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**DOING  
BUSINESS  
IN  
MICHIGAN**

**A GUIDE FOR INVESTORS AND BUSINESSES**

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## INTRODUCTION

Michigan is a unique and cosmopolitan area whose businesses are among the world's leaders in automotive, furniture design, technology, research and development, life sciences and advanced manufacturing. The Detroit region is the automotive capital of the world and is home to research, engineering and manufacturing facilities of the world's largest automakers and suppliers. Nine universities, seven colleges and ten community colleges provide superior training and educational opportunities and have created new centers of study that focus on cutting-edge research and applications in many high-technology areas. The future of business in Michigan is bright and many opportunities for investment are available.

This guide has been prepared for individuals and companies considering investing in a Michigan business or locating operations in Michigan. It provides an overview of legal and business topics that are normally of primary interest to investors and companies with new or expanded operations. The level of detail varies with each section and is related to the nature of the topic addressed.

Because of the many complex issues involved and the evolving nature of the law, this guide does not constitute and should not be considered legal advice or a legal opinion. It is simply not possible or prudent to offer legal advice or a legal opinion without a prior thorough investigation and analysis of the facts attendant to any specific situation. Michigan legal counsel should be consulted regarding a specific issue or transaction.

### About Butzel Long

Butzel Long is one of Michigan's leading law firms, with over 200 lawyers and seven offices in Michigan and Florida and alliance offices in Shanghai and Beijing. Since its founding in 1854, the firm has played a prominent role in the development of Michigan as an industrial, engineering and manufacturing center. The firm has a tradition of representing companies at their earliest stages of innovation and development, providing the guidance and counsel necessary for future success. From the formation of General Motors and the Dodge Motor Company to computer technology companies and bio-tech start-ups, Butzel Long has provided legal counsel to businesses across multiple industries for over 150 years.

Today business leaders from various industries turn to Butzel Long for innovative solutions and advice. The firm strives to be on the cutting edge of significant trends and developments in the business world including advanced technology and manufacturing, e-commerce, internet law, cross border trade and transactions and international operations. The firm's approach is to provide a personalized attorney / client relationship based on a recognition of and responsiveness to each client's unique concerns and requirements. We seek a clear understanding of the business needs of each client through industry-focused research, knowledge management and partnering relationships. A distinguishing advantage of the firm is a commitment to providing value added counseling and advice to its clients. It is dedicated to providing full value for every dollar invested in legal services. For more information visit: [www.butzel.com](http://www.butzel.com).

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Technology Law  
Transaction / Finance  
Wealth Management /  
Estate Planning

## ***FORMS FOR CARRYING ON BUSINESS***

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### **SOLE PROPRIETORSHIPS**

The term "sole proprietorship" refers to a business engaged in by an individual which 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 which 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 meetings or record keeping like those which apply to corporations, partnerships or limited liability companies, and 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 Single Business 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.

### **BUSINESS CORPORATIONS**

#### **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.

#### **Formation**

A corporation is formed by the filing of Articles of Incorporation with the Bureau of Commercial Services of the Department of Labor and Economic Growth. One or more persons may serve as incorporators, and those persons 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 Business Corporation Act, the broadest possible authority.

3. The aggregate number of shares which 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 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 for foreign corporations which are authorized to transact business in Michigan (which is discussed below at "BUSINESS CORPORATIONS--Foreign Corporations").

6. The names and addresses 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.

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 pursuant to shareholder approval.

## **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 corporate 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 which the corporation will have; the officers which 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.)

## **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 left to 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 pro rata 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.

## **Management**

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 is normally fixed in the Bylaws.

The directors of the 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 must be authorized in the corporation's Articles of Incorporation.

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 elect to 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 for breach of their duty under certain circumstances.

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. Among the types of provisions authorized by Section 488 are the following:

- Unequal distribution rights within a class (although this would not be permitted to Subchapter S corporations).
- The identity of the board and/or the manner of selecting board members.
- Use of director proxies and weighted voting among directors.
- Provisions governing the exercise or division of voting power among shareholders and providing weighted voting rights between classes of shares or within the same class of shares, whether in general or with regard to specific matters.
- Requirements that the corporation be dissolved on the request of one or more shareholders or upon occurrence of certain events.
- 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. If amended by an amendment to the articles of incorporation or bylaws, the amendment must be approved by all shareholders. If amended by written agreement, the amendment must be in a writing signed by all shareholders, unless the original agreement provides otherwise. Section 488 provisions must be conspicuously noted on certificates and persons who become shareholders without knowledge of such restrictions are entitled to rescind their purchase.

### **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 provided 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 communications equipment, so long as all participants can hear 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.

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 the 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). 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 amendment of the Articles of Incorporation, approval of a merger, share exchange or 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 actions.

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.

Any action which 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 which allows action to be taken without a meeting upon the written consent of holders of the number of shares which would be sufficient to take the action at a shareholders meeting at which all voting shares were present and voted.

### **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:

- a. The corporation can pay its debts as they become due in the usual course of business; and
- b. 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 make the determination as to whether the tests are satisfied. It 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.

A corporation is taxed on any earnings before they are passed down to shareholders. Once received by shareholders, these earnings are then taxed at that persons applicable individual rate. Therefore, unlike an LLC, the earnings of a corporation are subject to "double taxation".

### **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 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.

### **Extraordinary Transactions**

Certain extraordinary transactions involving corporations, including mergers, share exchanges and sales of all or substantially all assets out of the ordinary course of business, 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.

### **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 Bureau of Commercial Services of the Department of Labor and Economic Growth. 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.

A foreign corporation which procures a Certificate of Authority will be subject to Michigan Single Business 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 allocation percentage or both), an additional fee is required. A tax advisor should be consulted regarding tax issues.

### **Filing and Record Keeping**

In addition to filing its Articles of Incorporation with the Bureau of Commercial Services, 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. Each Michigan corporation, and each foreign corporation authorized to transact business in Michigan, must file a Corporation Information Update with the Bureau of Commercial Services 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 which 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 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 which 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 Bureau of Commercial Services.

### **Subchapter S Corporations**

For United States income tax purposes, corporations may be one of two types; a “C” corp, which is the typical corporate form and contains all the characteristics detailed above, or an “S” corporation. An S corporation is essentially a corporation that 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 75 or less shareholders, all of whom are either natural persons who are U.S. residents, the estate of natural persons or certain trusts. An S corporation can only issue one class of stock. 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.

## **NONPROFIT CORPORATIONS**

### **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. As of this writing, a substantial revision of the Nonprofit Corporation Act is anticipated but has not yet been adopted.

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.

## **Formation**

A nonprofit corporation is formed by filing Articles of Incorporation with the Bureau of Commercial Services of the Department of Labor and Economic Growth. The filing fee is \$20.00. These Articles must include the following information:

1. Name of the corporation. Unlike business corporations, nonprofit corporations are not 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 which imply educational purposes may result in the Bureau of Commercial Services 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 the general "any lawful purpose" statement, but must describe a specific purpose. The Bureau of Commercial Services 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 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).
  - In a directorship corporation, the directors themselves elect all directors. In stock or membership corporation, stockholders or members elect directors (similar to business corporations).
4. Designation of registered agent and registered address for the corporation.
5. Name and address of at least one incorporator.
6. 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.



## Organization

As with business corporations, the Articles of Incorporation of a nonprofit corporation address broad structural matters, and more routine and detailed matters are addressed in the Bylaws. The incorporator or the first board of the corporation can 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; officers' positions and duties.

## 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.

**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.

**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.

## 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:

**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.

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

**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.

**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:

- a. Nonliability for breach of fiduciary duty by volunteer Directors (except in certain cases of fraud, self-dealing, bad faith, or gross negligence). If this protection is in place, volunteer Directors cannot be sued by the corporation, or by its members or shareholders. This type of liability protection is essentially a counterpart to that which can be provided to directors of business corporations. 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.
- b. 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.
- c. Liability limitation for other (nondirector) volunteers. 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.

**Recordkeeping.** Nonprofit corporations must file an annual Corporate Information Update (with a \$10 fee) with 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 Bureau of Commercial Services of the Department of Labor and Economic Growth in advance of the filing deadline.

## State and Local Tax Requirements

**Single Business Tax; Income Taxes.** Generally, nonprofit corporations that are exempt from federal income taxation are exempt from Michigan single business tax and from local corporate income taxes in the cities that have such taxes in Michigan except with respect to this organization's unrelated business taxable income.

**Michigan Sales and Use Tax.** Nonprofit corporations which 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 sales/use tax on items sold by a nonprofit corporation.

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

**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).

## Michigan Attorney General Registration

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

**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.

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

**Application for License to Solicit Donations.** Charities which intend to solicit contributions must file for a license. The application requires information on expenses by program category and supplemental disclosure if professional fund-raisers are used.

**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.

**Dissolution.** Generally, the Attorney General must approve the dissolution plan of a nonprofit organization.

## **Bureau of State Lottery**

This agency regulates raffles, bingo games and other such charitable fund-raisers. A separate application must be made to obtain a license for each such fund-raising event; allow six to eight weeks lead time.

## **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 make an application 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 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.

**Annual IRS Returns.** For nonprofit corporations with an annual gross income of \$25,000 or more, there are annual return filing requirements (IRS Form 990).

**Various Restrictions on Exempt Organizations.** 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.

## **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.

### **GENERAL PARTNERSHIPS**

Michigan has adopted the Uniform Partnership Act which has also been adopted by numerous other states. Under the 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.

## **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' best interest will 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.

## **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.

## **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 would include 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.

## **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, it is advisable that the partnership agreement clearly provides for the allocation of income and losses and also for the distribution of available cash.

## **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 which 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.

## **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 which the assigning partner would have otherwise be entitled to and is not entitled to access to 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.

## **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 which 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 to be satisfied out of its assets are 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 clearly 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 to insure such payments.

### **Limited Liability Partnerships**

The Michigan Uniform Partnership Act permits a partnership to organize as a limited liability partnership by filing a registration with the Bureau of Commercial Services of the Department of Labor and Economic Growth. 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 of the 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 the payment of the registration fee and remains in effect for one year. A registration may be renewed for annually by filing a renewal registration.

Registration of a limited liability partnership shields the partners from liability for most partnership obligations. Except for a tax obligation of the partnership, a partner of a registered limited liability partnership is not liable directly or indirectly for debts, obligations and liabilities of the partnership, whether in tort, contract, or otherwise, and whether arising from negligence, wrongful acts, omissions, misconduct, or malpractice committed while the partnership is a registered limited liability partnership and in the course of the partnership business by another partner or an employee, agent, or representative of the partnership. However, a partner in a registered limited liability partnership is not exempt for 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.

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 Bureau of Commercial Services relating to a registered limited liability partnership are open to public.

### **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.

### **Organizational Concerns**

Two or more persons may form a limited partnership in Michigan by filing the appropriate certificate with the Bureau of Commercial Services of the Department of Labor and Economic Growth. The Certificate of Limited Partnership (preprinted forms of which are available from the Bureau of Commercial Services) 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 which 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;
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 limited partnership on the records of the Corporations and Securities Bureau. 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.

### **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.

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.

### **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.

### **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.

### **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 return of capital to a limited partner which does not violate the limited partnership agreement or applicable Michigan law may nonetheless be required to be refunded within one year after payment, but only to the extent necessary to discharge the limited partnership's liabilities to creditors who extended credit to the limited partnership prior to the distribution of the capital to the limited partner. Further, a limited

partner remains liable for six years for any distribution of capital in violation of the partnership agreement or applicable Michigan law and amounts recovered under this provision can be used for any partnership purpose. 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.

### **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.

### **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.

## **LIMITED LIABILITY COMPANIES**

### **Introduction**

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.

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, not 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.

## **Formation**

An LLC is created under Michigan law when Articles of Organization are filed with the Bureau of Commercial Services of the Department of Labor and Economic Growth, 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. This period should be seen as a maximum duration, as opposed to the number of years for which the entity is likely to exist. The Articles of Organization may set forth a perpetual term.
5. If the LLC is to be run by managers, a statement to that effect must be included.

At the option of the members, other provisions may be added to the Articles of Organization as long as the additions do not conflict with Michigan law. Examples of optional provisions include guidance as to indemnification, 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 any statement in the original Articles of Organization becomes untrue (except regarding the office location or agent name).

## **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.

There is no limit on the maximum number of members (unlike the 75 shareholder restriction of S corporations). 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.

### **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 all the members of the LLC having more than one member unanimously vote to admit the assignee as a member.

### **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 an LLC could not pay its debts as they become due, or if the LLC's total assets would be 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.

### **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 provides 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. An amendment to the Articles of Organization.
5. 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.

### **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. Thus, an LLC affords maximum flexibility in its structure, permitting a corporation-like organization and characteristics (such as centralized management, continuity of life and free transferability of interests) with partnership taxation.

### **JOINT VENTURES**

A joint venture is a relationship between two or more 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 which 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. 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 fill in any gaps, as it may be in the case of partnerships, LLCs and corporations.

### **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 Bureau of Commercial Services of the Department of Labor and Economic Growth 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.

## ***TRADE REGULATION***

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### **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.

#### **Federal Antitrust Law**

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.

**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. Under the Sherman Act, some restraints are "per se" unreasonable (such as price-fixing agreements between competitors) and others are subject to analysis under a "rule of reason" (such as some 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 market and balancing the restraints pro-competitive and anti-competitive effects.

**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 agreements under which one product is sold subject to the requirement that the purchaser also buy another product from the seller (known as a "tying" arrangement).

**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 commodities "of like grade and quality." While the Act focuses on price discrimination, it also addresses other concerns such as discriminatory advertising and promotions, brokerage fees and commissions.

**The Federal Trade Commission Act.** The FTC Act declares unlawful "unfair methods of competition" and "unfair or deceptive acts or practices."

**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 Federal Trade Commission and the Justice Department. Failure to report may result in very substantial fines.

**Enforcement.** Private individuals and corporations may bring lawsuits under the Sherman Act, the Clayton Act and the Robinson-Patman Act. Remedies may include injunctive relief, treble (triple) damages and attorney fees. The government may enforce the Sherman Act through criminal prosecutions and civil suits. In addition, the government may enforce the Clayton Act and the Robinson-Patman Act through the FTC or the Justice Department. Only the government can enforce the Federal Trade Commission Act and the Hart-Scott-Rodino Act.

## **Michigan Antitrust Law**

The Michigan Antitrust Reform Act is largely based on the Uniform State 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.

### **Antitrust in Practice**

Antitrust is a complex area of the law and the resolution of antitrust issues often requires an extensive factual analysis. As the penalties for antitrust violations can be quite substantial, however, 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.

## **OTHER MICHIGAN TRADE REGULATION**

### **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 unconscionably.

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 an implied warranty is one of two product liability actions which may be brought in Michigan, the other being 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 state's version of the UCC applies exclusively.

### **Consumer Protection**

**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.

**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.

**Price Labeling.** Michigan has a price labeling law for consumer items, which requires prices to be affixed to the item, not just posted on a shelf. It is a prima facie violation if the price charged by electronic checkout means varies from the label. Under some circumstances a retailer is required to offer "rainchecks" if there are insufficient quantities to meet consumer demand.

**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.

### **Sales Representatives**

The Michigan Sales Representatives Commission Act provides protection for 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.

## ***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.

### **EMPLOYMENT DISCRIMINATION LAWS**

#### **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 prohibition of Title VII applies to employers with fifteen 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.

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

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.

#### **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 harassment is prohibited under both state and Federal laws. Unlike its Federal counterparts, however, this state law also prohibits discrimination on the basis of marital status, weight and height. 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 handicap 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.

#### **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 the Michigan Handicappers' 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.

#### **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 Michigan employment discrimination statute because the standards of proof and damages available to an employee are more favorable than under the Michigan Equal Pay Act.

#### **THE NATURE OF THE EMPLOYMENT RELATIONSHIP**

As a general rule, employment relationships in Michigan are terminable-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 terminable-at-will, well drafted employment applications and employee handbooks can help establish and protect the existence of that arrangement.

#### **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 against an employer -- even if the charges are found to have no merit -- are protected under these laws.

Michigan, as do many states, also has a general statute (the Whistleblower 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.

### **FAMILY AND MEDICAL LEAVE ACT**

The Federal Family and Medical Leave Act of 1993 (FMLA) requires most employers to provide eligible employees with up to 2 weeks of job-protected unpaid leave each year for family or medical-related reasons. (Michigan currently does not have a state counterpart to this law.)

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:

- a. Child birth and newborn child care, adoption or foster care placement of a child;
- b. Care of a spouse, child or parent with a serious health condition;  
or
- c. 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.

### **WAGE AND HOUR LAWS**

#### **Federal 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:

- a. No less than the statutory minimum wage, which is currently \$5.15 per hour; and
- b. 150 percent of their average wage earned during a workweek for each hour actually worked in excess of 40 during that workweek.

### **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:

- a. professionals;
- b. executives;
- c. administrative employees; and
- d. "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. Penalties for non-compliance -- as enforced by the U.S. Department of Labor, or by lawsuits brought by individual employees -- can be extremely burdensome.

### **Federal Child Labor Rules**

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

- a. Youths 16 and 17 years old may perform nonhazardous work, for unlimited hours;
- b. Youths 14 and 15 years old may perform nonmanufacturing and nonhazardous work for limited hours during periods when school is in session.

### **Michigan Law**

Michigan's Youth Employment Standards Act: Michigan has its own child labor law, the Youth Employment Services Act. The provisions of this Act are similar, but not identical, to the federal law and the state law is more restrictive in certain situations. In the following instances, the more restrictive Michigan state law will apply:

- 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.
- 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 am or after 9:00 pm or during any time school is in session.
- Minors aged 16 to 17 cannot work before 6:00 am or after 10:30 pm (11:30 pm if school is not in session).
- Supervision: No minors shall be employed unless the employer or employee who is 18 years of age or older provides supervision. The adult supervisor must actually be present at all times if a minor is employed at a fixed site in an occupation that involves cash transactions after sunset or 8:00 pm, whichever is earlier.

### **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.

### **EMPLOYMENT RECORDS**

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

- a. Pay and time records (for non-exempt employees) should be retained for at least three years;
- b. Job application forms of non-hired applicants should be retained for two years;

- c. 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
- d. 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. 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.

#### **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.

#### **PLANT CLOSINGS & MASS LAYOFFS**

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.

### **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.

### **NONCOMPETITION AGREEMENTS**

Under Michigan law, agreements which limit an employee's ability to compete against the employer while employed or after employment is terminated, are now 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.

### **POLYGRAPH EXAMINATIONS**

#### **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.

#### **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.

## **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.

## **WORKERS' COMPENSATION**

As with the laws of virtually every state, the Michigan Workers' 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 employee. Only in such cases are employers potentially liable to their employees for damages relating to pain and suffering, and the like.

## **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.

## ***EMPLOYEE BENEFITS***

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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 and securities.

### **ERISA**

ERISA imposes Department of Labor reporting and disclosure requirements and fiduciary standards on health and welfare plans and pension benefit plans and 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 excess benefit plans.

### **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 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 and funding 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 plans are not subject to the Code-imposed participation, vesting and funding 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.

### **State Law**

For employers or benefit programs not subject to ERISA, Michigan's Wages and Fringe Benefits Act requires that benefits subject to a written employer policy be provided in accordance with the written policy. Michigan's Third Party Administrator Act regulates the conduct of third party administrators providing benefits claims administration for various welfare plans. Michigan's Insurance Code 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. Fully insured MEWAs are not subject to these requirements.

## Qualified Plans

**Defined Benefit Plans.** Under a defined benefit plan, a participant is entitled to a predetermined benefit 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.

**Profit Sharing Plans.** Under a profit sharing plan, the employer contributes a discretionary 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 amount of the contributions allocated to his account and the rate of return earned by the plan on those contributions.

**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. The employer may or may not make matching contributions to the plan. Contributions to 401(k) plans are allocated to separate accounts for each participant, and benefits depend upon the 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.

**Money Purchase Pension Plans.** Under a money purchase pension plan, the employer contributes a fixed amount to the plan. Like a profit sharing plan, the contribution is 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.

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

## Nonqualified Plans

**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 coverage by the ERISA and Code-imposed participation, vesting and funding standards, nonqualified plans 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.

**Excess Benefit Plans.** Under an excess benefit plan, an employee will receive the difference between his benefit under a qualified plan and the amount that he would have received under the qualified plan, if the Code-imposed limits on benefits did not apply.

## Health and Welfare Plans

**Medical Plans.** Many employers in Michigan view medical plans as a key part of their employees' overall benefit package. Employers either pay the entire cost of medical plans or, primarily due to

increasing health costs, charge their employees for a portion of the cost. Medical plans are either provided on a fully insured or a self-insured basis. Self-insured plans are subject to Code-imposed nondiscrimination standards.

Employers with 20 or more employees who sponsor medical plans are subject to the Consolidated Omnibus Budget Reconciliation Act (COBRA). Under COBRA, employees or their dependents who lose coverage under the medical plans as a result of certain events are entitled 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.

**Life Insurance.** Many employers provide life insurance for their key 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 which may not discriminate in favor of key employees as to eligibility to participate or the amount of the insurance.

**Dependent Care Assistance Programs.** 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.

**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 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 income.

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

## ***IMMIGRATION AND VISAS***

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### **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 in 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 in 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.

### **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:

#### **First Preference – Priority Workers**

1. 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.
2. Outstanding professors or researchers with international recognition with at least three years of teaching or research in the area.

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

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

**Third Preference.** Professionals, skilled workers, and unskilled workers.

**Fourth Preference.** Certain special immigrants, including religious workers.

**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 at all 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.

### **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**

##### **1. 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 proceedings involving the alien.

##### **2. 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**

### **1. 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.<sup>1</sup> 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.

### **2. 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.

### **3. 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 Patrol (CBP) officer at the border or pre-flight inspection station for admission into the U.S. If admitted, he or she will be given an arrival/departure card (Form I-94). The I-94 states the nonimmigrant category and the term of the alien's stay in the U.S.

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<sup>1</sup> As of June 1, 2001 expedited processing (15 days) is available for many petitions by paying an additional \$1,000 fee.

#### **4. 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.

## ***REAL PROPERTY***

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### **METHODS OF HOLDING TITLE**

As a general rule, only certain legal entities such as natural persons, corporations, trusts, limited liability companies, and partnerships, can hold title to Michigan real estate. Joint ventures and unincorporated associations cannot hold title to Michigan real estate.

#### **Individual Ownership**

Any individual of legal age may own 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 entirety. 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.

#### **Corporate Ownership**

Foreign or domestic corporations may hold title to Michigan real estate. In addition to the degree of insulation from liability provided by corporate ownership, the use of a corporation as a purchaser may be advantageous to the purchaser, which needs flexibility in financing because usury laws provide certain exemptions for corporate 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.

#### **Partnership Ownership**

Foreign or domestic partnerships may own real estate in Michigan. Prior to the advent of limited liability companies, limited partnerships were the preferred form of partnership 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.

#### **Limited Liability Companies**

Limited liability companies have been recognized as legal entities in Michigan since 1993. See, "FORMS FOR CARRYING ON BUSINESS--Limited Liability Companies." Limited liability companies ("LLC") are frequently used for ownership of commercial real estate in Michigan. 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.

#### **Dower**

Michigan continues to recognize a married woman's inchoate "dower" interest in her husband's real property. A dower interest attaches to all real property acquired by a married man in his individual capacity at any time during the marriage, but does not become vested until the husband's death. A dower interest provides the widow a one-third interest in such real property, which she may use during her natural life, unless the dower interest has been lawfully barred or formally relinquished. Since the common law right of courtesy has been abolished by statute, there is no similar interest in real property for a husband in Michigan.

The dower rights of a married woman, however, do not attach to any property which her husband holds in a fiduciary capacity, or as a partner in a partnership. Likewise, dower rights do not attach to real estate or to real property owned by a married man as a joint tenant with a third party, or for real estate being purchased on land contract.

A married woman may relinquish or subordinate her dower rights in real property. For example, a lender would typically require the wife of a married man who owns real property in his own name to join in the execution of a mortgage on the real estate, even if the debt is not joint, in order to subordinate the married woman's dower interest in the property to the mortgage.

Dower rights are also relinquished when a woman executes a deed of conveyance with her husband. Male mortgagors and grantors in Michigan are required to state their marital status on conveyances and mortgages so that the grantee or mortgagee can protect itself against potential dower rights. All rights to dower should be considered in the context of the Estates and Protected Individuals Code ("EPIC"). Dower may also be barred by a lapse of time.

## **Concurrent Ownership**

**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 out, 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.

**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 be enforceable. 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 tenancy, if one of the joint tenants dies, the decedent's title automatically passes to the surviving joint tenants. 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 other owners. 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, the conveyed interest 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 terminated.

**Tenancies by the Entireties.** When a husband and wife take title to real property, a tenancy by the entireties is presumed unless it is specifically indicated otherwise. 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. A tenancy by the entireties can be created only if the persons to whom title passes are husband and wife at the time the instrument transferring title takes effect.

## **MICHIGAN PURCHASE AND SALE TRANSACTIONS**

**Statutes of Frauds.** As in other states, Michigan law generally requires that contracts for the sale or transfer of an interest in real property be in writing to be enforceable. According to Michigan case law, a binding agreement for the sale of real estate may exist where there is a writing identifying the parties, the property and the price (and how and when it must be paid).

### **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.

It is good practice to have all parties who will be required to sign the deed in order to convey full title to 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. Buyers may also wish to 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. With a land contract, the deed to the property is not released to the buyer (or vendee) until the land contract is fully performed by the buyer. Instead, a memorandum of land contract is usually recorded to evidence the transaction. Because the deed is not delivered until the land contract is fully performed, the buyer is said to have "equitable title" to the property (usually including the right to possession), and the seller (or vendor) is said to have "legal title" to the real estate. Upon the buyer's default, a land contract may be foreclosed, much like a mortgage. The additional remedy of forfeiture is available to the land contract seller upon default of the buyer. In most cases, after forfeiture, a summary proceeding must be initiated to restore possession of the property to the seller. Under both foreclosure and forfeiture the buyer has a right to redeem the contract if the default is cured within a statutorily prescribed time period.

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, which 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 buyer. 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 based on that party’s possession during the applicable tax period. In Michigan, the method by which taxes are paid may vary from one local taxing authority to another. For example, some may collect taxes in advance, some in arrears. Thus, care should be taken to determine whether the local taxing authority requires that taxes be paid in advance, or in arrears, and whether the agreement calls for prorations to be made on a due date, fiscal year or calendar year basis, since these factors can make a significant difference in the outcome of the tax prorations.

Most sellers 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. For example, the seller of a home in the City of Detroit must obtain a pre-sale inspection of the property in most cases.

A variety of reporting documents are required or necessary upon the transfer of real estate in Michigan. Unless exempted, the transferee must file a Property Transfer Affidavit with the local assessor’s office within forty-five (45) days of the transfer. Fines are assessed for late filing. If the property is to be used as the buyer’s principle residence, a Homestead Exemption Affidavit should be filed promptly after the closing. This provides the buyer 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.

## **Title Insurance**

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 they will handle the initial ordering of the commitment.

Once a commitment has been obtained, it will be delivered to the prospective purchaser for review. If the purchaser finds flaws in the existing title, the purchaser should notify the seller and delay closing until the flaws are corrected. Most purchase agreements provide that, if the flaws cannot be corrected, the

purchaser is entitled to terminate the purchase agreement and obtain a refund of his deposit.

Assuming that the title commitment reveals marketable title, the title insurance policy is ordered at 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 some time 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 which confirms the contents of the final policy. In Michigan, the seller usually pays the premium for an owner's policy of title insurance. This can be modified by contract 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 which are applicable to all policies (unless removed by the title company) and specific exceptions which are applicable only to that parcel of property (such as mortgages, construction liens, tax liens, easements, leases, deed and use restrictions and other encumbrances which affect the quality of the title being conveyed). An astute purchaser will require 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. This issue should be addressed in the purchase agreement.

Title insurance is also available to and nearly always required by lenders. A lender making a mortgage loan on property will require that the borrower provide it with a policy of title insurance which 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.

## **Transfer Taxes**

Michigan also imposes transfer taxes upon the sale or conveyance of Michigan real property, both at the State and County levels. The amount of County tax is generally \$0.55 per \$500.00 of the purchase price. However, counties with a population of 2,000,000 or more are authorized to charge as much as \$0.75 per \$500.00 of the purchase price. The State also imposes an additional transfer tax of \$3.75 per \$500.00 of the purchase price upon the sale of Michigan real property. 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).

## **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. Michigan does not follow the procedure of some other states of an escrow closing. 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.

**Formalities of Transfer Instruments.** The conveyance of title is accomplished by execution and delivery of a deed from the seller to the purchaser. In order for a deed to be valid in Michigan, it must satisfy certain common law and statutory requirements. In order to satisfy the common law requirements, a deed must have a competent seller and a purchaser who has the legal capacity to own real estate. 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 and other valuable consideration." The property should be described in the deed by its proper legal description. The words of conveyance create the transfer and state the quality of the 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 sellers and the purchasers must be stated in the deed. The seller must sign the deed in the presence of two witnesses and acknowledge the signing before a notary public. The two witnesses and the notary public must then sign the deed and each name should be printed or typed beneath their signature. The deed must also state the name of the preparer of the deed and the preparer's business address. If the seller of the real estate is male, the deed must state his marital status.

In addition to signing the deed, the seller must also deliver the deed to the purchaser to convey title to the real estate.

In Michigan, two types of deeds are primarily used to convey real estate. A warranty deed states that the seller "conveys and warrants" title to the purchaser. This means that the seller warrants to the purchaser that the interest that the purchaser is receiving is fully vested in the seller and that there is no exception to clear title, except for specific limitations stated on the deed, such as "easements and restrictions of record." The seller will be required to defend the title if defects are subsequently discovered. A quit claim deed conveys whatever right, title, and interest the seller has in the real estate, but no other interest. Under a quit claim deed, the seller makes no warranty as to the quality of the title being conveyed and is not responsible for any defects in title.

A deed to Michigan real estate should be recorded promptly with the County Register of Deeds in which the property is located. Failure to record a deed may permit third parties to acquire rights superior to the rights of the purchaser.

## **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.

### **Types of Michigan Mortgages**

Several types of mortgages are recognized by Michigan law, including: the deed of trust; the trust mortgage; and the common or "standard" mortgage. Deeds of trust are commonly used in other states, but are uncommon in Michigan. In the deed of trust, a debtor conveys property to a trustee for the benefit of both the debtor and a creditor to secure an obligation pending full performance of the obligation. 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 or "standard" mortgage forms in Michigan are standard only in the sense that they provide for a "mortgage" of the Property to secure the debt or obligation. Otherwise, with the exception of certain provisions which 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 addition, an equitable mortgage may be imposed by a court of equity when no valid written mortgage exists but some sort of lien is required by the circumstances and the relationship of the parties, such as where a deed which appears to be absolute on its face is given as security for a debt.

### **Elements of a Michigan Mortgage**

By statute, an instrument which 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. In practice, such mortgages are not accepted by lenders, as no covenants are implied under Michigan law, so all covenants and obligations must be spelled out to be enforceable. In the absence of a covenant to pay the indebtedness, the mortgagor will have no recourse against the mortgagee under the mortgage, although recourse may be available under the underlying debt instrument.

In order for a mortgage to be in recordable form, Michigan law requires that it include such information as the parties' names and addresses and the marital status of a male mortgagor, and a description of the mortgaged property. It must be signed and notarized. Recent changes to Michigan statutes governing the recording of mortgages and other documents have eliminated the need for witnesses, but have imposed additional technical requirements such as margins, color of ink, type, size, and the like. Care should be given to strictly comply with these requirements, or the document may be refused by the Recorder.

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 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 and the date of repayment 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 such an intention, 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 if the future advances are to retain the original priority of the mortgage. There are two exceptions to this rule however: construction liens and state and federal tax liens may both take priority with respect to advances made subsequent to the priority 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. Assignments of rents are otherwise not enforceable in Michigan.

### **Foreclosure**

Lenders may foreclose in Michigan by judicial action or by advertisements. Both types of foreclosure procedures are governed by statute in Michigan. In either case, the mortgagee can make a

credit bid at the foreclosure sale up to the full amount of the mortgage debt, plus certain allowable expenses.

To foreclose by judicial action, the mortgagee must file suit in the circuit court where the property is located requesting that the court declare a default and order the sale of the property in order to satisfy the debt that is owed. As a general rule, the foreclosure sale cannot take place until at least six months after the foreclosure complaint was filed. The alternative to judicial foreclosure is foreclosure by advertisement. This enables the property to be sold without judicial supervision by advertising the property for sale for at least four consecutive weeks in a newspaper of general circulation. Immediately after the four week period, the property may be sold by the county sheriff to the highest bidder at a public auction. However, one may not foreclose by advertisement in Michigan unless the mortgage is recorded and contains a power of sale.

Foreclosure by advertisement is the quicker procedure, generally taking approximately six weeks from commencement of foreclosure to sale, compared with at least six 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 individuals 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. 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.

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. 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. However, 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.

## **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 purchaser holds an equitable interest in the land.

The purchaser's interest in the 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 debtor, but not subject to the "cramdown" provisions which may be applicable to mortgages. In addition, land contracts generally provide that, upon a default by the purchaser, the seller may either forfeit the land contract and retain all the land and amounts paid, or foreclose the land contract judicially, in the same manner as a mortgage. Land contracts cannot be foreclosed by advertisement. If the purchaser is in possession of the land, the purchaser has certain statutory protections provided by Michigan law in the event of a forfeiture. If the purchaser is not in possession, the statutory protections may not apply, and self-help repossession may be permitted. Acceleration of the debt is not permitted and no deficiency may be recovered in a forfeiture, but a deficiency judgment may be recovered in a foreclosure.

## **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 nor 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 which 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 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.

## **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.

### **Term**

The vast majority of leases in Michigan, including residential leases, are in writing and are for a fixed term. A lease for a term of more than one year must, by Michigan law, be in writing to be enforceable. Oral leases for residential property (and more rarely, commercial leases) 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 the end of any month if the party so desires. If neither party terminates, and each of them performs its obligations under the lease, the lease continues.

### **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", the Tenant pays its rent, its own utility costs and all of these other costs so that the rent received by the Landlord is considered to be its net income from the property. Oftentimes, a lease will be neither a Gross Lease nor a Triple Net Lease, and the parties will agree to a mutually acceptable manner of allocating these costs.

### **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 which 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.

### **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 attempt 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.

### **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 and provides for such things 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.

### **Ground Leases**

Ground leases are leases of unimproved land 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 revert to the owner of the land. Most ground leases in Michigan are Gross Leases.

### **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. In a multi-tenant development, a Tenant will want significant assurance that its neighboring Tenants will be utilizing their properties for compatible uses. In smaller strip shopping centers, a Tenant may also require that other users 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.

### **General**

Regardless of the type of lease, Landlords and Tenants must pay particular attention to environmental concerns, health standards and accessibility to the disabled. In recent years, the Federal government and the State of Michigan have enacted numerous 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.

## **ZONING AND LAND USE**

Land use and development in Michigan may be subject to both state and local regulatory programs. 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 which 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.

It is customary in most communities for a land developer to meet with the local planning department to discuss land use and development plans prior to commencing a specific project. Even if the property contains the proper zoning for the project, the municipality still may require submission of a site plan to obtain required permits to begin construction. The procedures for submission and approval of site plans are provided in the local zoning ordinance. A municipality must approve a site plan that conforms to the zoning ordinance's requirements for site plan approval.

If the property does not contain the proper zoning for the developer's plan, the developer may seek a rezoning of property. The rezoning process usually takes a few months. The ultimate decision to approve the rezoning is made by the village, city or township legislative body after a public hearing. However, the Michigan Supreme Court recently held that in order to challenge an existing zoning classification under the Michigan or U.S. Constitution the landowner must also apply for a use variance in addition to petitioning the planning commission and legislative body for a rezoning.

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 state circuit court within 21 days of 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 Appeal's decision may challenge the granting of a variance by seeking review of the decision in state circuit court.

### **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 which 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 are also 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.

### **Municipal Subdivision Regulations**

The legislature has also enabled cities, villages and townships to regulate the subdivision of land within its boundaries. 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 subdivider 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 subdivider with an approval of lot sizes, lot orientation and street layout for a one year period. Final plat approval provides the subdivider 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 to entitle the recording of a final plat. When the approval and certificate process has been completed, the final plat must be recorded with the register of deeds office.

Certain land divisions are not subject to the platting requirements of the Land Division Act. Whether or not a division of land may be effected 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 created from the "parent parcel" since March, 1997. All deeds transferring title to unplatted lands must contain a statement that the grantor is granting to the grantee its rights to divide the land outside of the platting requirements. Without such a statement, the division rights of the parent parcel are not conveyed to the grantee but remain with the parent parcel.

Additionally, all deeds for unplatted land must contain a verbatim statement provided in the Act to

the effect that the property may be located near farmland or a farm and the consequences thereof.

Land that is divided pursuant to Michigan's Condominium Act is also exempt from platting requirements.

## ***MINERAL RIGHTS***

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Michigan produces a variety of minerals, including iron ore, copper, potash, limestone, salt, asbestos, oil and gas. Oil and gas have been the principal focus of new mineral development since the late 1960's and early 1970's. Most of Michigan's oil and gas fields produce from pinnacle reef formations encountered above 5,000 feet. These reefs are vertical structures which do not cover large areas, so locating pinnacle reef reserves requires sophisticated geophysical techniques.

### **Creation**

Mineral interests are generally owned by the surface owner, except that Michigan is a “law of capture” state for oil and gas. 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.

Severed, oil and gas interest(s) can 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.

### **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, but 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.

### **Permits to Drill**

The application for 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 animal, 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.

## ***ENVIRONMENTAL REGULATION***

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### **CONTAMINATED PROPERTIES PART 201 OF NREPA AND CERCLA OR “SUPERFUND”**

#### **Part 201 and CERCLA**

Part 201 of the Michigan Natural Resources and Environmental Protection Act (Part 201) and the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund) contain similar language. The statutes provide for strict, retroactive, and joint and several liability for persons causing or contributing to a “release” or threatened release of hazardous substances from an onshore or offshore “facility.” However, there are significant differences between the two statutes, especially with respect to the identification of responsible parties.

#### **Part 201**

In 1995, the Michigan legislature consolidated the State’s various environmental statutes into the Natural Resources and Environmental Protection Act (NREPA). In addition to consolidating all of the environmental statutes into one comprehensive act, the legislature amended the provisions of what used to be known as the Michigan Environmental Protection Act (MERA). Part 201 of NREPA governs environmental remediation in place of MERA.

Part 201 substantially altered the liability for contaminated sites in Michigan. The Michigan legislature limited liability for owners and operators of contaminated sites purchased before June 5, 1995, to only those owners or operators who were responsible for the activity that caused the release or threat of release of hazardous materials. EPA also initiated administrative reforms of CERCLA liability that has reduced the incidence of new Superfund sites in Michigan over the past few years. The changes have made profitable development of Brownfields properties feasible, and since 1995, more than 5,000 such properties have been sold and are being operated again.

#### **Obtaining exemptions under Part 201**

Those who acquired ownership or control of a contaminated property after June 5, 1995, may avoid liability for cleanup of contaminated properties under Part 201 if they conduct a “baseline environmental assessment” (BEA) prior to or within 45 days after acquiring control or ownership of a contaminated property. A BEA is an evaluation of the property at the time of a change in ownership or control that adequately identifies existing environmental conditions and it highlights plans for site use or redevelopment, intended land and hazardous substances use, known contamination, and potential exposure pathways. The BEA must be submitted to the Michigan Department of Environmental Quality (MDEQ) and provided to subsequent purchasers. For a small fee, MDEQ will review submitted BEAs and issue confirmation that the BEA is adequate. However, a BEA provides protection only for those environmental conditions reported in it. Owners and operators remain strictly liable for any undiscovered or unreported contamination. In addition, Part 201 provides that owners and operators of contaminated sites who are not liable for cleanup costs continue to have affirmative obligations to prevent exacerbation of existing contamination and to institute due care obligations to those who may be exposed to remaining on-site contamination.

Technically, the provisions of CERCLA still apply in Michigan. However, EPA has removed many thousands of properties from its list of sites to be considered for remediation, and administrative changes appear to diminish the risks for innocent purchasers and small parties. Thus, while it is possible that additional properties in Michigan will be nominated to the National Priorities List for remediation under CERCLA, it does not appear likely that this will happen to sites that have complied with the Part 201 and have received favorable determinations from MDEQ. In addition, Congress has amended CERCLA in order to encourage development of Brownfield sites, changes of which in some ways are similar to Part 201.

As a result of the statutory and administrative changes to Part 201 and CERCLA, persons seeking to do business in Michigan and contemplating 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.

### **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. MDEQ traditionally has imposed numerical state water quality-based limitations for toxic pollutants in accordance with unpromulgated guidelines. Because these limitations are not based on an enforceable rule, EPA imposed federal water quality standards for NPDES permits in Michigan. Michigan is expected to impose the more stringent of EPA or state water quality standards in its NPDES permits.

EPA recently approved Michigan's authority to issue general permits under its NPDES program. The state has issued a general permit to cover discharges of storm water associated with industrial activity and has issued a "permit by rule" for discharges of storm water from any construction activity that disturbs five acres or more of land. 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 does not authorize "citizen suits" against facilities alleged to be in violation of applicable requirements.

### **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 MDEQ 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, MDEQ shares permitting authority with the United States Army Corps of Engineers (ACE), which will consider permit applications jointly with MDEQ. 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).

## **AIR POLLUTION CONTROL**

### **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.

### **Non-Attainment Areas in Michigan**

Control of criteria pollutants is achieved through the development and enforcement of State Implementation Plans (SIPs). For areas that are in non-attainment, the Clean Air Act mandates controls on sources of pollution under strict time tables. Three areas in Michigan are currently considered moderate non-attainment areas for ozone: Detroit-Ann Arbor, Grand Rapids and Muskegon. There are no non-attainment areas in Michigan for carbon monoxide or particulates.

In order to achieve attainment for ozone, existing major sources of volatile organic compound emissions and nitrogen dioxide emissions will be required to install Reasonably Available Control Technology, as defined by EPA. New sources of these pollutants will be required to obtain a new source review permit, install the Lowest Available Emissions Rate technology, and obtain reductions (offsets) in other sources of pollutants in the non-attainment region.

### **Hazardous Air Pollutant Control**

The 1990 amendments to the Clean Air Act greatly expanded the regulation of sources of hazardous air pollutants. EPA must now promulgate technology and risk-based standards to control emissions of 189 hazardous substances from 174 types of industrial sources. Michigan has had its own hazardous air pollution control program for over a decade. Under Part 55 of NREPA, state control of hazardous air pollutants cannot be more stringent than federal control requirements.

Pursuant to authority delegated to it by the USEPA, the MDEQ 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 the MDEQ. The MDEQ also conducts inspections of demolition and removal projects.

### **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 MDEQ 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.

### **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.

### **UNDERGROUND STORAGE TANKS**

Underground storage tanks (USTs) in Michigan are regulated under two statutes: Part 211 or the Underground Storage Tank Regulatory Act (USTR) and Part 213 or the Leaking Underground Storage Tank Act (LUST). 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, designation of state agency authority (the MDEQ has full responsibility), proof of financial responsibility, penalties and remedies.

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 American Society for Testing and Materials (ASTM) Standard Guide for Risk-Based Corrective Action (RBCA) protocols. Part 213 also empowers the MDEQ 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 the MDEQ 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 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.

### **WASTE**

Solid waste is governed by the terms of Part 115 and the regulations promulgated pursuant to it. Part 115 regulates the construction and maintenance of disposal and transfer 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). The MDEQ and Region V of the USEPA have signed a Memorandum of Understanding that recognizes the State of Michigan's voluntary 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 wastes (Part 121), and used oil recycling operations (Part 167). Violations of Parts 111 and 115 could lead to civil penalties, fines and criminal enforcement.

## ***PROTECTION OF INTELLECTUAL PROPERTY***

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Intellectual property is considered among the most valuable asset of many companies; therefore, the acquisition or right to use the intellectual property is the reason for many business transactions. Increasingly, lenders and financiers look to a company's intellectual property assets as collateral to secure the company's obligations and support financing.

Under federal and Michigan law, these intellectual property assets may be protected as patents, copyrights, trademarks, trade dress or trade secrets, or may be protected by principles of unfair competition, depending on the nature of the property and the type of protection sought. Some types of intellectual property may be eligible for more than one form of protection. For example, computer software programs may be protected by a copyright and/or a patent.

### **PATENT LAW**

Patents are exclusively matters of federal law and are governed by the 1952 Patent Act, as amended, which recognizes the following types of patents:

- Utility Patents, which protect the utilitarian aspects of a process, machine, manufacture or composition of matter;
- Design Patents, which protect the ornamental external design of an article of manufacture; and
- Plant Patents, which protect only distinct and new varieties of asexually reproduced or cultivated non-tuberosous plants.

### **Eligibility for Patent**

Patents are issued by the Patent and Trademark Office of the United States Department of Commerce on inventions or designs that are "novel" and "non-obvious."

An invention is considered novel if: (a) the applicant was the first to invent the Invention; (b) the Invention was not known or used in the United States, or patented or published in any country, before it was created by the applicant; and (c) the Invention was not in public use or on sale in the United States more than one year prior to the date of the application for patent. An Invention is "non-obvious" when the differences between the Invention and the prior art are such that the Invention would not have been obvious to a person having ordinary skill in the art.

### **Patent Owners' Rights**

Once a patent is issued, the patent holder has the exclusive right to prevent others from using, selling, offering for sale, importing, or manufacturing the patented Invention within the United States during the term of the patent. Patent terms are 20 years from the date of application.

## COPYRIGHT LAW

Copyrights are also exclusively matters of federal law, and are governed by the 1976 Copyright Act (the "Act") and its amendments. Copyrights are exclusive rights in an original works of authorship fixed in an tangible medium expression (the "Work").

### Copyright Owner's Rights

A copyright protects a creator's original expression of an idea or concept. Copyright law, however, distinguishes between an idea and the expression of an idea. Only the expression of an idea is protected. Thus, copyrights do not protect the owner from use by others of any idea, procedure, process, system, method of operation, concept, principle or discovery revealed by a copyrighted Work. Ownership of a copyright gives the owner the exclusive right to control the copying, distribution, performance, display or other recreation of the Work by another.

**Eligibility for Copyrights.** Copyright protection is available for original works of authorship fixed in a tangible medium of expression. Works of authorship include literary works, musical works, dramatic works, pantomimes and choreographic works, pictorial, graphic and sculptural works, motion pictures and other audiovisual works, sound recordings and architectural works.

**Computer Programs.** Copyright protection is available for computer programs to the extent that the program (including the structure, sequence and organization of the program) incorporates the programmer's expression of original ideas, as distinguished from the ideas themselves.

**Mask Works.** Mask works, such as the two-dimensional and three-dimensional features of the shape, pattern and configuration of the surface of the layers of a semiconductor chip product, are accorded sui generis protection under Chapter 9 of the Act. Mask works, though similar to pictorial, graphic and sculptural works, are not afforded the same protection because their configuration is inseparable from the useful object, the semiconductor ship. A mask work may not be reproduced, imported or distributed without the authority of the owner.

### Vesting of Rights

A copyright automatically vests in the author or joint authors of the Work when it is first reduced to tangible form. No registration or filing is necessary. Copyrights remain vested in the authors for the duration of the copyright unless the authors transfer their copyrights by written assignment. The Act does not permit an oral assignment of a copyrighted Work.

An employer will be the author of a Work, and therefore hold the copyrights in the Work, in the special case of a "work made for hire." A "work made for hire" may be one created by an employee within the scope of employment or, in certain limited and special circumstances, by a non-employee.

Because many consultants, advertising agencies, independent contractors and other non-employees create works that do not fall within the limited application of the "work made for hire" rules, ownership of copyrights in such Works must be obtained by an express written assignment.

## **Duration of Copyrights**

The duration of copyright protection depends upon who is the author, when the work was created and when federal copyright protection was first obtained. For works created after January 1, 1978, the following terms apply:

- An individual author is protected for a term of "the author's life plus seventy years."
- Joint authors are protected for a term of "the life of the last surviving author plus seventy years."
- For "works made for hire" the term of copyright is ninety five years from publication or one hundred and twenty years from creation, whichever is shorter.

The term may not be renewed or extended.

## **Formalities**

As of March 1989, federal law no longer requires the formalities of notice or registration to establish copyrights. However, it is still advisable to apply a copyright notice to each copy of a Work and to register copyrights in a Work.

The copyright notice consists of three elements: the word "copyright", "copr." or the copyright symbol "©"; the year of first publication; and the copyright owner's name. Notice can prevent inadvertent infringement and prevent an infringer from mitigating damages by claiming innocent infringement.

Registration is still a prerequisite for most copyright infringement actions and for recording the copyright with the Customs Office. (Registration is not a prerequisite for a U.S. copyright infringement action, if the Work originated in some other Berne Convention member country.) Registration establishes the owner's title to the Work and entitles the owner to claim statutory damages and attorney's fees in an infringement action and other benefits.

## **Moral Rights**

Protection for moral rights (or *droit moral*) is much more limited in the United States than in many foreign countries. The 1990 Visual Artists Rights Amendment to the Copyright Act grants to the author of a work of visual art the rights of attribution (to claim authorship) and integrity (to avoid attribution in the event of prejudicial distortion, mutilation or modification) in a Work for the life of the author, without granting such rights to any other type of copyrightable Work.

## **International Copyright Conventions**

The United States is a party to the Universal Copyright Convention and the Berne Convention. Under the Universal Copyright Convention, Works by nationals of member nations and Works first published in member nations are entitled to national treatment in every other member nation, if the Work is unpublished or carries the prescribed notice. Member states may impose additional requirements on their own nationals. In 1989, the United States became a party to the Berne Convention, under which member countries recognize copyrights created in other member countries without requiring any formalities.

## TRADEMARK LAW

Trademark protection is governed by both federal and state law and is founded on the common law notion that a merchant has an inherent right to the exclusive use of those marks which distinguish his goods or services. Unlike trademark rights in most other countries, this right is based on the merchant's use of the mark; there is no registration requirement. 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.

### Types of Marks

A mark is typically a name or word capable of distinguishing goods or services of one 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.

However, even though distinctive of a product or service, functional features of a product are not entitled to trademark protection.

### Registration of Marks

**Federal Law.** A trademark that is in use (or that the registrant has a bona fide intent to use) in interstate commerce may be registered (or reserved) under the federal trademark law, known as the Lanham Act. Upon application for registration, the U.S. Patent and Trademark Office will conduct an examination to determine whether the mark is eligible for registration.

Use of the registration symbol ® acts as a constructive notice to an infringer and allows the registrant to recover profits and damages from an infringer without giving actual notice of registration. A mark may be refused registration on the federal Principal Register for a number of specified reasons.

Registration on the federal Principal Register provides the registrant with the right to exclusive ownership of the mark, the right to the exclusive use of the mark during the initial ten-year term and any renewal terms, and the right to use the registration symbol ®.

**Michigan Law.** A registrant may also apply to the Department of Commerce 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. The restrictions on registration of the mark are similar to federal restrictions and the registration term is ten years.

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

## TRADE SECRET LAW

Unlike patents, copyrights and trademarks, trade secrets in Michigan are protected solely by state law. Michigan recently adopted the Uniform Trade Secrets Act, et al. and they joined a number of other states in enacting uniform trade secret legislation.

Under Michigan law, a trade secret may consist of any formula, pattern, device or compilation of information or other know-how that is used in a business, and gives that business an opportunity to obtain an advantage over competitors who do not know or use it. Trade secrets may include formula for chemical compounds, processes of manufacture, patterns for machines or other devices and customer lists.

Protection of trade secrets requires that those who know the secret agree or are otherwise obligated not to disclose it. The number of authorized people aware of the secret does not affect protection of the trade secret, as long as none of them disclose the secret to anyone else. Trade secrets are generally protected through written nondisclosure agreements with employees, written license and nondisclosure agreements with authorized users and the establishment and carrying out of secrecy policies and practices.

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

## **UNFAIR COMPETITION LAW**

Both federal and state laws prohibit the misappropriation and misuse of intellectual property under a theory of unfair competition.

### **Federal Law**

Section 43(a) of the Lanham Act, the federal law protecting trademarks, specifically prohibits the use of false designations of origin and false descriptions or representations of goods or services in commerce.

Both the person who creates the false designation or description, and the person having knowledge thereof who causes the goods or services to be transported or used in commerce, may be civilly liable for violation of this section. Any person doing business in the falsely designated area or any person who believes that he or she is likely to be damaged by the use of the false description may bring a civil action against the false designator.

### **Michigan Law**

Michigan law prohibits unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce. The elements of an action under the Michigan law are essentially the same as under the Lanham Act.

## **TRANSFER OF PROPRIETARY RIGHTS**

### **Copyrights**

The transfer of copyright, or any part of a copyright, requires a document that is in writing and signed by the owner of the rights conveyed. To be effective against conflicting transfer, the transfer should be recorded in the Copyright Office and the copyright should be registered. There are certain time limits within which recordation must be made.

### **Patents**

A written instrument is also required to transfer a patent, any interest in a patent or a patent application. To be effective against subsequent purchasers or mortgagees, the instrument must be recorded in the U.S. Patent and Trademark Office within specified time limits.

## **Trademarks**

A trademark may be assigned only with that part of the goodwill that is symbolized by the mark. A pending application for federal registration based on intent to use may be assigned only to the successor of the business of the applicant. Assignment of a federally registered mark or application requires a written instrument. To be effective against subsequent purchasers or mortgagees, the instrument must be recorded in the Patent and Trade Office within specified time limits.

## **Trade Secrets**

Trade secrets are not a clearly identified form of property that may be transferred as such. Instead, a person seeking to obtain rights in a trade secret must rely on contracts. These usually include the agreement of the transferor not to disclose the secret to anyone else, and an assignment of the transferor's confidentiality rights against employees, customers and others who may have had access to the secret. There is no system for registering such rights of recording such documents.

## **Partial Transfers and Licenses**

Licenses do not in general require written instruments. There is, however, an exception for exclusive copyright licenses, which are considered transfer of a part of the copyright and are subject to the rules for copyright transfers described above.

## **Security Interests**

Security interests in intellectual property rights may be created by written agreement. A financing statement under the Michigan Uniform Commercial Code should be filed with the Michigan Secretary of State to evidence a security interest.

## ***FINANCING INVESTMENTS***

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### **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.

#### **Equity**

Although not impossible, it is quite difficult to start a business without some equity investment by the owners. The amount required in a given 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 discussions with potential lenders that owners learn the minimum equity requirements that will be necessary to conduct business.

#### **Kinds of Equity**

**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.

**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 or not the preferred stock will participate in future growth or contraction of the corporation, voting rights, conversion rights, rights on default and rights of first refusal.

**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. In as much 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 well-seasoned 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 normally 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.

## **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.

### **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 of the assets of the borrower or by some portion thereof, 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.

**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.

**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 forecasted 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 repayable upon demand of the lender at any time.

**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. Again 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.

### **Documentation**

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

**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 into 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 ratios. These require careful consideration and may result in extensive negotiation. Other provisions include a default provision defining the conditions under which the lender may seek recourse for nonpayment or other non-performance and provisions relating to security and guaranties.

**Guaranty.** The lender may insist that the principal owners of the borrowing enterprise guarantee the full and punctual performance of all of the borrower's obligations under the agreement and promissory note. This converts a corporate liability into a parallel personal liability and is something that the potential guarantor will want to avoid; however, the lender may be unwilling to lend without a guaranty. 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.

**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 such 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 negotiation and assignment.

**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 above at "REAL PROPERTY--MORTGAGES AND LAND CONTRACTS". A security interest in collateral may be created only 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.

**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. A major change in the UCC adopted in 2001 changed the primary location for filing financing statements for business entities from the jurisdiction in which the property is located to the jurisdiction under whose law the entity was formed. Financing statements constitute public notice of the existence of a security interest. The proper method of perfection must be carefully examined for each type of collateral. Perfection of a security interest grants the secured party priority in the collateral over unperfected creditors and over other, later-perfected creditors. 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.

## **FEDERAL AND STATE SECURITIES LAWS**

### **Summary**

Many times businesses 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 Office of Financial and Insurance Services of the Michigan Department of Labor and Economic Growth (the "Michigan Office"). Offerings made in multiple states may also be subject to regulation by the securities regulations of each state. 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 decision.

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 of the funds raised from investors.

### **Investments Subject to Securities Laws - Definition of Security**

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.

### **Transactions Subject to Securities Laws**

Every offer and sale of securities must be registered with the Michigan Office or the SEC or have an appropriate exemption from registration. In addition, 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.

**United States Law.** 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.

**Michigan Law.** 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.

### **Offerings of Securities**

There are generally three methods by which a company can 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 all of 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.

## **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. The registration statement must contain all of the 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 all of 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.

## **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 after every quarter and at the end of each fiscal year. 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, have imposed significant new requirements on companies with publicly-held securities. These provide, among other things that:

- All such companies have an audit committee composed solely of independent directors;
- 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;
- Audit committees be directly responsible for the appointment, compensation, and oversight of the company's external auditors;
- 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;
- The company's public accounting firm provide a written report to the committee that describes of all critical accounting policies and practices to be used in the audit, any alternative treatments of financial information that have been discussed with management;
- 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 services to be rendered to the company;
- The chief executive officer and chief financial officer certify the SEC reports of their company;
- Reporting companies may not make or arrange any extension of credit in the nature of a personal loan by to any of their directors or executive officers;
- No officer or director may purchase or sell any of the company's equity securities during any blackout period for an employee benefit plan;
- 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.

### **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 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 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 a number of 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 offer and sale of certain securities, which are called "covered securities." Included as covered securities are those listed on certain stock exchanges and securities offered pursuant to Rule 506 of Regulation D.

### **Disclosure and Antifraud Requirements**

Even offerings of securities that are exempt from registration are subject to the antifraud provisions of the 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. Failure to disclose material facts is also prohibited. 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 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 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 which is inconsistent with the information in the disclosure document.

## **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, with the exception of fraudulent conduct, regulated exclusively by the SEC and need only make notice filings in states in which they are doing business.

## **Securities Laws of Other States**

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 which have contacts with the transaction or its participants should be considered. In transactions which may involve the laws of several states, it is customary for legal counsel to prepare a survey of the blue sky laws of the various states which analyzes the applicability of the laws and the availability of exemptions.

## **TAXATION**

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### **FEDERAL TAXATION**

#### **Personal Income Tax**

Federal taxation of income of foreign individual investors will depend on a host of factors, including the nature and extent of the individual's activities within the U.S. 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 35%. Recent tax reform on the federal level will cause these rates to fluctuate in different calendar 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.

#### **Corporate Income Tax**

**"C" Corporations** (all corporations not qualifying as "S" Corporations, 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 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: Aruba, Austria, Belgium, Cyprus, Denmark, Egypt, Finland, Germany, Greece, Hungary, Iceland, Ireland, Jamaica, Japan, Korea, Luxembourg, Malta, Morocco, Netherlands, Netherlands Antilles, Norway, Pakistan, People's Republic of China, Philippines, Sweden, Switzerland, and the United Kingdom.

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 recently 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.

### **"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. The use of "S" Corporations is restrictive, certain individuals and entities may not be able to use this device because they are not eligible S Corporation shareholders. Recent changes to the Internal Revenue Code have relaxed some of the prior restrictions on S Corporation shareholders but the provisions are still restrictive. One such restriction is that an "S" Corporation cannot have more than 75 shareholders.

### **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, it 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.

Partnerships and LLCs in Michigan, like other business entities, are subject to Michigan single business tax, discussed below.

### **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. Currently, any individual U.S. citizen may make up to \$1,000,000 in lifetime gifts and/or may transfer up to \$1,500,000 upon death in 2004. The Applicable Exclusion Amount, the amount of wealth that potentially can be transferred at death without federal estate tax, is changing nearly every year under current policy. The Applicable Exclusion Amounts for the next several years are as follows:

2004	\$1,500,000
2005	\$1,500,000
2006	\$2,000,000
2007	\$2,000,000
2008	\$2,000,000
2009	\$3,500,000
2010	Unlimited
2011	\$1,000,000 – unknown

In addition, federal law permits individuals to make additional annual gifts of cash or cash equivalents of up to \$11,000 per beneficiary without using up any portion of their exemptions. Taxable transfers in excess of \$1,000,000 are subject to a graduated tax ranging from 39 to 49 percent. Special rules apply to taxable estates valued at \$3,000,000 or more.

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 \$100,000 annually. Through proper estate planning, a married couple may shelter up to \$3,000,000 by using a Qualified Domestic Trust from gift and estate taxation, 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 \$1,500,000 are subject to the generation-skipping transfer tax at a flat rate of 55 percent. Beginning in 2004, the exemption amount is linked to the Applicable Exemption amount.

### **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."

**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 non-resident 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.

**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.

The first \$1,500,000 of the resident alien's taxable estate which remains after reduction for bequests to a surviving spouse, is exempt from estate taxation. The remainder of the estate is taxed at graduated rates of 39 to 49 percent.

**Estate Taxation of Nonresident 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 apply both to resident and nonresident aliens. Of the balance of the nonresident alien's estate remaining after bequests to a surviving spouse, the first \$100,000 (as contrasted with \$1,500,000 in the case of a resident alien) is exempt from estate taxation. The balance is taxed at graduated rates of 26 to 49 percent. Special rules apply to any taxable estate of \$10,000,000 or more.

**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.

## **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. Gifts of up to \$11,000 per year can be made to each donee without any gift tax liability. Gifts of up to \$100,000 can be made each year to a spouse by a resident alien or nonresident alien without gift tax liability if the spouse is not a United States

citizen.

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

## MICHIGAN TAXATION

### 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 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 2004 is a flat 3.9% of taxable income. The Michigan income tax is deductible in computing the individual's federal taxable income if the individual itemizes their deductions.

### Business Taxes in Michigan

Michigan has some of the most innovative tax incentive programs in the nation. Continuous improvement is part of these programs, resulting in significant reductions.

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 instituted a 100% personal property tax exemption for investments in qualified areas. Overall, Michigan's tax burden is now below the national average.

#### Michigan's key state taxes are:

- Single Business Tax – the only general state tax for business and one that is currently in the process of being phased out.
- Property Taxes.
- Sales and Use Taxes.

### Single Business Tax

The Single Business Tax (SBT) is a modified value-added tax that has been in effect since 1976. The **SBT tax rate of 1.9% for 2003** is scheduled to decline 0.1% per year until the tax is eliminated in 2021. The SBT:

- replaced seven different business taxes including business income taxes, franchise taxes and property tax on inventory.
- is based on value added during the production process, measured by total compensation with adjustments, business income, net interest paid and depreciation – all apportioned to Michigan.
- offers exemptions, deductions and credits, including an investment tax credit for capital purchases made in Michigan.

- provides eligible small businesses an alternative tax of 2% on adjusted business income.

**Other important SBT notes:**

- Treasury Department data show that approximately 61% of Michigan businesses pay \$1,000 or less in SBT; 47% of all businesses pay no SBT.
- The gross receipts reduction ensures that the tax liability cannot exceed 50% of adjusted gross receipts.
- For years after 1999, purchases of real and personal property in Michigan may be deducted as an investment tax credit and the value can be carried forward for 10 years.

**Property Taxes**

Michigan significantly reduced the state's property tax burden. Reforms instituted in 1994 have reduced the state's reliance on property taxes to fund schools.

- Major reforms have resulted in lowering property tax rates for businesses in excess of 10%.
- Michigan's per capita property tax burden is now below the national average.
- Michigan's property tax is assessed at the state and local levels, and can be abated at the local and state levels.
- Taxable value of property is 50% of current market value, including both real and personal property.
- Annual property assessment increases are limited to the lesser of 5% or the rate of inflation.

**For businesses, property tax exemptions are available for:**

- special tools, dies, jigs, and patterns in manufacturing.
- electricity and natural gas used in production.
- air and water pollution control abatement equipment.

**Workers Compensation**

Significant reforms in Michigan's workers' compensation system have resulted in lowered costs and increased efficiency. Under the reforms:

- An open competitive system allows employers to “shop around” for the least expensive insurance carrier.
- Eligible businesses can self-insure or join self-insurance pools allowing some companies to save as much as 50%.
- In each of the last five years, workers' compensation insurance rates have declined.

## **Sales Tax**

Michigan has a 6% state sales 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 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.

## **Personal Income Taxes**

Michigan has decreased its flat rate personal income tax to 3.9% effective in 2003.

## **Tax-Cuts**

Over the last several years, Michigan has enacted over 30 different tax cuts.

Highlights of Michigan's tax cuts:

- Single Business Tax (SBT)
  - Gradual phase-out of the tax over 23 years.
  - Rate decreases 0.1% a year, retroactive to January 1, 1999.
  - Replaced capital acquisition deduction with investment tax credit for purchases of Michigan capital investment, with no apportionment factors applied.
- Personal Income Tax
  - Extended child deduction (\$600 for all children).
  - Personal exemption increased to \$3,100 , and indexed to the rate of inflation.
  - Virtual elimination of state income tax on private pensions; senior citizen deduction of up to \$8,408 for earned interest, dividends, and capital gains.
- Property Tax
  - Constitutional limit on property tax collections, (the Headlee amendment), under which a mandatory rollback refunded \$113 million to taxpayers in 1995. Also, homestead property tax credits are available.
- Tax-Free Zones
  - Most state and local taxes eliminated in more than 100 designated Renaissance Zones statewide to spur creation of new jobs and investment.
- Additional Tax Reforms
  - Inheritance tax repealed.

- Intangibles tax eliminated.
- Brownfield Rehabilitation Credit exist.

## ESTATE TAXATION OF INDIVIDUALS

The death of a foreign individual may have estate tax implications under Michigan law. Different tests govern, depending on whether the individual is a "Michigan resident" or a "Michigan nonresident."

**Determination of Resident Status.** The location of an individual's "domicile" is determinative of the individual's status for state estate tax purposes. An individual is classified as a Michigan resident for Michigan estate tax purposes if domiciled in Michigan at the time of death; otherwise the decedent is classified as a Michigan nonresident.

**Estate Taxation of Michigan Residents.** A state tax is imposed on the estate of a Michigan resident, equal to the maximum credit for state death taxes allowed for federal estate tax purposes, assuming the Michigan resident had no real property outside Michigan. If the resident had real property outside Michigan, the Michigan estate tax is reduced by the proportion of the state death tax credit attributable to the property in the other state. The specific amount is prescribed by a table issued by the federal taxing authorities.

**Estate Taxation of Michigan Nonresidents.** A state tax is imposed on the estate of a Michigan nonresident equal to a portion of the maximum credit for state death taxes allowed for federal estate tax purposes. The credit is based on the proportion of the estate property located in Michigan. Property of an estate taxable in Michigan includes real property located in the state and tangible personal property that has an actual "situs" in the state.

**Generation Skipping Transfer Tax.** A state tax is imposed on the transfer of property subject to the federal generation-skipping transfer tax by a Michigan resident and/or on the transfer of property of a Michigan nonresident owning property taxable in Michigan. The tax is equal to the maximum credit (or for transfers subject to tax in more than one state, a portion of the maximum credit) for state generation-skipping transfer taxes allowed for federal generation-skipping transfer tax purposes. The specific amount is prescribed by a table issued by the federal taxing authorities.

## ***PRODUCT LIABILITY***

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### **Theories of Liability**

Michigan recognizes the following theories of 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 in order to assure 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.

### **Damage Caps**

Effective March 28, 1996, a standard limitation ("cap") of \$280,000 was established for non-economic 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 at the time of manufacture or distribution the defendant had actual knowledge the product was defective and that 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 yearly by the state treasurer based on variations in the consumer price index. For 2004 the caps, as adjusted, were \$366,000 and \$653,500 respectively.

### **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 limitations 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.

### **Comparative Negligence**

Generally, Michigan is a pure 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.

## **Joint and Several Liability**

Prior to March 28, 1996, Michigan was a joint and several liability state. This meant that recovery could be sought exclusively from one of multiple defendants. That defendant was then permitted to seek contribution from the other defendant(s). Effective March 28, 1996, the liability of a defendant in a product liability case is "several only and not joint." (MCL 600.6304(4)). Certain exceptions are recognized, however, where an action includes a medical malpractice claim or where the injuries, damages or death are caused by criminal conduct involving gross negligence or the use of drugs or alcohol. 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."

## **Duty to Warn**

Manufacturers and distributors have a duty to warn of dangers which 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) which were 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 which possess obvious material risks which would be recognized by a reasonably prudent user or a risk that should be a matter of common knowledge to persons situated similarly to the plaintiff. The duties of the manufacturer and distributor to warn or instruct may be altered if it can be established that the product was sold to a sophisticated user or where any additional warning or instruction would have been futile.

## **Remedial Measures**

Subsequent modifications or design changes to a product will generally not be admissible in a product liability action to prove liability; put otherwise, modifications or improvements may not be offered to prove that a product was defective in the first instance. Such matters, however, may be admissible if offered for another purpose, such as establishing ownership, control or feasibility of additional safeguards, if contested, or for impeachment.

## **Other Accidents**

In order for a plaintiff to be able to use evidence of other accidents, 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, such evidence is generally admissible on the issue of the manufacturer's notice or awareness of a defect. The absence of similar accidents is likewise admissible to rebut allegations of a manufacturer having been "on notice."

## **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.

## **Economic Loss Doctrine**

Michigan has adopted the Economic Loss Doctrine where the alleged defect has resulted in damages which are strictly economic, (i.e. lost profits or other commercial benefits) and the plaintiff is a commercial entity. More simply put, the Michigan Supreme Court has held that the Uniform Commercial Code 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, and that the plaintiff cannot seek tort or other remedies. Economic loss includes damage to the good itself.

### **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.

### **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 by way of merger, the acquired party's liability may be automatically assumed by the acquiror. If assets are acquired via a sale of 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. Where a corporation has merely acquired all or substantially all of the assets of another corporation, it will generally not be liable for product liability of the predecessor corporation, unless it can be shown that the successor corporation participated in the manufacture, sale or installation of the product or otherwise assumed liability either by contract or law.

### **Privity**

No privity is required for a plaintiff to bring suit against the distributor or manufacturer of an allegedly defective product.

## ***DISPUTE RESOLUTION***

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This commentary is intended to provide a brief introduction into the resolution of disputes arising in Michigan. 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 or arbitration.

The United States court system operates on an adversary basis, in which each party has the opportunity, through its counsel, to present evidence to the judge or jury and make arguments of fact and law to try to persuade the judge or jury of the correctness of its 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.

### **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.

#### **District Courts**

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

#### **Courts of Appeals**

The next level in the federal system is the United States Court of Appeals. The Court of Appeals consists of 12 Circuit Courts of Appeals located across the United States. Federal law gives parties the right to appeal any final judgment of a District Court to the Court of Appeals. 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. 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 written 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 the lower court's decision and order a different result or it may remand the case to the District Court for further proceedings.

## **Supreme Court**

The highest level in the federal court system is the United States Supreme Court in Washington, D.C. The Supreme Court consists of nine justices appointed by the President of the United States and approved by the United States Congress. Supreme Court justices, like all federal judges, 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 Writ of Certiorari requesting the Court to hear the appeal, although certain limited matters may be appealed to the Supreme Court as a matter of right. The Supreme Court generally has broad discretion in deciding whether to review a lower court's judgment, and as a practical matter only a small percentage of writs are granted.

## **STATE COURT SYSTEM**

The state court system operates generally in the same fashion as the federal system. State courts principally resolve disputes concerning state statutes or state common law (court decisions of that state). 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.

### **District Courts**

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

### **Circuit Courts**

Circuit Courts are located in each county in Michigan. These courts have original jurisdiction over equitable actions, 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 primary trial courts where evidence is presented, witnesses testify and trials are conducted. However, Michigan's Circuit Courts also serve an appellate function by reviewing appeals from final judgments rendered in the Michigan District Courts.

### **Michigan Court of Appeals**

The Michigan State Court of Appeals is divided into four divisions, 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 some circumstances. Appeals are reviewed by a panel of three judges who issue written opinions stating whether judgments rendered by a lower court were correct under applicable law.

### **Michigan Supreme Court**

The Michigan Supreme Court, located in Lansing, is the State's top court and is made up 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 appeal, which the Court has broad discretion to grant or deny.

## ALTERNATIVE DISPUTE RESOLUTION

Cases proceeding through the federal and state court systems described above often take a number of years to be resolved and may be very expensive. Therefore, in recent years, the popularity of private and court-initiated ADR mechanisms has grown significantly. The goal of ADR is to provide parties with a method of resolving disputes more quickly and less expensively than 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 parties. Some commonly-used mechanisms are conciliation, summary jury trials, mini-hearings, mediation and private arbitration.

Conciliation, summary jury trials and mini-hearings typically are non-binding. In conciliation, the parties meet together with a neutral third party for the purpose of discussing settlement of their dispute. The format of the meeting varies by case, and generally is decided by agreement of the parties. In a summary jury trial, attorneys summarize their clients' arguments before a jury, which then renders a verdict. In a mini-hearing, attorneys present their clients' positions to the opposing party's senior officials or to impartial experts in an effort to reach an out of court settlement.

In court-ordered case evaluation, the attorneys for the parties present arguments to a panel of case evaluators consisting of three experienced attorneys who have no involvement in the case. The case evaluators then render an 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 is ended. However, if one or both of the parties reject the evaluation, the case proceeds to trial. At trial, if the verdict is not more favorable to a rejecting party than the case evaluation, a rejecting party may be required to pay the opposing party's costs, including attorney fees. This is a departure from the rule which applies to most court proceedings, unless provided otherwise by statute, under which each party is responsible for its own expenses regardless of the outcome.

Finally, parties may submit their dispute to arbitration upon written agreement. In arbitration, the parties choose an arbitrator or panel of arbitrators who decide the matter generally after a hearing or series of hearings involving witness testimony and documentary evidence. The arbitrators' award is binding, with some exceptions, and may be confirmed by a court within one year of the award.

The use of ADR continues to grow. Of course, as with any system, there are some disadvantages. For example, ADR generally does not allow participants to file motions that could dismiss the action or to conduct discovery. Parties can, however, always mutually agree to tailor an ADR mechanism to encompass these or other common elements of litigation.

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Because of the many complex issues involved and the evolving nature of the law, this guide does not constitute and should not be considered legal advice or a legal opinion. It is simply not possible or prudent to offer legal advice or a legal opinion without a prior thorough investigation and analysis of the facts attendant to any specific situation. Michigan legal counsel should be consulted regarding a specific issue or transaction.