

Incorporation by Professional Service Providers: The Curious Case of Miller v Allstate

By Justin G. Klimko

Introduction

In the multiple proceedings in *Miller v Allstate Ins Co*,¹ Michigan courts recently considered whether a corporation providing professional services must incorporate only under the Michigan Professional Services Corporation Act (PSCA)² or may also incorporate under the Michigan Business Corporation Act (BCA).³ In a case that, as Alice remarked in *Wonderland*, got “curiouser and curiouser,”⁴ the outcome resulted in absolutely no resolution of the question, but managed to sow a fair amount of confusion over the issue.

The Corporate Law Issue Presented

In *Miller*, Allstate sought to avoid payment of a claim for physical therapy services on the grounds that PT Works, Inc., the corporation that provided the services, was improperly incorporated. The original plaintiff, Miller, had been injured in two different automobile accidents and diagnosed with whiplash. His physician prescribed therapy and referred him to PT Works. Allstate later denied PT Works’ claim for reimbursement on the grounds that Allstate was obligated by statute⁵ to pay only for services “lawfully” rendered. Allstate asserted that because PT Works provided professional services, it was permitted to incorporate only under the PSCA. Since it had in fact been incorporated under the BCA, Allstate contended that PT Works was not lawfully incorporated, and therefore, its services were not lawfully rendered.

Historical Practice

The long-standing practice of the state’s Corporation Division (now a part of the Department of Labor and Economic Growth) has been to require only those corporations providing services in the “learned professions” (law, medicine, and divinity) to incorporate under the PSCA, but otherwise to allow corporations rendering “professional services” to choose between the BCA and the PSCA.

This position has been based on practice and interpretation that predate both the BCA and PSCA, on earlier Attorney General opinions and on a careful reading of the statutory language. However, the statutory language is not without ambiguity.

Case History

The trial court rejected Allstate’s claim, finding that PT Works was not required to be incorporated under the PSCA.⁶ Allstate appealed to the Michigan Court of Appeals, which found the question of incorporation to be irrelevant. The parties had conceded that the services in question had been rendered by licensed physical therapists, and the Court of Appeals found this to be sufficient to constitute the lawful rendering of services, whether or not PT Works was lawfully incorporated.⁷

Allstate appealed to the Michigan Supreme Court. That court vacated the Court of Appeals’ ruling and remanded the case, instructing the Court of Appeals “to determine whether PT Works may properly be incorporated solely under the Business Corporations [sic] Act and not the Professional Services Corporations [sic] Act, and, once that determination is made, to reconsider (if necessary) whether physical therapy provided by PT Works was ‘lawfully rendered’ under MCL 500.3157.”⁸

On remand, the Court of Appeals held that PT Works was not lawfully incorporated because a corporation that renders any “professional service” may be incorporated only under the PSCA and may not incorporate under the BCA. However, because the services had been rendered by licensed therapists, the Court of Appeals again rejected Allstate’s claim that the physical therapy services had not been lawfully rendered.⁹

The ruling resulted in a conundrum for PT Works, some of whose shareholders were not licensed professionals. The PSCA provides that a corporation organized under that act may not issue stock to “anyone other than an individual who is duly licensed or otherwise legally authorized to render the same specific

professional services as those for which the corporation was incorporated.”¹⁰ The Court of Appeals’ decision would have required PT Works to incorporate under the PSCA, but such incorporation would not have been possible under that statute because of PT Works’ ownership structure.

Both parties appealed this ruling to the Supreme Court. Because of the potential impact of the Court of Appeals’ ruling on other corporations providing professional services, the case attracted considerable attention from the corporate law bar and from various professional organizations. In its order granting leave to appeal, the Supreme Court invited a number of groups and organizations to submit amicus briefs, including the Business Law Section of the State Bar of Michigan. Eight separate amicus briefs were ultimately submitted.¹¹

The Supreme Court’s Ruling

The Michigan Supreme Court issued its opinion on July 2, 2008.¹² The Supreme Court upheld the decision of the Court of Appeals on remand but vacated its rationale.¹³ Despite requesting briefing on the question of whether PT Works was required to be incorporated under the PSCA, the Supreme Court did not address that question. Rather, it held that only the Michigan Attorney General had standing to challenge the incorporation of a corporation whose articles had been accepted for filing, and therefore, the question of incorporation was not properly before the lower courts. The court held that Section 221 of the BCA¹⁴ “prevents any person—other than the Attorney General—from bringing any challenge to corporate status under the BCA: every such challenge would be doomed to failure, because the mere filing of articles of incorporation constitutes ‘conclusive evidence’ of the corporation’s legality. Because the Legislature has expressly forbidden Allstate from raising the affirmative defense asserted in this litigation, Allstate lacks statutory standing to challenge the corporate status of PT Works...the lower courts should not have considered the merits of Allstate’s claim.”¹⁵

This result was somewhat surprising, since in vacating the Court of Appeals’ original ruling the Supreme Court remanded with specific instructions to consider the incorporation claim and its impact on the case. The Supreme Court could have reached its conclusion on standing at that time, although it is probable that the issue had not been briefed.

As a result of the Supreme Court’s opinion, the question of proper incorporation remains unresolved, but the Corporations Division appears free to continue its prior practice of permitting incorporation under either the BCA or the PSCA for all professional corporations except those providing services in a “learned profession,” which are limited to incorporation under the PSCA.

However, persons forming professional corporations who elect to form under the BCA will still face uncertainty. While the Court of Appeals’ ruling on proper incorporation was vacated, it was not reversed on the merits. Incorporators thus may be permitted to file articles under the BCA but will be aware that a court that considered the question ruled that such formation was not proper, though that ruling is not in force. The consequences of improper incorporation could be significant; these might include personal liability for shareholders, violation of bank loan covenants, and invalidation of corporate action and agreements, among others.

Possible Resolutions

Proposed Amendments. A package of proposed statutory amendments was developed by the Corporate Laws Committee of the State Bar Business Law Section and introduced in the Michigan House of Representatives in the fall of 2007. In response to the Court of Appeals’ opinion on remand of *Miller*, a portion of these amendments was specifically designed to address the issues arising from that case. The package included proposed amendments to the BCA, PSCA, and the Michigan Limited Liability Company Act. These were divided into three bills: HB 5356, for the BCA Amendments; HB 5357, for the PSCA amendments; and HB 5358, for the LLC Act amendment.

The amendments were passed by the House in December 2007 and referred to the Senate Committee on Economic Development and Regulatory Reform. Prior to adoption by the House, certain changes were made to the *Miller*-related amendments at the urging of insurance industry interests, which generated some dispute. The amendments have languished in the Senate, apparently in anticipation of the Supreme Court’s holding in *Miller*. It is not clear whether these portions of the amendments will survive if reconsidered by the legislature.

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ability Company Act (LLCA)¹⁶ by expressly allowing corporations providing professional services to choose to incorporate under either the BCA or the PSCA, except that corporations providing services in a learned profession would be permitted to incorporate only under the PSCA. "Services in a learned profession" were originally defined in the amendments to encompass the services of a dentist, an osteopathic physician, a physician, a surgeon, a doctor of divinity or other clergy, or an attorney-at-law. As a result of the insurance industry revisions referred to above, this definition was expanded to include chiropractors, physical therapists, and optometrists. If this version were adopted, the definition of this term would differ from that in the LLCA, which does not include these last three groups.

Incorporation into BCA. A preferred resolution, in the opinion of this author, would be to imitate the model of the LLCA more fully by repealing the PSCA as a separate statute and adding provisions for professional corporations to the BCA.¹⁷ This would eliminate several difficulties related to the current structure. First, it would obviate the need to consult two different statutes to determine the rules governing professional corporations.¹⁸ Second, it would solve the "updating" problem inherent in the PSCA. The PSCA incorporates by reference certain provisions of the BCA to regulate corporations incorporated under the PSCA.¹⁹ In a 1989 opinion,²⁰ the Michigan Attorney General opined that "the Professional Service Corporation Act adopted the Business Corporation Act as it existed on July 18, 1980, the effective date of the last amendment to Sec. 13 of the Professional Service Corporation Act making specific reference to the Business Corporation Act." In reaching this conclusion, the Attorney General relied on earlier case precedent for the proposition that when a statute adopts by reference another statute, it incorporates only the other statute as it existed at the time of adoption of the incorporating statute, and not (absent a clear expression to the contrary) subsequent additions or modifications.²¹ This interpretation has meant that amendments to the BCA made after July 18, 1980 did not apply to corporations formed under the PSCA except when the PSCA was subsequently amended and Section 13 was restated. This has proved to be a continuing problem, because the PSCA has not been amended each time the BCA was amended,

resulting in lack of coordination of the statutes.²² Consolidating the PSCA into the BCA would eliminate this problem. It would also standardize the treatment of corporations and limited liability companies that provide professional services, by harmonizing the treatment under the BCA and LLCA. It makes little sense to have different rules apply based on the type of business organization chosen or to have this issue drive the determination of choice of entity.

NOTES

1. See the various cites below.
2. MCL 450.221 *et seq.*
3. MCL 450.1101 *et seq.*
4. Lewis Carroll, *Alice's Adventures in Wonderland*
5. See MCL 500.3157.
6. The trial court's opinion is not published, but apparently the trial court concluded that the services provided were not "professional services" and for that reason PT Works was not required to incorporate under the PSCA. See 481 Mich at 605.
7. *Miller v Allstate*, 272 Mich App 284, 726 NW2d 54 (2006).
8. *Miller v Allstate*, 477 Mich 1062, 728 NW2d 458.
9. *Miller v Allstate*, 275 Mich App 649, 739 NW2d 675 (2007).
10. See Section 8 of the PSCA, MCL 450.228.
11. The Business Law Section submitted an amicus brief. The author of this article was one of the authors of the brief. As of the date of this writing, all of the briefs remained available on the Supreme Court's Web site at <http://courts.michigan.gov/supremecourt/Clerk/04-08/134393-134406/134393-134406-Index.htm>.
12. *Miller v Allstate*, 481 Mich 601, 751 NW2d 463 (2008).
13. As a result, Allstate's attempt to avoid payment for PT Works' services was again rejected but the Court of Appeals' interpretation of the incorporation issue has no application.
14. MCL 450.1221.
15. 481 Mich at 611-612 (emphasis in original).
16. MCL 450.4101 *et seq.*
17. This approach would require a savings clause that would deem corporations incorporated and in good standing under the PSCA on the date of repeal to be duly incorporated, existing and in good standing under the BCA.
18. The PSCA is a fairly skeletal statute which relies, for most of the substantive rules governing professional corporations, on cross-reference to the BCA. Section 13 of the PSCA (MCL 450.233) provides that "The business corporation act, 1972 PA 284, MCL 450.1101 to 450.2098, is applicable to a corporation organized under this act except to the extent that a provision of this act is in conflict with the provisions of that act. If there is a conflict between a provision of this act and that act, the provision of this act applies with respect to a corporation organized under this act."
19. See note 15 *supra*.
20. OAG No 6592 (July 10, 1989)

21. *See, eg, Public Schs of the City of Battle Creek v Kennedy*, 245 Mich 585, 223 NW 359 (1929). For example, if statute A, adopted on January 1, 2000, incorporated statute B by reference, it would incorporate statute B only as it existed on January 1, 2000 and not as it may have been subsequently amended.

22. An attempt to rectify this situation by adding certain language to Section 123 of the BCA in 2001 resulted in some of the interpretive problems raised by the Court of Appeals' 2007 opinion.



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