Country Guide
USA - Michigan

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Chapter 1 - Forms for Carrying on Business

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1.1 SOLE PROPRIETORSHIPS

The term "sole proprietorship" refers to a business engaged in by an individual that is not formally organized as a business entity. It is not governed by specific statutes relating to organization, and there are no formalities to be observed in organizing a sole proprietorship. A sole proprietorship that wishes to conduct business under a specific assumed name, however, must make a filing in the county of its location to establish and safeguard its right to use that name.

Management of a sole proprietorship is in the sole discretion of the owner. There are no requirements as to meeting or recordkeeping like those that apply to corporations, partnerships, or limited liability companies, and there is no requirement for any filings with the state.

Sole proprietorships, like other businesses, are responsible for withholding of taxes from employees and are subject to Michigan Corporate Income Tax. A tax advisor should be consulted regarding tax issues.

A sole proprietorship is essentially indistinguishable from its owner. As a result, the owner is subject to unlimited personal liability for all of the debts and obligations of the business. This may include contractual liabilities, liability for torts or other wrongdoing committed by the business or its employees, and liability for withholding or other taxes.

Since a sole proprietorship is not formally organized, a sale or transfer of the business is accomplished simply by selling or transferring the assets involved in the business. The agreement of sale will determine whether the purchaser assumes responsibility for any of the debts or obligations of the business. In the absence of an express assumption by the purchaser, no liabilities would be assumed.

A sole proprietorship terminates on the death or retirement of the proprietor. There are no formalities for dissolution or winding up of the business.

1.2 BUSINESS CORPORATIONS

a. Introduction

The corporate form is an extremely popular vehicle for the conduct of business, primarily because of the protection it affords its owners from liability for corporate obligations. A corporation is considered a separate legal "person," and absent extraordinary circumstances, the owners of a corporation are not responsible to pay the debts and obligations of the corporation from their personal resources. The Michigan Business Corporation Act, which governs the formation and operation of corporations in Michigan, is a modern statute designed to streamline the requirements for conducting business as a corporation. It is continually reviewed and frequently amended to keep pace with the emerging needs of businesses and trends in corporate law.

b. Formation

One or more persons may form a corporation by filing Articles of Incorporation with the Corporations Division of the Bureau of Commercial Services of the Department of Licensing and Regulatory Affairs. The incorporators need not be shareholders, officers, or directors of the corporation. The corporation's existence begins at the time the Articles of Incorporation are filed. The fee for filing Articles of Incorporation is based in part on the number of shares authorized in the Articles. The minimum filing fee is $60.00.

The Articles of Incorporation must contain the following information:

1. The name of the corporation. The name must contain the words "Corporation," "Company," "Incorporated," or "Limited," or an abbreviation of one of those words. The name must not be confusingly similar with the name of an existing domestic or

foreign corporation, nonprofit corporation, limited partnership, or limited liability company, or with a name which has been reserved or assumed by another entity. Certain words implying banking or insurance activities are also not permitted; banking and insurance companies must be formed under separate statutes. The right to use a corporate name may be reserved by filing an application to reserve a name which is available for use. The reservation is good for six calendar months and may be extended upon expiration;

2. The purpose for which the corporation is formed. The Articles may simply state that the corporation is formed to engage in any activity for which a corporation may be formed under the Michigan Business Corporation Act; this language provides the broadest possible authority;

3. The aggregate number of shares that the corporation is authorized to issue. A corporation may not issue more than the number of shares authorized in its Articles of Incorporation without amending its Articles to authorize the additional shares. Michigan has eliminated the concept of "par value" for shares, and therefore, unlike many other jurisdictions, the Articles of a Michigan corporation need not designate a par value for shares;

4. If the shares are to be divided into separate classes or series, the Articles must detail the designation of each class and series; the number of shares contained in each; and the relative rights, preferences and limitations of each;

5. The street address, and the mailing address if different from the street address, of the corporation's initial registered office and the name of the corporation's initial resident agent at that address;

The corporation must maintain a registered office in Michigan and must also maintain a resident agent at that address. The registered office may be the same as the corporation's business office within the state or may be a different address. The resident agent may be served with service of process in any legal proceedings brought against the corporation. Commercial organizations exist in Michigan, as in many other states, which will agree to serve as a registered agent and to provide a registered office both for domestic corporations and foreign corporations that are authorized to transact business in Michigan (which is discussed further below at "BUSINESS CORPORATIONS – Foreign Corporations").

6. The names and address of the incorporators;

7. The duration of the corporation, if other than perpetual. If no other duration is specified, the corporation's duration will be perpetual; and

8. The Articles of Incorporation may contain other provisions in addition to this required information.

After filing and once the corporation has been organized, the Articles of Incorporation may only be amended upon approval of the amendment by the board of directors and shareholders. Shareholder approval requires the affirmative vote of a majority of all outstanding shares entitled to vote and the approval of a majority of the shares of any class entitled to vote separately as class. A class of shares will be entitled to vote as a class on an amendment, even if the class is not otherwise entitled to vote as a class or entitled to vote at all, if the amendment would increase or decrease the aggregate number of authorized shares of the class, or alter or change the powers, preferences or special rights of the shares of the class or other classes so as to affect the class adversely.

c. Organization

The Articles of Incorporation provide, in broad outline, the fundamental structure and rules governing the corporate existence. More detailed and routine matters are set out in the corporation Bylaws, which unlike the Articles of Incorporation are not filed with any state office. Initial Bylaws of the corporation may be adopted by its incorporators or by its initial Board of Directors. The Bylaws will customarily determine the number of directors that the corporation will have; the officers that the corporation will have and their respective duties;

the time and manner of convening meetings of shareholders and directors; and miscellaneous organizational matters, such as the form of corporate share certificates and the fiscal year of the corporation. The Bylaws may also contain provisions relating to the indemnification of directors and officers for liabilities incurred in connection with their positions (although these matters may also be included in the Articles of Incorporation).

d. Capitalization

A corporation will normally raise its initial capital, and often will raise additional capital from time to time, by the sale of its securities to investors. These securities normally include equity securities, such as common or preferred stock, or debt securities, such as notes or debentures. The issuance of securities to investors is regulated both by United States law and by Michigan law, and care must be taken to avoid violation of the complex provisions of these laws.

The Board of Directors normally must authorize the issuance of shares. Shares may be issued for any tangible or intangible property or benefit to the corporation, including cash, promissory notes, services already performed, services to be performed in the future, or other securities of the corporation. The determination of the adequacy of consideration received for shares is made by the Board of Directors, and when such consideration has been received, the shares are considered to be fully paid and nonassessable.

Shareholders of Michigan corporations formed after 1973 do not have pre-emptive rights to acquire a prorata share of newly issued shares unless that right is specifically granted in the Articles of Incorporation. This means that the Board of Directors normally may issue shares to any party it deems appropriate free of any claims of existing shareholders.

e. Management

i. General

The business and affairs of a corporation are managed by its Board of Directors. Corporations may have as few as one director. The number of directors, or the manner of determining the number, is normally fixed in the Bylaws. It is not unusual for corporate Bylaws to provide that the number of directors may be established from time to time either by the Board itself, the shareholders or both, often within certain prescribed minimum and maximum numbers. The directors of a corporation are elected by its shareholders, normally by a plurality vote of shareholders present at a shareholders meeting. However, a corporation may elect to implement cumulative voting, in which shareholders may apportion their votes among director candidates in any manner they choose. This device can enable minority shareholders to obtain representation on the Board of Directors. Cumulative voting is not available unless authorized in the corporation’s Articles of Incorporation.

Some states have added provisions to their corporation laws to facilitate majority election of directors, under which a person may not be elected if the number of votes cast against his or her election exceeds the number cast in favor of election. Usually, these statutory provisions are intended expressly to authorize and make enforceable mandatory resignation requirements for incumbent directors that fail to garner sufficient votes. The Michigan Business Corporation Act does not contain such provisions, but there is nothing in the statute that would prohibit a corporation from adopting such an arrangement. Whether a mandatory resignation provision would be enforced has not been addressed by Michigan courts.

Directors normally serve for a term of one year. However, a corporation may elect to implement a classified, or “staggered,” Board, which divides the Directors into classes and provides for their election on a rotating basis, with only a portion elected each year.

The day-to-day affairs of the corporation are supervised by its officers. A corporation must have a President, a Secretary, and a Treasurer and may also have a Chairman of the Board, one or more Vice Presidents and such other officers as the Bylaws may prescribe or the Board may determine. Normally, the officers of a corporation are appointed by its Board of Directors. One individual may hold more than one office at the same time under Michigan law.

A Director or officer must discharge his or her duties to the corporation and its shareholders in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner he or she reasonably believes to be in the corporation's best interest. Directors and officers may be liable to the corporation for violating these duties, although a corporation may include in its Articles of Incorporation a provision eliminating or limiting the monetary liability of Directors to the corporation and its shareholders for breach of their duty under certain circumstances. Liability may not be eliminated, for intentional infliction of harm on the corporation or the shareholders, for the amount of a financial benefit received by a director to which he or she is not entitled, for a distribution made in violation of the restrictions of the Business Corporation Act, or for an intentional criminal act.

ii. Section 488

Section 488 of the Business Corporation Act permits closely held corporations to be governed by numerous provisions that otherwise are not permissible for corporations. Section 488 is not available to a corporation if its shares are listed on a national securities exchange or regularly traded in a market maintained by one or more members of a national or affiliated securities association. Among types of provisions authorized by Section 488 are the following:

1. Unequal distribution rights within a class (although this would not be permitted to Subchapter S corporations);

2. The identity of the board and/or the manner of selecting board members;

3. Use of director proxies and weighted voting among directors;

4. Provisions governing the exercise or division of voting powers among shareholders and providing weighted voting rights between class of shares or within the same class of shares, whether in general or with regard to specific matters;

5. Requirements that the corporation be dissolved on the request of one or more shareholders or upon occurrence of certain events; and

6. Delegation to shareholders or other persons of powers normally reserved for the Board, including the right to break deadlocks.

Section 488 provisions must be set forth in a provision of the Articles of Incorporation or Bylaws approved by all persons who are shareholders at the time of adoption, or in a written agreement signed by all persons who are shareholders at the time of the agreement and made known to the corporation. Any amendment to such provisions, whether set forth in the Articles of Incorporation or Bylaws or a separate written agreement, must be approved by all shareholders, unless the original agreement provides otherwise. Section 488 provisions must be conspicuously noted on share certificates and persons who become shareholders without knowledge of such restrictions are entitled to rescind their purchase.

f. Action by Directors and Shareholders

Directors normally act at a meeting of the Board of Directors. Such meetings may be regular meetings or special meetings. If the time for regular meetings is specified in the Articles or Bylaws, no notice of the meeting need be given to the Directors. Special meetings may be called with the amount of notice designated in the Bylaws.

In order to transact business at a meeting, a quorum of Directors must be present. Unless the Articles or Bylaws provide otherwise, a majority of the Directors then in office constitute a quorum. The Articles or Bylaws may provide for a greater or lesser number, without limitation. The vote of a majority of Directors present at a meeting at which a quorum is present constitutes the action of the Board. Directors may attend a meeting in person or be present by conference telephone call or other remote communications equipment, so long as all participants can communicate with all other participants. Directors may also act without a meeting by unanimous written consent.

The Board of Directors may also appoint committees from among its members to act on behalf of the Board. A committee may be empowered by the Board to do most of the things which the Board itself may do, although certain powers may not be delegated to committees.

Shareholders also normally act at meetings. The corporation must hold a meeting of shareholders at least annually for the election of Directors, unless that action is taken by written consent of shareholders as described below. Shareholders must receive not less than ten nor more than sixty days written notice of an annual or special meeting of shareholders. The Board of Directors normally will fix a record date to determine which shareholders are entitled to receive notice of and to attend and vote at the meeting. The Michigan Business Corporation Act provides a mechanism for determining the record date if the Board of Directors fails to fix one. The Act permits corporations to deliver a single notice, report, or statement to shareholders sharing a common address, rather than being required to deliver separate notices to each holder, if the holders consent or do not object to the corporation's notice of its intent to engage in the practice.

A quorum of shareholders must be present to convene a shareholders meeting. Unless provided otherwise by the Articles or Bylaws, a quorum will consist of shareholders holding not less than a majority of the outstanding shares entitled to vote at the meeting. The Articles, or a Bylaw adopted by the shareholders or the original incorporators, may provide for a greater or lesser quorum without limitation. A shareholder may attend a meeting in person or by proxy and may also participate by conference telephone or similar communication equipment, provided that all participants can hear all others.

Shareholder action may normally be taken by affirmative vote of a majority of the shares represented at a meeting at which a quorum is present. However, Directors are normally elected by a plurality of the votes cast (although, in a cumulative voting system, as discussed above, minority shareholders may be able to elect Directors). As noted earlier, some states have added provisions to their corporation laws intended specifically to facilitate majority approval requirements for director elections, although Michigan has not. See "BUSINESS CORPORATIONS – Management"). Additionally, under the Michigan Business Corporation Act, certain actions require the approval of a majority of all shares entitled to vote, whether or not present at the meeting. These actions include amendments of the Articles of Incorporation, approval of a merger, share exchange, conversion to a different form of business organization, sale of all or substantially all of the assets of the corporation, or dissolution. Finally, the Articles of Incorporation may impose higher voting requirements for all or some action.

Shareholders may attend and vote at a meeting in person or by proxy. A proxy may confer general or specific authority to vote. For most publicly-held companies, solicitation of proxies from shareholders is regulated by Federal securities laws. Under certain circumstances described in the Business Corporation Act, a proxy that is entitled "irrevocable proxy" and which states that it is irrevocable will be irrevocable. Otherwise, a proxy is revocable at the election of the shareholder giving it.

Any action that may be taken at a shareholders meeting may also be taken without a meeting if all shareholders sign a written consent to the action. In addition, the Articles of Incorporation may contain a provision that allows action to be taken without a meeting upon the written consent of holders of the number of shares that would be sufficient to take the action at a shareholders meeting at which all voting shares were present and voted; when such action is taken, written notice must be promptly delivered to those shareholders entitled to notice who have not consented to the action.

g. Distributions to Shareholders

Under the Michigan Business Corporation Act, any direct or indirect transfer of money or other property (except the corporation's shares) or incurrence of indebtedness by the corporation, to or for the benefit of its shareholders in respect of their shares, is deemed to be a "distribution." This includes dividends to shareholders as well as the repurchase of shares from shareholders. As mentioned above, in Michigan, the concept of "par value" for shares has been eliminated, as has the corresponding concept of "surplus" as a source for the payment of dividends and making of other distributions to shareholders. Under the Michigan provisions, a corporation may not make a distribution to its shareholders unless, after the distribution, each of the following tests can be satisfied:

1. The corporation can pay its debts as they become due in the usual course of business, and

2. The corporation's total assets are greater than the sum of (i) its total liabilities plus (ii) the amount that would be needed upon dissolution to satisfy the preferential rights of any shares with rights superior to the shares receiving the distribution.

The Board must determine whether the tests are satisfied. The Board may base the determination either on financial statements prepared on the basis of reasonable accounting practices and principles or upon a fair valuation or other reasonable method.

Except for corporations that make an election under Subchapter S of the Internal Revenue Code, a corporation is taxed on any earnings before they are distributed to shareholders. Once received by shareholders, these earnings are then taxed at that person's applicable individual rate. Therefore, unless a corporation is an S corporation, the earnings of a corporation are subject to "double taxation."

h. Liability of Shareholders

As noted above, shareholders enjoy protection from personal liability for the obligations of a corporation. However, under certain extraordinary circumstances, a court of equity may elect to "pierce the veil" of a corporation to impose certain personal liability upon shareholders for corporate obligations. Although this practice is rare, among the factors which might lead a court to pierce the veil are the failure to observe corporate formalities (such as keeping corporate records, electing Directors and officers, holding meetings or taking action by written consent) and the commingling of corporate and noncorporate funds and assets. For this reason, it is important, once a corporation is formed, to observe scrupulously the formalities of corporate existence.

i. Extraordinary Transactions

Certain extraordinary transactions involving corporations, including mergers, share exchanges, conversion to a different form of business organization, sales of all or substantially all assets outside the ordinary course of business and voluntary dissolution, require, in addition to Board of Director approval, approval of the corporation's shareholders. In addition, shareholders who object to such transactions and who do not vote in favor of them may, under certain circumstances, elect to dissent from the transaction and, by following detailed procedures set forth in the Business Corporation Act, demand to be paid the fair value of their shares. Normally, however, shareholders may not dissent from a transaction in which they would receive only cash or publicly traded shares, or some combination thereof.

j. Foreign Corporations

A corporation formed under the laws of another jurisdiction but which transacts business in Michigan must apply for a Certificate of Authority to Transact Business in Michigan. The concept of "transacting business" is not a precise one, although the Act provides that certain actions (such as holding meetings within the state, maintaining a bank account or borrowing money, or affecting sales through independent contractors) will not by themselves constitute the transaction of business. Failure to procure a Certificate of Authority when required will prevent a corporation from maintaining an action or proceeding in any court of the state until the Certificate is obtained and may lead to the imposition of a monetary penalty.

An application for a Certificate of Authority is filed with the Corporations Division of the Bureau of Commercial Services of the Department of Licensing and Regulatory Affairs. The application must include the name of the corporation and the jurisdiction of its incorporation; the date of incorporation and the period of the corporation's duration; the street address and mailing address, if different, of its main business or headquarters office; the address of its registered office in Michigan and the name of its resident agent in Michigan; the character of the business it is to transact in the state; and a statement that it is authorized to transact such business in its jurisdiction of incorporation. It also must be accompanied by a certificate of good standing from the corporation's jurisdiction of organization dated not earlier than thirty days prior to the filing of the application.

A foreign corporation that procures a Certificate of Authority will be subject to Michigan Corporate Income Tax on the portion of its activities allocable to Michigan and will also be required to pay a filing fee based on the number of shares attributable to Michigan. When the number of shares attributable to Michigan increases (through an increase in the number of authorized shares, a change in the allocated percentage or both), an additional fee is required. A tax advisor should be consulted regarding tax issues.

k. Filing and Recordkeeping

In addition to filing its Articles of Incorporation with the Corporations Division, a corporation must also file a certificate whenever its Articles of Incorporation are amended, whenever it changes its registered agent or registered office, and whenever it engages in a merger or share exchange transaction or conversion to a different form of business organization. Each Michigan corporation, and each foreign corporation authorized to transact business in Michigan, must file a Corporation Information Update with the Corporations Division no later than May 15 of each year. The Update contains certain limited information about the corporation. Failure of a Michigan corporation to file an Update that continues for two years past the due date of the update will cause the automatic dissolution of the corporation, although any corporation so dissolved may be reinstated upon filing of delinquent reports and paying of fees and penalties required by statute. Failure of a foreign corporation authorized to transact business in Michigan to file the Update that continues for one year past the due date will lead to revocation of the Certificate of Authority, if the failure is not cured within 90 days after receipt of notice from the Corporations Division of the Bureau of Commercial Services.

l. Subchapter S Corporations

For United States income tax purposes, corporations may be one of two types: a “C” corporation, which is the typical corporate form and contains all the characteristics detailed above, or an “S” corporation. An S corporation is taxed like a partnership. It does not pay corporate income tax, but its shareholders pay tax on their pro rata share of corporate earnings, regardless of whether those earnings are actually distributed to them. There are strict guidelines that must be followed to qualify as an S corporation. The entity must have been created or organized in the United States, have 100 shareholders or less, all of whom are either natural persons who are U.S. residents, the estate of natural persons or certain trusts (there are rules permitting some family members to be treated as a single shareholder). An S corporation may issue only one class of stock; a “class” of stock for this purpose is determined by economic rights, so the rule is not violated by classes that have different voting rights but identical economic rights. A corporation can become an S corporation if it meets all the criteria and completes an IRS election form, which must be approved by all of the shareholders.

1.3 NONPROFIT CORPORATIONS

a. Introduction

Nonprofit corporations in Michigan are most often governed by the 1982 Nonprofit Corporation Act, which was the first comprehensive statute governing nonprofit corporations in Michigan. Before 1982, nonprofit organizations were governed by special purpose statutes (such as those governing churches of particular denominations), by the old General Corporation Act or the newer Business Corporation Act, or by a combination of those statutes.

In some circumstances, prior special purpose statutes still govern some nonprofit organizations, including certain lodges, fraternal organizations, and religious organizations. These special purpose laws are outside the scope of this commentary.

In addition, a nonprofit organization can be formed as a trust, rather than a nonprofit corporation, but a review of nonprofit trust law is also outside the scope of this commentary. The modern trend is toward the use of corporations, rather than trusts, for nonprofit organizations; and this trend is reinforced by liability limitation provisions available to nonprofit corporations.

b. Formation

A nonprofit corporation is formed by filing Articles of Incorporation with the Corporations Division of the Bureau of Commercial Services of the Michigan Department of Licensing and Regulatory Affairs. The filing fee is $20.00. These Articles must include the following information:

1. Name of the corporation. Unlike business corporations, nonprofit corporations are <u>not</u> required to use “incorporated,” “corporation,” “company” or “limited” in their names, although they may if they wish. The word “foundation” can only be used for organizations receiving and administering funds. Names that imply educational purposes may result in the Corporations Division requiring approval from the Michigan Department of Education before accepting the Articles for filing.

2. Description of specific purposes. Unlike business corporations, nonprofit corporations cannot use a general “any lawful purpose” statement but must describe a specific purpose. The Corporations Division will still accept Articles for filing with a broad statement of purposes, but certain language is necessary to obtain Internal Revenue Service tax exemption (such as no political activity; no private inurement; distribution of assets on dissolution). As a result, it is best to draft the purposes statement with the IRS requirements in mind, even though these are not required under Michigan law.

3. Description of the type of corporate structure. In order to provide flexibility in the control and management of nonprofit organizations, the Nonprofit Corporation Act provides not only for stock corporations similar in structure to business corporations but also for membership organizations and directorship corporations controlled by their boards (without members or shareholders). In a directorship corporation, the directors themselves elect all directors. In a stock or membership corporation, stockholders or members elect directors (similar to business corporations).

4. In a nonstock corporation (membership or directorship), the Articles must describe the type and value of real and personal property (if any) owned at the time of organization and state a plan of financing (in general terms).

5. Designation of registered agent and registered address for the corporation.

6. Name and address of at least one incorporator.

7. Duration of nonprofit corporation. Unless stated otherwise in the Articles of Incorporation, a Michigan nonprofit corporation has perpetual life.

The Articles may contain other provisions in addition to the required information.

c. Organization

As with business corporations, the Articles of Incorporation of a nonprofit corporation address broad structural matters, with more routine and detailed matters addressed in the Bylaws. The incorporator or the first board of directors of the corporation may adopt Bylaws. These will address matters such as annual and special meetings; fiscal year; member or shareholder requirements (for membership or stock nonprofits only); number of directors; method of electing directors; director’s terms; structure of board and committees; indemnification provisions; and officers’ positions and duties.

d. Capitalization and Distributions

The provisions regarding nonprofit corporations' capitalization and distributions are the areas where the Nonprofit Corporation Act differs most from the Business Corporation Act.

i. Capitalization

The capitalization of a nonprofit corporation depends on the type of structure chosen.

1. Nonprofit stock corporations may sell stock in a fashion somewhat similar to that of business corporations, but the substantial 1989 amendments to the capital structure and corporate finance provisions of the Business Corporation Act have yet to be added to the Nonprofit Corporation Act.

2. Nonprofit membership corporations may sell membership interests and subscriptions, and issue membership certificates, in a fashion similar to the sale of shares by a nonprofit stock corporation.

3. Nonprofit directorship corporations do not have the ability to sell interests or subscriptions in the same fashion. Generally, nonprofit directorship corporations are

formed and then seek funding through gifts, grants, contributions, or income-generating activities, although this may also be true of stock or membership corporations.

ii. Distributions

Nonprofit corporations are restricted in their ability to make distributions to shareholders or members. Although nonprofit corporations always have the power to pay reasonable compensation to employees, and reasonable fees for goods or service, they may not make any distributions except in conformity with their stated purposes.

Generally, a nonprofit corporation may not pay dividends or make distributions (on an ongoing basis or in liquidation), unless its purposes include providing member or shareholder benefits or a provision for redemption of shares is made pursuant to particular sections of the Nonprofit Corporation Act. Under no circumstances can assets held for charitable purposes be used, conveyed, or distributed for any other purpose.

Note that the IRS private inurement rules impose significant limitations on distributions by certain tax exempt organizations; these must be considered in addition to state law requirements.

e. Management and Control

The management and control of nonprofit corporations under the Nonprofit Corporation Act is essentially similar to that of business corporations under the Business Corporation Act. Some notable differences include:

i. Directors

As indicated above, one form of organization is a directorship corporation. In this type of nonprofit corporation, the Directors themselves elect the Directors. In a stock or membership nonprofit corporation, the shareholders or members elect the Directors. A Michigan nonprofit corporation must have at least three directors.

ii. Quorum

Although a quorum is generally a majority of the Board of Directors, any nonprofit corporation with seven or more Directors may specify a lower percentage for a quorum, although in no event lower than one-third of the Directors in office.

iii. Members

A nonprofit membership corporation may place provisions in its Articles or Bylaws relating to membership qualification, member voting, membership transferability, classes of members, and several other types of provisions.

iv. Liability Protection

The Nonprofit Corporation Act permits limitation of liability in certain circumstances. In each case, language must be included in the Articles of Incorporation in order for the protection to be effective. These protections may include the following:

1. Non-liability for breach of fiduciary duty by volunteer Directors or volunteer officers. A volunteer director is one who does not receive anything of more than nominal value from the corporation for serving as a director, other than reasonable per diem compensation and reimbursement for actual, reasonable, and necessary expenses incurred in his or her capacity as a director. If this protection is in place, volunteer Directors cannot be liable to the corporation, its members, or its shareholders. This type of liability protection is essentially a counterpart to that which can be provided to directors of business corporations, although the limitations are worded differently. Under the Nonprofit Corporation Act, liability cannot be eliminated or limited for a

breach of the director's or officer's duty of loyalty, for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, for a distribution made in violation of the restrictions of the Nonprofit Corporation Act, for a transaction from which the director or officer derived an improper personal benefit or an act or omission that is grossly negligent. In addition, liability cannot be limited retroactively for acts occurring before adoption of the limitation.

2. Assumption of liability of volunteer Directors to third parties by the corporation. If this protection is in place, volunteer Directors will be relieved of liability to outsiders, and the corporation itself will assume that liability. This type of protection is available only to charities exempt under Internal Revenue Code section 501(c)(3). There is no corresponding protection for directors of business corporations.

3. Liability limitation for other (nondirector) volunteers. If this protection is in place, volunteers will not be liable for acts performed for the nonprofit corporation (with some exceptions, such as bad faith, gross negligence, willful or wanton misconduct, intentional torts, and automobile accidents). The corporation assumes such liability. Nonprofit organizations which depend heavily on volunteer efforts may wish to consider whether such a provision would help attract volunteers.

v. Recordkeeping

Nonprofit corporations must file an annual Corporate Information Update (with a $20 fee) with the Corporations Division of the Bureau of Commercial Services (in October of each year) to remain in good standing. The form for this report is automatically mailed to the registered agent for the corporation by the Corporations Division in advance of the filing deadline.

f. State and Local Tax Requirements

i. Michigan Corporate Income Tax; Income Taxes

Generally, nonprofit corporations that are exempt from federal income taxation are exempt from Michigan Corporate Income Tax and from local corporate income taxes in the cities that have such taxes in Michigan except with respect to the organization's unrelated business taxable income.

ii. Michigan Sales and Use Tax

Nonprofit corporations that are tax-exempt under Internal Revenue Code Section 501(c)(3) (generally charitable organizations) or (c)(4) (civic leagues or similar organizations) are exempt from the sales and use tax on purchases. The Michigan Treasury Department will not issue separate sales/use tax exemption rulings to such organizations, which should instead provide copies of their IRS determination letter to vendors to document the exemption.

With certain exceptions including de minimis sales, there is generally no exemption for collection of sale/use tax on items sold by a nonprofit corporation.

iii. Employment Taxes

Nonprofit corporations that expect to have employees must register with the Michigan Department of Treasury (for employee wage withholding) and the Michigan Employment Security Commission (for unemployment taxes).

iv. Real Property Taxes

Certain, but not all, nonprofit corporations may be able to obtain exemption from local property taxes for real property used for their nonprofit purposes (e.g., charitable organizations using property for charitable purposes). This requires separate applications, review, and approval by local government property tax officials.

g. Michigan Attorney General Registration

Nonprofit corporations are regulated in several ways by the Michigan Attorney General's Charitable Trust Section.

i. Charitable Trust Registration

Every charitable organization must register with the Attorney General. Most of the information required for this registration is similar to that needed for the federal income exemption application (Form 1023), and thus, it can be prepared in connection with such exemption application but filed after Federal tax exempt status is granted.

ii. Charitable Trust Inventory

The charity must furnish to the Attorney General a description and value of its assets.

iii. Application for License to Solicit Donations

Charities that intend to solicit contributions over $25,000 per year, or that use professional fundraisers, must file for a license. The application requires information on expenses by program category and supplemental disclosure if professional fund-raisers are used.

iv. Annual Reports

Charities must file annual reports with the Attorney General. Note that this is different than (and in addition to) the corporate annual Update required to be filed with the Bureau of Commercial Services. In most cases, the filing with the Attorney General can be satisfied with a copy of the Form 990 filed by the charity with the Internal Revenue Service.

v. Merger or Dissolution

Generally, the Attorney General must approve the merger or dissolution plan of a charitable organization.

h. Bureau of State Lottery

This agency regulates raffles, bingo games, and other such charitable fundraisers. A separate application must be made to obtain a license for each such fundraising event – allow six to eight weeks lead time.

i. Federal Tax Exemption Requirements and Classification

Nonprofit corporations may fall into one of a number of classifications for federal income tax or may not be exempt from federal income tax. Federal income tax exemption is separate from state law nonprofit status. A nonprofit corporation is not automatically exempt from federal income tax and must apply for exemption to the IRS.

IRC Section 501(c)(3) governs entities organized and operated exclusively for charitable and other similar purposes. Section 501(c)(3) organizations are further classified as either private foundations or public charities.

Public charity status is generally subject to fewer IRS restrictions. To qualify as a public charity, a corporation must show a broad form of public support (i.e., contributions, gifts, and grants from the general public, excluding insider contributions, income from exempt function activities, and limited income from investments).

Private foundations are subject to additional regulations on operations, grants, and investments. A private foundation is not completely exempt from federal income tax because it is subject to tax on its investment income.

Numerous other Section 501(c) categories govern other types of exempt organizations and, thus, may be applicable to nonprofit corporations.

Form 1023 or 1024 must be filed by most nonprofit corporations to apply for recognition of exemption.

i. Annual IRS Returns

Nonprofit corporations must submit annual filings to keep their exempt status (depending on revenue, Form 990, 990-EZ, or 990-N).

ii. Various Restrictions on Exempt Organizations; Unrelated Business Income Tax

Depending on the classification of the exempt organization, it may be subject to a number of other IRS restrictions, such as a prohibition on private inurement, prohibitions on political activity, and taxation of income from unrelated business activities.

1.4 PARTNERSHIPS

Michigan law recognizes several forms of unincorporated business associations including partnerships. There are three kinds of partnerships recognized in Michigan: general partnerships, limited liability partnerships, and limited partnerships.

a. General Partnerships

Michigan has adopted the Uniform Partnership Act, which has also been adopted by numerous other states. Under this Act, a partnership is defined as an association of two or more persons to carry on as co-owners of a business for profit. That does not mean, however, that all business relationships between co-owners constitute partnerships. “Joint adventures” or “joint ventures,” which are associations to carry out a single project for profit, exist under Michigan law and do not constitute partnerships.

i. Organizational Concerns

Creation of a partnership in Michigan requires very few formal steps. A written agreement is not required, but the partnership is required to file a Certificate of Co-Partnership with the county clerk in the county in which it is located or intends to transact business. Prior to selecting a name, a name search should be conducted in each county in which the partnership is required to file a certificate so that the partnership can be certain that its choice of name is available. The Certificate of Co-Partnership must be signed by one partner and identify the names and addresses of all the co-partners, the name of the partnership, its business location, and the term of the partnership’s existence.

Although a partnership can be created without a written document, the parties’ interests will best be served if their intention to form a partnership and the corresponding business relationship is clearly stated in a partnership agreement. In the absence of a written agreement, however, acts and conduct of the parties are an appropriate test to determine whether a partnership was intended.

ii. Capital of the Partnership

Customarily, the written partnership agreement addresses the amount of capital to be contributed to the partnership by the various partners. Contributions of capital may be made in cash, property, or in-kind services. Partnerships may also borrow capital from partners or others. Loans from a partner to the partnership should be clearly documented as such to avoid treatment as a capital contribution. Because the partners are jointly liable for the partnership’s debts in the event it cannot repay them, partnership agreements usually contain a provision limiting the ability of the partnership to borrow funds or requiring the approval of all or a majority of the partners to do so.

iii. Management; Authority

Under Michigan law, the act of every partner, which apparently carries on in the usual way the business of the partnership, binds the partnership, unless the partner actually has no such authority and the person with whom the partner is dealing is aware of the fact that he or she has no such authority.

Because each partner is financially responsible for the debts of the partnership in the event that it is unable to pay them, it is not uncommon to appoint a managing partner and to limit the authority of partners other than the managing partner. Third parties who are unaware of the limitations on authority, however, are not bound by them and may conduct business with any partner on behalf of the partnership.

Under Michigan law, the partnership is bound by any admission or representation made by any partner within the scope of his or her authority. Further, the knowledge of a partner on any matter relating to partnership affairs may be attributed to the partnership and the other partners. In addition, any wrongful act or omission of any partner acting in the ordinary course of business of the partnership, which results in injury or loss to any person, is the responsibility of the partnership.

Partnership agreements frequently address the conduct of the partnership's business outside of the usual or ordinary course. This includes capital acquisitions, entering into a new business or a material contract, borrowing money and the like. These provisions usually require a majority, supermajority or unanimity of the partners to approve any such transaction.

iv. Profits and Losses; Cash Flow

Michigan law permits partners to agree among themselves as to the time and manner for the return of capital contributions and repayment of loans made by partners and the allocation and distributions of profits and losses. Most partnership agreements specify each partner's percentage interest in profits, losses and capital of the partnership and contain provisions addressing the distribution of available cash from time to time. In the absence of such an agreement, Michigan law requires that each partner is repaid his or her capital contribution, loans, and shares equally in the profit of the partnership after payment of all liabilities.

Because of the inflexibility in the Michigan statute, the partnership agreement should clearly specify the manner for allocation of income and losses and for the distribution of available cash.

v. Liabilities and Rights of Partners

Each partner in a general partnership is jointly liable for all debts and obligations of the partnership. This means that such debts and obligations may be collected from a partner's personal assets in the event the partnership's assets are insufficient. Partners are also personally jointly and severally liable for any wrongful act or omission by a partner acting in the ordinary course of business or with partnership authority and for any misappropriation of money or property of a third person by any partner acting within the scope of his or her apparent authority. Any person admitted as a partner into an existing partnership will not have personal liability for partnership obligations arising before the date of his or her admission; however, any such liability can be satisfied out of partnership property and, therefore, represents a reduction in the value of the partnership.

Although certain techniques can be employed to limit the exposure of partners, such as negotiating specific limits on liability of the partners under loan relationships or leases, the unlimited liability that attends to being a partner in a general partnership is a significant detriment to the use of the general partnership for a number of businesses. This is especially true considering the ease and convenience of the formation of either a corporation, a limited liability company, or a limited partnership, all of which offer limited liability to investors and principals.

vi. Transferability of Partnership Interests

A partner may transfer his or her interest in the partnership's profits, losses, and surplus to another person without causing the dissolution of the partnership; however, the assignee does not become a partner in the partnership and is not entitled to participate in the management or administration of the partnership's business and affairs. The assignee is merely entitled to receive the profits to which the assigning partner would have otherwise been entitled and has no right to access information regarding the partnership's transactions or to inspect its books. The assignee of an interest in a partnership can become a partner only with the approval of all of the partners of the partnership, unless the partnership agreement provides otherwise.

vii. Dissolution; Termination

Partnership agreements frequently provide that the partnership will exist for a fixed term and will then dissolve upon expiration of such term. In addition, the partnership can be dissolved by mutual agreement of all partners, the occurrence of any event which makes it unlawful for the business of the partnership to be carried on, the death of any partner, the bankruptcy of any partner or the partnership, or by decree of a competent court.

A partnership can also be dissolved by the withdrawal of any partner even if the partnership agreement provides for a specific term of life for the partnership. However, if a specific term is provided, or the withdrawal otherwise contravenes the partnership agreement, such dissolution may expose the withdrawing partner to liability for breach of the agreement. The non-breaching partners have the option to continue the partnership and redeem the interest of the terminating partner.

Although a partnership has been dissolved, it is not terminated until the process of winding up its business is completed. The authority of the partners in a partnership that has elected to wind up its affairs is limited to that authority necessary to bring about the end of the business. In connection with winding up, the partnership has two resources available to satisfy its liabilities: the partnership's property and the assets of the partners. In the event any partner is insolvent or cannot be sued for his or her contribution and refuses to contribute, the remaining partners are required to contribute any additional amount necessary to make up the shortfall, in proportion to their respective shares of the partnership's profits.

The liabilities of the partnership are to be satisfied out of its assets as follows (in the order in which they are to be satisfied): (i) obligations to creditors other than partners, (ii) obligations to partners other than for capital and profits interest, (iii) return to partners of their capital, and (iv) amounts owing the partners in respect to their profits interest in the partnership. Michigan law provides that these amounts shall be paid and that partners of the partnership are required to contribute their proportionate share of such amounts in order in insure such payments.

b. Limited Liability Partnerships

The Michigan Uniform Partnership Act permits a partnership to organize as a limited liability partnership by filing a registration with the Corporations Division of the Bureau of Commercial Services of the Department of Licensing and Regulatory Affairs. A preprinted form is available to use for registration. A limited liability partnership is a general partnership that has elected to register as a limited liability partnership; it should not be confused with a limited partnership, which is discussed below.

The registration for a limited liability partnership must set forth the partnership's name and address, a brief statement of its business, a statement that the partnership will operate as a limited liability partnership, its federal employer identification number (or, if a number has not been assigned to the partnership, the social security number of the person or persons signing the registration), and if the partnership is a foreign limited liability partnership, the address of its registered office in Michigan, and the name of its registered agent.

The name of a registered limited liability partnership must contain the words "limited liability partnership" or the abbreviation "L.L.P." or "LLP" as the last words or letters of the partnership's name.

The registration must be signed by a majority in interest of the partners or by individuals authorized to execute it by a majority in interest of the partners. The registration is effective immediately upon filing with the department and payment of the registration fee, and it remains in effect for one year. A registration may be renewed annually by filing a renewal registration.

Registration of a limited liability partnership shields the partners from liability for most partnership obligations. A partner of a registered limited liability partnership is not liable directly or indirectly for debts, obligations and liabilities of the partnership solely by being a partner. However, a partner in a registered limited liability partnership is not exempt from liability for the partner's own negligence, wrongful acts, omissions, misconduct, or malpractice or that of any person under the partner's direct supervision and control, that results in a debt, obligation or other liability of the partnership.

A registered limited liability partnership formed under the laws of another state or country is required to file a registration in Michigan if it conducts business in the state.

Although the records of a general partnership normally are not subject to public availability or inspection, the records and files of the Corporations Division relating to a registered limited liability partnership are open to public.

c. Limited Partnerships

A limited partnership offers many of the advantages, including federal tax benefits, associated with general partnerships. The principal distinction between a limited partnership and a general partnership is that a limited partnership is permitted to have "limited" partners who are not personally liable for the obligations of the partnership but are also not entitled to control or participate in management of the partnership's affairs.

Michigan has adopted the Revised Uniform Limited Partnership Act, which has also been adopted by numerous other states.

i. Organizational Concerns

Two or more persons may form a limited partnership in Michigan by filing the appropriate certificate with the Corporations Division of the Bureau of Commercial Services of the Department of Licensing and Regulatory Affairs. The Certificate of Limited Partnership (pre-printed forms of which are available from the Corporations Division) is required to contain or describe the following information:

1. The name of the limited partnership;
2. The general character of its business;
3. Its address and the name and address of its registered agent;
4. The name and address for each partner, specifying separately the general partners and the limited partners;
5. The capital contribution, in cash or property, made by each limited partner or which each limited partner has agreed to make in the future;
6. The times or the events that will trigger any additional contribution agreed to be made by each limited partner;
7. The existence of any power of a limited partner to grant, to an assignee of his or her partnership interest, the right to become a limited partner and the terms and conditions of such power;
8. The time or event the happening of which will trigger a partner's right to terminate his or her membership in the limited partnership and, in the case of a limited partner, the amount of or the method of determining the distribution to which such limited partner may be entitled;
9. The right of any limited partner to receive distributions of property including cash from the limited partnership;
10. Any right of the limited partner to receive, or of a general partner to make to a limited partner, a distribution which includes the return of all or any part of the limited partner's contribution;

11. The events which trigger dissolution of the limited partnership and winding up of its affairs; and

12. The right of the remaining general partners to continue the business upon the withdrawal of any other general partner.

The name of the partnership must include the words "limited partnership" and may not contain the name of a limited partner unless the name is also the name of a general partner or the business of the limited partnership had been carried on under that name before the admission of that limited partner. The name must also be distinguishable from any other domestic or foreign limited partnership or corporation on the records of the state. Michigan permits organizers of a limited partnership to reserve a name for four full calendar months following the month in which the application for reservation was filed. The reservation may be extended for additional four month periods.

The Certificate for Limited Partnership is available for review by the public and is required to be amended in the event that any of the information contained therein is changed or modified.

The certificate is, customarily, an extract of certain provisions of the limited partnership agreement. The partners to a limited partnership usually enter a limited partnership agreement containing the agreement among the parties regarding the partners' respective financial responsibilities, economic rights, operational obligations, withdrawal rights, and the like.

ii. Capital of the Limited Partnership

The limited partnership agreement should provide for contributions to be made to the capital of the limited partnership by the various partners. Capital can be infused into the limited partnership either by way of capital contribution or by loans from general or limited partners. Michigan provides broad discretion and flexibility on the part of the partnership in obtaining its capital. Some limited partnership agreements contain provisions under which the partners may be obligated to contribute additional capital under specified conditions.

Another source of capital is third-party financing. Under Michigan law, limited partners have no liability for the obligations of the limited partnership; general partners are jointly liable for its obligations. Therefore, in determining whether to make a loan to the limited partnership, third-party lenders will rely on the limited partnership's assets and operations and on the creditworthiness of the general partners. Another source of additional capital is the admission of new partners. Frequently, the limited partnership agreement provides for the admission of new partners setting forth the procedures to be followed and the requirements for their admission. In the event the partnership agreement contains no provision regarding the admission of new partners, Michigan law requires that all partners consent to the admission of any new limited partner.

iii. Management; Authority

Michigan law provides that the general partners of a limited partnership have the rights and powers and are subject to the restrictions of a partner in a general partnership. A general partner of a limited partnership may bind a partnership in the same way that a partner may bind a general partnership. The limited partnership agreement should clearly delineate the authority granted to the general partner and any limitations on that authority. For example, certain acts may require the approval of a majority, supermajority, or unanimity of the partners such as entering a new business, incurring indebtedness, settling lawsuits, and other acts out of the ordinary course of the partnership's business. In limited partnerships with more than one general partner, the agreement may differentiate the authority and responsibility of each general partner.

A limited partner will lose his or her limited liability protection if he or she participates in management or control of the partnership's business. Under those circumstances the limited partner will be treated as a general partner and assume liability for the partnership's obligations. Certain acts undertaken by a limited partner are deemed by the Revised Uniform Limited Partnership Act not to constitute participating in control of the limited partnership's business. These include voting on the following: the transaction of business by the limited partnership other than in the ordinary course of its business, the incurrence of indebtedness other than in the ordinary course of its business, the dissolution and winding up of the limited partnership, the removal of a general partner, or a change in the nature of the limited partnership's business.

iv. Rights of Limited Partners

Under Michigan law, the partnership agreement may grant voting rights to the limited partners as detailed in the previous paragraph. Most partnership agreements require approval of the limited partners for the transaction of business outside of the ordinary course, to sell or dispose of a substantial asset, to dissolve and wind-up the partnership, to settle or compromise a material lawsuit, or to incur indebtedness other than in the ordinary course.

Each limited partner is entitled to inspect and copy any of the partnership records, obtain information regarding the financial condition of the partnership, and obtain a copy of the partnership's federal, state and local income tax returns.

v. Profits and Losses

Under Michigan law, limited partnerships have great flexibility in allocating profits and losses and distributing assets among the partners. In the event the limited partnership agreement fails to contain a provision regarding allocation of profits and losses and distribution of assets, they are allocated and distributed among the partners in the proportion to the relative value of the capital contribution made by each partner.

For purposes of these allocations and distributions, the value of each partner's contribution is as stated in the Certificate of Limited Partnership.

A limited partner remains liable for six years to return any distribution of capital made in violation of the partnership agreement or applicable Michigan law and amounts recovered under this provision can be used for any partnership purpose. In addition, a return of capital to a limited partner, even if it does <u>not</u> violate the limited partnership agreement or applicable Michigan law, may nonetheless have to be refunded by the limited partner within one year after payment to the extent necessary to discharge the limited partnership's liabilities to creditors who extended credit prior to the capital distribution. A limited partner is deemed to have received a distribution of capital if the distribution causes his or her share of the fair value of the net assets of the partnership to fall below the value of the limited partner's contribution to the partnership as set forth in the Certificate of Limited Partnership. It is important, therefore, to amend the Certificate of Limited Partnership to reflect distributions of capital to limited partners.

vi. Transferability of Partnership Interest

An interest in a Michigan limited partnership is personal property. It is freely assignable, in whole or in part, and such assignment does not dissolve the partnership. The assignee of a general partner or limited partner may become a limited partner if admission is either permitted pursuant to a Certificate of Limited Partnership or approved by the consent of the other partners.

Unless the assignee becomes a limited partner, he or she is not entitled to exercise any rights of a partner and is merely entitled to the distributions and allocations to which the assignor would have been entitled.

The limited partnership agreement frequently addresses the terms and conditions under which an assignee of a partner's interest can become either a limited or general partner. Admission or substitution of a general partner may require approval of all or a majority of the partners and require the proposed new general partner to provide proof of its net worth.

vii. Dissolution; Termination

A limited partnership will be dissolved and its affairs wound up upon the occurrence of any of the following: (i) the happening of any events specified in the Certificate of Limited Partnership; (ii) the written consent of all partners; (iii) the withdrawal of a general partner unless at least one other general partner remains and the Certificate of Limited Partnership permits the limited partnership to carry on its business with the remaining general partners; and (iv) by decree of a court of competent jurisdiction. Even in the event the general partner should withdraw, the partnership will not be required to dissolve if within 90 days after the withdrawal of the general partner, all of the remaining partners agree to continue the partnership and appoint one or more additional general partners.

The withdrawal of a limited partner will not cause the automatic dissolution of a limited partnership. If the limited partnership is not continued and its business is wound up, the assets of the partnership are distributed as follows: first, to creditors including partners who are creditors of the partnership; second, to partners or former partners in satisfaction of any liability of the partnership to those individuals related to their withdrawal from the partnership; third, among the partners in return of their capital contributions; and finally, any balance among the partners in proportion in which the partners share distributions.

1.5 LIMITED LIABILITY COMPANIES

Limited liability companies ("LLC") combine some of the most favorable characteristics of both corporations and partnerships to achieve greater flexibility for businesses in structuring their business and tax objectives. In Michigan as in many other states, limited liability companies have come to outnumber corporations by a significant margin.

An LLC enjoys treatment as a partnership for tax purposes (taxable income, gains, losses, credits and deductions are passed through to individuals rather than imposed on the LLC itself) yet also enjoys the corporate characteristic of fully limited liability (liability for the debts or obligations of the entity attaches to the LLC, <u>not</u> to the owners of the LLC). Although these characteristics are available, at least to some extent, in certain existing business arrangements (such as limited liability partnerships, limited partnerships and S corporations), LLCs are subject to fewer restrictions and provide a high degree of organizational and operational flexibility.

a. Formation

An LLC is created under Michigan law when Articles of Organization are filed with the Corporations Division of the Bureau of Commercial Services of the Department of Licensing and Regulatory Affairs, unless a later effective date is requested in the articles. Owners of an LLC are referred to as "members." An LLC with only one member is called a "single member LLC" and is afforded the same pass-through tax treatment as an LLC with 2 or more members except the single member LLC is taxed as a sole-proprietorship instead of a partnership.

The LLC Articles of Organization must include the following information:

1. The name of the LLC. The name must include the words "limited liability company" or the abbreviation "L.L.C." or "L.C." (or "professional limited liability company," "P.L.C." or "P.L.L.C." in the case of limited liability companies organized by professionals such as attorneys, accountants, physicians and dentists) with or without periods;

2. The purposes for which the LLC is formed, which purposes may include any lawful purpose for which a Michigan corporation or partnership may be formed;

3. The address of the LLC's initial registered office and the name of its initial resident agent;

4. The maximum duration of the existence of the LLC, if other than perpetual. If no other duration is specified, the LLC's duration will be perpetual; and

5. If the LLC is to be run by managers, a statement to that effect must be included in the Articles of Organization, nor merely in the Operating Agreement.

At the option of the members, other provisions may be added to the Articles of Organization if the additions do not conflict with Michigan law. Examples of optional provisions include indemnification provisions, management restrictions, access to records of the LLC and other issues that the owners of the LLC deem important.

Amendment of an LLC's Articles of Organization is required in the event of a name change, change in purpose, change to or from the management of the LLC by managers (*See* Management discussion below), change in the legal duration of the LLC or if any statement in the original Articles of Organization becomes untrue (except regarding the office location or agent name).

b. Organization

Michigan law requires that an LLC have an Operating Agreement. Although significant differences exist, the Operating Agreement may be viewed as analogous to Bylaws for corporations. Even a single-member LLC may have an Operating Agreement. The Operating Agreement may evidence the members' agreement on matters such as capitalization, admission of members, treatment of profits and distributions, and management issues. If the members fail to define their rights and obligations in an Operating Agreement, Michigan law will supply the omitted terms. LLCs are creatures of contract to a greater degree than corporations, and therefore the Operating Agreement is the key document for establishing the rights and obligations of the members.

The Operating Agreement typically will identify the qualifications and procedures for becoming a member of the LLC, including the required contribution. Unless the Operating Agreement states otherwise, a member is not personally liable for the debts, acts or obligations of the LLC.

The Operating Agreement may also alter the statutory provision detailing a member's right to vote in proportion to the member's interest in the distributions of the LLC. Except as the Operating Agreement otherwise provides, a majority vote of the members is necessary to approve most matters referred to the membership for approval. A member may withdraw from an LLC consistent with the provisions in the Operating Agreement. However, if the Operating Agreement is silent on the withdrawal of a member, then it is not permitted. It is therefore required, if member withdrawal is an important characteristic of a particular LLC, that the Operating Agreement provide how withdrawal is to be accomplished.

c. Transfer of Membership Interest

A member's property interest in an LLC can take two forms: (1) the right to receive distributions (profits) as a member and (2) the ownership of the membership interest itself. The right to receive profits and distributions is an economic right and is freely assignable. The other is a true ownership right and is not assignable unless the LLC provides for this in the Operating Agreement or the members unanimously vote to admit the assignee as a member.

d. Capitalization/Distributions

Michigan law enables the members of an LLC to contribute tangible or intangible property or services to the LLC, as the members determine. Such contribution may include property, services, cash, or written undertakings to contribute such items in the future.

Cash and other distributions of an LLC are allocated among the members and classes of members in accordance with the Operating Agreement. Unless the Operating Agreement provides otherwise, distributions are made on an equal basis to each member. It is therefore important to address distribution shares in an Operating Agreement if the LLC intends to make distributions on a weighted basis such as in accordance with capital accounts, percentage membership interests or otherwise. An LLC may not make a distribution to a member if following that distribution, the LLC cannot pay its debts as they become due or if its total assets are less than the sum of its total liabilities plus, unless otherwise specified in the Operating Agreement, any amount needed to satisfy the preferential rights of other members if the company were dissolved at the time of the distribution.

e. Management and Control

An LLC is managed either by its members collectively or by managers. If the Articles of Organization fail to specify that the LLC is to be run by managers, the LLC will be member managed. The flexible management arrangements LLCs may use provide virtually unlimited structuring opportunities. The threat of exposure to personal liability that typically prevents management involvement by limited partners does not similarly prohibit management participation by LLC members.

If the LLC is managed by managers, the managers need not also be members. The Operating Agreement may address issues such as the qualification requirements and rights and responsibilities of managers and their term of office. Unless the Operating Agreement otherwise provides, decisions are made by the majority vote of the managers.

However an LLC is managed, its members retain the right to vote on the following matters:

1. The voluntary dissolution of the LLC before the expiration of its term;
2. The merger of the LLC with another entity;
3. A transaction involving the actual or potential conflict of interest between a manager and the LLC;
4. A conversion of the LLC;
5. An amendment to the Articles of Organization; and
6. Unless otherwise provided in the Operating Agreement, any sale or other disposition of all or substantially all of the LLC's assets outside of the ordinary course of business.

An LLC is bound by the actions of every manager as an agent of the entity. A manager of an LLC is required to act in good faith, with the care an ordinarily prudent person in a similar circumstance would use and in conformity with what the manager perceives to be in the best interest of the LLC. Assuming a manager complies with this standard of conduct, the manager is not liable for acts or omissions as a manager. The Articles of Organization or Operating Agreement may limit or eliminate the monetary liability of managers to the LLC or its members for a breach of the manager's duty, similar to the limitations permitted for corporate directors. Except as otherwise stated in the Operating Agreement or by law, a manager or member is not personally liable for the acts, debts or obligations of the entity.

f. Tax Status

Under the IRS' "check the box" regulations, an LLC will be taxed as a partnership unless the LLC affirmatively elects to be taxed as a corporation. There is no limit on the maximum number of members to receive flow-through tax treatment (unlike the 100-shareholder restriction of S corporations). Thus, an LLC affords maximum flexibility in its structure, permitting corporation-like organization and characteristics (such as centralized management, continuity of life and free transferability of interests) with partnership taxation.

g. Low Profit Limited Liability Companies

Michigan is one of several states whose law permit the formation of a low-profit limited liability company ("L3C"). An L3C is essentially a hybrid of a for-profit LLC and a nonprofit organization. It operates under purposes that state that its primary objective is to undertake a socially beneficial purpose, rather than to maximize income or investor return. L3Cs were designed make it easier for an organization oriented to social benefits to attract investments from private foundations (as well as perhaps obtaining investments from private investors. The reason private foundations may be attracted to this form of business is that L3C Articles of Organization conform to the federal tax standards for program-related investments ("PRI"). Investing in PRI allows private foundations to satisfy their obligation under federal tax laws to distribute a minimum amount each year for charitable purposes. Private foundations usually meet this requirement through grants, but investments in L3Cs and charities that qualify as PRIs could also meet this requirement, while providing some amount of return to the private foundation.

While L3Cs have attracted some interest and there is some literature on the subject, the Internal Revenue Service has yet to rule definitively that the PRI rules can be satisfied in this manner. L3Cs have seen limited use in practice.

1.6 JOINT VENTURES

A joint venture is a relationship between two or more persons or business entities for the purpose of conducting joint business operations. It may be structured as a contractual arrangement among the participants or as a separate business entity, such as a partnership, limited liability company, or corporation in which the participants are partners, members or shareholders. Where the operations the participants intend to conduct are narrowly limited in scope and/or time, a contractual arrangement among the participants will usually suffice. In more complex or long-term arrangements, the formation of an entity frequently occurs.

Regardless of the structure of a joint venture, it is important that the participants address the structure and conduct of management of the operations, the obligations of the participants to provide capital or other funds to finance operations, the manner of sharing any profits generated, the participants' liability for debts and obligations incurred in the operations, and the procedure for terminating the venture and distributing remaining assets, including those which may have been contributed by the venturers.

If a joint venture is to be conducted only pursuant to contract, these matters must be addressed in great detail, since state law is not available to fill in any gaps, as it may be in the case of partnerships, LLCs and corporations.

1.7 AUTHORIZATION OF FOREIGN ENTITIES TO DO BUSINESS

Limited Liability Companies and Limited Partnerships formed under the laws of other jurisdictions must obtain a Certificate of Authority from the Corporations Division of the Bureau of Commercial Services of the Department of Licensing and Regulatory Affairs if they conduct business in Michigan. These requirements are similar to those applicable to corporations incorporated under the laws of other jurisdictions. *See* "BUSINESS CORPORATIONS--Foreign Corporations." Certain other types of entities, such as business trusts, may also be required to obtain a Certificate of Authority. There is no requirement for a general partnership organized in another state to obtain a Certificate of Authority.

Chapter 2 - Trade Regulation

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2.1 ANTITRUST AND TRADE REGULATION

Federal and state antitrust laws seek to prevent and punish unreasonable restraints on trade, monopolistic practices, and unfair competition. Violations may result in severe penalties, including imprisonment and treble damages.

a. Federal Antitrust Laws

The antitrust laws of the United States are primarily reflected in five federal statutes: the Sherman Act, the Clayton Act, the Robinson-Patman Act, the Federal Trade Commission Act, and the Hart-Scott- Rodino Act.

i. The Sherman Antitrust Act of 1890

The Sherman Act is divided into two primary sections. Section 1 prohibits contracts, combinations, and conspiracies that unreasonably restrain trade. Section 2 prohibits unilateral and combined conduct that monopolizes or attempts to monopolize trade among several states or with foreign nations. Under the Sherman Act, some restraints are inherently unreasonable (such as price-fixing agreements between competitors) and per se illegal, for which there is no defense, and others are subject to an economic analysis under a "rule of reason" (such as some price restrictions placed on a distributor by a manufacturer). Restraints subject to the "per se" rule are never permitted. Restraints subject to the "rule of reason" will be evaluated by examining the overall effects on the market, balancing the pro-competitive and anti-competitive effects of any restraint.

ii. The Clayton Act of 1914

The Clayton Act prohibits certain specific anticompetitive activities. For example, the Act prohibits some corporate mergers, exclusive dealing contracts, and tying arrangement under which one product ("tying product") is sold subject to the requirement that the purchaser from the seller also buys another product ("tied product").

Section 8 of the Act prohibits "interlocking directorates." In other words, the Act does not allow one person to serve as a director or corporate officer for two or more competing corporations.
This provision is intended to prevent anticompetitive coordination between competing companies and the sharing of certain information between boards. In order for the Act to apply, the competitors must have at least $10 million in capital, surplus or undivided profits, adjusted on an annual basis, and the competition must be significant, as determined by a formula. Violations are not always obvious.

iii. The Robinson-Patman Act of 1936

The Robinson-Patman Act prohibits a seller from discriminating (or inducing others to discriminate) among competing purchasers in the price charged for goods "of like grade and quality." While the Act focuses on price discrimination, it also addresses other discriminatory advertising and promotions, brokerage fees, and commissions among competing sellers or dealers.

iv. The Federal Trade Commission Act

The FTC Act declares unlawful "unfair methods of competition" and "unfair or deceptive acts or practices." The Act is enforced by the Federal Trade Commission ("FTC") and generally follows the basic patterns of the Sherman and Clayton Act. There is no private right of action under the Act. There is no requirement. The market power exists for an activity to be unfair or deceptive and a violation of the Act.

v. The Hart-Scott-Rodino Antitrust Improvements Act of 1976

The Hart-Scott-Rodino Act requires that, under certain circumstances, a company proposing to merge with or acquire another company must give prior notice of the proposed acquisition to the FTC and the Justice Department; one of those two agencies shall then review the transaction to determine whether the result of such merger or acquisition shall result in monopoly power or a substantial restraint on interstate or foreign trade. Failure to provide notice may result in substantial fines.

vi. Enforcement

Private individuals and corporations may bring lawsuits under the Sherman Act, the Clayton Act, and the Robinson-Patman Act. Remedies may include divestitures of businesses, injunctive relief, treble damages, and attorney fees. The government may enforce the Sherman Act through criminal prosecutions, civil suits, or both. In addition, the government may enforce the Clayton Act and the Robinson-Patman Act. Private parties may enforce similar actions under the Sherman and Clayton Acts.

b. Michigan Antitrust Law

The Michigan Antitrust Reform Act is largely based on the Uniform State's Sherman Antitrust Act. The Act prohibits contracts, combinations, or conspiracies in restraint of or to monopolize trade or commerce and addresses covenants not to compete. Other Michigan statutes, including the Consumer Protection Act, Unlawful Trade Practices Act, and Pricing and Advertising Act, may also pertain to unfair and anticompetitive conduct.

The Michigan Supreme Court has held that non-competition and similar provisions are not governed by the traditional common law requiring reasonableness as the scope, period of time, and geography as it applies to restrictions on employees. Instead, such restrictions between commercial entities will be evaluated under the rule of reason, i.e., does it have an unreasonable impact on competition within a relevant market?

c. Antitrust in Practice

Antitrust is a complex area of the law, and the resolution of antitrust issues often requires extensive factual analysis. There are specific written policies on various matters, including mergers and joint ventures. As the criminal and civil penalties for antitrust violations can be quite substantial, the close and thoughtful consideration of antitrust questions is worthwhile. In addition to considering specific issues as they arise, multinational companies should also contemplate a periodic legal review of their business practices in order to flag potential antitrust problems.

2.2 OTHER MICHIGAN TRADE REGULATION

a. Warranties

Michigan has adopted the Uniform Commercial Code ("UCC"), which, among other things, regulates warranties on goods. Unless disclaimed in accordance with the standards provided in the UCC, the sale of goods automatically generates warranties on the part of the seller for merchantability and fitness for a particular purpose. Disclaimers can be effective but only if made conspicuously and not unconscionable.

The state's common law governs warranties in the area of personal injury. Every seller is presumed to have warranted its product to be reasonably fit for intended, anticipated, or reasonably foreseeable use and misuse. An action for breach of warranty or implied warranty may be brought in Michigan, as is an action for negligence. Strict liability in tort is not recognized.

Michigan has adopted the "Economic Loss Rule" concerning warranties and litigating commercial parties. Tort claims between commercial parties based on warranties are barred where the loss is economic in nature. In such cases, the remedies of the state's version of the UCC apply exclusively.

Consumer warranties are also regulated by the Federal Magnuson-Moss Warranty Act, which limits disclaimers of certain consumer warranties and requires prior disclosure of certain consumer warranties.

b. Consumer Protection

i. The Consumer Protection Act

The Consumer Protection Act applies to both goods and services. The Consumer Protection Act allows aggrieved consumers and/or the state's Attorney General to bring enforcement actions, including class actions and actions for injunctive relief. Prevailing parties are entitled to actual attorney fees and costs. The Act's prohibitions include misrepresentations about the origin, age, or condition of goods and "bait-and-switch" tactics.

ii. The Unlawful Trade Practices Act

The Unlawful Trade Practices Act prohibits the false suggestion to consumers that they are buying "wholesale," surplus or discounted goods, false suggestions that the vendor is a "miller," "manufacturer," or broker, and false suggestions that the vendor is affiliated with a military branch of the government, such as "army" or the like. Enforcement actions under this Act may be brought by any aggrieved individual, including competitors, and remedies include rescission. Prevailing litigants are entitled to attorney fees and costs. Actions must be brought within eight months after the sale.

iii. Price Labeling

Michigan has a price labeling law for consumer items, which requires prices to be displayed at the location where the item is located. It is a prima facie violation if the price charged by electronic checkout means varies from the notice. The consumer may be entitled to 10 times the difference.

iv. Other Statutes

Michigan has a variety of other consumer-oriented statutes regulating matters such as the amount that medical professionals may bill patients for work performed by clinical laboratories, tampering with automobile odometers, home solicitation sales, collection practices, retail installment sales, rental and purchase agreements for real estate, home improvement financing, and mortgage lending.

c. Sales Representatives

The Michigan Sales Representatives Commission Act provides protection for employees and independent sales representatives if a principal that is selling in the state refuses to pay commissions. Under the Act, if a principal intentionally fails to pay a commission when due, the principal may be liable for two times the commission owed (up to $100,000), plus attorney fees.

d. Trades Licensing

The Michigan Trades Regulation Act requires licensing of some trades, such as electrical, mechanical, and plumbing contractors.

Chapter 3 - Financing Investments

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3.1 BUSINESS FINANCE

This section summarizes the conventional kinds of financing available to a business in Michigan and the sources thereof. This summary is not intended as a detailed description of the equity and debt financing available to a particular enterprise. Rather, it is a general outline of such financing and the related security devices.

3.2 EQUITY

Although not impossible, it is quite difficult to start a business without some equity investment by the owners. The amount required in any case will depend on circumstances and the business involved. A potential provider of debt financing will be interested in the amount of capital that the owners have at risk. Indeed, it is often as a result of discussion with potential lenders that owners learn the minimum equity requirements that will be necessary to conduct business.

3.3 KINDS OF EQUITY

a. Common Stock

The owners of ordinary common stock are the primary risk takers in a corporate enterprise. In general, they may recoup their investment in the event of dissolution only after all other creditors and the holders of preferred stock are paid. Conversely, after other stockholders are paid, holders of common stock generally are entitled to share in whatever corporate assets remain, without limitation. Thus, the potential return to common holders is usually greater than for debtholders or other security holders.

b. Preferred Stock

An outside equity investor may desire that the investment be preferred in various ways to that of common stock. The most common preferences relate to payment of dividends and rights to distributions on liquidation. Important points to be negotiated include whether not the preferred stock will participate in future growth or contraction of the corporation, voting rights, conversion rights, anti-dilution rights, rights on default and rights of first refusal. Preferred stock may also have non-economic preferential rights, such as the right to approve certain transactions separately.

c. Other Considerations

Often an outside investor in a corporation will require a well-defined “exit strategy” at the outset of a transaction. Again, there are many options, such as a right to require the corporation to repurchase securities at a predetermined time and price, a right to participate in or to require the sale of the corporation as a whole or the registration of its shares for a public offering. Inasmuch as investment in private companies is generally viewed by outside investors as inherently risky, the returns demanded may be substantial; this fact may lead a company seeking an equity infusion to a public offering of its securities. A detailed discussion of initial public offerings is beyond the scope of this summary. Any such offering requires a great deal of advance planning and consultation with professional advisors, will be available to only a small number of companies at any given time, will be highly regulated (as discussed below) and require a full disclosure of all material facts. It will also impose on companies ongoing reporting and disclosure requirements under federal securities laws. Consequently, the costs of such an offering are quite high. Nonetheless, a successful public offering may be extremely advantageous by affording an issuer access to public securities markets and comparatively less expensive financing.

3.4 DEBT FINANCING

The most common sources of debt financing are financial institutions such as banks, savings and loan associations and finance companies. Other sources include insurance companies and pension funds as well as mezzanine lenders and other specialty lending entities.

a. Forms of Financing

Debt financing assumes many forms, from conventional loans from a bank for the purpose of providing working capital to a public offering of bonds or other debt securities. Loans may be secured by all or a portion of the assets of the borrower or may be unsecured and backed only by the borrower's general credit. Although debt financing transactions may vary widely in structure, type of indebtedness and return of security, certain common elements are found in most such transactions.

i. Borrower and Lender

The borrower generally promises to repay the indebtedness to the lender and to perform certain other obligations. There may be more than one borrower or more than one lender in a single loan transaction, and their respective rights may be identical or different.

ii. Loan Terms

Typically, the loan will have a term, after which time the loan must be paid off. The loan terms may also require periodic payments of principal during the term. Again, great variation is possible, and these payments may be arrived at only after extensive negotiation between the borrower and lender and based on agreed cash flows forecast for the future. Periodic loan payments may fully amortize the indebtedness, so that at the end of the payments the loan has been fully repaid, or may only partially amortize the indebtedness, leaving an additional amount, sometimes referred to as a "balloon payment," to be paid when the periodic payments end. Loans may also be made without a term but instead be repayable upon demand of the lender at any time. Loans to finance working capital are often structured on a "revolving" basis which allows the borrower to borrow, repay and re-borrow amounts during the term of the facility. Revolving credits are often tied to formulas to determine eligible collateral against which loans may be drawn and may have automatic repayment features such as account sweeps or lockbox accounts.

iii. Interest

Normally, interest will be paid at a fixed rate throughout the term of a loan or at a rate which varies with some agreed-on objective standard, such as the "prime" rate announced by a given bank, an interbank offered rate or some similar benchmark. Various London Interbank Offered Rates, or "LIBOR," historically have been widely used as a lending index but have been phased out beginning at the end of 2021. Some such loans are now pegged to other indices, such as the Secured Overnight Financing Rate ("SOFR"), which is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities. The Federal Reserve Bank of New Yok publishes the current SOFR rate each business day.

There are many different standards that may be adopted, and in some cases, the borrower may have an option to change the standard one or more times during the term. Normally, interest is payable at regular intervals during the loan term.

Lenders must ensure that interest arrangements do not violate Michigan usury laws. There are several of usury provisions under Michigan laws that govern different types of borrowers. Generally, corporations and limited liability companies may contract to pay any rate of interest and may not assert the defense of usury; however, Michigan's criminal usury statute makes it illegal for a lender to collect interest in excess of 25% per annum.

b. Documentation

The typical documents used in a conventional loan transaction are the loan or credit agreement, promissory note, mortgage, security agreement, and guarantee. Each transaction may have its own permutations and the documents will vary.

i. Loan Agreement

The loan or credit agreement sets out the basic agreement between the parties concerning the loan. Normally, it will contain the term, the principal amount of the loan, the interest rate, and the repayment schedule. It will also typically contain conditions that must be fulfilled in order to disburse the loan initially, and if there are to be subsequent disbursements, conditions to those disbursements. There will also be a series of representations made by the borrower, which describe the borrower's legal ability to enter the loan transaction, its current financial condition, and other factual representations, which the lender considers important. In addition, the agreement will often contain a series of covenants, sometimes referred to as affirmative and negative covenants, which the lender may require the borrower to observe during the term of the loan. These will concern the conduct of the business in the future, limitations on the sale or disposition of the business or its assets, the acquisition of other businesses, the payment of dividends or other amounts to shareholders and the maintenance of certain financial standards or ratios. These require careful consideration and may result in extensive negotiation. Other provisions include default provisions defining the conditions under which the lender may seek recourse for nonpayment or other non-performance and provisions relating to security and guaranties.

ii. Guaranty

The lender may insist that the principal owners of the borrowing enterprise (or some other creditworthy party) guarantee the full and punctual performance of the borrower's obligations under the loan documents. Typically, such guaranties are of payment, not of collection, and do not require the lender to look first to the borrower or the security for payment, permitting immediate recovery from the guarantor in the event the borrower defaults. Guaranties may be unlimited as to amount or may limit the liability of the guarantor to only a portion of the borrower's indebtedness.

iii. Note

A promissory note contains the borrower's specific promise to pay the amount of the principal and the interest provided in accordance with the terms of the note. The note will usually set forth default provisions and, upon the occurrence of a default, will enable the lender to accelerate the entire indebtedness. A promissory note is often drafted to be a negotiable instrument capable of assignment by negotiation.

iv. Security Interests

The grant of a lien or security interest in specified property or assets of a borrower is intended to give a lender a right, superior to other creditors of the borrower, to recover amounts owed to it from the value of that property, either by assuming ownership of it or selling it and collecting amounts owed from the sale proceeds. Security for repayment of loans takes two common forms: (i) a mortgage on real estate and (ii) a security interest in personal property. Often the same transaction will contain both types of security. Mortgages on real estate and interests in real estate are discussed in more detail elsewhere in this manual at "REAL PROPERTY – MORTGAGES AND LAND CONTRACTS." A security interest in collateral is created by a security agreement. In the security agreement, the borrower (or other party granting the security interest) will represent that the collateral is owned, that the borrower has the right to grant a security interest in the collateral and will covenant to maintain the collateral, not dispose of it or grant any other security interest in it. The security agreement will also contain default provisions and the rights of the secured party upon default. These will normally include the right to sell the collateral and apply the proceeds to repayment of the loan and associated expenses. If the sale is governed by the Uniform Commercial Code, as would be common, the secured party must act in a commercially reasonable manner in disposing of the property and comply with other applicable requirements.

v. Financing Statements

Security interests in personal property are typically governed by the Uniform Commercial Code ("UCC"), a uniform statute adopted with variations in Michigan and other states. Certain types of property are not covered by the UCC, such as certain types of aircraft and certain kinds of intellectual property. Typically, however, for the most common kinds of security, such as accounts receivable and most tangible personal property such as machinery, equipment, inventory, etc., perfection of a security interest requires the filing of an appropriate financing statement with the appropriate division of the Michigan Secretary of State (for entities created in Michigan) or, in certain instances, with local authorities. Financing statements constitute public notice of the existence of a security interest. Perfection of a security interest grants the secured party priority in the collateral over unperfected creditors and over other, later-perfected creditors. The proper method of perfection must be carefully examined for each type of collateral; there are certain types of collateral (such as deposit accounts) in which a security interest may not be perfected by filing a financing statement and other types for which physical possession of the collateral will take priority over a financing statement. Failure to properly perfect a security interest may cause a secured party to lose its ability to foreclose on collateral ahead of other creditors. A financing statement remains valid for five years after filing and may be renewed. Renewals may be filed no sooner than six months prior to the expiration of the currently effective financing statement.

3.5 FEDERAL AND STATE SECURITIES LAWS

a. Summary

Businesses often require equity or debt financing to raise capital to begin or expand operations. Such capital-raising sometimes involves the offer and sale of a "security." Offers and sales of securities are generally subject to regulation by the United States Securities and Exchange Commission (the "SEC") and/or the Michigan Department of Licensing and Regulatory Affairs (the "Michigan Office"). Every offer and sale of securities must be registered with the SEC or satisfy an appropriate exemption from registration. Offerings made in multiple states may also be subject to regulation by the securities regulations of each state, for instance by filing with the Michigan Office or satisfaction of a filing exemption. The goal of federal and state regulation of offers and sales of securities is to protect the investing public from fraud or abuse by issuers of securities or others, such as brokers or dealers, involved in the sale of securities. The regulatory scheme seeks to ensure that purchasers of securities are treated fairly and have adequate information to evaluate the risks and merits of the investment before they make their purchase decisions.

The securities laws take a three-pronged approach to protecting investors. First, all offers, and sales of securities must be registered with the SEC and/or the Michigan Office unless there is an exemption from registration available. Second, complete and accurate disclosure of material facts concerning the issuer of the security must be available to investors. Third, persons engaged in the business of offering and selling securities, such as broker-dealers or investment advisors, must be registered, follow strict guidelines concerning their dealings with customers and meet certain capital adequacy requirements.

Failure to comply with the securities laws can result in severe penalties. Criminal fines and imprisonment can be imposed for violations of state or federal securities laws. Civil damages can also be severe including the return of all funds raised from investors.

SEC and Michigan Office oversight is limited to transactions in securities. A "security" is broadly defined to include any arrangement in which a person invests money or other property in a common enterprise with the expectation of profit primarily through the efforts of others. The definition of a security encompasses conventional investments such as stocks, bonds, notes, options, and warrants. Other less conventional investments may also be included in the definition of a security, such as interests in real estate, oil and gas drilling, condominiums, orange groves, ostrich farms, prime bank notes, and certain franchises.

A general partnership interest is normally not considered to be a security, even if the general partner remains a passive investor. However, a general partnership interest has been found to be a security if the rights of the general partner are very limited in substance or if the general partner is an unsophisticated investor who must rely on the business acumen of some other person. A limited partnership interest is normally considered to be a security. Interests in limited liability companies are also generally treated as securities, but the treatment may depend on whether members have the right to control the business and affairs of the limited liability company, which in turn may depend on whether the limited liability company is organized as a member-managed company or a manager-managed company.

b. United States Law

For an offer and sale to be subject to the federal securities laws, the offer and sale must be made directly or indirectly to a person within the United States or to a United States citizen residing outside the United States. Foreign entities that wish to offer and sell their securities in the United States are required to register with the SEC. U.S. entities that wish to offer and sell their securities outside of the United States are required to register or rely on the exemption provided by Regulation S of the Securities Act of 1933. Regulation S allows U.S. entities to offer and sell securities without compliance with the registration requirement of the Securities Act of 1933 if the securities are sold in offshore transactions, there are no directed selling efforts of the securities in the United States and the securities come to rest outside the United States.

c. Michigan Law

State regulation must be based on the establishment of a sufficient jurisdictional nexus with the state, such as making offers to residents of the state or making offers from the state. Securities offered or sold to a Michigan resident are subject to the Michigan Uniform Securities Act. The application of the jurisdictional provisions of the Michigan Uniform Securities Act, as well as other Blue Sky Laws, can present complex problems and can result in the securities laws of various states and the federal government applying to a single transaction.

d. Offering of Securities

There are generally three methods by which a company may offer and sell securities. The first method is a firm commitment underwritten offering. In a firm commitment underwritten offering, an investment bank or other underwriter purchases the securities to be sold directly from the company and resells them through its broker-dealer network. The second method is a best-efforts offering. In a best-efforts offering, an underwriter agrees to purchase only as many securities as it can sell. Essentially, a company is using the investment bank's broker-dealer network to offer and sell its securities to investors with no guarantee of the number of securities that will be sold or the dollar amount of the proceeds to be raised. The third method is a self-underwritten offering. In a self-underwritten offering, a company and its officers and directors try to sell the securities themselves.

Generally, larger registered transactions are offered in a firm commitment or best-efforts underwritten offering. Smaller, unregistered private placement transactions are typically offered in best-efforts or self-underwritten transactions.

e. Registration

Unless an exemption from registration is available, an offering of securities must be registered. The process of registering an offering of securities requires the preparation of a registration statement that is filed with the SEC and/or the Michigan Office and other applicable state regulatory authorities. The registration statement must contain material information concerning the issuer's business, its audited financial statements, a description of the securities being offered, the method to be used to distribute the securities, and other information. The SEC and the Michigan Office will review the registration statement to verify that the required information is disclosed in the registration statement. The SEC does not evaluate the merits of making an investment in the securities. Unless the offered securities are "covered securities" (securities listed on certain stock exchanges), which are exempted from state regulation, the Michigan Office will consider whether certain terms of the offering are "unfair" or "unreasonable." The process of registering an offering of securities can be time-consuming and expensive.

f. Periodic Reporting

Once a company has sold securities to the public in a registered transaction (a process commonly referred to as "going public"), it will be required to make periodic filings with the SEC after every quarter and at the end of each fiscal year and to file reports during the interim to report certain specified occurrences. In addition, officers and directors of public companies have separate reporting obligations and additional restrictions on their ability to buy and sell securities of the company.

The Sarbanes-Oxley Act, adopted in 2002, and related rules and regulations adopted by the SEC and the various exchanges and Nasdaq, impose significant requirements on companies with publicly-held securities. These provide, among other things that:

1. All such companies with securities listed on an exchange have an audit committee composed solely of independent directors;

2. Each reporting company disclose, in its periodic reports, whether at least one committee member is a "financial expert" and if not, the reason that there is no expert;

3. Audit committees be directly responsible for the appointment, compensation, and oversight of the company's external auditors;

4. Audit committees establish procedures for handling complaints about accounting, internal accounting controls or auditing matters and systems by which employees can confidentially and anonymously submit concerns about questionable accounting or auditing matters;

5. The company's public accounting firm provide a written report to the committee that describes all critical accounting policies and practices to be used in the audit, any alternative treatments of financial information that have been discussed with management;

6. The company report annually on the adequacy of its system of internal controls and the auditors attest to the report;

7. External auditors are prohibited from engaging in certain specified prohibited non-audit activities for their audit clients, and the company's audit committee must approve any other non-prohibited non-audit to be rendered to the company;

8. The chief executive officer and chief financial officer certify the SEC reports of their company;

9. Reporting companies may not make or arrange any extension of credit in the nature of a personal loan to any of their directors or executive officers;

10. No officer or director may purchase or sell any of the company's equity securities during any blackout period for an employee benefit plan; and

11. If a company is required to prepare an accounting restatement due to noncompliance with regard to any financial reporting requirement as a result of misconduct, the chief executive officer and the chief financial officer of the registrant must reimburse the company for any bonus or other incentive-based or equity-based compensation, and any profits realized from the sale of the company's securities, in the twelve months following the first filing of the statement containing the information that was required to be restated.

g. Exemptions from Registration Requirements

There are various exemptions from registration available to a company. These exemptions follow two basic approaches. The first approach considers the issuer; the second considers the nature of the transaction. Certain types of securities sold by certain types of issuers are exempt from the registration requirements of federal and various state laws. Included in this group are securities issued by state and local governments, charitable organizations, banks (though bank offerings are separately regulated by federal banking law) and, to a limited extent, insurance companies.

The second approach considers the nature of the offering and sale transaction. Both federal and state law provide several transactional exemptions. Transactional exemptions are concerned with the amount to be raised from the offering, the nature of the investors purchasing the securities and the number of offers made. Regulations A and D of the federal securities laws provide safe harbor rules for "transactional exemptions." Offerings that meet the size and investor criteria are called "private placements." To be considered a private placement, the offer and sale of the securities in most cases must be made without general advertising or solicitation (although there are exceptions) and must be made to a limited number of investors. Properly structuring a private placement to avoid the requirement to register the transaction can be difficult. Offering and selling securities in a transaction that does not satisfy one of the issuer exemptions or one of the transactional exemptions without registration can result in criminal and civil penalties.

The states are preempted from regulating the substance of the offer and sale of certain securities, which are called "covered securities." (The states may still require a notice filing and collect a fee.) Included as covered securities are those listed on certain stock exchanges and securities offered pursuant to Rule 506 of Regulation D.

h. Disclosure and Antifraud Requirements

Even offerings of securities that are exempt from registration are subject to the antifraud provisions of federal and state securities laws. The antifraud provisions seek to prohibit the use of fraud, deception, devices, schemes or other means to mislead investors. The antifraud provisions prohibit the use of inaccurate statements of material facts in the offering and sale of securities. Also prohibited is failure to disclose material facts necessary to make the matters disclosed not misleading. Violations may result in criminal sanction or civil liability to investors.

To avoid liability under the antifraud provisions, a written disclosure document should be prepared for every offering of securities, regardless of whether a transaction is exempt from registration, and delivered to a prospective investor. In a registered transaction, the disclosure document is called a “prospectus.” In an exempt offering the disclosure statement is typically called an “offering circular” or a “private placement memorandum.” The preparation of an offering circular or private placement memorandum is less expensive and time consuming than registering securities, although still substantial.

The purpose of the disclosure document is to supply investors with the information a reasonably prudent investor would consider important prior to making an investment decision. Consequently, the disclosure document must be accurate, complete and updated periodically, if the offering takes place over an extended period of time. Issuers, promoters or others engaged in offering and selling the securities should not disclose information that is inconsistent with the information in the disclosure document.

i. Regulation of Brokers, Dealers and Investment Advisers

Both the United States and the Michigan securities laws extensively regulate the activities of persons engaged in the business of selling securities for themselves or for other persons. Such persons may be required to register under the United States laws as a “broker” or “dealer” and under the Michigan laws as a “broker-dealer.” In addition to registration and reporting requirements, broker-dealers are required to meet prescribed financial condition standards and follow certain rules in their dealings with customers.

The personnel of broker-dealers who act in connection with offers or sales of securities must register and pass an examination under United States law and must pass an examination and obtain a license under Michigan law.

Both United States and Michigan securities laws also require registration (with certain exemptions), and regulate the conduct, of persons who for compensation advise others on the value of securities or the advisability of investing in securities. These persons are referred to as “investment advisers” and may provide services directly to investment companies or individuals or by publication of investment advice. Investment advisers who are required to register must meet recordkeeping and reporting requirements, are prohibited from certain activities, must disclose potential conflicts of interest and are subject to restrictions concerning the terms and conditions on which they provide investment services, including certain restrictions on compensation arrangements. Investment advisers with $25 million or more of assets under management are regulated exclusively (except for fraudulent conduct) by the SEC and need only make notice filings in states in which they are doing business.

j. Securities Laws of Other States

Like, Michigan, each state has its own securities laws (often referred to as “Blue Sky Laws”). These laws, while often similar, can have important differences. For example, each state has its own registration and antifraud requirements. The need for compliance with a particular state’s Blue Sky Laws is based on the nature and extent of contacts with investors in that particular state. The securities laws of various states and the federal securities laws can apply to the same offering. Because the Blue Sky Laws can vary from state to state, compliance can be difficult and time consuming.

In any transaction involving the offer or sale of securities, the registration, disclosure and antifraud, and broker-dealer registration requirements of all the states that have contact with the transaction or its participants should be considered. In transactions that may involve the laws of several states, legal counsel may prepare a survey of the Blue Sky Laws of the various states that analyzes the applicability of the laws and the availability of exemptions.

Chapter 4 - Taxation

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4.1 TAXATION

a. Personal Income Tax

Federal taxation of income of foreign individual investors depends on a host of factors, including the nature and extent of the individual's activities within the United States. Investment income can be treated either as ordinary income or capital income.

All U.S. residents (whether citizens or aliens) are subject to U.S. income tax on their worldwide net income, at rates ranging from 10% to 37%. There are frequent proposals for tax changes on the federal level; if enacted these could cause rates to fluctuate in future years. Nonresident aliens are subject to tax on only their income derived from U.S. sources. Passive income of nonresidents, not effectively connected with a U.S. trade or business, is taxed at a flat 30% or lower if treaty provisions apply between the investor's country of residence and the U.S. The progressive rates (where applicable) are based on net income (gross income reduced by certain deductions), whereas the 30% rate (or lower rate if a treaty so provides) is based on gross income.

Determining whether income is effectively connected with a U.S. trade or business is critical to measuring its exposure to U.S. income tax. Generally, such income will be so treated if it is derived from a permanent establishment in the U.S., such as a store, office, or factory.

Gain upon sale of U.S. real property will be taxable to a foreign individual as effectively connected income.

b. Corporate Income Tax

i. "C" Corporations (all corporations not qualifying as "S" Corporation, as explained below)

The U.S. treats corporations not organized under the laws of the U.S. or one of its 50 states as foreign entities. As such, a foreign corporation is treated similarly to an individual who is a nonresident alien. The net income of a foreign corporation that relates to its U.S. activity is taxed at rates ranging from 15% to 35% depending upon the amount of income, the same as for a U.S. domiciled corporation. Its passive income, however, is taxed at 30% of gross income (or a lower rate if a treaty relief provision applies).

Repatriation of the income to the foreign owner of a U.S. business presents an additional obstacle. If the U.S. business is operated as a branch of the foreign corporation, its income (as reduced by the tax imposed on its net income) is again subject to a branch profits tax of 30% of the gross amount deemed to be remitted overseas. This second level tax operates to equate the total tax that would apply if the business were a subsidiary of the foreign corporation rather than a branch. If the foreign corporation (in the case of a U.S. branch) is a "qualified resident" of a country with which the United States has an income tax treaty, and such treaty contains a valid nondiscrimination clause, the branch tax can be avoided. The U.S. has tax treaties with nearly every industrialized country and with many developing countries; such treaties include:

Armenia, Australia, Austria, Azerbaijan, Bangladesh, Barbados, Belarus, Belgium, Bulgaria, Canada, China, Cyprus, Czech Republic, Denmark, Egypt, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Korea, Kyrgyzstan, Latvia, Lithuania, Luxembourg, Malta, Mexico, Moldova, Morocco, Netherlands, New Zealand, Norway, Pakistan, Philippines, Poland, Portugal, Romania, Russia, Slovak Republic, Slovenia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Tajikistan, Thailand, Trinidad, Tunisia, Turkey, Turkmenistan, Ukraine, United Kingdom, Uzbekistan, Venezuela and Vietnam.

Unfortunately, the certification as a “qualified resident” is not easily obtained by a private company. Generally, therefore, it is often more prudent to operate with a U.S. subsidiary than a U.S. branch.

If a U.S. subsidiary is used, any tax on repatriated income will be deferred until a dividend is actually paid. A second advantage of using a subsidiary is the possibility of using lower withholding rates that are available to parent corporations in treaty countries, since such dividends will be treated as passive income. Subject to the “earnings stripping” limitations enacted by the U.S., the subsidiary may obtain a U.S. income tax deduction for interest it remits to its parent, whereas dividends are not deductible.

Foreign investors should be cautioned that any intercompany transactions between a U.S. subsidiary and its foreign parent should involve arm’s length prices and other terms. If the U.S. tax authorities find that U.S. taxable income has been artificially depressed by unfair pricing, they can reallocate income and expense between the parties. This would create not only additional U.S. income tax but substantial penalties as well.

As noted with regard to individual rates above, there are frequent proposals to change U.S. income tax provisions that apply to corporations. Notably, there has been recent discussion of a change to a territorial tax system for multinational corporations, and a possible repatriation tax designed to encourage companies to bring offshore profits back to the U.S., but there are no firm proposals nor legislative language introduced at this time.

ii. “S” Corporations

Certain U.S. corporations are eligible to elect to avoid U.S. income tax at the corporate level by making an election under Subchapter S of the Internal Revenue Code. Instead of the income being taxed at the corporate level the income is taxed to the shareholders, pro rata, whether or not actually distributed. As a result, the tax treatment is similar to that for partnerships and limited liability companies. However, the use of S Corporations is limited; eligible S Corporation shareholders are generally only individuals and some trusts, and cannot include partnerships, other corporations, or non-resident aliens. S Corporations must also not have more than 100 shareholders and can have only class of stock, and some other restrictions apply.

c. Income Taxation of Partnerships and Limited Liability Companies

A partnership entity is not a separate person for Federal income tax purposes. As such, the net income of the partnership is allocated and taxed directly to the partners, whether or not cash is actually distributed to them. This avoids the “double taxation” that can plague a corporation’s earnings, i.e., a corporation (other than an S corporation) must pay tax on its earnings and then its shareholders must pay personal tax on any dividends or other distributions received by them from the corporation. A partnership’s earnings are taxed only once, to its partners. However, since the partners will pay tax whether or not the partner’s earnings are distributed, partners may have a tax liability even when they have received no distributions with which to pay the tax. In short, the allocation of profit is taxable, the distribution of profit to partners is not.

The flow-through nature of partnership taxation also means that partnership losses can be deducted by partners against their personal income from other sources. A number of limitations may limit this availability, however, including rules regarding basis and passive losses.

A limited liability company (See the discussion above at "FORMS FOR CARRYING ON BUSINESS – Limited Liability Companies") will be taxed in the same manner as a partnership unless it elects otherwise; that is, the LLC will pay no taxes at the entity level, and the members will be taxed on their allocated share of company earnings and will be allowed to deduct their allocated share of company losses.

Although a partnership or LLC pays no entity-level Federal income tax, a pass-through entity is responsible for withholding of payroll taxes from its employees and payment of the employer portion of social security taxes as well as state and Federal unemployment taxes.

d. Estate and Gift Taxation of U.S. Citizens

Federal law imposes an integrated gift and estate tax on certain transfers made by U.S. citizens. The law in this area changes often. For 2023, any individual U.S. citizen may make up to $12,920,000 in lifetime gifts; and additionally can make additional annual gifts of cash or cash equivalents of up to $17,000 per beneficiary without using up any portion of their lifetime exemptions (adjusted annually for inflation). Taxable transfers in excess of the exclusion amounts are subject to a 40% tax rate.

No tax is imposed on the transfer of assets from one U.S. citizen spouse to another. However, a gift tax is imposed on transfers by a U.S. citizen to a noncitizen spouse in excess of $175,000 annually (as of 2023). Through proper estate planning, a married couple may shelter additional amounts from gift and estate taxation by a Qualified Domestic Trust, and irrevocable trusts may be used to leverage even greater estate tax savings.

A related federal transfer tax is the "generation skipping" transfer tax, which is designed to prevent taxpayers from making transfers of substantial assets to grandchildren and lower generation family members so as to avoid taxation of such assets in the estates of the taxpayers' children. Generation- skipping transfers in excess of $12,920,000 are subject to the generation-skipping transfer tax at a flat rate of 40%.

The rates of taxation, and the amounts and limits available for use in the various exemptions, exclusions, and trusts vary from year to year, and therefore attention should be paid each year to IRS announcements of the various limits, exclusions, and rates.

e. Estate Taxation of Foreigners

The death of a foreign individual may have U.S. federal estate tax implications. As in the case of federal income taxation of foreign individuals, two different classifications apply to the estate taxation of foreign individuals, depending on whether the foreign individual at the time of death is a "resident alien" or a "nonresident alien."

f. Determination of Residency Status

The tests for determining residency status for federal estate tax purposes and for federal income tax purposes are different. For estate tax purposes, the crucial inquiry is the foreign individual's "domicile" at the time of death. A resident alien for estate tax purposes is one domiciled in the United States at the time of death. A nonresident alien is one not domiciled in the United States at the time of death.
A person who enters the United States with an immigrant visa (a "green card") is considered to be U.S. domiciled until he or she leaves the United States with no intention of returning. For other individuals, the

determination of domicile depends upon various factors, including the length and permanence of the individual's stay in the United States and the individual's ties with the individual's home country.

An individual may be classified as a resident alien for income tax purposes because he or she was in the United States for at least 183 days per year, yet as a nonresident alien for estate tax purposes because of an intention to return to the country of citizenship.

g. Estate Taxation of Resident Aliens

The estate of a resident alien is generally taxed in the same manner as the estate of a United States citizen. The taxable estate of a resident alien generally includes all property owned worldwide. Special rules reduce the taxable estate when the decedent makes bequests to, or on behalf of, a surviving spouse. If the resident alien's spouse is not a United States citizen, the bequests must be made to a special trust on behalf of the surviving spouse in order to qualify for this treatment. One of the requirements of the special trust is that the trustee must be either a United States citizen or a United States corporation.

Various exemptions and graduated rates apply as notes above.

h. Estate Taxation of Non-resident Aliens

The estate of a nonresident alien includes only property that on date of death is "situated" in the United States. Among items which are considered situated in the United States are United States real property, tangible property located in the United States and shares of stock in United States corporations. Shares of stock in a foreign corporation held by a nonresident alien are not subject to the United States estate tax. Nonresidents making investments in the United States through foreign corporations may avoid United States estate taxes by such investments.

The rules governing bequests to a surviving spouse and the exclusion from estate tax of $12,920,000 described that apply to citizens and certain resident aliens, do not necessarily apply to nonresidents. Careful tax planning and consultation with a tax advisor is particularly important for nonresidents with assets situates in the United States, and this can be taxed at rates of up to 40 percent.

i. Impact of Tax Treaties

The United States has entered into estate tax treaties with certain countries. Typically, such treaties set forth special "tiebreaker" rules which determine the estate tax status of a foreign individual who might otherwise be found to be domiciled in more than one country. Such treaties often provide for an increase of the $100,000 exemption applicable to the estate of a nonresident alien.

j. Gift Taxation

Gifts made by foreign individuals may be subject to United States gift taxation. Resident aliens are taxed on gifts made worldwide. Nonresident aliens are taxed on gifts only if the gift property is situated in the United States. For federal gift tax purposes "resident alien" and "nonresident alien" are defined as they are defined for federal estate tax purposes.

Certain gifts may be made without the imposition of tax. As noted above, the exclusions and limits change each year.

The United States has entered into gift treaties with some countries. Under these treaties special gift tax rules apply.

4.2 MICHIGAN TAXATION

a. Personal Income Tax

The Michigan income tax is imposed on residents as to virtually all income. It applies to nonresidents only to the extent such income is earned in Michigan. A person who is a resident in Michigan for at least 183 days of the taxable year is presumed to be a resident.

The tax base for the Michigan income tax is the federal income tax base, with certain modifications not likely to concern a foreign individual. The tax rate for 2023 is a flat 4.25% of taxable income. The Michigan income tax is deductible in computing the individual's federal taxable income if the individual itemizes their deductions and subject to specified limitations.

b. Business Taxes in Michigan

The Michigan Corporate Income Tax ("CIT") applies to business activity that has a substantial nexus with the State of Michigan. A business that conducts business in multiple states must apportion income derived from its Michigan activities pursuant to a formula.

Michigan offers major tax abatements for eligible businesses that create large numbers of well-paying new jobs. In addition, the state has more than 100 tax-free Renaissance Zones to spur investment and job creation. Michigan also offers several state affiliated venture capital funds to encourage early stage interests in certain types of technology and energy businesses. Michigan also instituted a 100% personal property tax exemption for investments in qualified areas. Michigan periodically reviews certain programs of tax credits for certain business activities and expansions, so attention to these changing provisions will be important to businesses establishing or expanding in Michigan

c. Michigan's Key State Business Taxes Are:

1. Michigan Corporate Income Tax;

2. Property Taxes; and

3. Sales and Use Taxes.

d. Important CIT Notes

The Michigan Corporate Income Tax:

1. Features a corporate tax rate of 6% of the corporate income tax base.

2. Applies to corporations that file as a C Corporations at the federal level.

3. Does not apply to "flow-through" entities, such as partnerships, S Corporations, limited liability companies, and trusts (although these entities may be required to withhold Michigan income tax at the corporate income tax rate on the share of business income distributed to its members or owners.

4. Does not apply to financial institutions and insurance companies, which are taxed differently. Insurance companies pay a premiums tax on 1.25% of the gross premiums written on property or risk located in Michigan, with certain exclusions and credits. Financial institutions

are generally taxed at .29% of net capital, with provisions for apportioning the financial tax base depending on operations inside and outside Michigan.

5. Contains provisions for alternate tax on certain qualifying small businesses with receipts below $20,000,000.

e. Property Taxes

The taxable value of property is 50% of current market value, including both real and personal property; and annual property assessment increases are limited to the lesser of 5% or the rate of inflation. For businesses, there are a number of Property Tax exemptions that may be available for items such as special tools, dies, jigs, and patterns in manufacturing and air and water pollution control abatement equipment. There are also various local county, municipal, and school district property taxes.

4.3 WORKERS' COMPENSATION

Michigan's workers' compensation system allows for the following:

1. An open competitive system allows employers to "shop around" for the least expensive insurance carrier;
2. Eligible businesses can self-insure or join self-insurance pools allowing some companies to save as much as 50%; and
3. Workers' compensation insurance rates have declined in recent years.

4.4 SALES TAX

Michigan has a 6% state sales tax and a 6% state use tax and allows no local sales tax. Many industrial and consumer goods and transactions are exempt from Michigan sales taxes: food, prescription drugs, medical devices, newspapers and periodicals, water, and commercial vessels. Also exempt are: sales for resale, property in interstate or foreign commerce, computers used in industrial processing, custom computer software, information services, railroad rolling stock, air and water pollution control facilities, and energy fuels. Machinery and materials used directly in a manufacturing process are also exempt. Organizations exempt under Internal Revenue Code Section 501(c)(3) are exempt from Michigan sales tax on items purchased for their exempt function.

4.5 PERSONAL INCOME TAXES

Michigan has a flat personal income rate of 4.25%. Several Michigan cities (including Detroit) also impose a local income tax (with rates ranging from 0.5 %, to 2.4%).

4.6 TAX REDUCTIONS

Michigan has a number of opportunities for tax savings. Highlights of these include:

1. Personal income reductions;
2. Personal exemption increased indexed to the rate of inflation;
3. Limits on state income tax on pensions;
4. Property tax reduction and constitutional limit on property tax collections
5. Homestead property tax credits are available;
6. Tax-Free Zones and incentives for certain activities and certain designated Renaissance zones statewide to spur creation of new jobs and investment;

Several types of economic incentives are available through the Michigan Economic Development Corporation for new business and investments.

Chapter 5 - Labor and Employment Law

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Michigan, because of its strong labor movement roots, often finds itself on the forefront of the pressing labor law issues of the day. While Michigan frequently establishes trends, most Michigan labor laws now are paralleled throughout the United States. The following is a summary of Federal and State of Michigan labor laws to assist companies doing business in Michigan.

5.1 EMPLOYMENT DISCRIMINATION LAWS

i. Federal Legislation

Title VII of the Civil Rights Act of 1964 prohibits employment discrimination on the basis of race, sex, color, national origin or religion. The United States Supreme Court has ruled that employment discrimination against individuals based on gender identity, sexual orientation and transgender status is also covered by Title VII of the Civil Rights Act. The prohibition of Title VII applies to employers with fifteen (15) or more employees whose business affects interstate commerce.

The Age Discrimination in Employment Act (ADEA) prohibits employment discrimination against anyone age 40 or over on the basis of age. The ADEA applies to employers in business affecting interstate commerce with twenty (20) or more employees. It applies to all facets of the employment relationship, including benefits.

Disability discrimination is prohibited by federal law through the Rehabilitation Act of 1973, the Americans With Disabilities Act and the ADA Amendments Act of 2008. The Rehabilitation Act applies to Federal contractors and subcontractors and recipients of Federal financial assistance. The Americans With Disabilities Act and the ADA Amendments Act of 2008 apply to all employers engaged in interstate commerce with fifteen (15) or more employees. These statutes prohibit discrimination against qualified individuals with disabilities who, with or without a reasonable accommodation, can perform the essential job functions.

Discrimination based on an employee's genetic information is prohibited through the Genetic Information Nondiscrimination Act of 2008 (GINA), a federal law that took effect in November 2009. Title II of GINA protects applicants and employees from discrimination based on genetic information in hiring, promotion, discharge, pay, fringe benefits, job training, classification, referral, and other aspects of employment. In addition, Title I of GINA restricts employers' acquisition of genetic information and strictly limits disclosure of genetic information. Genetic information includes information about genetic tests of applicants, employees or their family members; the manifestation of diseases or disorders in family members (family history); and requests for or receipt of genetic services by applicants, employees, or their family members.

The enforcement of these statutes is primarily the responsibility of the U.S. Equal Employment Opportunity Commission (EEOC). An individual claiming a violation of these laws must file a charge of discrimination with the EEOC before filing any lawsuit. The EEOC, on its own initiative or on behalf of an employee who files a charge, may file a suit against the employer. Also, the employee, after the processing of a charge by the EEOC, may proceed on his or her own behalf to file a suit.

ii. State Statutes

Much in the same manner as federal law, the Michigan Elliott-Larsen Civil Rights Act prohibits discrimination in employment on the basis of religion, race, color, national origin, age, sex, sexual orientation and gender identity or expression. Sexual harassment is prohibited under both state and Federal laws. Further, virtually all employers in the State, even those smaller than those covered by Federal law, are covered by Michigan's laws prohibiting employment discrimination.

Discrimination by an employer against an individual with a physical or mental disability unrelated to his or her ability to perform the duties of the particular job, with or without a reasonable accommodation, is prohibited by Michigan's Persons With Disabilities Civil Rights Act (formerly the Handicappers Civil Rights Act). In a manner similar to the Federal law prohibiting disability discrimination, this law requires employers to provide reasonable accommodations for disabled individuals to enable them to perform the necessary functions of the job for which they are under consideration or in which they are employed, unless to do so would constitute an undue hardship for the employer. Unlike the federal law, Michigan's law contains a financial formula to assist employers in their evaluation of what expenditures must be made toward satisfying the State (but not the federal) reasonable accommodation requirement.

These State laws are enforced by the Michigan Department of Civil Rights and the courts. Thus, individuals claiming discrimination may pursue his or her claim either through the Department's procedures, or by filing a lawsuit directly with the courts.

5.2 MICHIGAN AIDS TESTING AND CONFIDENTIALITY ACT

The Michigan AIDS Testing and Confidentiality Act requires written informed consent prior to testing for HIV, the AIDS-causing virus, and protects the confidentiality of AIDS test results.

The Michigan Civil Rights Commission's Policy Statement on AIDS sets forth the Commission's position that AIDS is a handicap protected under Michigan's Persons With Disabilities Civil Rights Act and that the Michigan Department of Civil Rights will accept and process complaints claiming discrimination based on AIDS, or a related condition, or on the perception of AIDS.

5.3 EQUAL PAY LAWS

Equal Pay Acts are in place at both the federal and State of Michigan levels. The Michigan act, like the federal act, prohibits discrimination in the payment of wages on the basis of sex. Generally speaking, however, challenges to pay differentials on the basis of sex are brought under the Title VII of the 1964 Civil Rights Act and Michigan Elliott-Larsen Civil Rights Act because the standards of proof and damages available to an employee are more favorable than under the Federal Equal Pay Act and Michigan Workforce Opportunity Wage Act.

The Lilly Ledbetter Fair Pay Act amends Title VII of the 1964 Civil Rights Act, the Age Discrimination in Employment Act, the Americans With Disabilities Act, and the Rehabilitation Act so that the time limits for filing a charge run from the last, not the first, alleged discriminatory decision. Under the Lilly Ledbetter Fair Pay Act, an employee's time limit for filing a charge of discrimination alleging sex discrimination regarding compensation would begin from her last paycheck, not her first. Because the issuance of each paycheck starts the statute of limitations period again, the practical effect of the Lilly Ledbetter Fair Pay Act consists of the effective elimination of a statute of limitations for this kind of claim under the amended statutes.

5.4 THE NATURE OF THE EMPLOYMENT RELATIONSHIP

As a general rule, employment relationships in Michigan are at-will. This means the employer retains the right to release an employee for any reason or no reason at all, as long as the reason is not unlawful. However, there are situations where an implied employment contract to not discharge an employee absent good or just cause may exist. For instance, express representations in employer handbooks, or clear unequivocal oral statements by employers, may alter the at-will relationship and entitle the employee to require the employer to have "just cause" in order to terminate the employment relationship. Also, representations to an employee, whether oral or in a handbook, which create a legitimate expectation on the part of the employee of an employment relationship terminable only for just cause, can also create an implied employment contract.

Having “just cause” rights is significant because the determination of what constitutes a good reason for discharge may be made by a jury many years after the employee’s termination.

For employers wishing to retain the legal position that employment is at-will, well drafted employment applications and employee handbooks can help establish and protect the existence of the at-will relationship.

5.5 WHISTLEBLOWER PROTECTION

Most federal and state employment-protection statutes, particularly those regarding discrimination, workers’ compensation, overtime pay, safety and health and union rights, also prohibit employers from in any way retaliating against employees who exercise their rights under those laws. In most cases, employees who bring charges or complaints against an employer (or co-workers) —even if the charges or complaints are found to have no merit—are protected under these laws.

Michigan, like many states, also has a general statute (the Whistleblowers’ Protection Act) protecting employees who either report to a public body or who are about to report to a public body a violation or suspected violation of local, state, or federal law, as well as employees who participate in any investigation or hearing regarding an alleged violation of law. Unless the employee knows the allegation to be false, the employee’s role in the claim or investigation cannot result in discharge, a threat of discharge, or otherwise affect his or her employment. Employees, who believe their rights under this Act have been violated, must bring a lawsuit making that claim within ninety days of the alleged retaliation.

5.6 FAMILY AND MEDICAL LEAVE ACT AND MICHIGAN’S PAID MEDICAL LEAVE ACT

The federal Family and Medical Leave Act of 1993 (FMLA) requires most employers to provide eligible employees with up to 12 weeks of job-protected unpaid leave each year for family or medical-related reasons.

The FMLA applies to private employers who employ at least 50 individuals during 20 work weeks in either the current or preceding calendar year. Eligible employees are those who have worked at least 12 months and 1,250 hours during the year preceding the leave and are employed at a work site within a 75-mile radius of 50 other of the employer’s employees. Eligible employees are entitled to an FMLA unpaid leave for:

1. Childbirth and newborn childcare, adoption or foster care place of a child;
2. Care of a spouse, child, or parent with a serious health condition; or
3. Their own serious health condition which makes the employee unable to perform the functions of his or her job.

The FMLA imposes notification requirements on employers. Employers must post a form prepared by the United States Department of Labor to notify employees of the Act.

Further, all collective bargaining agreements must comply with the FMLA. Also, written employee handbooks or written policies must include written notice of the employee’s rights and obligations under the FMLA. Where employers have no handbook or written policies, upon receipt of requests for a leave, the employer must provide the employee with notice of rights and obligations under the FMLA.

The employer must continue group health insurance benefits for an employee on an approved FMLA leave. Other benefits need not be continued unless the employer would do so for other unpaid leaves. Unless an employee is a “key employee” as defined under the FMLA, upon return from leave the employee must be reinstated to his or her previous position or to an equivalent position. All benefits must be resumed at the same level as provided when the FMLA leave began.

The Fiscal Year 2010 National Defense Authorization Act expands the coverage for the FMLA, as it relates to military families, in two important respects. First, the Act extends exigency leave benefits to include family members of active duty service members, not just reservists. Prior to the Act's passage, exigency leave was limited to family members of National Guard and reservists, but now it will be extended to active duty service members. Qualifying exigency leave includes, among other things: short-notice deployment, military events, childcare and school activities, financial and legal arrangements, and

post-deployment activities. Second, the Act expands caregiver leave to include veterans, not just active service members. Prior to the Act, caregiver leave only applied to active service members, but will now encompass medical treatment, recuperation, and therapy for veterans.

The Michigan Paid Medical Leave Act (MPMLA) allows employees to accrue up to 1 hour of sick leave for every 35 hours worked. The act further requires that an employer shall allow an eligible employee to use up to 40 hours of sick leave per 12-month period of eligibility. In addition, an employee may carryover up to 40 hours of unused sick pay.

As an alternative to the above, an employer may provide at least 40 hours of paid medical leave to an eligible employee at the beginning of a benefit year. There is a rebuttable presumption that an employer is in compliance with this Act if the employer provides at least 40 hours of paid leave to an eligible employee each benefit year. This includes paid vacation leave (vacation) or paid time off (PTO).

5.7 VETERANS AND EMPLOYEES IN MILITARY SERVICE

Employees who serve in the military are entitled to certain protections under both state and federal law. These protections are intended to provide not only equal treatment but also a measure of preferential treatment. Under the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), an employer may not deny any person initial employment, reemployment, retention in employment, promotion, or any other benefit of employment because of that person's "membership, application for membership, performance of service, application for service, or obligation" to perform service in the uniformed services.

Employers with employees in Michigan need to be aware of the Military Leaves/Reemployment Act of 1955 (MLRPA), Michigan's counterpart to the federal USERRA. The MLRPA provides greater coverage to returning service members than USERRA. For example, under the MLPRA a returning employee is entitled to re-employment without exception while under USERRA the employer can avoid re-employing a returning employee if it can establish that circumstances have changed such that re-employment would be impossible, unreasonable, or would impose an undue hardship.

The MLRPA expressly applies to National Guard members in addition to members of other branches of the armed forces. Under the MLRPA, returning service members need not re-apply for employment if they have served for more than 180 days. Instead, the employee must only report to work within 90 days of completion of service. Re-employment rights do not cease unless the employee has served for five consecutive, not cumulative, years. Under the MLPRA, there exists a civil remedy for an aggrieved employee that includes reinstatement and reasonable attorneys' fees.

5.8 MICHIGAN SOCIAL SECURITY NUMBER PRIVACY ACT

The Michigan Social Security Number Privacy Act restricts certain uses of social security numbers and imposes certain obligations on entities that collect those numbers. The "SSN" Privacy Act is designed to combat identity theft in Michigan. The SSN Privacy Act's primary purpose is to prohibit the use of all or more than four sequential digits of social security numbers by persons, partnerships, corporations, government agencies, public and private educational institutions, and other legal entities.

5.9 WAGE AND HOUR LAWS

a. Minimum Wage and Overtime Requirements

The Federal Fair Labor Standards Act sets forth minimum wage, overtime, and child labor standards with which virtually all employers doing business in the United States must comply. Under this law, most employees must be paid:

1. No less than the statutory minimum wage, which is currently $7.25 per hour (however, Michigan's minimum wage will apply—see below); and

2. 150% of their average wage earned during a workweek for each hour actually worked in excess of 40 during that workweek.

Michigan minimum wage:

Effective September 1, 2014 the State of Michigan instituted a graduated increase in its minimum wage. The minimum wage in 2023 is $10.10 per hour. There is pending litigation which may impact the minimum wage and calculation for future increases.

For tipped employees, the minimum wage has been increased in a similar graduated fashion. Beginning on September 1, 2014, the minimum wage for tipped employees is 38% of the minimum wage and adjusted annually. As of January 1, 2023, it was $3.84 per hour.

While this is a state law, it is applicable to virtually all employers in Michigan. The state law applies to any employer which has 2 or more employees. The federal Fair Labor Standards Act ("FLSA") has thresholds for coverage but applies to most employers in Michigan. However, the FLSA requires covered employers to apply state and local wage laws which are more favorable to the employee than the federal law. Thus, the Michigan minimum wage applies to employers covered by the federal FLSA.

In regard to locally higher minimum wages or "living wage" ordinances, Michigan's 2015 Local Government Labor Regulatory Limitations Act prohibits any local unit of government from enforcing any ordinance requiring employers to pay higher than the state minimum hourly wage, or, if applicable, the minimum wage of the FLSA unless those provisions would result in a lower minimum wage than provided under state law. However, the Act does not prohibit a local governmental body from enforcing a written agreement voluntarily entered into and in effect prior to October 1, 2015 and allows a local governmental body to condition the receipt of a grant, tax abatement, or tax credit from the local governmental body on a higher minimum wage.

b. Federal Exemptions

Some employees are exempted from one or both of the above pay requirements, but those exemptions are quite narrow and many are specific to particular industries. The broadest and most common exemptions from these requirements apply to the following categories of employees --provided that, in most instances, the employees are paid on a "salaried basis" as defined by the applicable federal regulations:

1. Professionals;

2. Executives;

3. Administrative employees; and

4. "Outside" sales employees.

Employers should review their pay practices as to exempt employees very carefully to ensure that all of the technical requirements for claiming the exempt status are satisfied. In recent years the regulations have been amended, making a compliance update especially important. Penalties for non-compliance -- as enforced by the U.S. Department of Labor, or by lawsuits brought by individual employees -- can be extremely burdensome.

c. Nursing Mother's Amendment to the Fair Labor Standards Act

Although the FLSA does not generally require employers to provide break periods, employers must provide a reasonable break time for nursing mothers to express breast milk and a place, other than a bathroom, that is shielded from view and free from intrusion from coworkers and the public. This law is part of the Patient Protection and Affordable Care Act ("PPACA"). While an employer is not required to compensate employees for such breaks, to the extent that the employee uses otherwise available paid break time to express milk, an employer may not deny pay for the break. Also, the provisions of the FLSA concerning breaks for nursing mothers do not modify existing regulations under the FLSA concerning break time for nonexempt employees. These regulations require that rest periods of short duration (from 5 to 20 minutes) be paid. Employers with fewer than 50 employees are not subject to the nursing-mother break requirement if it would impose an undue hardship by causing the employer significant difficulty or expense when considered in relation to the size, financial resources, nature, or structure of the employer's business.

d. Federal Child Labor Rules

Federal law restricts the employment of children under age 18. For non-agricultural jobs, the following general restrictions apply:

- Minors ages 16 and 17 years old may perform nonhazardous work.

- Minors ages 14 and 15 years old may perform nonmanufacturing and nonhazardous work for limited hours during periods when school is in session.

e. Michigan Law

Michigan has its own child labor law, the Youth Employment Standards Act. The Act, while similar to federal law, is more restrictive in certain situations. Because the federal child labor law states that more restrictive state laws control, in the following instances, the more restrictive Michigan state law will apply to minor employees:

- Employers must obtain a work permit for each minor employed. Work permits are obtained from the local school authority;

- Minors cannot work more than six days in any week or more than 10 hours in any day with an average of no more than 8 hours per day.

- When school is in session, the combined hours of school and work per week may not exceed 48 hours;

- Minors may not be employed more than 48 hours in a week when school is not in session;

- Minors aged 14 to 15 cannot work before 7:00 a.m. or after 9:00 p.m. or during any hours school is in session;

- Minors aged 16 to 17 cannot work before 6:00 a.m. or after 10:30 p.m. (11:30 p.m. if school is not in session);

- Minors cannot work more than 5 hours continuously without at least a 30 minute meal/rest period;

- No minors shall be employed unless the employer or employee who is 18 years of age or older provides supervision; and

- An adult supervisor must be physically present at all times after sunset or 8:00 p.m., whichever is earlier, if a minor is employed at a fixed site in an occupation that involved cash transactions.

5.10 SPECIAL LABOR REGULATIONS FOR GOVERNMENT CONTRACTORS

Companies doing business with the federal government (directly or indirectly) are generally subject to a group of labor laws commonly referred to as “prevailing wage laws.” These laws (the Davis-Bacon Act, the Service Contract Act, and the Contract Work Hours and Safety Act) require employers to pay employees working on most federally-financed projects no less than the wages and benefits officially deemed as prevailing in the locality for employees doing similar work. Most suppliers to the federal government of goods and services are subject to these requirements, as are construction contractors performing under federally-subsidized contracts (whether for the federal government, or for state and local governments). These laws are quite complex, and should a routine government audit determine that prevailing wages have not been paid in accordance with the federal regulations, the contractor will usually be required to correct the error—without being able to adjust its contract price. Additional penalties and fines, both civil and criminal, may also be assessed.

Michigan has a similar law for contractors working on state financed construction contracts. When a project is both federal and state funded, however, Michigan’s prevailing wage law will generally not apply.

In addition to these prevailing wage laws, federal contractors must also comply with other employee-related rules. For instance, most federal contractors must prepare and adhere to affirmative action plans setting forth how they intend to improve the utilization of minorities, women, and veterans in their workforces. In addition, most federal contractors must implement and adhere to a policy prohibiting drug abuse in the workforce.

5.11 EMPLOYMENT RECORDS

Both federal and Michigan laws impose recordkeeping requirements on employers. The general standards for complying with these requirements are:

1. Pay and time records (for non-exempt employees) should be retained for at least three years;

2. Job application forms of non-hired applicants should be retained for two years;

3. Application forms and most other records pertaining to employees should be retained throughout the employee’s employment, and for at least three years after their employment is severed; and

4. Records relating to an investigation by a governmental agency, such as one pertaining to a discrimination claim, must also be retained throughout the period of the investigation.

While these retention requirements set forth the basic statutory mandates, due to Michigan’s six-year statute of limitations for contract claims brought by employees, it is generally advisable to retain employment records for at least six years beyond the employee’s last date of employment.

Most states, including Michigan, have laws regulating and allowing employees (and former employees) access to their personnel files. Michigan’s law, known as the Bullard-Plawecki Employee Right to Know Act, broadly defines what is meant by a “personnel record.” In essence, the file includes all pay records, evaluations, discipline records and any other documents in the employer’s possession which are used or which could be used by the employer in the making of employment decisions. Notes from a grievance investigation of a disciplinary action are not part of the personnel record. Employees and former employees must be given reasonable opportunity to review their files, and they must be given a copy of the files (at their cost) upon request. Moreover, should the employee disagree with an entry in the file, the employee must be allowed to attach to the document his or her comments about the entry. Documents not made a formal part of the file within six months of the underlying incident or concern may not – in many cases – be relied upon in the making of a later employment decisions regarding the employee. Moreover, documents not provided to the employee when a copy of the file is requested may not, in some instances, be relied upon by the employer in future decisions or litigation involving the employee.

5.12 CRIMINAL RECORD CHECKS

There is no federal law that clearly prohibits an employer from asking about arrest and conviction records. However, it is the position of the EEOC that using such records as an absolute measure to prevent an individual from being hired could limit the employment opportunities of some protected groups and thus may constitute a discriminatory process.

The EEOC distinguishes between arrest and convictions records, and takes the position that an arrest does not indicate that criminal conduct occurred, and therefore, exclusion from employment based on an arrest generally is not job-related and consistent with business necessity. However, it does provide that an employer may make an employment decision based on the conduct underlying the arrest if that conduct makes the individual unfit for the position in question. On the other hand, according to the EEOC, a conviction record generally provides sufficient evidence that the individual has engaged in the conduct in question.

The EEOC has also ruled that the mere request for arrest information, even if the employer does not consider such information, is illegal because it tends to discourage minority applicants.

In Michigan, an employer may request criminal conviction records and records of pending felony charges and past felony arrests when a conviction did not occur.

An employer in Michigan who wishes to perform a criminal records check on an applicant should have the applicant sign a release and authorization, which can be included on the application form.

5.13 INTERNET PRIVACY PROTECTION ACT

Michigan's Internet Privacy Protection Act prohibits an employer from requesting an employee or a job applicant grant access to, allow observation of, or disclose information that allows access to or observation of the employee's or applicant's personal internet account. The Act also prohibits discharging, disciplining, failing to hire, or otherwise penalizing an employee or a job applicant for failing to grant that kind of access to a personal internet account. The "access information" protected from disclosure consists of "user name, login information, or other security information that protects access to a personal internet account." The Act does permits an employer to require an employee's cooperation in an investigation aimed at ensuring compliance with applicable laws or prohibitions against work-related employee misconduct or when the employer has specific information about an alleged unauthorized transfer of the employer's confidential information, or financial data to an employee's personal internet account.

5.14 PAYMENT OF WAGES AND BENEFITS

Michigan's Wages and Fringe Benefits Act sets forth certain pay practice standards for employers, in addition to some basic recordkeeping requirements. The Act requires that pay be given in regular intervals (at least monthly), and that it include a statement setting forth such information as the wage rate, hours paid, and support for all deductions. Deductions may only be made as allowed by law (e.g., for taxes), by a union collective bargaining agreement, or pursuant to the employee's written authorization. Deductions for the benefit of the employer (such as for reimbursements for lost tools, relocation, etc.) may only be made if pursuant to a voluntary written authorization, for a specified amount, and for a specific pay period. The amount of any deduction cannot be such that it results in the employee receiving less than the minimum wage for all hours worked during that pay period.

Employees are entitled to all earned pay and benefits by the end of a pay period following that in which they are earned or as soon as possible after their termination. Benefits (such as sick and vacation pay) are only payable under this law as required by the employer's written policies.

The Act was amended to permit, subject to certain conditions, the mandatory use of either direct deposit or a payroll debit card, which is also known as a payroll card or a paycard. This amendment means that an employee cannot insist on payment by the means of a paper check, and that an employer can compel the use of direct deposit or payroll debit cards and can accordingly transition into a paperless payroll system with associated savings. An employer that has a collective bargaining agreement with a labor organization, however, would be permitted to unilaterally implement the use of direct deposit or payroll debit cards only if the collective bargaining agreement authorizes that kind of unilateral action. If, as some collective bargaining agreements provide, an employer is required to pay employees by paper check, then the employer would have to negotiate with the labor organization in order to implement a system of mandatory direct deposit or payroll debit cards, regardless of the amended Act. The terms of the collective bargaining agreement would take precedence over that amended statute.

5.15 PLANT CLOSINGS AND MASS LAYOFF

Under the federal Worker Adjustment and Retraining Notification Act (WARN), employers of 100 or more employees must provide—in most instances—60 days prior written notice to employees (or their unions), as well as to the applicable local and state governments, of a mass layoff or plant closing. WARN defines a "mass layoff" as employment losses of more than six months long which either affect at least one-third of the workforce at the site, provided at least 50 employees are affected, or affect 500 employees. A "plant closing" is the shut-down of an entire employment site, or operational unit within a site, for 30 or more days, which results in the layoff of 50 or more employees. The notice requirements may be shortened or waived in a few limited situations which typically involve unforeseeable circumstances.

5.16 UNIONIZED WORKFORCES

The federal National Labor Relations Act recognizes that employees have the right to organize unions and designate unions as their exclusive representative for the purpose of collectively bargaining over wages, hours, and other terms of employment. Employees may not be discriminated against because of their union activities. When a union has been recognized in accordance with legal procedures, an employer may only change wages, hours, and employment conditions of the involved employees pursuant to an agreement with the union, or after fully exhausting its bargaining obligation under the law. Violations of these obligations may subject the employer to remedies imposed by the National Labor Relations Board, such as back-pay, reinstatement, or return to the status-quo which existed prior to the improperly implemented decision. Employers acquiring operations from unionized employers may, under certain circumstances, also acquire obligations to the predecessor employer's unions. For instance, a buyer of a business may agree to assume the obligations of the predecessor employer, or may automatically assume those obligations if the acquisition is a stock purchase. In a typical asset purchase, however, the new employer only acquires a duty to bargain with the predecessor's union if more than 50% of the new employer's work force were employed by the seller, and if the new employer's operations are basically a continuation of the seller's operations.

5.17 NON-COMPETITION AGREEMENTS AND ARBITRATION AGREEMENTS

Under Michigan law, agreements which limit an employee's ability to compete against the employer while employed or after employment is terminated are permissible. However, to be enforceable, the agreement must protect a reasonable competitive business interest and the duration, geographical area, and type of employment or business restricted must be reasonable. Otherwise, the agreement will either not be enforced when challenged, or alternatively, a court may revise the agreement to make the restrictions reasonable. There is currently pending proposed federal legislation that would invalidate non-compete agreements. We anticipate significant developments in 2023 concerning the proposed legislation.

Under Michigan Law, arbitration agreements were generally enforced as a mechanism to resolve all employment related disputes. However, the federal Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act of 2021, amended the Federal Arbitration Act to give employees who are parties to arbitration agreements with their employers the option of bringing claims of sexual assault or sexual harassment either in arbitration or in court.

5.18 POLYGRAPH EXAMINATIONS

a. Federal law

The federal Employee Polygraph Protection Act of 1988 prohibits an employer from directly or indirectly requiring, suggesting, or causing a prospective or current employee to take or submit to any lie detector test. Further, the employer may not use, accept, refer to, or inquire about the results of any lie detector test of a prospective or current employee.

The employer may not deny an employment opportunity to a prospective employee or discipline or deprive a current employee of employment because he refuses, declines or fails to take or submit to a lie detector test or on the basis of the results of any lie detector test. There is an exemption for the government and individuals involved in national defense and security, FBI contractors, and those authorized to manufacture, distribute, or dispense controlled substances. A limited exemption allows for the use of polygraph examinations for ongoing investigations.

b. Michigan Law

Michigan also has a statute which controls the use of lie detector tests in the employment setting. As a general rule, an employer or employment agency cannot as a condition of employment require a job applicant or current employee to take or submit to a polygraph examination. Further, an employer cannot require that an applicant or current employee give an express or implied waiver of a practice prohibited by the Michigan Polygraph Protection Act of 1981.

A polygraph examination is broadly defined under the statute to include psychological stress evaluation or examination or any other procedure which involves the use of instrumentation or mechanical device. Further, an employer cannot avoid the Polygraph Act's prohibitions by asking an applicant or current employee questions, recording the statements, and subsequently submitting them for evaluation.

The exception to the prohibition of use of polygraph examinations is where an applicant for employment or current employee voluntarily requests a polygraph examination. However, the request must truly be voluntary. Further, the safeguards specified by the Act then must surround the polygraph examination.

Despite the voluntary agreement of an applicant or current employee to submit to the test and compliance by the employer with required safeguards, an employer is prohibited under the statute from taking any action against an applicant or current employee based on an alleged or actual opinion that the applicant did not tell the truth during a polygraph examination.

c. General

Based on the Michigan and federal statutes controlling polygraph examinations, it is best for Michigan employers not to utilize polygraph tests in screening job applicants or investigating employee conduct, even if the respective job applicant or employee agrees to it.

5.19 MARIJUANA AND THE WORKPLACE

The Michigan Medical Marihuana Act and Michigan Regulation and Taxation of Marihuana Act allow the medical and recreational use of marijuana. In Michigan an employer does not need to accommodate the ingestion of marihuana in any workplace or any employee working while under the influence of marihuana. In addition, an employee is not permitted to (1) “undertake any task under the influence of marihuana, when doing so would constitute negligence or professional malpractice”; (2) possess or engage in the medical use of marihuana on any school, school bus, or correctional facility; (3) smoke marihuana in any public place; or (4) “operate, navigate, or be in actual physical control of any motor vehicle, aircraft, or motorboat while under the influence of marihuana.”

For private sector employers, the key question has been whether the acts protect an employee from disciplinary action by the employer under its work rules or drug testing policy. The acts do not protect an employee against disciplinary action by a business. A Michigan employer accordingly can lawfully enforce its work rules against the use of drugs and its drug testing policies against employees who use marijuana.

5.20 MICHIGAN SMOKE FREE LAW

Michigan prohibits smoking in most public places, which includes places of employment and food service establishments. The Smoke Free Law defines “smoking” or “smoke” as “the burning of a lighted cigar, cigarette, pipe, or any other matter or substance that contains a tobacco product.” The law will be enforced against any employer who allows smoking anywhere within an enclosed building (4 walls and a roof), but will allow smoking by employees to occur outside the building in an area that is detached from the building.

5.21 WORKERS’ COMPENSATION

As with the laws of virtually every state, the Michigan Workers’ Disability Compensation Act covers payments to employees for work-related injuries incurred out of and in the course of employment on the job. The workers’ compensation law requires employers to accept responsibility for virtually all on-the-job injuries (lost pay and medical costs), in exchange for the assurance that an injured employees’ exclusive remedies for the injuries are limited to those provided by the Act. Injuries sustained as the result of an intentional act on the part of the employer, however, may result in general personal injury liability to the employer. Only in such cases are employers potentially liable to their employees for damages relating to pain and suffering, and the like.

It is unlawful to retaliate (generally termination or discrimination) against an employee who exercises a right afforded under the Act. Furthermore, the Act gives an employee the right to seek medical services, when needed, for work-related injuries.

5.22 UNEMPLOYMENT COMPENSATION

Michigan, as does every other state, has a system for compensating employees who lose their jobs. However, unemployment compensation benefits may be denied to an employee if the employer can establish that the employee was released due to “misconduct”, as defined by the statute, or can establish that the employee resigned from employment or abandoned the job without reasons attributable to the employer.

Chapter 6 - Employee Benefits

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6.1 EMPLOYEE BENEFITS

Employee benefits in Michigan are generally governed by two federal statutes, the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986, as amended (Code). State law has limited impact on benefit plans since ERISA preempts state laws relating to benefit plans covered by ERISA, except laws regulating insurance, banking, discrimination, securities, and taxation.

a. ERISA

ERISA imposes Department of Labor reporting and disclosure requirements and fiduciary standards on health and welfare plans and pension benefit plans, and also imposes participation, vesting, and funding standards on certain pension benefit plans. Unless specifically excluded, ERISA applies to employee benefit plans established by employers engaged in commerce or in any industry or activity affecting commerce. Plans specifically excluded from ERISA coverage include church plans, governmental plans, and unfunded excess benefit plans.

b. Internal Revenue Code

An employee pension benefit plan is either a qualified or a nonqualified arrangement that defers the payment of benefits until termination of employment or retirement. Qualified retirement plans are entitled to certain income tax benefits. Employer contributions are deductible in the year made, and participants are not taxed on contributions or plan earnings until an actual distribution occurs. In exchange for this favorable tax treatment, the Code imposes participation, vesting, funding, and non-discrimination standards on such plans, limits the deductible amount that may be contributed to the plan and limits the amount of benefits that may be paid by the plan. Failure to comply with these standards will cause the employer and employee to lose favorable tax treatment.

Nonqualified retirement plans are not subject to the Code-imposed participation, vesting, funding, or non-discrimination standards, but they do not confer the same tax advantages on employers and employees as qualified plans. Under a nonqualified plan, the employer is not entitled to a deduction until the year in which the employee includes a contribution in his gross income, and plan investments do not generally accumulate on a tax-deferred basis. Depending on the specific design and operation of the nonqualified retirement plan, the employee may or may not be entitled to defer recognition of the benefits that accrue under the plan until the benefits become payable.

c. State Law

The following State laws apply with respect to benefit programs within the State of Michigan.

i. Payment of Wages and Fringe Benefits Act

For employers and benefit programs not subject to ERISA, Michigan's Payment of Wages and Fringe Benefits Act, Act 390 of 1978, requires that benefits subject to a written employer policy be provided in accordance with the written policy. It prohibits an employer from withholding payment due an employee as a fringe benefit to be paid at a termination date, unless the withholding is authorized by law, a collective bargaining agreement, or agreed upon by written contract or a signed statement obtained with the full and free consent of the employee without intimidation or fear of discharge for refusing to agree to the withholding of the benefit. It permits the employer to correct certain overpayments of fringe benefits paid directly to an employee by taking a deduction from the employee's regularly scheduled wage payment without the written consent of the employee if certain conditions are met.

ii. Third Party Administrator Act

Michigan's Third Party Administrator Act, Act 218 of 1984, regulates the conduct of third party administrators providing benefits claims administration for various welfare plans. Among other things, it requires Third Party Administrators to only provide services pursuant to a written contract, requires the Third Party Administrator to maintain a Certificate of Authority from the state, requires books and records of all transactions under the service contract to be maintained in accordance with generally accepted accounting principles or as required by ERISA, and provides that the Third Party Administrator is a fiduciary when collecting, expending, and maintaining money for the payment of claims pursuant to the service contract.

iii. Insurance Code

Michigan's Insurance Code, Act 218 of 1956, regulates the establishment and maintenance of multiple employer welfare arrangements (MEWA), requiring self-insured MEWAs to satisfy certain financial and structural requirements as a condition of operating in Michigan. A MEWA is generally an employee welfare benefit plan or an arrangement established or maintained for the purpose of providing benefits to the employees of two or more employers, meaning the two employers are not sufficiently related to qualify for treatment as a "single employer" under the Code, and at least one of the employers is either domiciled in Michigan or has its principal headquarters or principal administrative office in Michigan, or the MEWA solicits the participation of such an employer. Fully insured MEWAs are not subject to these requirements. The Insurance Code also regulates the insurance carriers and insurance policies providing insured health and welfare benefits within the state, even if the benefits are payable by an ERISA-governed employer-provided group health and welfare plan. Michigan law requires health insurance issuers to include coverage for certain benefits and services in health plans that employers can purchase from issuers. These Michigan health benefit mandates apply to group hospital and medical insurance policies covering at least five employees who live or work in Michigan. The health benefit mandates do not apply to employers that have self-insured group health benefit plans.

iv. Elliott-Larsen Civil Rights Act

Michigan's Elliott-Larsen Civil Rights Act, Act 453 of 1976, prohibits discrimination in Michigan on the basis of "religion, race, color, national origin, age, sex, height, weight, familial status, or marital status" in employment, housing, education, and access to public accommodations. In 2022, the term "sex" was interpreted by the Michigan Supreme Court to prohibit discrimination on the basis of an individual's sexual orientation, not just their gender. The Act has been interpreted by the Michigan Civil Rights Commission as requiring employer-provided group health plans that provide coverage for prescription drugs and services, to provide coverage for contraceptive drugs and services, in order to avoid sex discrimination. An exemption is provided for certain "religious employers" organized under Code section 501(c)(3). The state requirements essentially parallel the requirements under the federal Civil Rights Act of 1964, and therefore is not preempted by ERISA. As a state law of general applicability, it applies to Michigan employers with respect to any Michigan employees.

d. Qualified Plans

i. Defined Benefit Pension Plans

Under a defined benefit pension plan, a participant is entitled to a predetermined amount of benefits upon attaining retirement age. The employer must contribute an actuarially-determined amount to the plan each year to assure that the plan will have sufficient assets to pay promised benefits when due.

The Pension Benefit Guaranty Corporation (PBGC) was established under ERISA to provide minimum benefits to defined benefit plan participants and to provide a means for distributing benefits to defined benefit plan participants in the event that a terminated plan does not have sufficient assets to pay the PBGC-prescribed minimum benefit. Employers sponsoring a defined benefit plan are required to pay premiums to the PBGC, and are required to report certain actions to the PBGC.

ii. Defined Contribution Plans

1. **Profit Sharing Plans.** Under a profit sharing plan, the employer contributes a discretionary or fixed amount to the plan each year. The contribution is allocated among accounts maintained for eligible participants in accordance with an allocation formula set forth in the plan. A participant's benefit at termination of employment or retirement will depend upon the vested amount of the contributions allocated to his account and the rate of return earned by the plan on those contributions. Fully vested employer profit sharing contributions may be made as Roth contributions, starting in 2023. Roth contributions are contributions made on an after-tax basis, but unlike other after-tax contributions, the earnings on these contributions are not taxable upon distribution in retirement.

2. **401(k) Plans**. A 401(k) plan is a profit sharing plan or stock bonus plan which contains a cash or deferred arrangement. Under the cash or deferred arrangement, participants enter into salary reduction agreements, pursuant to which their compensation is reduced by a stated percentage or amount and contributed to the plan. A 401(k) plan may be structured to automatically enroll participants in the plan or to require elective enrollment. The employer may or may not make matching contributions, and may permit catch-up contributions (available to participants age 50 or older) to the plan. Fully vested employer matching contributions may be made as Roth contributions, starting in 2023. Starting in 2024 any catch-up contributions made by high-paid participants must be Roth contributions. Contributions to 401(k) plans are typically allocated to separate accounts for each participant, and benefits depend upon the vested value of the account at termination of employment or retirement. Participants are not taxed on the amount of salary deducted and contributed to the plan until contributed amounts are distributed to them, unless those contributions were made on an after-tax basis or as Roth contributions.

3. **Stock Bonus Plans**. A stock bonus plan is a profit sharing plan that invests primarily in the employer's stock.

4. **Money Purchase Pension Plans.** Under a money purchase pension plan, the employer contributes a fixed amount to the plan calculated pursuant to a definite formula which cannot vary from year to year. A money purchase pension plan is also subject to certain funding rules that apply to defined benefit pension plans. Like a profit sharing plan, the contribution is typically allocated among accounts maintained for participants in accordance with a formula set forth in the plan, and benefits are determined by the value of the participant's account at retirement.

e. Nonqualified Plans

i. Deferred Compensation Plans

Employees often seek to defer a portion of their compensation until retirement, when they anticipate that they will be in a lower income tax bracket. In order to avoid ERISA and Code- imposed participation, vesting, funding and non-discrimination standards, nonqualified plans typically cover only top management and highly compensated employees, and are usually unfunded. Plan participants have a mere contract right against the employer for the promised benefit. While there are ways for the employer to set aside assets to pay benefits under the plan, such as in a "Rabbi Trust," the assets of the trust must remain subject to the claims of the employer's general creditors. Code Section 409A imposes significant restrictions and limitations on employee deferral elections, distribution requirements, payment acceleration events, and payments to certain key employees.

f. Health and Welfare Plans

i. Medical Plans

Many employers in Michigan view medical plans as a key part of their employees' overall benefit package. For employers subject to ERISA, ERISA applies in full to medical benefits. A large number of other federal requirement apply, as well. Employers either pay the entire cost of medical plans or charge their employees for a portion of the cost. Employers may self-insure their medical plans, or may provide fully-insured coverage. Self-insured plans are subject to Code-imposed nondiscrimination standards. Medical benefits are frequently subject to network arrangements, meaning the individual will pay more for benefits obtained from a non-network provider.

Employers with 20 or more employees who sponsor medical plans are subject to the federal Consolidated Omnibus Budget Reconciliation Act (COBRA). Under COBRA, employees and their dependents who lose coverage under the medical plans as a result of certain events are entitled to continue to maintain medical coverage under the plan for periods of up to 18, 29, or 36 months if they elect COBRA coverage and pay a premium for the coverage.

Michigan does not have a state COBRA law.

The Patient Protection and Affordable Care Act (PPACA) imposed a number of requirements on group medical plans, employers, and insurers offering medical coverage. Additionally, this law imposes an excise tax on certain large employers that fail to offer substantially all of their full time employees and their dependents affordable medical coverage that meets specific requirements. Reporting requirements apply, as well. PPACA also expanded the nondiscrimination requirements to apply to insured plans, but the enforcement of these requirements by federal agencies had been put on hold indefinitely.

ii. Dental and Vision Benefits

Many employers in Michigan provide dental and vision benefits to their employees and their dependents. For employers subject to ERISA, ERISA applies in full to these benefits. Benefits may be insured or self-insured, and often are provided through a preferred provider or network-type arrangement. For an employer subject to COBRA, these benefits are usually subject to COBRA.

iii. Life Insurance

Many employers provide life insurance for their employees. Generally, when the employer pays premiums on the life of an employee and the proceeds of the policy are paid to the employee's beneficiary, the amount of the premium is income to the employee and a deductible expense for the employer. If life insurance is provided through a group term life insurance plan, the cost of the first $50,000 of insurance is not included in the employee's income. To obtain this exclusion from taxation, the first $50,000 of group term life insurance must be provided through a plan that may not discriminate in favor of key employees as to eligibility to participate or the amount of the insurance.

iv. Dependent Care Assistance Program

Under a dependent care assistance program, an employer either pays or reimburses an employee for expenses incurred by the employee for dependent care. These programs must be provided pursuant to a written plan and may not discriminate in favor of officers, owners or highly compensated employees with respect to eligibility, contributions or benefits. Amounts paid by the employer are not included in the employee's taxable income to the extent that they do not exceed $5,000, or $2,500 in the case of a married taxpayer filing a separate federal tax return.

v. Disability Plans

A short-term disability plan that is designed and operated as a payroll practice rather than an ERISA-governed plan will be subject to state law and not to ERISA. A long-term disability plan will be subject to ERISA if the employer is otherwise subject to ERISA. Disability benefit programs may interact with several federal and state laws, such as the Family and Medical Leave Act, the Americans with Disabilities Act, the Pregnancy Discrimination Act, the Social Security Act, Workers' Compensation laws, and state disability laws. Insured disability plans and short-term plans not designed and operated to fall outside of ERISA will be subject to ERISA's reporting and disclosure requirements. Michigan insurance law mandates pertain to group disability insurance coverage issued by commercial insurers and health maintenance organizations.

g. Cafeteria Plans

Cafeteria plans are generally structured in one of two ways. Under the first type of arrangement, an employee may choose between cash or a nontaxable employer-paid benefit, such as medical coverage, group term insurance, or dependent care. To the extent that the employee does not elect nontaxable benefits, he will receive additional cash compensation, which is taxable in the year received.

Under the second type of arrangement, the employee may elect to have his current salary reduced and applied toward the cost of nontaxable benefits. This enables the employee to pay for nontaxable benefits with pre-tax dollars, as the amount of the salary reduction is not included in the employee's taxable income. The benefits available under a cafeteria plan are generally limited to cash and qualified benefits, including: (1) group term life insurance up to $50,000; (2) certain accident or health plan coverage; (3) health Flexible Spending Accounts; (4) premiums for COBRA continuation coverage; (5) dependent care assistance program benefits; (6) certain adoption assistance benefits; (7) an accidental death and dismemberment insurance policy; (8) long-term or short-term disability coverage; (9) post-retirement group life insurance plans maintained by certain educational organizations; (10) contributions to Health Savings Accounts (HSAs); (11) participation in a qualified cash or deferred arrangement that is part of a profit-sharing plan or stock bonus plan; and (12) certain premiums payable to a state health exchange.

Cafeteria plans may not discriminate in favor of highly compensated employees as to eligibility, contributions, or benefits.

Chapter 7 - Immigration and Visas

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7.1 INTRODUCTION TO THE UNITED STATES VISA SYSTEMS

U.S. law divides all people into two basic categories: United States citizens or nationals; and aliens. The rights of aliens to enter, work, and remain the United States are governed by a complex and constantly evolving system of laws, regulations and interpretations. For most purposes, aliens are further divided into two categories: immigrants and nonimmigrants. In order to enter and remain the United States, an alien must be admissible and must fit into one of the numerous immigrant or nonimmigrant categories listed in the statute and regulations. These categories are generally of two types: temporary and permanent. Temporary immigration categories permit entry for a limited period and may or may not permit the alien to work in the United States. Permanent categories permit an alien to reside in the United States permanently and to work in the United States. In addition, after three or five years a permanent resident alien of the United States is eligible to apply for U.S. citizenship.

The U.S. immigration system is administered by the Department of Homeland Security (DHS), the Department of Labor (DOL), and the Department of State (DOS). There are other government agencies which are involved in limited areas (for example, state employment agencies) and even private entities which may have authority in specific cases (for example, universities approve practical training for F-1 students).

Due to the tremendous complexity and constant change of immigration laws, regulations and agency interpretations, the number of agencies with which the employer must work, and the shifting needs of the workplace, the sponsoring employer must carefully select and request the appropriate immigration category. The status of each foreign worker must be considered as an individual matter. Often the easiest visa to obtain is the wrong choice because of long term planning or other considerations. For example, the choice of temporary category may later affect the ability to obtain permanent residence.

7.2 PERMANENT RESIDENCE AND THE PREFERENCE SYSTEMS

In most cases, United States permanent residence is granted according to two “preference” systems based on employment and family relationships. This summary discusses the “employment based” preference system, but family preferences are available to spouses, children, mothers, sisters, and parents of U.S. citizens, and to spouses and unmarried children of U.S. permanent residents.

There are five employment based preferences:

i. First Preference – Priority Workers

Persons who have demonstrated extraordinary ability in the sciences, arts, education, or athletics, as measured by sustained national or international acclaim and whose achievements have been recognized in the field through extensive documentation, and who seek entry to continue work in their field of extraordinary ability.

Outstanding professors or researchers with international recognition with at least three years of teaching or research in the area.

Executives or managers transferred within a multinational group of affiliated companies who have worked as a manager or executive outside the U.S. with a qualifying company for at least one year in the three years prior to application.

ii. Second Preference

Members of the professions holding an advanced degree or with exceptional ability.

iii. Third Preference

Professionals, skilled workers, and unskilled workers.

iv. Fourth Preference

Certain special immigrants, including religious workers.

v. Fifth Preference

Persons establishing a new commercial enterprise (including a purchase and restructuring of an existing business), investing at least $1,000,000 (or $500,000 in certain designated high unemployment or rural areas), and which creates at least 10 jobs for U.S. workers other than the applicant and his family.

The choice of preference category is important because there are annual limits on the number of immigrants in each category, and some classifications also require labor certification.

If the number of eligible aliens applying exceeds the available quota, the remaining applicants are placed on a waiting list. The length of wait varies by preference category and by country from no wait to many years.

Labor certification is required for the second and third preferences. Labor certification is a lengthy and complicated process, generally requiring the sponsoring employer to conduct a government prescribed and administered recruitment process to demonstrate that there are no minimally qualified U.S. workers willing to accept the position offered.

7.3 TEMPORARY (NONIMMIGRANT) CATEGORIES

There are several different types of nonimmigrant categories from which to choose. Most require prior DHS approval of a petition filed by the employer. Though each nonimmigrant category has its own particular requirements for approval, some common criteria apply.

a. Substantive Issues

i. Nonimmigrant Intent

All nonimmigrant categories are temporary, and their periods of validity vary. Most nonimmigrant categories require that the alien have an intention to return to his or her foreign residence. Factors which tend to show the requisite intent to return are: (1) the maintenance of the alien’s address abroad and sufficient economic and social ties to the foreign country; (2) a reason for coming to the U.S. which is either short in duration or limited in scope and purpose and confined to a reasonable pre-determined period; (3) the absence of any prior or pending applications for permanent U.S. residency by the alien or filed on his or her behalf; and (4) the absence of any exclusion or deportation/removal proceedings involving the alien.

ii. Limitation

Alien limited to authorized activities for sponsoring employer.

It is important to note that an alien admitted to the United States in one of the several nonimmigrant categories, must at all times remain in compliance with the requirements of his or her nonimmigrant status. Taking on duties other than those listed in the petition approved by the DHS, switching employers without prior authorization, working while in a category which does not explicitly permit employment, or failing to be employed while in a category which is specifically linked to employment may all lead to the individual falling out of lawful status, which can have serious consequences both for the individual and for the sponsoring employer.

It is important to note that an alien cannot simultaneously hold more than one type of nonimmigrant status. Nevertheless, the alien (or the alien's U.S. employer) may usually petition to change the alien's status to a different nonimmigrant status. However, no change in an alien's status may occur if the alien entered the U.S. under the Visa Waiver Program (unless the alien marries a U.S. citizen).

b. Procedural Notes

i. The Petition for Nonimmigrant Worker

Most nonimmigrant categories require prior approval of a nonimmigrant petition filed by the intending employer with a United States Citizenship and Immigration Service (USCIS) regional service center in the United States. Although processing times vary, employers should keep in mind that for most categories, processing times of two months or more are not unusual.[1] The nonimmigrant petition must demonstrate the eligibility of the individual employee to meet all requirements specific to the particular category being requested, and must demonstrate that the employer qualifies to sponsor nonimmigrants in that status, is a genuine viable and ongoing business in the United States, and has the ability to pay the nonimmigrant for the duration of his or her stay. Treaty traders and treaty investors as well as their managerial, executive, and essential skill employees may usually bypass the step of petitioning with a USCIS regional service center.

ii. Visa Application

USCIS approval of a nonimmigrant petition does not guarantee ultimate entry into the U.S. Aliens of most nationalities must next apply for a visa at a U.S. embassy or consulate abroad. To apply, the alien usually must appear at the embassy or consulate and submit an Application for a Nonimmigrant Visa; together with a passport valid for six months beyond the expiration of the requested visa, in addition to other documentation which varies depending on the type of visa, nationality, and consular rules.

[1] Expedited processing (15) days is available for many petitions by paying an additional $2,500 fee.

iii. *Inspection and Admission*

A visa does not guarantee entry into the U.S. After obtaining the visa, the alien must still pass inspection by a Customers and Border Protection (CBP) officer at the border or pre-flight inspection station for admission into the U.S. If admitted, he or she will be issued an entry stamp. The arrival/departure card (Form I-94), which states the nonimmigrant category and the term of the alien's stay in the U.S. is available at www.cbp.gov.

iv. *Non-Visa Entries*

Nationals of certain countries do not need to obtain visas prior to entering the U.S.

In many circumstances, Canadian citizens and certain Mexican citizens may not require a visa for entry. These groups may apply for admission at the port of entry, but some categories may nonetheless require prior USCIS service center approval. Certain groups which are exempt by statute and treaty, and citizens of participant countries in the Visa Waiver Program, may also be exempt from the entry visa requirement. Entry under the Visa Waiver Program should be made with caution, however, since neither a change of status nor extension of stay is permitted if the alien has entered under the Visa Waiver Program. Visa Waiver entry may be made for tourism or business trips, but not to engage in gainful employment.

Chapter 8 - Real Property

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8.1 METHODS OF HOLDING TITLE

As a general rule, only natural persons and certain legal entities such as corporations, limited liability companies, and partnerships, can hold title to Michigan real estate. Joint ventures and unincorporated associations cannot hold title to Michigan real estate. A common law business trust formed in a state other than Michigan that treats such trusts as corporations will also be treated as such under Michigan law and can hold title to real estate in Michigan, but Michigan law does not otherwise treat trusts as entities. Thus, Michigan trusts cannot hold title to real property - instead title must be held by the person or persons appointed as trustee(s).

a. Individual Ownership

Any individual of legal age may hold title to real estate in Michigan. Two or more individuals may hold title to real estate as co-tenants, joint tenants or, in the case of husband and wife, as tenants by the entireties. These forms of ownership are discussed more fully below. Because of the risk of environmental and other liabilities, individual ownership is not often used for commercial real estate. Most commercial properties are owned by some form of legal entity, which provides a measure of liability protection to the entity's owners.

b. Corporate Ownership

Foreign or domestic corporations may hold title to real estate in Michigan. In addition to the degree of insulation from liability provided by corporate ownership, the use of a corporation as a title holder may be advantageous to the owner that needs flexibility in financing because usury laws provide certain exemptions for corporate borrowers that may not be available to individual borrowers. The tax implications of entity ownership must always be considered before deciding what form of entity is most appropriate. A tax advisor should be consulted regarding tax issues.

c. Partnership Ownership

Foreign or domestic partnerships may hold title to real estate in Michigan. Prior to the advent of limited liability companies, limited partnerships were the preferred form of ownership of commercial property. Limited partnerships allow for both insulation from personal liability for limited partners and the tax benefits of a partnership. The general partner in a limited partnership does not enjoy insulation from liability, but that risk is commonly avoided by the use of a corporation or a limited liability company as the general partner. A potential drawback to the limited partnership is that the limited partners are not permitted to take part in the management of the partnership.

d. Limited Liability Companies

Foreign or domestic limited liability companies may hold title to real estate in Michigan. Limited liability companies ("LLC") are now the favored vehicle for ownership of commercial real estate in Michigan. *See*, "FORMS FOR CARRYING ON BUSINESS - Limited Liability Companies." Unlike limited partnerships, LLC's provide real property owners with both limited liability and the opportunity to actively participate in management of the entity. LLC's also permit the pass-through of income and losses from the entity to its owners for Federal tax purposes. Thus, the LLC's provide all of the tax advantages and liability insulation of a limited partnership, with the added right to participate in the management of the company.

e. Dower

By statute, Michigan no longer recognizes a married woman's inchoate "dower" interest in her husband's real property.

f. Concurrent Ownership

i. Tenancy in Common

In Michigan, any two or more people may hold title to real property together as tenants in common. Tenants in common each hold an undivided fractional interest in the property as a whole by distinct titles and do not enjoy the right of survivorship. Instead, the interest of a deceased tenant in common passes to his or her heirs. The interest of a tenant in common may be conveyed, mortgaged, or otherwise transferred independently of the interests of the other tenants in common. Conveyances to two or more persons who are not husband and wife are presumed to convey title as tenants in common absent an expression of intent to the contrary.

ii. Joint Tenants

Joint tenancies are recognized in Michigan. Because of the presumption favoring tenancy in common, an express declaration of joint tenancy is required in order to create a joint tenancy. A joint tenancy may not be created or presumed by operation of law. Typically, a joint tenancy is created by a conveyance to two or more persons with the words "as joint tenants" or "as joint tenants and not as tenants in common." Persons who hold property in joint tenancy enjoy rights of survivorship. With such a tenancy, if one of the joint tenants dies, the decedent's title automatically passes to the surviving joint tenant(s). Joint tenancy enables a decedent's interest to pass to the other joint tenant(s) outside of the probate administration of the decedent's estate. Generally, a deed from one or more, but not all, joint tenants to a third party severs the joint tenancy as to the interest of the grantors only, and results in the grantee being a tenant in common with the owners that did not join in the conveyance. If more than one joint tenant did not join in the conveyance, they would remain joint tenants vis-à-vis each other.

A variation of joint tenancy is created if the deed to the joint tenants identifies the grantees "as joint tenants with full rights of survivorship." In Michigan, such grants will create joint life estates with cross-contingent remainders, that is, the estate created is a joint life estate in all the grantees, with the survivor of the grantees holding a remainder interest to the entire property. This type of "joint tenancy" cannot be severed by a conveyance from fewer than all the joint tenants. Rather, if fewer than all of the joint tenants conveyed their interests to a third party, the interest conveyed is a life estate with a contingent remainder that remains subject to the life estates and cross-contingent remainders of the other joint tenants for the life of the grantor. If the grantor predeceases the remaining joint tenants, the grantee's interest in the real property is extinguished. Only if all of the non-conveying joint tenants die before the grantee will the grantee acquire full fee title to the property.

iii. Tenancies by the Entireties

A tenancy by the entireties can be created only if the persons to whom title passes are husband and wife at the time the deed conveying title takes effect. When a husband and wife take title to real property, a tenancy by the entireties is presumed unless it is specifically indicated otherwise in the deed conveying title to them. Like joint tenancy, tenancy by the entireties results in automatic passing of a decedent's title to the survivor without including the interest of the decedent in the decedent's probate estate. Unlike joint tenancies, the interest of only one of the spouses cannot be conveyed independent of the other and the tenancy by the entireties cannot be severed by a deed from only one spouse.

8.2 MICHIGAN PURCHASE AND SALE TRANSACTIONS

a. Statute of Fraud

As in other states, Michigan law generally requires that contracts for the sale or transfer of real property or interests in real property be in writing to be enforceable. While this requirement is generally satisfied by the use of comprehensive written agreements for the purchase and sale of real property, Michigan courts have found that a binding agreement for the sale of real estate may exist where there is a simple writing identifying the parties, the property, and the price.

b. Purchase Agreements

There are many issues to be considered in drafting an agreement for the sale and purchase of real property in Michigan. Many real estate brokers furnish pre-printed forms for use in residential, and sometimes commercial, transactions. These forms are not standard, however. Many pre-printed forms are specifically designed to favor one party over the other, and many contain variables reflecting local customs, such as the method for prorating real estate taxes. The parties should obtain legal counsel to review any such document before signing any pre-printed form.

All parties who will be required to sign the deed in order to convey full title should also sign the purchase agreement. The legal description for the property should be included in the agreement or attached as an exhibit to the agreement. In addition, the street address and parcel identification number should be included, whenever possible, to reduce the possibility that the property to be conveyed has not been sufficiently described.

If there is personal property included with the sale, the agreement should so provide. A separate bill of sale should be utilized at the closing of the transaction to reflect the sale of the personal property.

The agreement should express not only the purchase price, but also the method and time for payment. Any contingencies for obtaining financing should be clearly expressed. If the parties intend for time to be of the essence of such contingencies, the agreement should clearly reflect such intent. Purchasers should also make the agreement contingent upon satisfactory inspections and tests of the land and structures.

Land contracts, a form of seller financing, are sometimes utilized in the sale and purchase of real property in Michigan. Typically, a written purchase agreement precedes a land contract, and the land contract is executed at the closing in place of title conveyance documents. Occasionally, land contracts are entered into without a preceding purchase agreement, but this is not a sound or customary practice. With a land contract, the deed to the property is not delivered to the purchaser (or "vendee") until the land contract is fully paid by the purchaser. Instead, a memorandum of land contract is usually recorded to provide record evidence of the transaction. Because the deed is not delivered until the land contract is fully paid, the purchaser is said to have "equitable title" to the property (usually including the right to possession), and the seller (or "vendor") retains "legal title" to the real estate until the land contract is paid and the deed is delivered. The characteristics of land contracts, and the remedies available to a seller upon default by the purchaser, are discussed below under "MORTGAGES AND LAND CONTRACTS."

Earnest money deposits are not required by Michigan law but, as a matter of custom, are generally utilized by the parties to an agreement for the sale and purchase of Michigan real property. Statutes and regulations govern the holding of an earnest money deposit by a licensed real estate broker, but others, such as title companies, attorneys, or one of the parties, may also hold the earnest money deposit.

The agreement should address the condition in which title must be conveyed, and how title problems are to be resolved. Any encumbrances that will remain upon title, such as easements and building and use restrictions of record, and zoning ordinances, if any, should also be set forth in the agreement. At a minimum, the agreement should require the seller to convey a "marketable title." Under Michigan case law, title is considered "unmarketable" if a reasonably careful and prudent person, familiar with the facts, would refuse to accept the title in the ordinary course of business. It is not necessary that the title be actually bad in order to render it unmarketable. It is sufficient if there is such a doubt or uncertainty as may reasonably form the basis for litigation. It is customary in Michigan for the seller of real estate to purchase an owner's policy of title insurance for the benefit of the purchaser. There is no legal requirement that this be done, however.

The agreement should state who is responsible for the payment of real estate taxes and assessments at the closing, and whether real estate taxes and assessments should be paid in full by one party, or prorated between the parties as of the closing date. In Michigan, the taxing authorities (at a minimum the local municipality, county, local school district and intermediate school district) may all have different fiscal years for which taxes are levied. For that reason, tax pro-rations are rarely done on a fiscal year basis. In addition, the method used for property tax pro-rations differs in various parts of the state. In some areas taxes are pro-rated as if paid on a calendar year basis and in some areas on a due date, paid in arrears basis. But the most common method of pro-ration is the due date, paid in advance method. This method treats all taxes as if paid in advance for the twelve month period commencing with the due date of the tax payment (generally July 1 and December 1), without regard to the fiscal years of the various taxing authorities. Thus, care should be taken to determine which method of pro-ration is specified in the agreement, since these different methods of pro-ration can make a significant difference in the outcome of the tax prorations. By statute, unless the purchase agreement provides otherwise, taxes are prorated on a due date, paid in advance basis.

Most sellers (trustees and other fiduciaries are generally exempt) of residential real estate must also provide the purchaser with a statutory form Seller's Disclosure Statement, describing the condition of the real and personal property to be sold. Some municipalities and other governmental bodies require certain inspections prior to the sale of residential real estate.

The transferee must file a Property Transfer Affidavit with the local assessor's office within forty-five (45) days after the transfer. This affidavit provides notice of the transfer so that, unless the transfer falls within certain statutorily-prescribed exemptions, the assessor can adjust the taxable value of the property for property tax purposes[1]. A nominal fine of $5 per day, not to exceed $200, is assessed for late filing of the affidavit, but the greater risk to a transferee for not filing is the possibility of a retroactive increase in property taxes and the assessment of interest and penalties for late payment of taxes, once the assessor does discover the unreported transfer.

If the property is to be used as the purchaser's principle residence, a Homestead Exemption Affidavit should be filed promptly after the closing. This provides the purchaser with a significantly lower tax rate than that for non-homestead property. Other reporting documents, such as the Notice to Assessor of the Right to Make a Division of Land may be required under certain circumstances.

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[1] Historically, real property taxes were based on state equalized value, which is supposed to be 50% of the "true cash," or fair market, value of the property. However, in order to help minimize the property tax impact of runaway inflation or periods of rapidly increasing property values, property taxes are now based on the "taxable value" of the property. Increases in taxable value from one year to the next are limited to the lesser of the CPI increase or 5%. This has generally resulted in a taxable value that is lower than state equalized value. When property is transferred in a non-exempt transfer, the taxable value is adjusted to equal the state equalized value. For purposes of the adjustment of taxable value, the term "transfer" is broadly defined by the statute to include leases for a period of 35 years or longer (including any option periods) and cumulative transfers of more than 50% of the ownership interest in an entity that owns the real estate.

c. Title Insurance

As mentioned above, in any transaction involving the purchase and sale of real property in Michigan, the purchaser should require that the seller furnish a policy of title insurance. A title insurance policy insures that the ownership interest being conveyed is good and marketable.

A typical purchase agreement requires the seller to order and obtain a commitment for title insurance from a reputable title insurance company within a specified time after the purchase agreement. If a broker or lawyer is being utilized by the seller, usually one of them will handle the initial ordering of the commitment. Lawyers do not write title insurance in Michigan.

Once a commitment has been obtained, it will be delivered to the prospective purchaser for review. If the purchaser finds defects in the existing title, the purchaser should notify the seller and, if necessary, delay the closing until the defects are corrected. Most purchase agreements provide that, if the defects cannot be corrected, the purchaser is entitled to terminate the purchase agreement and obtain a refund of his deposit, but if the agreement does not provide for it, there is no right of termination.

Assuming that the title commitment reveals marketable title, the title insurance policy is ordered at the closing by the seller and is delivered to the purchaser within a few weeks thereafter. The effective date of the policy will be the closing date or the date of recording of the pertinent documents, depending on the title company and the preference of the purchaser even though it may not be delivered until sometime after the closing. In order to avoid any later question, it is advisable for the purchaser to obtain a marked- up title insurance commitment from the title company at closing that confirms the contents of the final policy. In Michigan, the seller customarily pays, at the closing, the premium for the owner’s policy of title insurance, but the parties can shift that obligation in the purchase agreement.

A title insurance commitment will specify the current owners of the property, a legal description of the property being conveyed, standard exceptions that are applicable to all policies (unless removed by the title company), and specific exceptions that are applicable only to that parcel of property (such as mortgages, construction liens, tax liens, easements, leases, deed and use restrictions, and other encumbrances that affect the quality of the title being conveyed). An astute purchaser will require, in the purchase agreement, that the standard exceptions be deleted. Normally this will require that the seller or the purchaser furnish the title company with an accurate survey of the property and that the seller provide an affidavit regarding the property to the title company. The agreement should be clear on which party is responsible for paying for the survey, otherwise the seller’s obligation to provide title insurance without standard exceptions could be construed to impose on the seller the obligation to pay for the survey required to delete the survey exception from the title policy.

Title insurance is also available to, and is required by, mortgage lenders. A lender making a mortgage loan on property will require that the borrower provide it with a policy of title insurance that insures the priority of its mortgage lien on the property. The contents of such a policy are similar to the contents of an owner’s policy. The cost of a mortgage title policy is generally paid by the borrower.

d. Transfer Taxes

Michigan imposes transfer taxes upon the sale or conveyance of real property or interests in real property[2], both at the State and County levels. The County transfer tax rate is $0.55 per each $500.00, or fraction

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[2] While transfer taxes have historically been payable only upon the conveyance of a direct interest in real estate, Michigan law now provides for the payment of transfer taxes upon the transfer of a “controlling interest” (80% or more) in entities whose assets are at least 90% real estate. This expansion of the imposition of transfer taxes to entity interest is recent and the application of the amended statute is unsettled.

thereof, of the purchase price. The State transfer tax rate is $3.75 per $500.00, or a fraction thereof, of the purchase price. Transfer taxes are payable upon the recording of the deed or other instrument of conveyance. If the purchase price is stated on the deed, the transfer tax will be based on that amount. If it is not stated on the deed, the grantor must execute a Real Estate Transfer Tax Valuation Affidavit, setting forth the full purchase price, which is then filed (but not recorded) along with the deed and the transfer tax is then paid on the purchase price disclosed in the affidavit. By statute, the grantor is obligated to pay the transfer taxes, but the parties may modify that obligation by written agreement. Certain instruments and transfers are exempt from transfer tax, such as instruments where the consideration is less than $100.00. Additional exemptions may be found in MCLA 207.505(a)-(o) and MCLA 207.526(a).

e. Closing

Closing of the transaction will generally be governed by the purchase agreement. Generally, at the closing the parties exchange a deed and the consideration simultaneously. Closings are customarily face to face, not by escrow, but escrow closings are not uncommon. In addition to the deed or land contract and financing documents, the parties will exchange a bill of sale (for any personal property), a closing statement, and any other documents provided for in the purchase agreement.

f. Formalities of Deeds and Other Instruments

The conveyance of title is accomplished by execution and delivery of a deed from the grantor to the grantee. In order for a deed to be valid in Michigan, it must satisfy certain common law and statutory requirements. The deed must include a recital of consideration, a description of the property to be conveyed, and words of conveyance. The statement of consideration given for the property may either be the agreed upon sale price or it may be perfunctory, for example, "for $1.00."[3] The property should be described in the deed by its proper legal description. The words of conveyance effectuate the transfer and establish the type of conveyance, as discussed below.

A deed must also meet certain statutory requirements to be valid in Michigan. A deed must be in writing and the full names and addresses of the grantors and the grantees must be stated in the deed. The grantor must sign the deed and acknowledge the signing before a notary public. The notary public must then sign the deed and the notary's name must be printed or typed beneath his/her signature. The deed must also state the name of the preparer of the deed and the preparer's business address. The marital status of all male grantors must be stated on the deed (if husband and wife are grantors, the designation "husband and wife" is sufficient to satisfy this requirement).

Michigan law also prescribes certain other requirements for recordability, such as minimum font size, minimum margins, instrument titles and ink colors. In addition, all deeds conveying un-platted lands must contain a statement that the grantor is, or is not, granting to the grantee its rights to divide the land outside of the platting requirements. Without such a statement, unless the entire parent parcel is conveyed (see discussion of "Subdivision Regulations" below), the division rights of the parent parcel are not conveyed to the grantee but remain with the parent parcel. All deeds conveying un-platted land must also contain a statement to the effect that the property may be located near farmland or a farm and the consequences thereof.

Michigan law also requires that recorded instruments must reflect only a single recordable purpose, which must be expressed in its title. So, for example, an instrument cannot be titled "Deed and Release of Lien" as that title reflects two recorded purposes.

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[3] *But see* discussion under "Transfer Taxes" above concerning the requirement of filing a Real Estate Transfer Tax Valuation Affidavit if the purchase price is not stated on the deed.

In addition to signing the deed, the grantor must also deliver the deed to the grantee to convey title to the real estate. Simply recording a deed to an unsuspecting grantee will not affect a transfer of title to the named grantee.

In Michigan, two types of deeds are primarily used to convey real estate, warranty deeds and quit-claim deeds. In a warranty deed, the grantor warrants to the grantee that the title that the grantee is receiving is unencumbered fee title and that there is no exception to title, except for specific limitations stated on the deed, such as “easements and restrictions of record.” The grantor could be required to defend the grantee’s title if defects in title are subsequently discovered. A deed that states that the grantor “conveys and warrants” title to the grantee is a sufficient warranty deed under Michigan law, and includes all warranties of title.

A quit claim deed merely conveys whatever right, title, and interest the grantor has in the real estate, if any, but it does not include any warranty of title. So the grantor under a quit claim deed is not liable for any defects in title. The forms of both warranty deeds and quit-claim deeds are prescribed by statute in Michigan.

A third type of deed commonly used in Michigan is a “covenant deed,” sometimes referred to, as a “deed C.” A covenant deed is similar to a “special warranty” deed in other jurisdictions. It is something of a hybrid in that it does not include any warranty against any defects in title that may predate the acquisition of title by the grantor, but it includes a covenant by the grantor that the grantor that he/she/it has not done anything to affect the title (except as may be expressly set forth in the deed) and usually contains a warranty against the claims of any person claiming title to the property by, through or under the grantor. Covenant deeds are not prescribed by statute, so the forms used can vary widely.

Needless to say, deeds and conveyances should be recorded promptly with the Register of Deeds for the county in which the property is located. Failure to record a deed may permit third parties to acquire rights superior to the rights of the grantee.

8.3 MORTGAGES AND LAND CONTRACTS

In Michigan, a mortgage is a lien on real property securing the payment or performance of an obligation. The obligation is usually evidenced by a promissory note, but may be set forth in another type of agreement. A mortgage may be given to secure an existing debt, a new debt, future advances, a guaranty, all debts of the mortgagor to the mortgagee, or the obligations of another party.

Any real property interest may be mortgaged in Michigan, such as a tenant’s leasehold interest, a land contract vendee’s interest or an interest in minerals. However, in order for a mortgage to constitute a lien, there must be a genuine and valid obligation created for which consideration has been given. A mortgage may be executed and recorded prior to the making of any advances. The priority of the lien securing advances made pursuant to a future advance mortgage is discussed below.

a. Types of Michigan Mortgages

Michigan law recognizes, and has statutes governing, trust mortgages and common mortgages. Deeds of trust are also permitted in Michigan but, while commonly used in other states in lieu of mortgages, are not common in Michigan.

The trust mortgage is a mortgage given to one person as trustee for the benefit of several holders of the mortgagor’s debt instruments, such as bonds. The common mortgage generally secures a single loan held by a single lender, though mortgages may secure more than one loan and participation in a single mortgage is also permitted.

Other than prescribing the necessary elements of a mortgage, discussed below, Michigan law does not prescribe a specific form of mortgage. Thus, mortgages in Michigan vary widely and, with the exception of certain provisions that typically appear in all mortgages (such as covenants to pay the debt secured, pay taxes, maintain insurance and avoid waste) the length and complexity of mortgages are as varied as the lenders and their counsel.

In certain circumstances, an equitable mortgage may be imposed by a court of equity when no valid written mortgage exists but the court determines that some sort of lien is required by the circumstances and the relationship of the parties, such as where a deed that appears to be absolute on its face is given as security for a debt.

b. Elements of a Michigan Mortgage

By statute, an instrument that provides that “A mortgages to B,” and includes a description of the property and the debt or other obligation secured, is sufficient to constitute a mortgage, but without any warranty of title. The phrase “mortgages and warrants” will give rise to a mortgage with full warranty of title, much like a warranty deed. In practice, such simple mortgages are not used and would never be accepted by lenders, as no covenants are implied under Michigan law, so all covenants and obligations must be spelled out to be enforceable. For example, in the absence of a covenant to pay the indebtedness, there is no implied covenant on the part of the mortgagor to pay the indebtedness. So the mortgagee would have no recourse against the mortgagor under the mortgage, only against the mortgaged property, if the debt is not paid, although recourse may be available under the underlying debt instrument.

As in the case of deeds and other conveyances, in order for a mortgage to be recordable, Michigan law requires that it include such information as the parties’ names and addresses, the marital status of a male mortgagor, and a description of the mortgaged property. It must be signed and notarized. Mortgages are subject to the same technical requirements for recording as are deeds, such as minimum margins, color of ink, font size, and the like. Care should be given to strictly comply with these requirements, or the document may be refused by the Recorder. In particular, the single recordable purpose referenced in the discussion of Formalities of Deeds and Other Instruments above would be violated by an instrument with the customary title “Mortgage, Assignment of Leases and Rents, Security Agreement and Fixture Filing.” To be recordable, the title should simply be “Mortgage.”

While recording is not necessary to render a mortgage enforceable between the parties or for judicial foreclosure, the mortgage must be recorded to permit foreclosure by advertisement and, of course, to protect the mortgagee’s priority against subsequent purchasers or encumbrancers without actual notice. Like many other states, Michigan follows the rule that as between two mortgages on the same property, generally the mortgage first recorded has priority, unless the mortgagee under the first-recorded mortgage had actual notice of a pre-existing but subsequently recorded mortgage. However, a mortgage that has been recorded first may be made expressly subordinate to a subsequent mortgage if valid consideration is given.

Michigan law requires that the sum for which the mortgage is granted or a description of the indebtedness should be set forth in the mortgage. However, mortgages can be written to secure more than just the amount owing under a specified promissory note. Mortgages frequently contain “dragnet” clauses that provide that the mortgage will also secure all other indebtedness of the mortgagor to the mortgagee. In addition, if a mortgagee is forced to pay delinquent taxes or fund expenses in order to maintain the property, these payments may also be secured by the mortgage.

Mortgages may secure future advances and, if the mortgage specifically states that it is a “future advance mortgage," a future advance will have priority as if it were made on the date the mortgage was recorded. A residential future advance mortgage must include a specific disclosure on the first page of the mortgage, including the maximum amount to be secured, if the future advances are to retain the original priority of the mortgage.

There are, however, two exceptions to this future advance priority: construction liens and state and federal tax liens. Both may take priority with respect to advances made subsequent to the recording date of the construction lien or tax lien.

A commercial mortgage may also contain an assignment of rents as collateral, or the assignment may be contained in a separate instrument given in connection with a commercial mortgage. It is customary to both include assignment of rents language in the mortgage and to record a separate assignment of leases and rents. Assignments of rents are otherwise not enforceable in Michigan.

c. Foreclosure

Lenders may foreclose in Michigan by judicial proceedings or, subject to certain limitations discussed below, by advertisement. Both types of foreclosure procedures are governed by statute in Michigan.

The right to foreclose judicially is a common law right that exists whether or not it is spelled out in the mortgage, and whether or not the mortgage is recorded. To foreclose by judicial proceedings, the mortgagee must file suit in the circuit court for the county in which the property is located. Judicial foreclosure is appropriate where the lender seeks the appointment of a receiver to take control of the property pending the foreclosure and expiration of redemption rights, or where there are priority issues that need to be resolved. However, it is much slower and far more expensive than foreclosure by advertisement and, for that reason, is less favored than foreclosure by advertisement. Publication of notices for the foreclosure sale cannot commence until at least six months after the foreclosure complaint was filed, which means that the sale will not take place until seven and one-half to eight months after the complaint is filed.

The alternative to judicial foreclosure is foreclosure by advertisement. It is an accelerated procedure which is far less expensive than judicial foreclosure and which enables the property to be sold without judicial supervision. As a result, it is the more favored approach to foreclosure in Michigan. It is a creation of statute, not a common law right, thus it can only be exercised in accordance with the statute. In order to foreclose by advertisement the statute requires that the mortgage first be recorded and it must contain an express power of sale. The procedure for foreclosure by advertisement is governed by the statute. It requires both the posting of a notice of foreclosure sale on the mortgaged property and the publication of a notice of foreclosure sale for at least four consecutive weeks in a newspaper of general circulation in the county in which the property is located, though publication customarily takes place for five consecutive weeks, to give the foreclosing lender an opportunity to correct any errors in the published notice and still have four weeks left to satisfy the statutory requirement. Otherwise, material errors in the published notice could require the lender to start the foreclosure process over. The week following the last publication of the foreclosure notice, generally on the same day of the week, the property may be sold by the county sheriff to the highest bidder at a public auction. The sale may be postponed from week to week or to a date certain by complying with the statutory requirements without having to repeat the publication process. Again, however, one may not foreclose a mortgage by advertisement in Michigan unless the mortgage is recorded and contains a power of sale.

As mentioned above, foreclosure by advertisement is the quicker, and usually preferred, method of foreclosure, generally taking approximately six weeks from commencement of the foreclosure process to sale, compared with at least seven and one-half months or more in the judicial process. However, foreclosure by advertisement does not resolve priority issues. Thus, if there are any priority disputes between a foreclosing lender and other persons claiming an interest in the property, such as construction lien holders, then a foreclosure by advertisement may not be advisable, as subsequent litigation may be required to resolve priority disputes.

If the mortgage or underlying obligation provides for personal liability of the mortgagor, then the lender may bring a separate action for deficiency following foreclosure by advertisement. However, if the lender brings an action on the debt before commencing foreclosure, the lender must either dismiss the action on the debt or, if judgment has been entered, execution on the judgment must be returned unsatisfied. Generally, an action on the debt is an action on the promissory note or other instrument secured by the mortgage, and does not include an action on a guaranty. However, in a recent case in which “indebtedness” was defined in the mortgage in such a way as to include obligations arising under a guaranty, the court held that an action on the guaranty was an action on the debt. In a judicial foreclosure, the judgment of foreclosure must include a determination of which parties, if any, will be liable for a deficiency and provide for a judgment against such persons if a deficiency exists after the foreclosure sale.

In the context of certain residential foreclosures, only the lender may be required to offer the borrower the opportunity to meet with a mortgage counselor in an effort to modify the mortgage and, if such counseling is unsuccessful, judicial foreclosure may be required.

In either type of foreclosure, the mortgagee is permitted to make a credit bid at the foreclosure sale up to the full amount of the mortgage debt, plus certain allowable protective advances and expenses. After the property is sold at a foreclosure sale, the mortgagor has a specified redemption period in which to pay all outstanding amounts owed and retain title to the property despite the sale. The length of the redemption period in a foreclosure by advertisement depends upon the character of the property and the proportion of the indebtedness paid by the borrower, though it is usually six months. In a judicial foreclosure, the redemption period will be six months in all cases. The redemption price will equal the amount bid at the foreclosure sale, plus interest at the rate provided in the note or mortgage from the date of the foreclosure sale until the date of redemption, and may also include property taxes or insurance premiums required to be paid by the purchaser subsequent to the foreclosure sale. If the property is not redeemed upon expiration of the redemption period, title vests in the person who was the successful bidder at the foreclosure sale. If the mortgage foreclosed is a second mortgage or if it is otherwise subordinate to other liens or mortgages, the title conveyed by the foreclosure deed will also be subject to those prior liens and mortgages. In the case of residential property, only if the property is abandoned by the owner, the redemption period may be shortened to 30 days by taking certain steps specified by statute.

d. Land Contracts

One of the common methods of selling land in Michigan is the land contract. A land contract is an alternative financing arrangement that provides for the financing of the sale by the seller, with the conveyance of title to the property to take place when the land contract is paid in full. During periods of high interest rates, or in circumstances where institutional financing is difficult to obtain, land contracts are often used to finance the purchase of property because the interest rates that may be charged by sellers are often lower than those provided by institutional lenders. When a land contract is executed, the seller retains legal title to the property until the purchaser pays the sums required by the land contract, but generally delivers possession to the purchaser upon the execution of the land contract. During the term of the land contract, the seller holds legal title to the property and the purchaser holds an equitable interest in the property.

Upon the purchaser’s default, a land contract may be judicially foreclosed, in the same manner as a mortgage. Land contracts cannot be foreclosed by advertisement. Land contracts typically provide that the land contract balance may be accelerated in the event of a default, if the seller elects to pursue a judicial foreclosure, and such acceleration is permitted. As in the case of judicial foreclosure of mortgages, if the property is not sold for enough at the foreclosure sale to pay the indebtedness and all other permissible charges in full, a deficiency judgment may be obtained against the land contract purchaser.

The additional remedy of forfeiture, which permits the seller to terminate the land contract and retain all funds paid to that date and title to the property, is available to the land contract seller upon the default of the purchaser, but only if the right of forfeiture is specifically set forth in the land contract. Acceleration of the debt is not permitted in connection with a forfeiture, and no deficiency may be recovered following a forfeiture. If the purchaser is not in possession of the property, and if no memorandum of land contract has been recorded, it may be permissible to exercise self-help in connection with the repossession of the property following a forfeiture. However, in most cases, after delivery of the requisite forfeiture notice and failure of the purchaser to cure the existing defaults, a summary proceeding must be initiated to restore possession of the property to the seller and, if a memorandum of land contract has been recorded, to clear title to the property.

Under both judicial foreclosure and forfeiture the purchaser has a right to redeem the property. In the case of judicial foreclosure, redemption requires payment of the full amount of the foreclosure bid, plus interest and other permissible charges, as in the case of redemption from a judicial foreclosure of a mortgage. In the event of summary proceedings following a forfeiture, since no acceleration of the debt is permitted, the purchaser need only cure the defaults set forth in the judgment within the prescribed time in order to redeem, following which the land contract is then reinstated.

The purchaser's interest in a land contract has been subject to a variety of interpretations in Michigan. It has the characteristics of both an interest in real property and also a right provided by contract. While in substance a land contract is much like a mortgage, there are significant differences. For example, in the bankruptcy context, land contracts have been held to be executory contracts subject to assumption or rejection by the bankruptcy debtor, but not subject to the "cramdown" provisions which may be applicable to mortgages.

e. Easements

An easement, generally speaking, is a right which one person has to the use or benefit of, or over, the land of another person. An easement may be personal to the beneficiary without regard to that person's ownership of land. This type of an easement is called an easement "in gross" and is generally not assignable or inheritable, except that easements in gross for pipelines, utilities and railroads are generally assignable.

Easements in favor of another property owner for the benefit of his property are known as easements "appurtenant" and generally "run with the land." In other words, a deed or other conveyance of the land benefited by the easement will also carry with it the right to use and benefit from the easement. Similarly, a conveyance of property burdened by an easement carries with it the obligation to permit the beneficiary of the easement to use and enjoy the easement. Most easements are appurtenant and, when the instrument creating an easement is not clear as to whether the easement is intended to be in gross or appurtenant, the law will generally presume that the easement was intended to be appurtenant.

Easements are usually created in a written instrument, either by express grant (such as an easement granting to a property owner an easement over adjoining property) or by reservation in an instrument of conveyance (such as a driveway easement reserved in a deed for the benefit of adjoining property in which the grantor retains ownership). Easements by express grant and reservation must be in writing to be enforceable.

Easements may also be created by implied grant, implied reservation or by prescription. For example, if the owner of a large tract of land conveyed the portion of that land providing access to a public road or highway, and retained only a land-locked parcel without expressly reserving an easement for ingress and egress, an easement by implied reservation could arise. Conversely, if that same property owner conveyed the land-locked parcel without granting an easement, an implied grant of easement could arise. Implied easements arise only as a matter of necessity, not merely for convenience.

An easement by prescription may be created where the owner of one property utilizes the property of another for his own benefit, such as for driveway purposes, in a peaceable, open and uninterrupted manner for a period of fifteen (15) years or more. Such use must be without the permission of the owner of the burdened property, as permissive use cannot give rise to a prescriptive easement. While easements created by grant or reservation should show up in title work for real property that is going to be purchased or leased, prescriptive easements will generally be discoverable only by a physical inspection of the property. For this reason it is always advisable to inspect property for signs of such usage prior to signing a purchase agreement or lease.

Easements may also be acquired by the government and certain utility companies by the exercise of the power of eminent domain.

The owner of the property burdened by an easement may generally use the easement area for any purpose which will not interfere with the enjoyment of the easement by the owner of the benefited property. The instrument creating the easement may, however, impose greater restrictions upon the use of the easement area by the owner of the burdened property. Conversely, the beneficiary of the easement may use the easement only for the purposes for which it was granted. As an example, an easement granted solely for pedestrian access cannot be used for motor vehicles.

Once created, an easement will continue until it is extinguished. An easement acquired by prescription may be extinguished by non-use or abandonment by the owner of the benefited property or by an express release of easement by that property owner. An easement created by express grant or reservation generally may be extinguished only by a written instrument releasing the benefited property owner's rights to the easement.

8.4 REAL PROPERTY LEASES

A lease is the transfer of the right to the possession, use and occupancy of real property by the owner of the property (called the "Landlord" or "Lessor") to the person renting the property (called the "Tenant" or "Lessee") in exchange for rental payment. This right to possession is transferred for a period of time (the "term" of the lease). During the term, the Landlord retains ownership of the property and the Tenant has the right to use the property for the purposes upon which the parties have agreed. At the end of the term, the Tenant's right to possession expires and reverts to the Landlord.

a. Term

Customarily, leases in Michigan, including residential leases, are in writing and are for a fixed term. Under Michigan law a lease for a term of more than one year must be in writing to be enforceable. Oral leases for residential property (and more rarely, commercial property) are occasionally entered into on a month-to-month (or even year-to-year) basis. A month to month lease is a form of tenancy at will, intended to last for an uncertain duration, and either party can terminate the lease at any time by giving appropriate notice of termination. If neither party so terminates the lease and each of them performs its obligations under the lease, the lease continues.

b. Costs and Expenses

Written leases also determine the responsibility of the Landlord and Tenant for occupancy costs in addition to rent. These costs include items such as real estate taxes, insurance of the property and liability insurance, maintenance and repair expenses, common area utility charges and management fees. In a "Gross Lease," generally the Tenant only pays rent and utilities for his own usage, and the Landlord pays all of the other costs. In a “Triple Net Lease,” which is by far the more common form of commercial lease, the Tenant pays its rent, its own utility costs and its share of all of these other costs so that the rent received by the Landlord is considered to be its net income from the property. Sometimes a lease will be neither a true Gross Lease nor a Triple Net Lease, and the parties will agree to a mutually acceptable manner of allocating these costs.

c. Other Provisions

Many other important issues will be addressed in a properly drafted lease contract. For example, the lease should specify what use the Tenant may make of the property and should allocate maintenance responsibilities (aside from the cost) and the types and requirements for improvements that both the Landlord and Tenant may undertake. The lease will specify who bears the risk of loss due to fire or other casualty or due to condemnation by the government. In the event of such casualty or condemnation, the lease should set forth the rights and obligations of the parties with respect to termination and/or rebuilding. The lease may include clauses that give the Tenant the option to extend or renew the lease, or terminate early, to expand its rented space to adjoining or nearby premises, or even to purchase the property. The lease may restrict or govern the rights of the Tenant to assign its interest in the lease or to sublease the premises. The lease may specify whether the property is being rented “as-is” or whether the Landlord is required to install “Tenant Improvements” in the premises prior to or during occupancy and, if so, who pays the cost of the Tenant Improvements.

d. Default and Remedies

A lease will normally detail the respective rights of each of the parties in the event that either the Landlord or the Tenant fails to perform its required obligations (i.e., breaches the lease). Michigan law sets forth specific requirements and time frames for eviction of a Tenant by a Landlord if the Tenant fails to pay rent or perform its other lease obligations. The Landlord also has the right to collect delinquent rent and other money damages due to the Tenant’s breach. In Michigan, these rights are subject to the Landlord’s obligation to act reasonably to mitigate its damages. Similarly, if the Landlord is required to and fails to maintain the property such that it becomes uninhabitable, the Tenant’s obligation to pay rent may be temporarily excused, or the Tenant may even have the right to surrender its occupancy and terminate the Lease.

e. Residential Leases

Leases for occupancy of the premises as a residence are governed by certain specific statutes designed to protect the Tenant’s interests. Among these are the “Truth in Renting Act” which prohibits discrimination in renting, prohibits certain provisions in leases and requires certain other provisions, such as the right to a trial by jury, and the “Landlord/Tenant Relations Act” which places significant requirements and restrictions on the Landlord’s ability to accept and utilize a security deposit. Most residential leases in Michigan are Gross Leases.

f. Ground Leases

Ground leases are leases of land, usually unimproved, made by a Landlord who does not want to expend time and money to develop a property but wants to retain ownership of the land. Tenants under Ground Leases generally insist on a long lease term (often 50 years or more) because they will be investing large sums of money developing and making improvements to the property, which they must amortize and seek to recover over the term of the lease. At the end of the term, the improvements made by the Tenant which are affixed to the land generally revert to the owner of the land. In the past, ground leases have not been as common in Michigan as in other states, but are becoming more common. Ground leases in Michigan are generally Triple Net Leases.

g. Commercial Leases

Commercial leases apply to different types of properties such as industrial, office, and retail properties. Commercial leases are normally structured as Triple Net Leases or, in some cases, a "Modified Gross" lease, in which the rent for the first year is a gross rent, but the tenant pays its share of increases in operating expenses and property taxes after the first year. In a multi-tenant development, a tenant will want significant assurance that its neighboring tenants will be utilizing their properties for compatible uses. In shopping centers, tenants may also require that other tenants and occupants in the center not be in direct competition with the tenant. This may be less of an issue in a large shopping mall where massing of similar uses attracts large numbers of retail customers.

Retail leases often require an additional rental payment known as "Percentage Rent" requiring the Tenant, in addition to its base rent, to pay the Landlord a percentage of its sales revenues above a base amount. Formulas for Percentage Rent can become complex and require specific definition regarding what items are to be included as sales revenues.

h. General

Regardless of the type of lease, Landlords and Tenants must pay particular attention to environmental concerns, health standards and accessibility for the disabled. There are numerous federal and state statutes addressing these issues, and failure on the part of either the landlord or tenant to take into account the impact of these laws can create substantial liability exposure for both parties.

8.5 ZONING AND LAND USE

Land use and development in Michigan may be subject to both state and local regulation, though most regulation is done at the local level. This section deals only with local zoning regulations and their impact on the development and use of land in Michigan. The developer should also refer to state legislation concerning historic preservation, wetland preservation, and other environmental laws that may affect land use and development.

The Michigan legislature has enabled cities, villages, townships and rural counties in Michigan to regulate land use and development within their borders pursuant to a plan. Cities and villages are governed by the same zoning enabling act, while townships and rural counties are each guided by separate zoning enabling legislation. Most local governments have their own set of zoning regulations and master or future land use plans. Many Michigan communities also have local historic district, wetland and woodland preservation ordinances. All these regulations may have an impact on land development and, consequently, the preparation of site plans submitted for approval of a particular land use.

There is very little, if any, un-zoned land in Michigan. Thus, it is customary, and a requirement in most communities, for a land developer to meet with the local planning department to discuss land use and development plans and to obtain site plan approval prior to commencing a project. Even if the property contains the proper zoning for the project, the municipality will still require submission of a site plan application to obtain required permits to begin construction. The procedures for submission and approval of site plans are provided in the local zoning ordinance. By law, a municipality must approve a site plan that conforms to the zoning ordinance requirements for site plan approval but, in practice, municipalities have great latitude in imposing requirements on developers.

In cities, villages and townships, landowners may apply for variances from the zoning ordinance to the Zoning Board of Appeals. The law however is unclear whether Townships may grant use variances. Cities and villages are empowered to grant use variances. The landowner may appeal the denial of a variance request to the circuit court for the county in which the property is located within 21 days after the date upon which the minutes of the hearing at which the action was taken are approved. Additionally, a party with an interest affected by the Zoning Board of Appeals' decision may challenge the granting of a variance by seeking review of the decision in state circuit court.

If the property does not contain the proper zoning for the developer's plan, the developer may also seek a rezoning of property. The rezoning process usually takes a few months, but could take much longer. The ultimate decision to approve the rezoning is made by the village, city or township legislative body after a public hearing. The Michigan Supreme Court has held that, even if a rezoning petition has been filed and denied, the landowner must also apply for a use variance before the landowner can challenge an existing zoning classification under the Michigan or U.S. Constitution.

a. Special Land Use Permits and Planned Unit Developments

Cities, villages and townships all have authority to enact zoning ordinances containing provisions for special land uses and planned unit developments. These ordinances contain specific standards that must be met and procedures for application and approval of the use. Applications for special land use permits and for planned unit developments require site plan submission and review. A special use permit is required for those uses that may be a permitted use under the zoning ordinance, but which require special consideration in order for the use to be granted.

Planned unit developments may also be available through a special procedure or site plan review process. These provide the land developer with more options to create multi-use developments or residential developments, allowing a different mixture of uses or densities not normally permitted under the zoning ordinance.

Under Michigan law, if a party's application for a special land use permit or a planned unit development meets all the standards provided in the local ordinance for granting such a permit or use, the municipality must grant the permit. If it does not, the landowner may bring an action directly to the circuit court seeking an order to compel the municipality to approve the special land use or planned unit development. Depending upon the circumstances, the action may be taken by appeal, mandamus or superintending control. Based on unclear case law, parties are well advised to bring such actions within 21 days of the date upon which the minutes of the hearing at which the action was taken are approved. If the municipality's zoning ordinance provides for an administrative appeal of a decision to deny such a permit, these remedies must be exhausted prior to bringing suit.

Site plan submission is mandatory for special land uses and planned unit developments. The municipality must also approve the site plan if it meets all the requirements under the ordinance for site plan approval.

b. Subdivision Regulations

Division, or subdivision, of land is governed by the state Land Division Act. However, the legislature has also enabled cities, villages, and townships to regulate the subdivision of land within their boundaries. Depending on the size of the "parent parcel" of land (generally the parcel sought to be subdivided) and the number of division the land owner seeks to make, the landowner may or may not be required to plat the property into a platted subdivision. If platting is necessary, the approval of preliminary and final plats will be conditioned upon compliance with the Land Division Act, the local government's rules, any published rules of the county drain commissioner, county road commission or county plat board, the relevant rules of State Highways, Department of Treasury, Water Resources Commission, and Department of Public Health.

The sub-divider (referred to as the "proprietor" under the land division act) must submit a preliminary plat for approval prior to submitting its final plat for approval. Following submission of a preliminary plat for approval, the local legislative body must act on the submission within 90 days of the date of filing the preliminary plat. Tentative approval of a plat provides the proprietor, with an approval of lot sizes, lot orientation and street layout for a one-year period. Final plat approval provides the proprietor with a conditional right, for a period of two years from the approval date, to develop the land in accordance with the plat. The locality may not alter the general terms and conditions under which it granted preliminary approval. The one -and two-year periods may be extended pursuant to the terms of the local ordinance.

Following final approval of the plat, certain certificates must be obtained and appear on the plat from local government agencies, such as the county road commission and county drain commission, and in a certain order, to entitle the recording of a final plat. When the approval and certificate process has been completed, the final plat is submitted to the state for final approval, then it must be recorded with the register of deeds office for the county in which the property is located.

Certain land divisions are not subject to the platting requirements of the Land Division Act. Whether or not a division of land may be accomplished without compliance with platting requirements requires analysis of a number of factors including the size, as of March, 1997, of the “parent parcel” from which the division is to be made and the number of divisions, if any, created from the “parent parcel” subsequent to March, 1997.

Michigan’s Condominium Act provides an alternate means of dividing property. Divisions of land pursuant to the condominium act are exempt from the platting requirements of the Land Division Act, though local ordinances, including but not necessarily limited to site planning ordinances, will apply. Platting under the Land Division Act is more time consuming and, generally, more expensive than dividing under the Condominium Act, so many developers now prefer to subdivide land by the creation of a “site” condominium, rather than platting under the Land Division Act.

Chapter 9 - Mineral Rights

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9.1 CREATION

Mineral interests are generally owned by the surface owner. Michigan has recognized the "law of capture" as it related to oil and gas, but the harshness of its application has been modified by adoption of the fair share, or ownership in place rule. The mineral interest may be severed from the fee ownership by a reservation at the time of the sale of the land, or a separate conveyance by mineral deed. When a mineral interest is separated from the surface ownership, in the absence of an express prohibition, there is an implied right to use the surface for exploration, drilling, production, storage, and transportation. Accordingly, it is advisable when purchasing land that is subject to a grant or reservation of mineral rights to seek some limitation on those rights before accepting title to the land.

Severed oil and gas interests may be reunited with the surface ownership by operation of the Dormant Minerals Act if a mineral interest has not been leased or transferred by recorded instrument for a period of 20 years, no drilling permit has been issued, and there has been no actual production or withdrawal of oil or gas from the land during the 20 year period. The owner of the severed mineral interest may record a written notice containing prescribed information within the twenty year period, however, and avoid loss of the interest.

9.2 LEASING

Oil and gas leases normally provide for a primary term and an extended term while production in paying quantities is possible. Shut-in well clauses are common. There is limited case law interpreting leases in Michigan, and the few decisions have drawn heavily on Texas law. An implied covenant of development is recognized to protect royalty owners. A statute provides for forced pooling.

9.3 PERMITS TO DRILL

The application for a permit to drill a well is made to the Supervisor of Wells, Geological Survey Division, Department of Environmental Quality, State of Michigan. After the filing of the permit, the applicant is required to complete an Environmental Impact Statement (EIS), which can also be done prior to and in conjunction with the filing. The only basis for the denial of an application to drill is threat of excessive damage to public or private land or to animals, fish, or aquatic life.

After a successful well is drilled, the allowable rate of production and the acreage to be included in the producing unit are determined for an oil well by the Supervisor of Wells and for a gas well by the Michigan Public Service Commission. The allowable rate of extraction is intended to avoid waste or damage to the reservoir and is set pursuant to the findings of a public hearing.

When a well becomes non-productive, it is required that all casing be pulled and that it be plugged and all surface level pits and excavations be filled and debris eliminated by the operator. The Department of Environmental Quality will issue instructions to the Supervisor of Wells specifying the type and amount of plugging material required to be used.

A permit must also be obtained from the Supervisor of Wells for secondary recovery involving any type of injection. The forced pooling statutes contain provisions covering formation of secondary recovery units.

Chapter 10 - Environmental Regulation

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10.1 CONTAMINATED PROPERTIES PART 201 OF NREPA AND CERCLA OR "SUPERFUND"

a. Part 201 and CERCLA

Part 201 of Michigan's Natural Resources and Environmental Protection Act (NREPA), MCL 324.20101-.20142, governs the cleanup and redevelopment of contaminated properties in Michigan. Part 201 addresses the liabilities and responsibilities associated with owning and operating contaminated properties in Michigan and provides certain liability protections to prospective purchasers to encourage redevelopment of impacted properties. While Part 201 was modeled after the federal Comprehensive Response, Compensation and Liability Act (CERCLA), there are differences between the two statutes.

b. Part 201

Part 201 is "triggered" by a release or threatened release of a hazardous substance at a property which results in the property becoming a "facility". A "facility" is defined as "any area, place, or property where a hazardous substance in excess of the unrestricted residential cleanup criteria established under Part 201 has been released, deposited, disposed of, or otherwise comes to be located." MCL 324.20101(1)(r). Responsible parties liable for clean up at a facility include (i) current owners and operators of a facility responsible for causing a release of hazardous substances; (ii) past owners and operators of a facility who owned or operated the facility at the time of disposal of a hazardous substance if the owner or operator was responsible for an activity causing a release or threat of release;(iii) current owners and operators of a facility regardless of whether such owner or operator caused the release or threatened release of a hazardous substance unless the owner or operator conducted and disclosed a Baseline Environmental Assessment (BEA) in accordance with Part 201 and (iv) transporters and arrangers for disposal. The BEA is the mechanism by which the State of Michigan provides liability protection to purchasers and operators of contaminated properties to encourage redevelopment of those properties.

c. Baseline Environmental Assessments and Liability Protection

Those who first own, occupy, or foreclose on a contaminated property after June 5, 1995, may avoid liability for the cleanup of contaminated properties under Part 201 if they conduct a "baseline environmental assessment" (BEA) prior to or within 45 days after purchasing, occupying, or foreclosing on a facility. A BEA is a written document that describes the results of an All Appropriate Inquiry (AAI) in compliance with 40 CFR 312, describes sampling and analysis that confirm that the property is a facility (i.e., contains contamination above applicable unrestricted generic residential criteria and contains documentation of the property identity.

The BEA must be submitted to the Michigan Department of Environment, Great Lakes and Energy (EGLE) and provided to subsequent purchasers. A BEA provides protection only for those environmental conditions reported in it. Owners and operators remain strictly liable for any undiscovered or unreported contamination unless a claim as an innocent purchaser can be made with respect to such contamination. In addition, Part 201 provides that owners and operators of Part 201 facilities, including those who are not liable for cleanup costs, continue to have certain affirmative "due care" obligations to prevent exacerbation of existing contamination and to protect those who may be exposed to remaining on-site contamination. A BEA does not protect an owner or operator from federal liability under CERCLA, RCRA, or TSCA.

Persons seeking to do business in Michigan and contemplating the purchase or lease of property in Michigan should have an environmental assessment conducted on any real property they intend to own or operate. Prospective owners or operators should consult with appropriate real estate, environmental, and legal professionals to determine the status of the property, the type of assessment or assessments needed, and the best approach to the acquisition of that property consistent with the lowest feasible risk of environmental liability.

10.2 WATER WITHDRAWAL

Part 327 of NREPA governs water use and withdrawal. Permits for large quantity water withdrawals are required. Large withdrawals are those of more than 2,000,000 gallons per day (or 1,388 gallons per minute) withdrawal capacity or which will transfer more than 100,000 gallons per day, averaged over any 90-day period, from the watershed of one Great Lake to the watershed of another Great Lake. Withdrawals of less than or equal to 2,000,000 GPD (1,388 GPM) of water but greater than 100,000 GPD (or 70 GPM) in withdrawal capacity require registration with EGLE. EGLE is also responsible for collecting annual water use data, making determinations on the potential impacts to water resources as a result of a proposed withdrawal, and issuing water withdrawal permits.

10.3 WATER POLLUTION CONTROL

Michigan has thousands of miles of Great Lakes coastline and thousands of inland lakes. Michigan implements the Federal Clean Water Act’s National Pollutant Discharge Elimination System (NPDES) permit program in Michigan for discharges of “waste or waste effluent” into Michigan surface waters. Pursuant to Part 31 of NREPA, Michigan also administers a state permit program for discharges into groundwater.

NPDES permits generally impose both technology-based discharge limitations and any more stringent limitations necessary to attain and maintain water quality standards in the receiving stream.

EPA has approved Michigan’s authority to issue general permits under its NPDES program. Part 31 of NREPA and administrative rules promulgated pursuant to Part 31 govern the state’s permitting program as well as the development of water quality standards. There are three types of NPDES permits- individual permits, general permits, and "permit by rule." EGLE determines the appropriate permit type for each surface water discharge. Facilities discharging pollutants indirectly into surface waters through a publicly- owned treatment works must also meet pretreatment requirements. These indirect dischargers also may be subject to local pretreatment requirements.

Groundwater discharges may not degrade the quality of a usable aquifer below local background levels unless a variance is granted by the state for exceptional circumstances. Unless waived by Michigan, a hydrogeological study is required to support a new groundwater permit application. There are substantial civil and criminal penalties for permit violations. Unlike the Federal Clean Water Act, however, Michigan’s Part 31 does not authorize “citizen suits” against facilities alleged to be in violation of applicable requirements.

10.4 Wetlands

Under Part 303 of NREPA, Michigan implements the Clean Water Act’s permit program for discharges of dredged or fill material into wetlands. Regulated wetlands exclude wetlands no greater than five acres that are not contiguous to the Great Lakes, an inland lake or pond, or a river or stream unless EGLE determines that their protection is essential to preserve the natural resources of the state. Permits generally are required for the following activities: depositing fill material in a wetland; dredging soil or minerals from a wetland; constructing, operating, or maintaining any use in a wetland; or draining surface water from a wetland. Depending on the nature of the wetland to be filled or dredged, EGLE shares permitting authority with the United States Army Corps of Engineers (ACE), which will consider permit applications jointly with EGLE. The

United States Environmental Protection Agency (USEPA) has enforcement authority for federally regulated wetlands under the federal Clean Water Act. With respect to real property development, NREPA also imposes requirements with respect to soil erosion and sedimentation control (Part 91), inland lakes and streams (Part 301), and floodplains (Part 31).

10.5 AIR POLLUTION CONTROL

a. The Clean Air Act

Under the Clean Air Act (amended significantly in 1990), EPA established air quality standards for so-called "criteria" pollutants (ozone, nitrogen dioxide, sulfur dioxide, particulates, lead, and carbon monoxide) and developed emissions standards for numerous sources of criteria and hazardous air pollutants. EPA has also established a basic permitting program for new sources of air pollution (new source review permits) and a model operating permit. Other programs implemented by the Clean Air Act include programs to protect the stratospheric ozone layer, reduce acid rain, and control emissions from mobile sources.

EPA has delegated to the State of Michigan authority for Part 60 New Source Performance Standards (NSPS) and Part 61 National Emission Standards for Hazardous Air Pollutants (NESHAPs) standards. Michigan has primary implementation and enforcement authority for the delegated standards.

Pursuant to authority delegated to it by the USEPA, EGLE also oversees asbestos emissions under the National Emission Standards for Hazardous Pollutants (NESHAP). Projects involving the demolition or renovation of structures with asbestos containing materials (ACM) that will be removed require prior notification to EGLE. EGLE also conducts inspections of demolition and removal projects.

b. Permits for Air Emissions

Under Michigan law, a person may not emit an air contaminant from a new source without both a permit to install and a permit to operate. Under Part 55 and the administrative rules that were promulgated pursuant to Part 55, the Air Quality Division of EGLE is charged with issuing both types of permits.

Permits to install are required before installation or construction of a new source of air pollution or modification of an existing source may be undertaken. Such permits generally require extensive air modeling and a complete characterization of emissions. If the permit is sought in an area that is covered by the federal Prevention of Significant Deterioration Program (PSD), the source will be required to install at least the best available control technology. A facility must apply for a permit to operate within thirty days of completion of the installation allowed under the permit to install. Permits to operate must now be consistent with federal permitting rules, including a five-year permit renewal requirement and emission-based permit fees.

c. Interface Between State and Federal Programs

Michigan is authorized under the Clean Air Act to implement and enforce federal air pollution programs and requirements. Thus, state and federal programs are coordinated by a single state agency in Michigan.

10.4 UNDERGROUND STORAGE TANKS

Underground storage tanks (USTs) in Michigan are regulated under Part 211 and Part 213 of NREPA. Part 211 provides a regulatory framework for all underground storage tank systems that are used to store petroleum products or hazardous chemicals, with a few minor exceptions. It includes provisions for tank registration, annual registration fees (EGLE has full responsibility), proof of financial responsibility, penalties, and remedies. Part 211 is administered by the Department of Licensing and Regulatory Affairs (LARA)

EGLE administers the Leaking Underground Storage Tank Program under Part 213 of NREPA. Part 213 sets forth procedures for the proper investigation and handling of a release from an underground storage tank system, including reporting, hiring of consultants, spill containment, and risk-based cleanup standards and procedures based on the American Society for Testing and Materials (ASTM) Standard Guide for Risk-Based Corrective Action (RBCA) protocols. Part 213 also empowers EGLE to engage in cleanup activities and seek reimbursement from responsible parties.

These Acts contain extremely time-sensitive reporting requirements. Under Part 213, for example, a release from a regulated UST system must be reported to EGLE within 24 hours of confirmation, a site investigation report must be submitted within 90 days, a remedial action plan submitted within 360 days, and a certified closure report submitted within 30 days of completing the remedial action. There are statutory penalties for failure to meet these deadlines, as well as other civil and criminal penalties for violations of the acts. Further, under Part 211, there are detailed regulations concerning reporting of the proposed installation of USTs, the design and operation of new UST systems, the upgrading of existing systems (including upgrade deadlines), and for closure of UST systems.

In December of 2014, the Michigan Underground Storage Tank Cleanup Fund and the Michigan Underground Storage Tank Authority were created. Under P.A. 416, the State collects 7/8 of a cent from the sale of each gallon of refined petroleum “to fund corrective actions to address releases from refined petroleum underground storage tank systems, to assist owners and operators of refined petroleum underground storage tank systems in meeting their financial responsibility requirements pursuant to part 211, and to achieve compliance with part 213.” Eligible owners and operators of leaking underground storage tanks may make claims to the fund for reimbursement of cleanup costs associated with the release.

10.5 WASTE

Solid waste is governed by the terms of Part 115 and the regulations promulgated pursuant to it. Part 115 regulates the construction and operation of solid waste disposal, transfer, and processing facilities. Part 111 governs hazardous waste generation, storage, transportation, disposal, and treatment. The State of Michigan has USEPA authority to enforce the federal Resource Conservation and Recovery Act (RCRA). EGLE and Region V of the USEPA have signed a Memorandum of Understanding that recognizes the State of Michigan’s cleanup and brownfield redevelopment statutes as applied to the RCRA corrective action program. Several statutes govern specific solid wastes, such as batteries (Part 171), liquid industrial by-products (Part 121), and used oil recycling operations (Part 167). Violations of Parts 111 and 115 could lead to civil penalties, fines, and criminal enforcement.

Chapter 11 - Protection of Intellectual Property

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Intellectual property (IP) is often the most valuable asset of technology companies. Forward-looking businesses tend to generate, acquire and value IP over simple brick and mortar.

This primer provides a high-level view of some of the most valuable IP: utility patents, design patents, copyrights, trademarks, and trade secrets.

11.1 PATENT LAW

Patent law deals with protection of functional and design inventions to encourage new technology and invention. A patent is a grant to an inventor by the United States government of the right to exclude others from making, using, selling, offering for sale or importing a patented invention of another without permission. See, Title 35 of the US Code.

There are three types of patents: utility, design and plant.

A utility patent may be granted for (1) a machine, (2) an article of manufacture, (3) a composition of matter, or (4) a process. A utility patent covers the functional aspects of the four types of items listed above. A utility patent has a term of twenty years from the earliest non-provisional priority date of the patent application.

A design patent may be granted for the ornamental aspects of an article of manufacture to prevent others from copying the unique appearance of the product. Design patents protect non-functional, ornamental features and configurations; for example, the design of running shoes or the configuration of a sports car. A design patent has a term of fourteen years.

In addition, an individual who develops or discovers and reproduces a new variety of plant may obtain a plant patent.

For most companies, only utility and design patents have commercial importance. A utility patent includes one or more "claims" that provide the legal definition of the inventive processes, machines, articles of manufacture, and/or compositions described in the patent. Design patents include only one claim which is made with reference to images of the patented design. A design patent protects only the ornamental features of the invention as shown by drawings in the specification. Both can be extraordinarily valuable, as evidenced by recent damages awards.

a. Patent-Eligible Subject Matter

Although not the precise language of Section 101 of Title 35, it has been said that *anything under the sun made by man* may be eligible for a utility patent. In recent years, the US Supreme Court has reminded us that abstract ideas such as "hedging risk" and DNA sequences are not sufficiently made by man to be considered patent-eligible subject matter. As such, isolated DNA sequences, mathematical formulas such as $E=mc^2$ and software routines that merely implement preexisting non-computerized processes are not patent eligible. Thus, it may be advisable to conduct a patentability analysis before filing a patent application, and to do this, the patent attorney needs an accurate, comprehensive description of the invention. The description may include how the invention differs from the prior art, how it can be implemented (if not yet done so by the inventor), and any existing technology that is incorporated into the invention, such as off-the-shelf components.

b. Statutory Requirements

In addition to being directed to patent-eligible subject matter, to obtain a patent on a new invention the invention must meet several requirements: (i) it must be new, (ii) useful, (iii) not obvious in view of the prior art, and (iv) described in a patent application in sufficient detail that one of ordinary skill in the art could make and use the invention.

An invention is new if it is not identical to any device, process, composition, etc. that is already known anywhere in the world.

An invention is useful if it is capable of being made and used. This requirement is most often used to exclude inventions that are not physically possible, such as perpetual motion machines, or inventions that are not described sufficiently for one of ordinary skill in the art to understand the invention.

An invention is not obvious if it would not have been obvious to one of ordinary skill in the art when considering all available prior art. This requirement is the most common reason for rejection of new patent applications and the most likely area in which inventors argue and negotiate with the Patent Office during examination of the patent application.

Finally, a patent applicant must describe the invention in a patent application which ultimately will be published and publicly available. The document includes a specification, which usually has illustrations, and which must be sufficient to enable those of ordinary skill in the art to make and use the full scope of the claimed invention. As such, there is a trade-off of public disclosure in order to obtain the 20-year monopoly granted by a patent. It is not possible to get a patent without “going public.”

c. Patentability of Eligible Subject Matter

The patent aspects of every new product or process should be carefully considered. To do so, patent attorneys often conduct a patentability search of prior art. Prior art is the body of knowledge that exists about the subject matter of the invention. The prior art is compared with the invention to determine whether the differences are significant enough to warrant the award of a patent. For example, the patentability search may reveal a similar device in an existing patent which, if sufficiently similar, may cause the Patent Office to refuse to grant a patent on the grounds that the invention is not new or is obvious in view of the similar device.

If the results of a search are unfavorable, then the inventor has saved the expenses of preparing and filing an application. In addition, if the patent attorney knows the most similar prior art when s/he prepares the application, s/he will be able to write a better and more persuasive application (perhaps avoiding conflicts with preexisting patents). A patentability search may include an investigation of the records in the United States Patent and Trademark Office to determine relevant prior art in the form of existing patents, as well as an analysis of other known prior art such as scholarly publications, technical papers, and the like.

d. Patent Enforcement

Patents may be enforced in the federal courts for injunctions and/or damages, or in the International Trade Commission (ITC) for an exclusion order, assuming there is a domestic industry.

Certain federal courts have more patent traffic than others, such as district courts in the Eastern District of Texas, District of Delaware, and the Northern District of California, but we in the Eastern and Western Districts of Michigan have managed numerous patent cases, most famously in the automotive industry. Patent cases are governed by a specialized US Court of Appeals; thus, patent cases filed here are appealed to the Federal

Circuit rather than the Sixth Circuit.

If you find yourself on the receiving end of a Patent Complaint or an ITC investigation, you may want to consider using a relatively new and popular mechanism to fight back: an *Inter Partes* Review (IPR) before the Patent Trial and Appeal Board (PTAB). So far, IPRs have resulted in numerous final decisions holding that issued patent claims were obvious and therefore should never have resulted in an issued patent.

e. Freedom to Operate

Sometimes a study is made to determine whether a new product infringes an existing patent. A search of the records in the United States Patent and Trademark Office is made to isolate relevant patents. The claims of those patents are compared to the new product or process. Many companies will perform a “freedom to operate” analysis of new products to identify any such patents and with patent counsel either to confirm that the proposed product does not infringe any known patent, or to design alterations to the product to avoid infringement. Such studies can help to avoid the expense of unexpected patent litigation when a new product is launched, as well as identifying available “white space” in which the business may want to file its own patents to cover the new product.

11.2 COPYRIGHT LAW

Copyrights are also exclusively matters of federal law and are governed by the Title 17 of the US Code, which preempts state law claims that are equivalent to the rights granted under federal law.

Copyrights are exclusive rights in original works of authorship fixed in a tangible medium of expression. More familiarly, these include literary works, musical works, dramatic works, pictorial or sculptural works, motion pictures, sound recordings, and architectural works.

a. Copyright Owners’ Rights and Duration

A copyright protects a creator’s original *expression* of an idea. Copyright law, however, distinguishes between an idea and the expression of an idea. *Only the expression is protected*. Thus, copyrights do not protect the others from copying the idea underlying the expression. Copyright law does not protect ideas, concepts, systems, or methods.

Ownership of a copyright gives the owner the exclusive right to control the modification, reproduction, distribution, performance, or display of the work by another.

The duration of a copyright depends on several factors including the date the work was created and whether the author created it as a work for hire (for another individual or for a company). For those works that were created on or after January 1, 1978, the duration of the copyright is the life of the author plus 70 years for a work prepared by an author. If a work was created as a work-for-hire, an anonymous work or a pseudonymous work the duration is 95 years from first publication or 120 years from creation, whichever term is shorter. A complex regime of rules applies for works created before 1978 and will vary depending on several factors.

b. Renewal of Copyright

A copyright does not have to be renewed if it was created on or after January 1, 1978. For works published or renewed prior to January 1, 1978, renewal is optional after 28 years.

c. Notice and Registration

Federal law does not require notice or registration to establish copyrights. The rights attach when the work is fixed in a tangible medium. Registration is advised, however, as it is required before an infringement suit can be filed in a U.S. court. Further, the registration provides evidence of the validity of the copyright and allows for statutory damages, attorneys' fees, and costs if the registration is filed within three months after the publication of the copyrighted work. A registered copyright also permits an owner to establish a record with the U.S. Customs and Border Protection to protect against the importation of infringing works.

The copyright notice has three elements: (1) the word "copyright" or the copyright symbol "©"; (2) the year of first publication; and (3) the copyright owner's name. Providing this notice has advantages but is not required to protect a work which was published in the U.S. on or after March 1, 1989.

d. Copyright Enforcement

Copyright infringement occurs when a copyrighted work is reproduced, distributed, performed, displayed, or made into a derivative work without the permission of the copyright owner. To bring a successful claim, a copyright owner must prove (1) that they are the owner of a valid copyright that relates to the infringed material in question or has the authority to enforce a valid copyright; and (2) that the defendant actually copied the work and had access to the original work or that the work has a striking similarity.

Three defenses are traditionally asserted by those accused of infringement. First, a defendant can assert that the work in question is not protected by a copyright. Second, they can assert that they independently created the work without using the original, copyright protected work. Third, they can assert that the use is "fair use." The fair use doctrine allows copyrighted materials to be used to benefit society. Fair use contemplates the purpose of the use, the type of work, how much is used, and how the market is impacted. Some other defenses contemplate the purpose and character of the use, the nature of the copyrighted material or work, the amount and substantiality of use in relation to the whole, the effect on the potential market for value of the work, and scénes á faire elements.

11.3 TRADEMARK LAW

Trademarks are governed by both federal (Title 15 of the US Code) and state law.

Unlike trademark rights in most other countries, common law rights are based on the merchant's use of the mark; there is no registration requirement. Common law trademark rights are developed when a merchant begins using its mark in commerce in connection with its goods or services in a geographical location. A merchant that uses a mark in commerce, but does not register the mark, can prevent others from subsequently adopting and using confusingly similar marks. However, common law trademarks are limited to the geographical area in which the mark is used.

a. Types of Marks

A mark is typically a word or symbol that distinguishes goods or services from a particular source from those of other sources. A mark can also be, among other things, a symbol or logo, a series of sounds, a three-dimensional object, a distinctive combination of colors, or a fragrance.

The strongest marks are distinctive, fanciful, arbitrary or suggestive marks; weaker marks are descriptive of the goods or services or generic. However, some descriptive marks which have gained affiliation with the source of goods rather than the product or service itself through "secondary meaning," may be sufficiently distinctive.

b. Registration

i. Federal Law

There are two types of trademark applications that can be applied for at the United States Patent and Trademark Office ("USPTO"). An intent-to-use application can be used to reserve rights to a mark and preserve priority through an early application date. For a use-based application, a company that is currently using a mark in interstate commerce in the United States may apply for protection under the Lanham Act. In order to fully register with either type of application, a mark must be in commerce.

After a trademark application is published, those with competing marks may "oppose" registration of the mark in the Trademark Trial and Appeal Board (TTAB). After registration, would-be opposers can seek to "cancel" registrations at the TTAB.

Once a mark registers, you may use the ® symbol together with the mark acts as a constructive notice to an infringer and allows the registrant to recover profits and damages from an infringer without giving actual notice.

Registration provides, among other rights, the right to use the mark in 50 states, the right to assert the trademark in federal court, and a presumption of exclusive ownership of the mark (once the mark has become incontestable).

ii. Michigan Law

A hopeful registrant may also apply through the Michigan Department of Licensing and Regulatory Affairs Corporations, Securities & Commercial Licensing bureau in Michigan for registration of any mark that is adopted and used in Michigan. Registration is sometimes more easily obtained at the state level because the mark need not be in use in interstate commerce.

Unlike other states, Michigan does not offer state-based protection against dilution of the distinctive quality of the mark.

c. Enforcement

Trademarks with federal registrations are enforced in the federal courts. Unlike patent law, there is no specialized Court of Appeal. The regional circuits have their own trademark case law. Lanham Act cases filed in the Eastern and Western are appealed to the Sixth Circuit.

11.4 TRADE SECRET LAW

Like trademark law, trade secrets are now protected both on the federal and state level.

a. Federal Law

While trade secrets continue to be protected by state law, the Defend Trade Secrets Act of 2016 (DTSA) established a federal cause of action for misappropriation of trade secrets, so long as the trade secret is related to a product or service used in interstate or foreign commerce. Under the Act, Plaintiffs may now bring a trade secrets case in federal court, permitting parties to more easily subpoena witnesses across state lines, subpoena documents from out-of-state parties, and to enforce injunctions and court orders throughout the

United States.

The DTSA also provides a significant new weapon where trade secrets are threatened, if stringent elements are met, for a party to obtain ex parte seizure orders. Under an ex parte seizure order, if someone steals a company's trade secrets, the company can seek a court order to seize the trade secrets, the electronic devices or computers they are found in, or other means or devices of misappropriation without first providing notice to the defendant. This type of seizure is intended only in "exceptional circumstances" where an injunction would not suffice and it can be shown that the person who misappropriated the trade secret would destroy, move, hide, or otherwise make the matter inaccessible to the court if that person were given notice of the claims against it.

The DTSA also specifies that any injunction must be "based on evidence of threatened misappropriation and not merely on the information the person knows." Depending on how courts interpret this provision in the long term, this is likely to curtail use of the "inevitable disclosure" theory. Similarly, the DTSA provides that any injunctive relief cannot "otherwise conflict with an applicable State law prohibiting restraints on the practice of a lawful profession, trade or business." Thus, in states such as California where non-competes and other restrictive agreements are essentially unenforceable, parties cannot use the DTSA to circumvent state policy.

Lastly, the DTSA also has a whistle blower protection provision. This offers immunity from liability for the confidential disclosure of a trade secret to the government or in a court filing made under seal. This provision includes a notification requirement that employers should immediately implement in all its agreements with its employees. Butzel Long can assist with updating your agreements.

b. Michigan Law

Under Michigan law, a trade secret may consist of any formula, pattern, device or compilation of information. To be a trade secret, the information must (1) derive independent economic value from not being generally known, and (2) be subject to reasonable efforts to maintain secrecy.

Typical trade secrets include, for example, methods of synthesizing chemical formulations, customer lists, and the like.

Clients may seek to preserve the secrecy of their trade secrets through employment agreements, non-compete agreements, non-disclosure agreements, limiting access to sensitive documents, prototypes and facilities, etc.

If a trade secret is disclosed or used by an unauthorized party, the owner or licensee of the trade secret can bring a civil action for trade secret misappropriation. Relief for trade secret misappropriation is much more variable and much broader in the US than in many other countries.

Chapter 12 - Product Liability

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12.1 THEORIES OF LIABILITY

Michigan recognizes the following theories of product liability: negligence (design and manufacture), breach of warranty (implied and express), and failure to warn.

A negligence claim requires that the manufacturer be shown to have breached its duty to use reasonable or ordinary care under the circumstances in the design or manufacture of the product to ensure that it would be reasonably safe for the purposes for which it was intended. A product is defective in design if the risk of injury or harm is unreasonable when balanced against the utility of the product and the foreseeable risk of injury.

There is no doctrine of strict liability for a defective product. However, breach of implied warranty is similar to strict liability. Breach of implied warranty requires proof that the product was defective when it left the manufacturer's or seller's control and that the defect caused the injury. A product is defective if it is not reasonably fit for its intended, anticipated or reasonably foreseeable use, including a reasonably foreseeable misuse. As in a strict liability action, no negligence on the part of the manufacturer need be shown.

12.2 DAMAGE CAPS

Effective March 28, 1996, a standard limitation ("damage cap") of $280,000 was established for noneconomic losses, with a higher cap of $500,000 set in the event of death or permanent loss of a vital bodily function. Exceptions to the limit for death or permanent loss of vital bodily functions are established in the event of gross negligence or if the Court determines that (1) at the time of manufacture or distribution the defendant had actual knowledge the product was defective, and (2) there was a substantial likelihood the defect would cause the injury that was the basis of the action and the defendant disregarded that knowledge. The damage caps are adjusted annually by the state treasurer based on variations in the consumer price index. For 2023, the damage caps, as adjusted, were $437,900 and $960,500, respectively.

12.3 STATUTES OF LIMITATION

There is a three-year statute of limitation for product liability actions. However, in a wrongful death action, under limited circumstances, the period may be extended by up to three additional years. In addition, the three-year limitation period as to non-parties may be extended by identification of those non-parties by a defendant. Michigan also applies a discovery rule for certain kinds of products, and therefore, under appropriate circumstances, the limitation period may not begin to run until a plaintiff discovers or through the exercise of reasonable diligence should have discovered a possible cause of action.

12.4 COMPARATIVE NEGLIGENCE

Generally speaking, Michigan is a comparative negligence state. However, if the plaintiff's percentage of fault is greater than the aggregate percentage of fault attributable to all other persons, plaintiff's economic damages are reduced by the percentage of the comparative fault, and non-economic damages (e.g., pain and suffering) shall not be awarded. An absolute defense is recognized where the person injured or killed had an impaired ability due to alcohol or controlled substances and, due to that impairment, was 50% or more at fault.

12.5 JOINT AND SEVERAL LIABILITY

Prior to March 28, 1996, Michigan was a joint and several liability state, meaning that a plaintiff could seek to recover the full amount of its damages exclusively from one of multiple defendants. The chosen defendant was then permitted to seek contribution from the other defendant(s). As of March 28, 1996, however, the liability of a defendant in a product liability case is "several only and not joint." (MCL 600.6304(4)). There are certain exceptions, though, where an action includes a medical malpractice claim or where the injuries, damages, or death resulted from criminal conduct involving gross negligence or the use of drugs or alcohol. Moreover, under MCL 600.2957 and 600.6304, liability may be allocated among all responsible persons, "regardless of whether the person is, or could have been, named as a party to the action."

12.6 DUTY TO WARN

Manufacturers and distributors have a duty to warn of dangers that they know or should have known to be inherent in the use of a product. The scope of this duty extends to all uses (including misuses) that are reasonably foreseeable. The duty to warn also includes a duty to provide adequate instructions.

The duty to warn or instruct has been relaxed for those products that possess obvious material risks, which a reasonably prudent user would recognize, or risks that should be commonly known to persons situated similarly to the plaintiff. The duties of the manufacturer and distributor to warn or instruct may be altered in cases in which the product was sold to a sophisticated user or in which any additional warning or instruction would have been futile.

12.7 REMEDIAL MEASURES

Subsequent modifications in the design or manufacture of a product are generally inadmissible as evidence in a product liability action to prove liability. In other words, such modifications may not be offered at trial to prove that a product was defective before the modifications were made. Such modifications may be admissible, however, if offered for another purpose, such as establishing ownership, control or feasibility of additional safeguards, if contested, or to impeach adverse witness testimony.

12.8 OTHER ACCIDENTS

For a plaintiff to establish a product defect through evidence of other accidents involving third-parties, the plaintiff must usually prove that there is a substantial factual similarity as to time, place, and circumstances involving the same product. Once the plaintiff has met that threshold, evidence of the other accident(s) is generally admissible on the issue of the manufacturer's notice or awareness of a defect. Conversely, the absence of similar accidents may be admissible to rebut allegations that the manufacturer was "on notice" of a product defect.

12.9 PUNITIVE DAMAGES

Unlike many jurisdictions, Michigan does not allow punitive damages in a product liability action. Instead, Michigan recognizes exemplary damages, which theoretically serve only to compensate a plaintiff for a sense of insult, indignity, embarrassment, humiliation, or injury to feelings resulting from an injury so maliciously and wantonly inflicted as to demonstrate a reckless disregard of plaintiff's rights.

12.10 ECONOMIC LOSS DOCTRINE

In Michigan, the Economic Loss Doctrine applies when the alleged defect has resulted in damages that are strictly economic (i.e., lost profits or other commercial benefits) and both parties are commercial entities. Indeed, the Michigan Supreme Court has held that the Uniform Commercial Code, as opposed to tort law and other sources of relief, provides the exclusive remedy for a business plaintiff in a case involving an economic loss arising out of the purchase of an allegedly defective good. Economic loss includes damage to the good itself.

12.11 INTEREST

Michigan allows prejudgment interest from the date of filing of the complaint and post-judgment interest until the date of satisfaction. This interest rate varies and is tied to the U.S. Treasury note rate.

12.12 SUCCESSOR LIABILITY

Successor liability often becomes an issue when the business of a liable party, such as a manufacturer, is acquired or otherwise continued by a different entity. If an acquisition occurs through merger, the acquired party's liability may be automatically assumed by the acquiring party. However, if a company simply purchases another company's assets, a more detailed analysis is necessary. The primary factor in analyzing potential successor liability is whether the totality of the acquisition demonstrates a basic continuity of enterprise between the acquiring corporation and the acquired entity. Where a corporation has merely purchased all or substantially all of the assets of another corporation, the purchasing corporation will generally not be liable for product liability of the selling corporation, unless the purchasing corporation is shown to have participated in the manufacture, sale, or installation of the product, or has otherwise assumed such liability by contract or by law.

12.13 PRIVITY

There is no privity requirement for a plaintiff to bring suit against the distributor or manufacturer of an allegedly defective product.

Chapter 13 - Dispute Resolution

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This commentary is intended to provide a brief introduction to the various methods and systems available in Michigan for the resolution of disputes. The three basic arenas for dispute resolution are the federal court system, the state court system, and various alternative dispute resolution ("ADR"") mechanisms, such as mediation and arbitration.

Both the State and Federal court systems operate on an adversary basis, giving each party the opportunity, through its counsel, to present evidence to the judge or jury, and to make arguments of fact and law to try to persuade the judge or jury of the correctness of the party's position. Determinations are made on the basis of the evidence presented and arguments made by the parties. The courts do not independently adduce evidence or engage in advocacy.

13.1 FEDERAL COURT SYSTEM

The federal court system is primarily used for resolving disputes arising under the United States Constitution, laws and treaties. It is also available where the amount in controversy is greater than $75,000 and is between United States citizens (including corporations) from different states, or between a United States citizen and a foreign citizen. The federal court system has three primary levels.

a. District Courts

The first level in ascending order is the United States District Court. District courts are located in each state. In Michigan, the United States District Court is divided into the western and eastern districts. The District Court is the primary Federal trial court for both criminal and civil matters. Disputed questions of fact may be decided by a judge or jury. In civil cases, judgments may award or deny monetary relief or may provide for equitable relief, such as an injunction prohibiting or compelling certain conduct.

Proceedings in the District Court are governed by certain rules. Those rules include methods by which the parties may obtain "discovery" from each other, including obtaining certain documentary and testimonial information about their respective claims in a pending case prior to the actual trial. Those discovery methods include requests for documents and depositions of persons with information about a party's claims and/or defenses. The discovery rules enable the parties to obtain this information in advance of, and to prepare for, the trial that will be conducted in the Court.

b. Courts of Appeals

The next level in the federal system is the United States Court of Appeals. The Court of Appeals consists of 12 geographically designated Circuit Courts of Appeals located across the United States and a thirteenth Circuit Court, the Court of Appeals for the Federal Circuit, located in Washington, D.C. (The Federal Circuit has nationwide jurisdiction over certain matters including, for example, international trade, government contracts, patents and trademarks.) Federal law gives parties the right to appeal to the Court of Appeals any final judgment of a District Court or any order granting or denying a preliminary injunction (i.e. an injunction prior to trial of the case). The Court of Appeals also has the discretion to accept for appeal non-final decisions of the District Courts, known as interlocutory appeals, under certain limited circumstances. Except for matters within the jurisdiction of the Federal Circuit, appeals from District Court judgments in Michigan are heard by the Sixth Circuit Court of Appeals located in Cincinnati, Ohio.

The appellate courts determine whether judgments rendered in District Court actions are correct under the applicable law. In conducting its review, the Court of Appeals does not hear witnesses, receive new evidence or conduct trials, but rather bases its decision on review of the written transcript of District Court proceedings and the written arguments (called briefs) and oral presentations by counsel involved in the matter. If the Court of Appeals agrees with the District Court's judgment, it will affirm the result. If it disagrees with the judgment, it may reverse or modify the District Court's decision and order a different result, or it may remand the case to the District Court for further proceedings.

c. Supreme Court

The highest level in the federal court system is the Supreme Court of the United States located in Washington, D.C. The Supreme Court consists of nine justices. Supreme Court justices, like all federal judges, are appointed by the President of the United States, approved by the United States Congress, and have lifetime appointments. The Supreme Court primarily reviews decisions made by the United States Circuit Courts of Appeals or decisions by the highest Court of a state on matters involving the constitutionality of state law. Cases are appealed to the Supreme Court by filing a petition for a Writ of Certiorari requesting the Court to hear the appeal. The Supreme Court generally has broad discretion in deciding whether to review a lower court's judgment, and as a practical matter, only a very small percentage of requests for Writs are granted.

13.2 STATE COURT SYSTEM

Each state has its own court system, which generally operates in the same fashion as the federal system, including providing rules in the trial court (not the appellate courts) by which the parties may conduct discovery to obtain information about an opposing party's claims and/or defenses to prepare for the trial of the case. State courts decide a wide variety of criminal and civil disputes, including business disputes such as claims for breach of a contract. As with the federal system, there are various levels in the state court system. In Michigan, there are four basic levels: the District Court, the Circuit Court, the Court of Appeals, and the Supreme Court.

a. District Courts

District Courts are located in each judicial district, except in those cities that have elected to maintain municipal courts. The district courts hear civil actions involving claims for $25,000 or less and criminal matters involving minor offenses.

b. Circuit Courts

Circuit Courts are located in each county in Michigan. These courts have original jurisdiction over equitable actions (e.g., actions seeking an injunction), civil claims asserting more than $25,000 in damages, and more serious criminal offenses.

Similar to the United States District Courts, Michigan's District and Circuit Courts are primarily trial courts where evidence is presented, witnesses testify, and trials are conducted. Michigan's Circuit Courts also serve an appellate function, however, by reviewing appeals from final judgments rendered in the Michigan District Courts.

c. Michigan Court of Appeals

The Michigan Court of Appeals is divided into four divisions, which are located in Detroit, Southfield, Lansing, and Grand Rapids. The Court hears appeals from final judgments of the Circuit Courts and is also given the discretion to review non-final rulings of the Circuit Courts under certain circumstances. Appeals are reviewed by a panel of three judges who issue written opinions on whether judgments rendered by a lower court were correct under applicable law.

d. Michigan Supreme Court

The Michigan Supreme Court, located in Lansing, is the State's highest level appellate court and consists of seven justices elected from time to time by the citizens of Michigan. The Supreme Court primarily reviews decisions of the Court of Appeals, but it may also review orders from the Judicial Tenure Commission or Attorney Discipline Board and give advisory opinions. Parties are required to file applications requesting the Court to hear their respective appeals, which the Court has broad discretion to grant or deny.

13.3 ALTERNATIVE DISPUTE RESOLUTION

Cases proceeding through the federal and state court systems, as described above, can take a number of years to be resolved and may be very expensive, depending on the nature and complexity of the case. Therefore, in recent years, the popularity of private and court-initiated Alternative Dispute Resolution ("ADR") mechanisms has grown significantly. A goal of ADR is to provide parties with a method of resolving disputes more quickly and less expensively than by use of the court system.

Many different ADR techniques are used throughout Michigan. In some instances, ADR is initiated by the courts and, in other instances, by the agreement of the parties. Some commonly-used mechanisms are conciliation, summary jury trials, mini-hearings, case evaluations, and private arbitration.

Conciliation, summary jury trials, and mini-hearings are typically non-binding and conducted by an agreement of the parties. In conciliation, also known as facilitative mediation, the parties meet together with a neutral third party for the purpose of discussing and attempting to reach a settlement of their dispute with the assistance of the neutral third party. The format of the meeting varies by case and generally is governed by an agreement of the parties. In a summary jury trial, attorneys summarize and present their clients' arguments to a mock jury, which then renders a non-binding verdict. In a mini- hearing, attorneys present their clients' positions to the opposing party's senior officials or to impartial experts who provide comments or opinions about the parties' positions. Those comments and opinions are considered by the parties in their efforts to reach an out-of-court settlement.

The case evaluation procedure is provided in the rules governing proceedings in the Circuit Court, and is applied to most cases commenced in that Court. In the case evaluation process, the attorneys for the parties present arguments to a panel of case evaluators consisting of three experienced attorneys with no involvement in the case. The case evaluators then render their evaluation, which the parties may accept or reject within 28 days. If both parties accept the award, a judgment is entered in the amount of the evaluation and the case ends. However, if one or both of the parties reject the evaluation, the case proceeds to trial. If the verdict at trial is not more favorable (as defined by the Court's procedural rules governing the case evaluation process) to a rejecting party than the case evaluation, that party may be required to pay the opposing party's costs, including attorney fees. This departs from the general rule that applies to most court proceedings, unless provided otherwise by statute, under which each party is responsible for its own expenses, including attorney fees, regardless of the outcome.

Finally, parties may submit their dispute to arbitration. To do so, the parties must have entered into a written agreement to arbitrate their disputes. The arbitration agreement may be contained in the provisions of the parties' written contract, or the parties may enter into a separate written agreement to arbitrate their disagreements. Many arbitration agreements provide that the arbitration is to be administered by, and in accordance with the rules of, such dispute resolution associations as the American Arbitration Association. Absent specific provisions in the parties' arbitration agreement, those association rules will govern the manner in which the parties choose an arbitrator or panel of arbitrators who will decide the claims of the parties in their dispute. The rules also provide for a limited exchange of information between the parties so that they may prepare for the arbitration hearing—a trial-like proceeding in which each party presents its witnesses' testimony and documentary evidence on which the arbitrators make their decision. Subject to certain narrow exceptions, the arbitrators' award is binding and may be confirmed by a court through entry of a judgment within one year of the award.

In providing for binding arbitration—either in the parties' contract or by a separate written arbitration agreement—the parties may vary the procedures and rules by which the arbitration is to be conducted. The parties may provide for more expanded discovery, such as some of the discovery that is permitted under the rules governing pre-trial discovery in the courts. The parties also may provide for the application of certain rules to govern the types of evidence that are admissible at the arbitration hearings. In other words, within certain limitations, the parties may customize the arbitration process through careful drafting of the arbitration agreement.

The use of ADR is increasing. Of course, as with any system, there are some disadvantages. Unless the parties provide otherwise in their ADR agreement, ADR generally does not allow participants to file motions that could dismiss the action or to conduct discovery. However, parties mutually can agree on an ADR format that permits motions to dismiss, discovery, and other procedures common to litigation.