

New Amendments to the Michigan Business Corporation Act

By Justin G. Klimko

Introduction

The Michigan Business Corporation Act (“BCA”)¹ was amended in the waning days of the 2007-2008 legislative session. After more than a year of consideration, revision, and debate, what began as HB 5356 became Public Act 402 of 2008. It was passed in final version on December 18, 2008 and signed by the Governor on January 5, 2009. The amendments added provisions permitting conversion of Michigan corporations into different types of business entities (and other entities into corporations); made clear that interested director transactions are not immune from all attack simply by virtue of independent director approval; made technical clarifications to provisions regarding indemnification of directors; repealed the Michigan Control Share Act, which imposed restrictions on takeovers of certain types of Michigan corporations; and included certain other miscellaneous amendments. These changes are discussed in more detail below.

Background

Michigan has a number of statutes that govern the formation and operation of business entities in the state. Principal among these are the BCA; the Michigan Limited Liability Company Act;² the Michigan Professional Service Corporation Act;³ the Michigan Nonprofit Corporation Act;⁴ the Michigan Revised Uniform Limited Partnership Act;⁵ and the Michigan Uniform Partnership Act.⁶ The Corporate Laws Committee of the State Bar of Michigan Business Law Section monitors the acts that apply to for-profit corporations, principally the BCA and the Professional Service Corporation Act, and proposes amendments from time to time. The amendments principally serve to keep Michigan statutes up-to-date with developments in the corporate laws of other jurisdictions and the Model Business Corporation Act; to reflect general trends in corporate governance and regulation; and to address matters resulting from judicial holdings. The BCA typically is amended on a three- to four-year cycle, with

significant previous amendments in 1989, 1993, 1997, 2001, and 2006.

The principal reason for the long consideration and delay of HB 5356 was the portion of the amendments drafted to deal with the Michigan Court of Appeals’ holding in *Miller v Allstate*.⁷ Various insurance industry interests objected to those provisions and endorsed amendments to the proposed language. Other interests opposed the insurers’ proposals. In the meantime, the *Miller* holding was appealed to the Michigan Supreme Court. At the Supreme Court’s invitation, the Business Law Section, along with several other groups, submitted a brief as amicus curiae. The Supreme Court issued its opinion on July 2, 2008,⁸ which cured the immediate need for relief but did little to resolve the ultimate question.⁹ After all of the wrangling over the issues raised by *Miller*, the *Miller*-related provisions were ultimately dropped from the bill.

The following discussion summarizes the BCA amendments implemented by PA 402.

Amendments to Permit Entity Conversions

Sections 745 and 746¹⁰ have been added to the BCA to permit direct conversion of domestic corporations into other forms of domestic and foreign business organizations. They also permit foreign business organizations to convert directly into domestic corporations. These sections use the same definition of “business organization” used in Section 736: a domestic or foreign limited liability company, limited partnership, general partnership, or any other type of domestic or foreign business enterprise, incorporated or unincorporated, except a domestic corporation.¹¹

The conversion provisions mean that corporations will not have to engage in mergers in order to change their form of organization or domiciliary jurisdiction, at least where reciprocal provisions exist in the laws that would govern the entity after conversion. However, the Limited Liability Company Act, Revised Uniform Limited Partnership Act, and Uniform Partnership Act do not yet

have corresponding provisions permitting conversion.¹² Therefore, the BCA conversion provisions are currently available only for conversion of Michigan corporations into business organizations in other states.

Prerequisites

Conversion of a Michigan corporation into another type of business organization is permitted under the BCA if it is permitted by the law that will govern the internal affairs of the surviving business organization and the surviving organization complies with that law.

Similarly, conversion of business organizations formed in other states into Michigan corporations is permitted under the BCA if the conversion is permitted by the law that governs the internal affairs of the foreign business organization and the converting organization complies with that law.

Plan of Conversion

The board of directors of a domestic corporation converting into another form of domestic or foreign business organization must adopt a plan of conversion containing certain specified information. Among the information that is required is the following:

- the name and type of the business organization into which the domestic corporation will convert;
- the statute that will govern the internal affairs of the surviving business organization;
- the street address and the principal place of business of the surviving business organization;
- the designation and number of outstanding shares of each class and series of the domestic corporation, including the classes and series entitled to vote, those entitled to vote as a class, and, if the number of shares may change before the effective date of conversion, how the change may occur;
- the terms and conditions of conversion, including how the domestic corporation's shares will be converted into shares or other ownership interests or obligations of the surviving organization, into cash, or into other consideration that may include ownership interests or obligations of a non-party entity (or any combination of the foregoing);

- the terms and conditions of the organizational documents that will govern the surviving organization.

Shareholder Approval

Following board approval, the plan must be submitted for shareholder approval¹³ in the same manner as applicable for mergers under Section 703a(3).¹⁴ This means that the board must recommend the conversion to the shareholders (unless it determines that because of conflicts of interest, subsequent events, contractual obligations, or other special circumstances it should make no recommendation). Also, shareholders must be informed that they have a right to dissent under Section 762¹⁵ and demand fair value for their shares if they vote against the conversion but it is nonetheless completed.

The voting provisions applicable to the approval of a conversion may present some interpretive questions. This is because Section 745 refers to Section 703a(2) but the latter section by its terms mentions only mergers and share exchanges. Under Section 703a(2), a plan of merger or share exchange is approved if it receives the affirmative vote of holders of a majority of the outstanding shares entitled to vote on the plan *and*, if a class or series is entitled to vote on the plan as a class, the affirmative vote of the holders of a majority of the outstanding shares of the class or series. Section 703a(2) further provides that a class or series of shares is entitled to vote as a class *in the case of a merger* if the plan contains a provision that, if contained in a proposed amendment to the articles of incorporation, would entitle the class or series of shares to vote as a class, and, *in the case of a share exchange*, if the class or series is included in the exchange. Further, Section 703a states that a class or series of shares is not entitled to vote as a class *in the case of a merger or share exchange*, if the board determines on a reasonable basis that the class or series will receive consideration under the plan with a fair value not less than the shares' fair value on the date of plan adoption.

The question is whether these provisions of Section 703a(2) will also apply in determining whether a class vote is required in a conversion. On the one hand, Section 745 directly refers to Section 703a(2) and gives no indication that these provisions should not fully apply to a conversion. Additionally, there seems to be no policy reason to apply different standards to a conversion than to

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a merger or share exchange, especially since the end result of a conversion can also be accomplished via a merger or (at least in some cases) a share exchange. The Section 703a(2) provision regarding the board's determination that a class will receive fair value is well adapted to the circumstances of a conversion. There is no indication that the legislature believed that different rules should apply when determining whether class votes are required in a conversion.

On the other hand, some provisions of Section 703a(2) do not apply neatly to conversions. Section 703a(2)(e),¹⁶ for example, states that action by the shareholders of the surviving corporation on a plan of merger is not required if (i) the articles of incorporation of the surviving corporation will not differ from its articles before the merger, and (ii) after the merger, each surviving corporation shareholder will hold the same number of shares, with identical designations, preferences, limitations, and relative rights, as before the merger. Could this provision be applied to deny a converting corporation's shareholders a right to vote? When the domestic corporation is converting into a different type of business organization, the answer would seem to be "no."¹⁷ But what of a conversion that will merely change a corporate domicile to a state other than Michigan but otherwise will preserve the corporation's structure? The shareholders of the converting corporation in effect *are* the shareholders of the surviving corporation, since there is really a single entity involved in the transaction. At least in this type of conversion, it might be argued that Section 703a(2)(e) applies. The basic principles of the conversion provisions, however, seem to contemplate shareholder approval in all conversions.

Certificate of Conversion

If a plan of conversion receives the requisite shareholder approval, the domestic corporation must file whatever formation documents are required to be filed under the laws governing the internal affairs of the surviving business organization.¹⁸ It also must file a certificate of conversion with the Department of Energy, Labor and Economic Growth. The certificate of conversion must contain much of the information required to be included in the plan as described above, must include statements that the plan was approved by the board and shareholders as required by Section 745, and must identify any assumed

names of the domestic corporation that will be used by the surviving organization.

Effects of Conversion

Once the certificate of conversion becomes effective, the domestic corporation is converted into the business organization specified in the plan. The shares of the domestic corporation are converted into the ownership interests or other consideration specified in the plan. The articles of incorporation of the domestic corporation are canceled. The surviving organization has all of the liabilities of the domestic corporation. The conversion does not affect any obligations or liabilities of the domestic corporation incurred before the conversion and does not limit or affect the personal liability of anyone incurred prior to conversion. Also, although the surviving organization will be governed by the laws of its jurisdiction, the conversion does not affect the choice of law applicable to the domestic corporation with respect to matters arising before the conversion.

Upon conversion, the title to real estate and other property and rights owned by the domestic corporation remain vested in the surviving business organization without reversion or impairment. The rights, privileges, powers, and interests in property of the domestic corporation, as well as the debts, liabilities, and duties of the domestic corporation, will not be considered, as a result of the conversion, to have been transferred to the surviving business organization for any purpose under Michigan law. This should prevent the conversion, for instance, from inadvertently violating loan agreement covenants against transfer of assets¹⁹ and should also prevent any interruption in a secured creditor's security interest in the assets of the surviving organization. However, in the case of a conversion to a business organization formed under another state's laws, secured creditors will have to file new financing statements under that state's UCC. Also, while the conversion may not trip anti-assignment covenants, any pledge of the shares of the domestic corporation may be violated by the conversion. Although the pledged interests should automatically be converted in the hands of the pledgee into ownership interests in the surviving organization, a pledgee may want to insure that pledged shares are replaced with ownership interests of the surviving organization.

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The surviving business organization may use the name and the assumed names of the domestic corporation, providing that the assumed names were previously on file and are identified in the certificate of conversion²⁰ and the laws regarding use and form of names in the surviving organization's jurisdiction are followed. Legal proceedings against the domestic corporation may be continued as if the conversion had not occurred, or the surviving business organization may be substituted for the domestic corporation. The surviving business organization is liable, and is subject to service of process in a Michigan proceeding, for the enforcement of an obligation of the domestic corporation. It is also liable in a proceeding by a dissenting shareholder of the domestic corporation.

Unless otherwise provided in the plan of conversion, the domestic corporation is not required to wind up its affairs or pay its liabilities and distribute its assets because of the conversion, and the conversion does not constitute dissolution of the domestic corporation.

Certificate of Authority

If the surviving business organization of a conversion is organized under the laws of another jurisdiction but transacts business in Michigan, it will be required to seek a certificate of authority to transact business as a foreign organization.

Dissenters' Rights

Shareholders of a corporation making a conversion will have dissenters' rights. Section 762(d)²¹ has been added to the BCA to provide that such a shareholder may dissent if the shareholder is entitled to vote on the plan of conversion. However, under Section 762(d), a shareholder may not dissent if the corporation is converted into a foreign corporation and the shareholder receives shares with terms as favorable in all material respects, and that represent at least the same voting percentage of the surviving corporation, as the shares held before the conversion (such as in a merger meant solely to change a corporation's domicile of incorporation). Also, the right to dissent is subject to the exceptions otherwise contained in Section 762. For example, no right is available for transactions in which the shareholder receives cash or marketable shares or a combination thereof.

Conversion by Foreign Organizations

The provisions of Section 746 applicable to conversions of foreign business organizations into Michigan corporations are similar to the provisions of Section 745. The foreign organizations must follow the law of their jurisdiction of organization, must adopt a plan of conversion containing much of the same information required of such plans for domestic corporations under Section 745, and must file a certificate of conversion with the Department of Energy, Labor and Economic Growth, as well as articles of incorporation for the surviving Michigan corporation. The effects of the conversion are essentially the same as those for conversion of domestic corporations described in Section 745.

Fees

Section 1060(e)²² has been amended to provide a \$50.00 fee for filing a certificate of conversion.

Interested Director Transactions

BCA Section 545a,²³ which governs corporate transactions in which a director or officer has an interest, has been amended to reverse the outcome of *Camden v Kaufman*, 240 Mich App 389, 613 NW2d 335 (2000). Section 545a provides a procedural approval mechanism for corporate transactions in which a director or officer has an interest. It provides a means to remove the common law taint that would make such a transaction in which a director or officer has an interest void or voidable *solely because of the interest*.²⁴

In *Camden*, the Michigan Court of Appeals, in dictum, stated that approval of a transaction in accordance with Section 545a barred a claim for breach of fiduciary duty. In other words, the court stated that approval of a transaction in accordance with Section 545a prevented any challenge to the transaction. This produced the anomalous result that transactions in which a director or officer is interested may be afforded *greater* protection than transactions in which no such interest is present. The Committee felt that this was a misreading of the language of Section 545a, which was not intended to validate transactions or to afford a conflict transaction greater protection than a non-conflict transaction.

Under new Section 545a(4),²⁵ satisfying the procedural requirements of Section 545a(1) will not preclude other claims relating to a transaction in which a director or officer has an interest. Instead, those claims

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will be evaluated under principles of law applicable to a transaction in which a director or officer does not have an interest. As a result, a transaction with an interested director or officer could still be subject to attack for other defects, such as insufficient corporate approval, breach of fiduciary or other duties, or illegality, even though the taint of the conflict is removed by satisfying section 545a(1). What, then, is the value of satisfying Section 545a(1)? It should result in application of the business judgment rule presumption to any such attack. A transaction that is not approved under Section 545a(1) may be held to the entire fairness standard otherwise applicable to interested party transactions.

Indemnification

BCA Section 564a(1)²⁶ has been amended to make clear that, when a person is entitled to mandatory indemnification pursuant to Section 563,²⁷ the corporation is not first required to make a determination that the person has met a required standard of conduct. This clarification is intended to harmonize the statute. Section 563 provides that a defendant who is successful on the merits or otherwise in defense of an action or claim must be indemnified. Section 564a(1), however, could have been read to imply that an inquiry into the standard of conduct would first be necessary for the corporation voluntarily to pay such a claim. In cases where indemnification is mandatory under Section 563 because the defendant has been successful, an evaluation of the indemnitee's standard of conduct should not be required.

BCA Section 564b²⁸ has been amended to permit a general authorization of future advances in connection with a single proceeding. This will eliminate any question as to whether each advance must be separately authorized.

Repeal of Chapter 7B

PA 402 has repealed the Michigan Control Share Act, Chapter 7B of the BCA.²⁹ The Committee had suggested repeal in connection with the 2006 amendments, but the change was dropped in the legislative process.

Chapter 7B applied to the acquisition of voting shares in certain Michigan corporations that conferred on the acquiror voting power in excess of any of three different levels of control. It provided that the acquired shares would lose their right to vote unless the remaining shareholders voted, by specified percentages, to continue those rights.

Chapter 7B was one of a number of similar acts adopted by states in the mid-to-late 1980's in response to a furor over hostile takeovers of corporations. This style of act gained favor because, after other types of state takeover regulation had been struck down by federal courts as unconstitutional, Indiana's control share act was upheld by the U.S. Supreme Court.³⁰ Although primarily aimed at transactions involving publicly held corporations, Chapter 7B also applied to transactions in shares of privately held companies with more than 100 shareholders of record and other designated connections to Michigan.

The Committee believed that Chapter 7B was not an effective protection for corporations facing hostile takeover attempts³¹ and could serve as a trap for the unwary in transactions unrelated to its original purpose. In connection with the repeal of Chapter 7B, BCA Section 762(1)(h),³² which provided an appraisal right tied to Chapter 7B, was also eliminated.

Miscellaneous BCA Amendments

The following BCA sections were also amended by PA 402:

- A new subsection (2) was added to Section 1002³³ to provide that the BCA does not authorize Michigan to regulate the organization or internal affairs of a foreign corporation authorized to transact business in the state. This would codify the internal affairs doctrine. The Committee does not believe that it constitutes a change in Michigan law.
- BCA Section 241(b)³⁴ was amended to permit limited liability companies to act as registered agents.
- BCA Section 201³⁵ was amended to eliminate the requirement that incorporators sign articles of incorporation "in ink." The amendment would bring this section up to date with prior amendments permitting electronic transmission of filings.
- BCA Section 211³⁶ would make clear that abbreviations in corporate names ("inc.," "co.," "corp.," etc.) may be used with or without periods (e.g., "inc." or "inc").

In cases where indemnification is mandatory under Section 563 because the defendant has been successful, an evaluation of the indemnitee's standard of conduct should not be required.

NOTES

1. MCL 450.1101 et seq.
2. MCL 450.4101 et seq.
3. MCL 450.221 et seq.
4. MCL 450.2101 et seq.
5. MCL 449.1101 et seq.
6. MCL 449.1 et seq.
7. 275 Mich App 649, 739 NW2d 675 (2007).
8. 481 Mich 601, 751 NW2d 463 (2008).
9. The Court of Appeals held in *Miller* that a corporation which rendered any professional services was permitted to incorporate only under the Professional Service Corporation Act. The Supreme Court vacated that holding without ruling whether it was correct. For a description of the *Miller* case, its history and the Supreme Court's holding, see Justin G. Klimko, "Incorporation by Professional Service Providers: The Curious Case of *Miller v Allstate*," 28 Mich Bus LJ 26 (Fall 2008).
10. MCL 450.1745 and 450.1746.
11. MCL 450.1736.
12. Note, however, that Section 707 of the Limited Liability Company Act (MCL 450.4707) permits conversion of a domestic partnership or domestic limited partnership into a domestic limited liability company. The applicable committees of the Business Law Section are developing amendments to these other statutes to authorize conversions of the type now authorized by the BCA.
13. If the corporation has not commenced business, issued shares or elected a board, the incorporators may approve the conversion by unanimous consent and a majority of the incorporators must execute and file a certificate of conversion.
14. MCL 450.1703a(2).
15. MCL 450.1762.
16. MCL 450.1703a(2)(e).
17. Since the new organization into which a corporation would convert would have neither articles of incorporation nor shares, the threshold requirements of Section 703a(2) could not be met in this type of conversion.
18. For example, a domestic corporation converting to a Delaware limited liability company would be required to file a certificate of organization under Delaware law.
19. Lenders, however, could begin to add covenants to loan agreements that are specifically addressed to conversion.
20. See new Section 217(5), MCL 450.1217(5).
21. MCL 450.1762(d).
22. MCL 450.2060(e).
23. MCL 450.1545a.
24. Generally, if the transaction is approved by a majority of the board's disinterested directors, a majority of a committee of disinterested directors, all of the "independent" directors (as that term is defined in the BCA) or a majority of the votes held by disinterested shareholders, in each case after full disclosure of the interest, the transaction may not, "because of the interest, be enjoined, set aside, or give rise to an award of damages or other sanctions." (Emphasis supplied.)
25. MCL 450.1545a(4).
26. MCL 450.1564a(1).
27. MCL 450.1563.
28. MCL 450.1564b.
29. MCL 450.1790-1799.
30. *CTS Corp v Dynamics Corp of America*, 481 US 69 (1987).

31. In *Simon Properties'* bid for control of Taubman Centers, Inc. in 2002-2003, Chapter 7B was used as an *offensive* weapon by Simon, and it took an amendment to Chapter 7B to avoid the potential application of Chapter 7B to prohibit the Taubman family's ability to vote its interest.

32. MCL 450.1762(1)(h).
33. MCL 450.2002.
34. MCL 450.1241(b).
35. MCL 450.1201.
36. MCL 450.1211.



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