)(r), *Securities exempt from MCL 451.2301 to 451.2306 and MCL 451.2504*.

34. *Pransky* at 186.

35. *See* Posner, note 4.

36. *See* MCL 451.2608(2)(b), Uniformity and cooperation with other agencies. Historically, courts have leaned heavily on federal court decisions and the decisions in other states in interpreting Michigan statutory language. Moscow and Makens, *Michigan Securities Regulation, Second Edition*, 1994.

37. *Pransky* at note 6.

38. *See also* note 10.

39. *See* Posner, note 4

40. Section 25201.1, *Broker-dealers: exemptions: finders*, Corporate Securities Law of 1968, added by Laws 2015, Ch. 743, A.B. 667, eff. Oct 10, 2015.

41. The Bureau is presently engaged in the rulemaking process to adopt a new ruleset under the MUSA. The Bureau may well feel constrained in its rulemaking by the *Pransky* opinion, so a legislative solution may be necessary. The initially proposed rules, together with initial comments by the Rules Review Subcommittee of the Securities Committee of the Business Law Section, State Bar of Michigan, are available at http://connect.michbar.org/businesslaw/home. The Business Law Section is not the State Bar of Michigan itself, but rather a section which members of the State Bar choose voluntarily to join, based on common professional interest. The position expressed is that of the Business Law Section only and is not the position of the State Bar of Michigan. To date, the State Bar does not have a position on this matter.

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Departure of Key Employees, Capital Raising Activities, and the Risks Involved with Form S-8 Registration

By Jennifer A. Cupples and Joseph P. McGill

Introduction

Key employees who depart publicly traded companies often do so by entering into consulting agreements, which may include the issuance of stock as compensation for the services provided during the term of the consultancy. Shares issued in a private transaction of this type must bear a restrictive legend and cannot be sold in a public marketplace without registering the shares with the Securities and Exchange Commission ("SEC"), unless an exemption from the SEC registration requirements is available.[1]

Use of Form S-8 is the preferred method of registration for shares issued as compensation under a consulting agreement; however, caution is advised particularly when the consultant has been involved in capital raising activities on behalf of the issuing company. There is very little guidance on the issue of what level of involvement in a capital raising transaction would prevent Form S-8 registration. The scenario below demonstrates the necessity of a fact specific analysis of this issue and careful consultation between attorney and client.

Illustrative Factual Scenario

A publicly traded company enters into a consulting agreement with its immediately retiring executive. The agreement provides for issuance of shares of the company's stock as compensation, with the potential for Form S-8 registration if permissible under the securities laws. The consultant thereafter demands that the company register the shares by way of Form S-8 claiming such registration is permissible and required because, in addition to involvement with capital raising activities, he also provided bona fide services unrelated to capital raising. The company refuses to do so because it concludes that the consultant was directly and indirectly involved in services relating to capital raising transactions on behalf of the company.

Assume the consultant's activities include:

- intentional participation in arrangements with brokerage firms for proposed capital raising transactions;
- engagement of placement agents to seek investors who would later be introduced to the company in connection with a proposed private placement of the company's securities;
- involvement in investment proposals;
- involvement with revisions to engagement letters with investment firms, including determination of the offering and private placement terms;
- the purpose of the issuing company's capital raise was to retire preferred shares held by an investment firm (partially owned by the consultant) which thereafter received proceeds from the capital raise;
- access to inside information regarding a proposed share redemption, directly related to the propsed capital raise, by way of participation in emails and conference calls with executives at investment firms and at the company;
- analysis and revision to the company's term sheet and company profile summaries for broker use in seeking investors and placing the sales of the company's common stock; and
- instructions to the company's executives relating to key aspects of the company's business operations specifically for use in roadshow presentations to potential investors.

The consultant will claim the above activities and involvement was for "informational purposes only."

Due to the character of the services provided by the consultant, registration of such shares issued in this scenario requires an in depth analysis of the Form S-8 General Instructions, caselaw, and no-action letters. Also required is review and analysis of the historical background and intent of the SEC in amending the requirements for S-8 registration, which largely focus on prevention of abuses by consultants who had been involved in transactions that tend to facilitate securities fraud.[2]

Registration by Form S-8

Form S-8 registration is attractive because it is an abbreviated process and is effective upon filing.[3] However, it may only be used to register shares issued to an "employee" under an "employee benefit plan" or an interest in such plan.[4] Included in the definition of an employee benefit plan is a "written compensation contract solely for employees, directors, general partners, trustees (where the registrant is a business trust), officers, or consultants or advisors."[5] Consultants or advisors may participate in an employee benefit plan *only if:*

(1) they are natural persons;

(2) they provide bona fide services to the company; *and*

(3) the services are not in connection with the offer or sale of securities in a capital-raising transaction and do not directly or indirectly promote or maintain a market for the registrant's securities.[6]

Simply, S-8 registration can be used only when a company issues stock as a means of compensating consultants for bona fide services *not* connected with raising capital. There is no exception stated where bona fide services are provided that absolves a party from Form S-8 limitations, even if the other services are not provided in connection with the offer and/or sale of securities in a capital raising transaction.

If the above requirements are met, "control securities" or "restricted securities" acquired in an employee benefit plan may be registered using Form S-8 in a resale offering.[7] However, General Instruction C places volume restrictions on the amount of "control" or "restricted" securities a holder may resell at any given time. The volume limitations depend on the status of the issuer/registrant at the time of filing the prospectus.[8]

In addition to the requirements for registration by Form S-8 above, the company must certify that it has reasonable grounds to believe that it meets the requirements for filing.[9] By signing the Form S-8, the issuing company also explicitly agrees to amend the form "during any period in which offers or sales are being made. . . to reflect . . . any facts or events arising after the effective date of the registration statement … which, individually or in the aggregate, represents a fundamental change in the information set forth in the registration statement" and to "include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement."[10]

The issuing company thereby takes on the responsibility of registering the shares in accordance with the strict requirements of the securities laws. An analysis of the history of the Form S-8 sheds light on the SEC's considerations in determining a company's qualification to use this short form registration for shares issued to their consultants.

History of Form S-8

The definition of "employee" relating to S-8 registration was amended in 1990 to include, in addition to employees, directors and officers, consultants, or advisors, provided they render services not in connection with an offer or sale of securities in a capital raising transaction.[11] Following this amendment, the Commission noted particular concerns relating to the automatic effectiveness of the S-8 registration and the lack of SEC staff review relating to shares issued to individuals who reportedly did not provide bona fide services to the company.[12] Also of concern to the Commission was a company's distribution of securities to the public without the protections of registration under Section 5 of the Securities Act and the use of the Form S-8 as a vehicle to make unregistered securities distributions to the general public.[13] In an attempt to prevent the abuses of Form S-8 filing by companies on behalf of their consultants/advisors, the SEC further amended the Form S-8 in 1999 to specifically require:

> […] that the services rendered by the consultant or advisor '*not* directly or indirectly promote or maintain a market for the registrant's securities[,]' and that the consultant be a natural person who provides bona fide services to

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> the registrant. 'Whether activities that otherwise promote the registrant,' the Commission adds, 'would indirectly promote the registrant's securities would depend upon the facts and circumstances.' The requirement that the consultant's services not promote or maintain a market for the registrant's securities is *in addition* to the requirement that such services *not* be in connection with the offer or sale of securities in a capital-raising transaction.[14]

In particular, for consultants and advisors, the character of the service(s) provided will determine whether a Form S-8 is available.[15] Furthermore, the Commission Release adopting the 1999 amendments states:

> Brokers, dealers and *persons who find investors* will be *excluded* from receiving securities registered on Form S-8 because their services, as securities industry professionals, are inherently capital-raising. *Consultants who provide investor relations or shareholder communications services* also will be *excluded*, because of the promotional nature of their services.
>
> * * *
>
> The prohibition relating to services that directly or indirectly promote or maintain a market for securities is aimed at *services that may reasonably be expected to raise (or sustain) the market price of the registrant's securities.*
>
> * * *
>
> A consultant who arranges a financing that involves any securities issuance – whether equity or debt – will not be eligible.
>
> * * *
>
> Whether a consultant retained to perform management functions traditionally performed by an employee, such as a consultant chief financial officer, is eligible will *not* be determined based on the person's title. *Instead*, eligibility will depend on the primary character of the services provided. Where the services are primarily capital-raising or promotional, Form S-8 will not be available to register securities issued as compensation.[16]

The SEC further explained the situations in which it would view a transaction as seeking to raise capital from the public in violation of the S-8 requirements:

> Form S-8 is not available to register offers and sales of securities to […] consultants and advisors where:
>
> By prearrangement or otherwise, the issuer or a promoter controls or directs the resale of the securities in the public market; or
>
> The issuer or its affiliates directly or indirectly receive a percentage of the proceeds from such resales.[17]

The SEC's published interpretations of its own regulations are treated by the courts as controlling if not plainly erroneous or inconsistent with the regulation.[18] Securities regulations and SEC guidance (litigation releases, opinions and no-action letters) on S-8 registration are otherwise sparse for the scenario in which a consultant offers bona fide services that also involve a level of participation in investor relations and fund raising for the issuing company.

Most published materials and cases involving a violation of the Form S-8 regulations involve a consultant who is clearly involved in capital raising activities on behalf of the company and has not offered any bona fide services.

Caselaw Regarding Form S-8 Registration Issues

Most published materials and cases involving a violation of the Form S-8 regulations involve a consultant who is clearly involved in capital raising activities on behalf of the company and has not offered any bona fide services. Two such cases relating to securities law violations associated with S-8 registration are discussed below.

SEC v Phan

The United States Court of Appeals for the Ninth Circuit in *SEC v Phan*[19] found that S-8 registration can be used by a company *only* to issue stock as a means of compensating consultants for bona fide services *not* connected with raising capital. In this case, the consultant was provided an option to purchase shares of the company and filed the option agreement and Form S-8 with the SEC. After the form was filed and Phan was paid, the chairman of the company claimed that he orally modified the option agreement to allow the consultant to receive the shares in exchange for a promissory note, which was not noted in its form. Within months, the consultant resold most of the shares below issuance price. At the chairman's direction, the consultant then wired the proceeds of two sales to the company's investment partners to pay the company's outstanding debts. The SEC alleged that Phan used the stock to raise capital from the public for the cash-strapped publicly traded company, thereby violating the securities laws.

The district court granted summary judgment in favor of the SEC, holding that Phan both engaged in an unregistered securities sale and committed securities fraud. The U.S. Court of Appeals affirmed the District Court's summary judgment rulings relating to the registration issue. However, the court vacated the antifraud claim relief against Phan because it could not find that the S-8 registration form contained a material misstatement due to its failure to disclose the change in payment terms.

SEC v East Delta Res Corp

The U.S. District Court, Eastern District of New York in *United States SEC v East Delta Res Corp*[20] found that although the consultant performed other services, the work served the primary purpose of raising capital and promoting a market for East Delta's securities, so a Form S-8 could *not* be used to register the consultant's shares. East Delta was a publicly traded company that claimed to own and/or operate mineral mining properties in China. Its common stock was registered with the SEC. East Delta filed a Form S-8 with the SEC relating to its consulting agreement with Mayer Amsel. The agreement provided that Amsel would be issued common stock shares for services relating to analysis of financial, engineering, and mining experiences of mining entities operating in China, and recommendations regarding potential partners and affiliates who may have an interest in investing in East Delta's projects. Amsel's services also included arranging meetings and discussions with potential joint venture partners, property options and mergers/acquisition candidates, and assisting in all due diligence. The agreement also noted that Mayer had developed an extensive network of businessmen in North America and was always involved in attempting to raise money on behalf of East Delta and searching for people to buy East Delta stock.

The SEC filed suit against East Delta and various related individuals, including Mayer Amsel, alleging violations of section 17(a) of the Securities Act of 1933, section 10(b) of the Securities Exchange Act of 1934, SEC rule 10b-5, and sections 5(a) and 5(c) of the Securities Act. Summary judgment was entered against Mayer Amsel, except with regard to sections 5(a) and 5(c) of the Securities Act.

The District Court ultimately determined that the SEC had clearly established that Amsel had offered or sold his shares of East Delta without a registration statement due to East Delta's failure to qualify under the Form S-8 requirements. Not only did Mayer fail to provide bona fide consulting services to East Delta, but any services that he did perform were for the primary purpose of promoting and maintaining a market for East Delta's securities. Therefore, a Form S-8 could not be used to register securities issued as compensation for his consulting services.[21] The primary character of Mayer's role was capital-raising, and although he performed some limited recruitment functions, Mayer's primary role was the promotion of East Delta stock. The Form S-8 registration statement was rendered void, meaning then that Mayer had violated Sections 5(a) and 5(c) of the Securities Act. The SEC's request for a permanent injunction was granted because of Mayer's ongoing pattern of activity that occurred over several years. The Court also ordered disgorgement[22] and levied civil penalties.[23] Due to his violations of sections 5(a) and 5(c) of the Securities Act, Mayer was permanently enjoined from violating these statutes.

Based upon the above caselaw, if the issuing company is not certain about its eligibility for Form S-8 registration, the company should be cautious and consider other forms of registration of the consultant's shares. Failure to carefully consider all relevant facts and circumstances of the consultant's conduct in light of the Form S-8 requirements risks a violation of section 5 of the Securities Act of 1933.

Other Registration Options—Form S-3, Form S-1, and Rule 144

If the issuer meets the requirements to use Form S-3,[24] then control and restricted securities may be registered for resale without volume limitations. If, however, the issuer does not meet the stringent requirements to use Form S-3 (which include that the company be listed on a national exchange), the amount of securities to be resold in any three month period may not exceed one percent of the issuer's outstanding shares.[25] Therefore, if, for example, the company's stock is traded only in the OTC market, this form of registration is not permitted.

Another option for registration of shares is the Form S-1, which is a standard form of registration statement but is much more involved than registration under Form S-8. Form S-1 presents a long list of required disclosures and is a form that shall be used

Planning and understanding the intricacies of registration by Form S-8 for business succession purposes is instrumental in managing risk and appropriately advising an issuing company.

for registration under the Securities Act of 1933 of securities of all registrants for which no other form is authorized or prescribed.[26] Form S-1 registration requires an extensive comment and review process with the SEC that can take months to complete, thereby delaying the registration. This registration process should be avoided by the issuing company if possible, particularly if the consulting agreement requires registration by a certain deadline date.

The rule 144 exemption from registration requires a six-month waiting period,[27] in addition to a number of conditions including the manner in which the securities are sold, and the amount that can be sold at any one time.[28] This rule provides a "safe harbor" for the seller so long as the stated conditions are met related to holding period, current public information, trading volume formula, ordinary brokerage transactions, and the filing of a notice of proposed sale with the SEC.[29] Under rule 144, the waiting or holding period begins when the securities are purchased and only applies to restricted securities (i.e. not those acquired in the public market). For affiliates, the conditions are more stringent.[30]

Even if the conditions of rule 144 are met, the sale of restricted securities to the public is not permitted until a transfer agent removes the legend.[31] This usually occurs by way of an opinion letter from the issuer company's counsel, providing consent of the issuer that the restrictive legend can be removed. Without the opinion, the transfer agent does not have the authority to remove the legend and permit trade of the shares in the marketplace.[32]

Practice Pointers

Planning and understanding the intricacies of registration by Form S-8 for business succession purposes is instrumental in managing risk and appropriately advising an issuing company. It is critical to clearly define the duties of the consultant in the separation/consulting agreement and document the tasks performed. The company should specify any manner and timing associated with its potential commitment to register shares. The separation/consulting agreement should contain an acknowledgement from the employee that the decisions regarding securities registration, by any method, shall be solely within the discretion of the company. When uncertain if Form S-8 registration is permissible, an individual or entity may request a "no action" letter from the SEC. If the SEC concludes that it would not recommend an enforcement action relating to your particular fact pattern, disputes between the company and employee can be avoided or better defended.[33]

In litigation, the complexities and lack of precedent related to S-8 registration leave the courts lacking clear guidance where a consultant is involved in capital raising activities on behalf of the issuing company and also provides unrelated bona fide services. Reliance on an established expert in securities law can help define and explain the registration requirements to the court and/or the jury so that the presentation of the facts and circumstances of the consultant's activities is made in light of the strict requirements of Form S-8.

NOTES

1. *See* Section 5 of the Securities Act of 1933 (liability for any securities sale for which a registration statement is not in effect, not limited to initial distribution). *See also* 15 USC 77(e).

2. An example of a common securities fraud scenario involving a consultant/advisor is termed a "pump and dump" scheme where S-8 registration is not permitted to be utilized by persons who arrange or effect mergers that take private companies public. See Bloomenthal, Harold S., *Securities Law Handbook*, 2015 ed., Volume 1, Section 6:60. A merger into a thinly capitalized "shell" company with a class of securities registered under the Exchange Act, or a subsidiary of such a company, will fall into this category. *Id.* These mergers are often used to develop a market for the merged entity's securities. *Id.*

3. *See* Form S-8, General Instructions D; Rule 462 at 230.462; and Rule 456 at 230.456.

4. *See generally*, Form S-8, General Instructions at A.1.(a)(1). To be eligible to use Form S-8, the registrant must be a reporting company and must have filed all reports required to be filed during the preceding 12 month period (or such shorter period that it has been a registrant). *See* Form S-8, General Instructions A.1. *See also,* 17 CFR 230.405 (stating that a consultant may participate in an employee benefit plan only if "[…] [t]hey provide bona fide services to the registrant and […] [t]he services are not in connection with the offer or sale of securities in a capital-raising transaction, and do not directly or indirectly promote or maintain a market of the registrant's securities"). *See also*, 17 CFR 239.16b(a)(1)(stating that a Form S-8 may be used to register securities to be offered to its employees under any employee benefit plan).

5. *See* Rule 405 of Regulation C under the Securities Act of 1933; 17 CFR 230.405.

6. *See* endnote (4), *supra.*

7. Control shares are those held by affiliates of the issuer, and restricted shares, generally, are shares acquired directly or indirectly from the issuer, or from an affiliate of an issuer, in a transaction or chain of transactions not involving any public offering. *See* Form S-8, General Instruction C.1(a) and (b); see also, Rule 144(a)(3).

8. *See* Form S-8, General Instruction C.2(a) and (b); see also, Rule 144(e).

9. *See* Form S-8, Part II, Signatures.

10. 17 CFR 229.512(a)(1).

11. *See* Form S-8, General Instructions A.1.a.

12. Bloomenthal, Harold S., *Securities Law Handbook*, 2015 ed., Volume 1, Section 6:60.

13. *Id.*

14. Bloomenthal, Harold S., *Securities Law Handbook*, 2015 ed., Volume 1, Section 6:60 (emphasis added).

15. *Id.*, citing to the Commission Release adopting the 1999 amendments, Sec. Act Release No. 33-7646, 34-41009, 1999 SEC LEXIS 404, 1999 WL 95488, at *6 to 8 (February 25, 1999) (footnotes in original omitted) (emphasis added).

16. *Id.* (emphasis added).

17. S-8 Release, 64 Fed Reg at 11, 103-04 and 11 at 106 (footnote omitted), as cited in *SEC v Phan*, 500 F3d 895, 903 (9th Cir 2007).

18. *Phan*, *supra* at 904, citing *Auer v Robbins*, 519 US 452, 461 (1997); see also *Epstein v MCA, Inc*, 50 F3d 644, 654 n 17 (9th Cir 1995) (applying such substantial deference to an interpretation published in a SEC Release).

19. *SEC v Phan*, 500 F3d 895, 903 (9th Cir 2007).

20. *SEC v East Delta Res Corp*, No 10-CV-310, 2012 US Dist LEXIS 127644 (EDNY Aug 31, 2012).

21. *See* Registration of Securities on Form S-8, SEC Releases No. 33-7646, 34-41009, 1999 SEC LEXIS 404 at *15 (SEC Feb 25, 1999), as cited in *SEC v East Delta* at *12. Eligibility does not depend on "the person's title," but "will depend on the *primary character* of the services provided." *Id.* (emphasis added).

22. *See SEC v East Delta Res Corp, supra* at *9, citing *SEC v Universal Express, Inc*, 646 F Supp 2d 552, 564 (SDNY 2009), and *SEC v Shah*, No 92 Civ 1952, 1993 US Dist LEXIS 10347 (SDNY July 28, 1993).

23. Section 20(d) of the Securities Act and Section 21(d) of the Exchange Act authorize the imposition of civil monetary penalties.

24. An issuer is eligible to use Form S-3 when: (1) the registrant is organized under the laws of the US or any state or territory or the District of Columbia and has its principal business operations in the US or its territories; (2) the registrant has a class of securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") or a class of equity securities registered pursuant to 12(g) of the Exchange Act or is required to file reports pursuant to Section 15(d) of the Exchange Act. Additionally, the registrant must meet several additional requirements, including transaction requirements, and meet aggregate market value of common equity held by non-affiliates, or "public float", previously at least $75 million. See Form S-3, General Instructions at I. The $75 million requirement was removed in 2007 to allow smaller reporting companies, so long as the issuer is (a) not a shell company, (b) has a class of common equity securities listed and registered on a national exchange; and (c) does not sell more than one-third of its public float in any 12 month period. *Id.*

25. *See* Form S-8, General Instruction C.2; *see also*, Rule 144(e).

26. See Form S-1, General Instructions; except that this Form shall not be used for securities of foreign governments or political divisions thereof or asset-backed securities, as defined in 17 CFR 229.1101(c). *See also* Regulation C and Regulation S-K (17 CFR 230.400 to 230.494, and 17 CFR Part 229).

27. If the company that issued the securities is a "reporting company." If it is not, the hold or waiting period is at least one year. The holding period only applies to restricted securities. *See* Securities and Exchange Commission, Investor Publications, *Rule 144: Selling Restricted and Control Securities*, by the Officer of Investor Education and Advocacy (modified January 16, 2013); <www.sec.gov/investor/pubs/rule144.htm>.

28. *See* Rule 144 of the Securities Act of 1933 and SEC Form 144.

29. *See* Rule 144 of the Securities Act of 1933 and SEC Form 144.

30. *Id.*

31. *See* Securities and Exchange Commission, Investor Publications, *Rule 144: Selling Restricted and Control Securities*, *supra*.

32. *Id.*

33. Most no-action letters describe the issue presented, analyze the facts and circumstances involved, discuss applicable laws and rules, and, if the staff grants the request for no action, concludes that the SEC staff would not recommend that the Commission take enforcement action against the requester based upon the facts and representations described in the individual or entity's request. *See* Securities and Exchange Commission, Fast Answers, *No-Action Letters*, <www.sec.gov/answers/noaction.htm>. The SEC staff sometimes responds in the form of an interpretive letter to requests for clarifications of certain rules and regulations. *Id.*

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*The Future of Disclosure-Only M&A Class Action Settlements in Michigan Post-*Trulia

By Robert E. Murkowski and Todd Holleman*

One of the most distinctive recent developments in class action litigation has been the rise of merger and acquisition objection litigation. Over the past five years, nearly every corporate merger and acquisition deal valued at over $100 million has resulted in a flurry of shareholder litigation.[1] Typically, most of these cases resolve as quickly as they began, based on disclosure-only settlements. Nationwide, approximately 80 percent of these suits have concluded with settlements in which the merging corporation agrees to provide the shareholders with additional information about the financial state of the organization or structure of the transaction (for example, deal protection mechanisms) to supplement the proxy materials so the shareholders can cast more informed votes in deciding whether to accept the proposed merger and acquisition agreement.[2] In return, the shareholders, as a class, agree to release all future claims against the corporation and its fiduciaries as they relate to the sale or merger transaction.[3] The stockholders generally obtain no monetary compensation, although the attorneys representing the plaintiff class receive a fee award from the corporation. For a long time, the courts—both in Delaware and elsewhere—approved the vast majority of these class-action settlements as being fair and reasonable.

The Trulia Decision

In recent years, however, the Delaware Court of Chancery has displayed increasing skepticism and even animosity toward these types of disclosure-only settlements, questioning and, at times, intensely scrutinizing whether the shareholders have received sufficient benefit from the disclosed information to justify a broad release of claims.[4] This trend reached its apex in January of 2016 with Chancellor Bouchard's opinion in *In re Trulia, Inc Stockholder Litig*.[5]

The *Trulia* case arose as a result of a proposed merger between Trulia and Zillow, two online providers of listing information for residential real estate sales and rentals.[6] Almost immediately after the two companies announced the merger, four independent shareholders filed class action complaints against Trulia and several of its directors for breach of fiduciary duty, seeking to preliminarily enjoin the transaction.[7] Several months later, the plaintiffs and Trulia reached a settlement in which Trulia agreed to provide its shareholders with additional financial ratios and industry comparisons.[8] In return, the shareholders agreed to release "any claims arising under federal, state, statutory, regulatory, common law, or other law or rule" held by any member of the proposed class relating in any conceivable way to the transaction, with the exception of antitrust claims.[9]

In evaluating the proposed settlement, Chancellor Bouchard emphasized the duty of the court to exercise its independent judgment in a case-by-case examination of "not only the claim, possible defenses, and obstacles to its successful prosecution, but also the reasonableness of the 'give' and the 'get.'"[10] In other words, the court must weigh the assessed viability of the claims the shareholders give up against the value of the additional information they receive. The Chancery Court cautioned against what it perceived as the proliferation of "routinely fil[ed] hastily drafted complaints" in this type of deal litigation and the tendency of defendant corporations to "self-expedite" the settlement by volunteering to release what may turn out to be nominal disclosures.[11] Additionally, Chancellor Bouchard emphasized the breakdown of the adversarial system in the negotiation of these settlements: namely, the defendant corporation has significant incentives to obtain a release from potentially meritorious (and expensive) litigation by offering up desired information, and the plaintiffs' attorneys generally receive substantial fees as part of the settlement.[12]

*The authors would like to acknowledge and thank Erika Giroux, a law student at the University of Michigan Law Shcool, for her invaluable research and assistance in drafting this article.

Consequently, to preserve the adversarial incentives of litigation, the court advocated additional judicial review of proposed disclosure settlements through two procedures: (1) a preliminary injunction hearing in which the plaintiff would bear the burden of demonstrating that the omitted information is reasonably likely to be material,[13] and (2) a mootness fee hearing to determine attorneys' fees after the corporation has voluntarily disclosed the sought-after information.[14] In both contexts, the adversary system is preserved because no release is at issue.

Significantly, Chancellor Bouchard announced that the Court of Chancery would disfavor disclosure-only settlements going forward, unless the supplemental disclosures were plainly material, and the release was narrowly circumscribed to cover only those claims related to the sale process with sufficient exposition in the record for the court to evaluate the relative give and get.[15] Under Delaware law, the materiality of the disclosure "should not be a close call."[16] Although the court encouraged other jurisdictions to adopt its approach, it also acknowledged that these other jurisdictions are not bound by its ruling and may evaluate disclosure settlements differently.[17] To date, *Trulia* represents the last word from the Court of Chancery on this topic.

The Impact of *In re Trulia* on Michigan Law

The impact of the *Trulia* decision on Michigan law governing disclosure settlements has yet to be determined. Michigan's corporate law generally follows that of Delaware when Delaware law has been explicitly incorporated into Michigan law, or where no independent body of Michigan law exists.[18] However, Michigan's class action statute[19] differs from Delaware's[20] in one significant respect: Michigan expressly requires that class members be given the opportunity to opt out and be excluded from the settlement,[21] thereby preserving any additional claims they might have against the corporation to be pursued individually later. Thus, there is less risk of prejudice to the interests of individual shareholders who disagree with the disclosure settlement or, more specifically, with the court's evaluation of the strength of their potential claims.

Additionally, with regard to class action litigation generally, Michigan courts have tended to look to caselaw interpreting Federal Rule of Civil Procedure 23 for guidance in applying MCR 3.501, since "Michigan's requirements for class certification are nearly identical to the federal requirements, [and] similar purposes, goals, and cautions are applicable to both."[22] Relying on this body of law, the court must first preliminarily approve the proposed settlement; an opportunity to opt out must then be offered to class members; and finally, the court must determine whether the proposed settlement is fair, reasonable, and adequate.[23] In assessing this third prong, a judge must balance seven factors: "(1) the risk of fraud or collusion; (2) the complexity, expense and likely duration of the litigation; (3) the amount of discovery engaged in by the parties; (4) the likelihood of success on the merits; (5) the opinions of class counsel and class representatives; (6) the reaction of absent class members; and (7) the public interest."[24] Michigan courts have also recognized an overriding public interest in the settlement of lawsuits.[25]

Thus, Michigan courts faced with class-action shareholder lawsuits must decide between these two considerations: defer to Delaware's expert corporate law or defer to the body of law that has developed around FRCP 23. Since the vast majority of shareholder litigation—at least to date[26]—occurs in Delaware, Michigan courts have had scant opportunities to develop a similarly robust body of caselaw addressing disclosure settlements. As a result, whether and how the *Trulia* decision will affect the choice between Delaware law versus civil procedure caselaw remains to be seen. Interestingly, the court in *In re Consumers Power Co Derivative Litigation* found it appropriate to look to Delaware's rule on derivative suits for guidance in interpreting the similarly-worded federal rule.[27]

All of this suggests that a Michigan court could decide to apply the three-part *Vukovic*/seven-factor *Poplar Creek* test and then incorporate *Trulia*'s "plainly material" requirement into the fourth factor of the test: likelihood of success on the merits. This appears to be precisely the approach adopted by the only Michigan court to consider a proposed disclosure-only settlement since *Trulia* was decided. Judge Lita Popke, a Wayne County Business Court judge, ruling from the bench in *In re Compuware Corp Shareholder Litigation*, expressly held that "public policy favor[s] settlements of class action lawsuits" and then went on to find that "Michigan's class action rules are similar to federal rules," and thus

Over the past five years, nearly every corporate merger and acquisition deal valued at over $100 million has resulted in a flurry of shareholder litigation.

the court should look to federal law for guidance.[28] In considering the objectors' likelihood of success on the merits, Judge Popke specifically addressed the *Trulia* decision's materiality requirement and found that the plaintiffs had met their burden of showing that the information was material and the settlement reasonable.[29]

Most significantly, Judge Popke strongly suggested that Michigan courts should not necessarily follow the Court of Chancery's decision in *Trulia*. While acknowledging the trend in Delaware to look upon disclosure-only settlements with disfavor, Judge Popke heavily emphasized the "absolutely crucial . . . distinction" between Delaware and Michigan: the opt-out provision of MCR 3.501(A)(3), which preserves the interests of objecting shareholders by giving them the option, if they "don't like" the proposed settlement, to opt out and litigate their claims instead.[30] In addition, Judge Popke's decision in *Compuware* also went on to suggest that *Trulia* is a product of the peculiar circumstance of the Delaware Court of Chancery as a forum for much of the shareholder litigation that has proliferated in the last decade, rather than a fundamental attack on disclosure settlements in general.[31] As such, the *Trulia* test may simply be a necessary tool for separating the meritorious wheat from the frivolous chaff in Delaware's abundant field of shareholder litigation.[32] These same concerns do not animate Michigan's system, and thus the rule need not apply.

The impact of the *Trulia* decision on Michigan law governing disclosure settlements has yet to be determined.

Strategic Takeaway

In response to the growing volume of disclosure-only settlements in shareholder merger litigation, the Delaware Court of Chancery has been increasingly skeptical of the value of these disclosures and, in Chancellor Bouchard's recent *In re Trulia* decision, effectively denounced these settlements and articulated a higher standard of materiality instructing courts to carefully scrutinize the relative "give" and "get" between the corporation and its stockholders. Although it is unclear whether Michigan courts will follow Delaware's lead in evaluating proposed settlements, the only Michigan court to address the issue thus far has declined to do so. While *In re Trulia* appears to have led to a decline of class action shareholder lawsuit filings in Delaware,[33] disclosure-based settlements and, therefore, class action M&A litigation may very well still be alive and well in the future for Michigan.

NOTES

1. Matthew D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2015*, at 2 (Jan. 14, 2016), http://ssrn.com/abstract=2715890.

2. *See* Olga Koumrian, *Shareholder Litigation Involving Mergers and Acquisitions* 4 (2014), https://www.cornerstone.com/GetAttachment/73882c85-ea7b-4b3c-a75f-40830eab34b6/-Shareholder-Litigation-Involving-M-and-A-2013-Filings.pdf.

3. *See* Robert S. Reder & Lauren Messonnier Myers, *Delaware Chancery Court Resets the Rules of the Road for Disclosure-Only Settlements*, 69 Vand. L. Rev. En Banc 41, 43 (2016).

4. *See, e.g.*, *In re Riverbed Tech, Inc Stockholders Litig*, no 10484-VCG, 2015 Del Ch LEXIS 241 (Sept. 17, 2015); *In re Transatlantic Holdings, Inc Stockholders Litig*, No 6574-CS, 2013 Del Ch LEXIS 90 (Mar. 8, 2013).

5. 129 A3d 884 (Del Ch 2016).

6. *Id.* at 888.

7. *See id.* at 889–89.

8. *See id.* at 900.

9. *Id.* at 890.

10. *Id.* at 891 (internal quotation marks omitted).

11. *In re Trulia, Inc Stockholder Litig*,129 A3d 884, 892 (Del Ch 2016).

12. *See id.* at 892–96.

13. *See id.* at 896.

14. *See id.* at 896–97.

15. *Id.* at 898.

16. *Id.*

17. *See In re Trulia, Inc Stockholder Litig*, 129 A3d 884, 899 (Del Ch 2016).

18. *See In re Consumers Power Co Derivative Litig*, 132 FRD 455, 462 (ED Mich 1990).

19. MCR 3.501.

20. Del. Ch. R. 23.

21. MCR 3.501(A)(3).

22. *Henry v Dow Chem Co*, 484 Mich 483, 772 NW2d 301, 309 (2009); *Brenner v Marathon Oil Co*, 222 Mich App 128, 565 NW2d 1, 3 (1997) ("[I]n the absence of available Michigan precedents, we turn to federal cases construing the similar federal rule for guidance.")

23. *See Williams v Vukovich*, 720 F2d 909, 921–22 (6th Cir 1983).

24. *Poplar Creek Dev Co v Chesapeake Appalachia, LLC*, 636 F3d 235, 244 (6th Cir 2011).

25. *Brenner*, 565 NW2d at 3.

26. It remains to be seen whether corporations will decide to include include forum-selection provisions in their charters to avoid the adverse effects of the *Trulia* decision, as the Court of Chancery suggested they might.

27. 132 FRD at 462.

28. *In re Compuware Corp Stockholder Litig*, No 14-011437-CB, Tr. 60:4–60:7; 68:5–68:10, Mar 24, 2016.

29. Tr. 64:25–66:3.

30. Tr. 31:18–32:3.

31. Tr. 68:5–68:10.

32. *Id.*

33. "Shareholder Litigation Involving Acquisition of Public Companies: Review of 2015 and 1H 2016 M&A Litigation," Cornerstone Research, August 2, 2016, available at: https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-2016.

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Case Digests

Wells Fargo Bank, NA v SBC IV REO, LLC, No 328186, 2016 Mich App LEXIS 2217 (Nov 29, 2016)

In 2003, two tenants in common granted a mortgage to Option One Mortgage Corporation on property in Mackinac County, securing a $449,000 loan to the mortgagors under a promissory note. In 2004, the same mortgagors granted a $400,000 mortgage to Capitol to the same property encompassed by the first mortgage and partially secured a loan in excess of $1 million. In 2005, the two mortgagors granted another mortgage to Option One to the real property, securing a $520,000 loan. At the closing, $458,109 of the loan proceeds were used to pay off the entire balance on Option One's original mortgage, the mortgagors received the remaining $34,566 (after delinquent taxes and charges). After the closing on the Option One mortgage, one of the mortgagors conveyed his tenants-in-common interest in the property to the other mortgagor pursuant to a quitclaim deed. In 2009, American Home Mortgage Servicing, Inc., the successor-in-interest to Option One, mortgage was assigned to Wells Fargo. In 2013, Wells Fargo filed a quiet-title action against Capitol alleging that the Option One mortgage was superior. Wells Fargo asserted that Capitol's mortgage was satisfied but no discharge of mortgage was recorded. While this suit was pending, Capitol assigned its mortgage to SummitBridge Credit Investments IV, LLC, who later assigned it to SBC. During the foreclosure sale, all these issues came to a head.

Wells Fargo challenged a failure of a prior mortgage holder, Capitol, to discharge the mortgage and alleged that the doctrine of equitable subrogation gives Wells Fargo a senior lien on the property. The court held that because the mortgagors did not pay off or satisfy the prior mortgage, there was no effective and valid discharge of the mortgage and MCL 565.41(1) did not require that a discharge be recorded. The trial court therefore did not err regarding the counts premised on the discharge. As to the claims based on the doctrine of equitable subrogation, Wells Fargo is not entitled to equitable subrogation regarding the additional monies over the straight refinancing amount because it would result in prejudice to the prior mortgage holder. However, Wells Fargo was entitled to equitable subrogation concerning the amount other than new or additional money because there would be no resulting prejudice to the prior mortgage holder. In addition, the applicable statute of limitations for equitable subrogation, MCL 600.5801(4), is 15 years because it is part of a suit to determine an interest in real property under MCL 600.2932.

Stenzel v Best Buy Co, Inc, No 328804, 2016 Mich App LEXIS 2383 (Dec 22, 2016)

Paullett Stenzel purchased a Samsung refrigerator from Best Buy. When Best Buy installed the refrigerator, they connected the ice maker and water dispenser to the water line in the house. A few days later, Stenzel came home and noticed water all over the floor from the refrigerator that was spraying water through the dispenser. Stenzel contacted Best Buy and the employee told her to shut off the water line. Upon the employee's direction, Stenzel went into the crawl space in her house and shut off the line and found that the crawl space also had water leaking from the refrigerator. Stenzel took all of her towels and attempted to cover the surfaces where the water had been standing. She wrung out the towels in her sink and put some of the other towels in the laundry basket. Stenzel grabbed her laundry basket, dragging it on the floor, into her sunroom to hang the towels outside. After hangiung her towels outside, Stenzel came back inside to get more wet towels. While trying to drag her second laundry basket full of wet towels through her sunroom, she slipped and fell, causing her to break her leg and ankle. Stenzel noted that the floor in the sunroom was wet, but not sure if the water came from her foot or from the refrigerator leak.

Stenzel brought suit against Best Buy arguing negligence, breach of contract, and breach of warranty. She later amended her complaint to add Samsung as a party to the claims. The trial court granted summary disposition in favor of Best Buy and Samsung. Stenzel appealed. The Court of Appeals reversed its grant of summary disposition in favor of Stenzel, holding that but for Best Buy and Samsung's negligence, she would not have had water on either her feet or on the floor and she would not have fallen while cleaning it up. The court went further and found that Stenzel slipping and falling in the sunroom while cleaning up the water from a defective refrigerator is a foreseeable consequence. It did not break the chain of causation because the incident occurred in a different room than the refrigerator.

Additionally, the court declared a conflict with *Williams v Arbor Home, Inc*, 254 Mich App 439, 656 NW2d 873 (2002). *Williams* held that MCL 600.2957, read in conjunction with MCR 2.112, required leave of the court before an amended pleading adding a nonparty became effective. The court, finding the *Williams*' dissent compelling, argues that plaintiff Stenzel properly added Samsung as a party under the requirements of the court rule, not the statute, and her amended complaint was timely because it related back to the date of her original complaint against Best Buy. The court therefore requested the convening of a special conflict panel pursuant to MCR 7.215(J)(2).

Gillis v Miller, 845 F3d 677 (6th Cir 2017)

A jail administrator is responsible for the care and custody of the inmates. In the Bay County jail, there was a particular inmate that was suffering from severe halitosis. Since this inmate could not leave to see an outside dentist, Captain Troy Stewart, the Bay County jail administrator, had his wife, a dental assistant, prescribed a bottle of mouthwash. Captain Stewart picked up the prescription, took off his wife's name from the label and gave it to the inmate. The word spread quickly to all the other inmates and soon after, to the jail staff. Once word traveled to the

Sheriff's office, an initial investigation was ordered. The Bay County prosecutor reviewed the investigation report and declined to prosecute due to a lack of criminal intent.

Soon after, a second investigation was initiated. This investigation involved Sergeant Walraven, a supervising CFO at Bay County jail, and misconduct during night shifts. Sergeant Walraven was found on video footage engaging in unacceptable activities, such as using his cell phone, playing cards, damaging jail property, and not monitoring the video security cameras. During this investigation, Matthew Gillis, President of the Correctional Officers Union, started to receive complaints that the staff felt intimidated by the management's tactics. Gillis and Sergeant Walraven drafted a memorandum informing all the jail staff of their rights. After the memorandum was posted, there was a third investigation initiated against Gillis alleging sexual relations with an inmate. During the investigation of Gillis, he submitted a resignation letter. Gillis alleged that he was discharged in retaliation for engaging in protected speech and affiliating himself with the union.

The court ruled against the First Amendment retaliation claims of two correctional officers who argued that they were terminated for posting a memorandum about employees' right to union representation during an investigation of a drug trafficking incident in jail. In an issue of first impression in this circuit, the court found that the sheriff's department did not have to show actual disruption of jail operations by the posting of the memorandum. Under the *Pickering* balancing test, the department could reasonably believe that the posting of the memorandum may disrupt the operations within the jail.

ECM BioFilms, Inc v Federal Trade Comm'n, No 15-4339, 2017 US App LEXIS 4609 (6th Cir 2017)

ECM BioFilm sold an additive that claimed to accelerate the biodegradability of plastic products manufactured with the additive. Before 2009, ECM did not include any specific time frame but did relate the plastics' biodegradability to be similar to things like "wood or pieces of sticks." Due to market demands, ECM began to advertise its plastics as biodegradable in a "landfill" within nine months to five years. The Federal Trade Commission (FTC) was disputing: the scientific validity of the claims, the rate of biodegradation of ECM plastics after customary disposal; and whether consumers interpret these unqualified claims to mean the whole product would decompose into elements found in nature within ta reasonably short period of time. Relying on two consumer surveys, the FTC found that ECM's unqualified claim of biodegradability was falsely conveyed to a significant majority of consumers.

The FTC held that the advertised claims were misleading as there was no reference to a correct time frame and was intentionally vague. Specifically, under section 260.8(c), "'[i]t is deceptive to make an unqualified degradable claim for items entering the solid waste stream if the items do not completely decompose *within one year* after customary disposal.'" The evidence supported the claim that ECM plastic completely biodegraded *within five years*. The court affirmed the FTC's holding that ECM's claims were false and misleading under section 5 of the Federal Tax Act.

ECM further argued that the FTC violated its due process rights. ECM believed that they did not know that the FTC was interpreting the claim of biodegradability within a "reasonably short period of time" as a claim to mean within five years after disposal. ECM alleged that they lacked "fair notice and an opportunity to develop facts to support its defense on that point." The court found that the complaint provided ECM with adequate notice to prepare a defense. It was unnecessary for the complaint to specifically state that the FTC was interpreting the claim within the specific time frame of five years. ECM's petition to review the case was denied.

I*BEW Local No 58 Annuity Fund v EveryWare Global Inc*, 849 F3d 325 (6th Cir 2017)

Investors sued a now-bankrupt EveryWare's officers, directors, and shareholders under the Securities Exchange Act and the Securities Act. The investors who purchased EveryWare securities from 2013 to 2014 argued there was a "pump and dump" scheme by EveryWare's upper management to inflate the prices of the shares and then sell these shares before the prices plummeted.

The investors alleged: 1) EveryWare's CEO released financial projections that he knew were false and misleading; the CEO and CFO falsely informed investors of these knowingly inaccurate financial projections with the intent to "deceive, manipulate, or defraud, that EveryWare was on track to meet its projections"; and the underwriters and the directors failed to disclose material downward trends in the business. The court affirmed the lower court by holding that the investors failed to establish scienter and failed to state a legitimate violation of section 10(b) of the Securities Exchange Act or SEC Rule 10b-5.

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(vol 30 and succeeding issues)*

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CUMULATIVE INDEX

The cumulative index for volumes 16 to volume 36 No 1 may be found online at the Business Law Section's website (http://connect.michbar.org/businesslaw/newsletter). The index in this issue is cumulative from volume 30 No 1 (Spring 2010).

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BUSINESS LAW SECTION
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Published in cooperation with
The Institute of Continuing
Legal Education
Kanika S. Ferency
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Copy and Production Editor

SECTION CALENDAR

Council Meetings

DATE	TIME	LOCATION
June 6, 2017	3:30 p.m.	Bloomfield Hills, MI