MICHIGAN'S INTERNAL BUSINESS GOVERNANCE LAWS: A FRAMEWORK FOR ECONOMIC GROWTH

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INTRODUCTION

One of the more overlooked aspects of any business is the legal identifier at the end of its name: Inc., LLC, LP, etc. For a customer of a business, these identifiers likely have little impact. However, for the owners, investors, and the business itself, legal identifiers create a host of implications which are important for the business's success. While entrepreneurs often focus heavily on their business models, building relationships, and perfecting their products – and rightly so! – their choices as to entity structures are also important. This is a crucial step, as it lays the legal groundwork upon which the entity aims to flourish. Michigan's laws governing internal operations of business entities are an important part of that legal framework. The goals of this article are to provide an overview of the most common business entities in Michigan and to examine some of the more prominent doctrines related to their internal governance structure.[1] These internal governance laws not only affect the particular businesses, but play a role in Michigan's economy overall.

BUSINESS ENTITY CHOICES

SOLE PROPRIETORSHIP

A sole proprietorship is "a business entity where one person owns all of the assets, owes all of the liabilities, and operates in his or her personal capacity."[2] It is also the "default" business entity when a single business owner does not choose an entity form.[3] The business is not a legal entity separate and distinct from its owner.[4] Rather, the sole proprietorship

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[1] Internal governance structure refers to the internal allocation of control, as well as the rights and obligations of business owners to their co-owners and the business itself.

[2] *See* Black's Law Dictionary (10th ed 2014).

[3] Treas. Reg. § 301.7701-3(b)(ii) (2018).

[4] United States v. Fox, 721 F.2d 32 (1983).

and its owner are one in the same.[5] In fact, as long as the business operates under the name of its owner, there are no filing requirements that need to be made with the state. Additionally, governing documents are not required and there are no annual fees.[6] Ultimately, the laws governing internal business matters are generally irrelevant for sole proprietorships. The lack of formality makes the sole proprietorship the easiest business entity to manage.

One of the drawbacks accompanying the simplicity of the sole proprietorship, however, is that the business owner is personally liable for all of the debts and obligations of the business.[7] This exposure often leads people to consider more modern business entity structures — such as limited liability companies or corporations — which offer considerable legal protections including the avoidance of personal liability for business obligations[8] and tax benefits not realized by a sole proprietorship.[9]

Nonetheless, merely because business owners ***can*** choose an LLC or corporation to protect themselves from personal liability, these protections are not necessarily guaranteed simply by virtue of operating in a particular entity form. For example, in *Radio Electronics Supply Co. v. Smith*,[10] the business owner elected to operate as a corporation. The business owed money on a promissory note and the holder sued to collect the amount due.[11] The plaintiff/note-holder sought to collect against the owner

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[5] Accordingly, for this reason, listing a sole proprietorship as an entity is a bit of misnomer since it is not recognized as a legal entity separate and distinct from its owner. It is merely its owner doing business. However, for purposes of providing a more complete overview of common structures, the sole proprietorship is briefly addressed.

[6] Mich. Dept. of Licensing and Reg. Affairs, *Filing at the County Level*, ST. OF MICH. (last visited April 26, 2019), https://www.michigan.gov/lara/0,4601,7-154-89334_61343_35413_60640-120017--,00.html.

[7] Richardson v. Secretary of Labor, 689 F.2d 632, 633 (6th Cir. 1982).

[8] Note, however, that business owners still remain generally liable for their own torts, and they can be responsible for debts of the company if they fail to observe corporate formalities. Thus, creditors of business with no assets sometimes try to sue the owners. To obtain the benefit of the limited liability of the corporation or the LLC, the owners should, *inter alia*, observe corporate formalities by treating the company as separate from the owners. Thus, the business owners should keep separate finances for the business, not commingle personal and business funds, not pay personal debts from the business checkbook - or if that happens, the accountant should either treat such funds as income to the owners or require the owners to reimburse the company.

[9] However, while tax concerns are a major consideration in choosing a business entity, taxation is a matter outside the scope of this article. It is recommended to consult with a tax expert for matters related to business entity taxation.

[10] Radio Electronics Supply Co. v. Smith, 372 Mich. 393 (1964).

[11] *Id.* at 394.

personally. The owner attempted to rely on the corporate form in arguing that he could not be personally liable. The Michigan Supreme Court looked beyond the legal designation of the business, however, and considered the substance of the business rather than strictly its legal form. The Court found that even though the president had made the appropriate filings to become a corporation, the owner, by failing to treat the business as a distinct entity, "essentially was carrying on a sole proprietorship."[12] Thus, because the owner was not treating it as a distinct entity, the Court held that the business ***was a sole proprietorship***.[13] This opened up the owner to personal liability on the promissory note held by his corporation. However, if the corporate form was instead properly employed, which requires, among other things recognition of the business as an entity separate and distinct from its owner(s), the individual business owner in *Radio Electronics* would have been shielded from liability against the note-holder.

LIMITED LIABILITY COMPANY

The limited liability company ("LLC") is an unincorporated entity, owned by its members.[14] The Michigan Limited Liability Company Act, MCL 450.4101 *et seq.*, governs the formation of LLCs.[15] Since 1993, when Michigan enacted the LLC Act, the LLC has become the most popular business entity in the state.[16] In fact, for every six new businesses formed in Michigan every year, approximately five of them are LLCs.[17] The LLC has understandably been a powerhouse in every state since its inception.

The proliferation of LLCs is not a mere coincidence. Under the LLC Act, members of an LLC generally will not be held liable on the business's obligations and its members are provided rights with respect to other members.[18] Additionally, LLCs typically have fewer formalities compared to corporations. However, one of the most appealing reasons to start a Michigan LLC is for federal income tax purposes. By default, even though an LLC is its own legal entity, an LLC itself does not pay income taxes;

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[12] *Id.* at 396.
[13] *Id.*
[14] Mich. Comp. Laws § 450.4102(k) (1993).
[15] M.C.L. § 450.4101 et seq. (1993).
[16] Mich. Dept. of Licensing and Reg. Affairs, *Total Business Entities as of October 1, 2018*, (last visited April 26, 2019), https://www.michigan.gov/lara/0,4601,7-154-61343_35413-114907--,00.html.
[17] Mich. Dept. of Licensing and Reg. Affairs, *FY 2018/2019 New Corporation and Limited Liability Company Monthly Totals*, (last visited April 26, 2019), https://www.michigan.gov/lara/0,4601,7-154-89334_61343_35413-482346--,00.html.
[18] M.C.L. 450.4501(4).

rather, it is taxed as a partnership.[19] Just like a partnership, the taxable income gets passed through to the LLC's members (which is commonly referred to as "pass-through taxation").[20] Alternatively, LLC members may elect pass-through taxation, taxable as an S-corporation, by filing a Form 2553 with the IRS.[21] This election provides flexible taxation.

Despite the broad protections and authority given to members of LLCs, the LLC Act and common law do provide certain limitations on the activities of LLC members. Controlling members can still face personal liability, *inter alia*, for interested transactions,[22] minority member oppression,[23] common law actions to pierce the corporate veil,[24] and breaches of common law fiduciary duties.[25] Furthermore, the manager or controlling members may be exposed to a derivative action under the LLC Act, which allows a member to bring a claim on behalf of the LLC and against its managers or controlling members who have otherwise acted wrongfully toward the LLC.[26] Derivative suits can generally be avoided by properly and fairly managing the company.

CORPORATION

A corporation is an incorporated entity, owned by stockholders and operated by directors and officers.[27] In a closely held corporation, stockholders commonly serve as the corporation's officers or directors. In Michigan, corporations are governed by the Business Corporation Act, M.C.L. 450.1101 *et seq.*, enacted in 1972.[28]

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[19] *Limited Liability Company (LLC)*, I.R.S. (May 8, 2019), https://www.irs.gov/businesses/small-businesses-self-employed/limited-liability-company-llc.

[20] *Partnerships*, I.R.S. (May 6, 2019), https://www.irs.gov/businesses/small-businesses-self-employed/partnerships.

[21] *About Form 2553, Election by a Small Business Corporation*, I.R.S. (Jan. 31, 2019), https://www.irs.gov/forms-pubs/about-form-2553. This assumes that entity will qualify for S corporation status. Again, entity taxation is beyond the scope of this article, but it is a very important consideration in the choice of entity.

[22] M.C.L. § 450.4409 (effective December 16, 2010).

[23] M.C.L. § 450.4515 (effective December 16, 2010).

[24] *See* Gallagher v. Persha, 315 Mich. App. 647 (2016).

[25] *See* Salvadore v. Connor, 87 Mich. App. 664 (1978).

[26] M.C.L. § 450.4510 (detailing when a member may bring a lawsuit on behalf of the entity and against those individuals in control).

[27] M.C.L. § 450.1101.

[28] *Id.*

Corporations offer many of the same benefits as LLCs – limited liability for its owners, perpetual existence, free transferability of ownership interest, and simplicity in organization and governance. However, since these advantages are available in other legal entities such as the LLC – sometimes to a greater extent – the decision on what business entity to select often rests on tax considerations. Other considerations may include how many owners the corporation anticipates having, whether the owners are individuals or entities, or if there is an intent to publicly trade the corporation's stock.

PARTNERSHIP

A partnership is an association of at least two people who elect to carry on a business for profit.[29] Michigan's partnership statutes provide for three varieties of partnerships: (1) general partnerships;[30] (2) limited partnerships;[31] and (3) limited liability partnerships.[32] Partnerships in Michigan are governed by the Michigan Uniform Partnership Act ("MUPA").[33] Limited partnerships and limited liability partnerships are subject to additional rules found in the Michigan Revised Uniform Limited Partnership Act ("MRULPA")[34] and the Michigan Limited Liability Partnership Act ("LLPA"),[35] respectively.

Unlike a sole proprietorship, and, similar to an LLC, a partnership has its own legal identity, such that it is legally distinct from its individual owners. Still, however, general partnerships do not provide the same statutory protections for the entity's partners as seen with LLCs. Under the MUPA, each partner in a general partnership is jointly and severally liable for the partnership's acts, obligations, and liabilities.[36] One mechanism by which personal liability may be avoided is to have an entity with liability protections – such as a corporation or an LLC - serve as the general partner of the partnership. Such personal liability avoidance mechanisms effectively leverage the protections afforded to either shareholders of a corporation or members of an LLC. Even if the entity serving as the general partner were held liable on the partnership obligations, the corporation or LLC will serve as a buffer, shielding the individual owners of the underlying entity from

[29] M.C.L. § 449.6 (effective September 27, 1957).
[30] *Id*.
[31] M.C.L. § 449.44 (effective October 12, 1994).
[32] M.C.L. § 449.1201 (effective January 1, 1983).
[33] M.C.L. § 449.1 (1917).
[34] M.C.L. § 449.1101 (effective January 1, 1983).
[35] M.C.L. § 449.44.
[36] M.C.L. § 449.15 (effective October 12, 1994).

any personal liability. Therefore, these individual shareholders or members acting as general partners could not be held personally liable for obligations incurred by the entity. This all begs the question: If a corporation or an LLC is the general partner, why not form a corporation or an LLC for the entity in the first place?

Michigan law also recognizes limited partnerships, which recognize two different classes of partners. Under MCL 449.1101, a limited partnership is an entity "formed by 2 or more persons under the laws of this state and having 1 or more general partners and 1 or more limited partners."[37] The fundamental differences between general partners and limited partners concern (1) their rights to participate in the management of the entity and (2) their exposure to the entity's liabilities.[38] With respect to management rights, general partners participate in the management of the limited partnership; in contrast, limited partners have no such default rights.[39] However, general partners' management rights come at a cost in that they are subject to personal liability for the limited partnership's acts, liabilities, and obligations.[40]

THE SUBSTANCE-OVER-FORM-APPROACH: THE COMMON LAW PARTNERSHIP

While a core focus of this article is on the internal matters of Michigan businesses, it is helpful to include an analysis of Michigan's common law partnership. The Michigan common law partnership is an example of how failing to comply with business entity requirements can impact a business's rights with respect to third parties.

Michigan case law has established that a partnership may be recognized irrespective of the entity owners' intent to form a partnership.[41] In determining whether a partnership has been formed the question is whether the owners intended to jointly carry on a business for-profit, not whether they intended to form a partnership.[42] This means that, if, in running their business, individuals take actions consistent with that of a partnership (such as, the owners sharing in both profits and losses of the business) they may nonetheless be found to have formed one under the common law.

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[37] M.C.L. § 449.1101(8).
[38] M.C.L. §§ 449.1301 et seq. (1982); 449.1401 et seq. (1982).
[39] M.C.L. §§ 449.1302; 449.1303.
[40] M.C.L. § 449.1403 (1982).
[41] Byker v. Mannes, 465 Mich. 637 (2002).
[42] *Id*. at 653.

The seminal case on common law partnerships is *Byker v. Mannes*, 465 Mich. 637 (2002);[43] aff'd *Byker v Mannes*, 469 Mich. 881 (2003).[44] In this case, the parties engaged in the creation of various business enterprises in which they shared equally in the business's profits and expenses. After the defendant refused to make additional monetary contributions (resulting in plaintiff bearing substantial costs), plaintiff brought suit for recovery, claiming that the parties had entered into a partnership.[45] Ultimately, the case came before the Michigan Supreme Court, which adopted Judge White's Court of Appeals dissent,[46] which reasoned as follows:

> The fact that the parties created a series of separate business entities to facilitate the investment of limited partners and to limit their liability to outside creditors [did] not negate the existence of an agreement between the parties that, as between the two of them, they would equally share overall profits and losses.[47]

That is, even though the two individuals had separate non-partnership business entities, the two of them were informally conducting business as if it were a partnership and were equally sharing overall profits and losses. Thus, they did in fact have a partnership.[48] What this means for Michigan business owners is that the substance of the business's transactions and internal operations can trump its form. As such, members of an LLC, for example, must treat the entity as an LLC, by recognizing formalities and adhering to governance protocols, to retain the benefits of the LLC entity form— otherwise, they risk potentially being treated as a partnership. If the members agreed to split both profits and losses and otherwise fail to adhere to the corporate formalities of their designated structure, a court may rely on these facts in determining that members are actually partners under common law. A court's recognition of an entity (i.e. that the parties subjectively intended to be an LLC) as a partnership could subject its owners to liability for the business's debts, losses, unpaid contracts, etc.

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[43] *Id*.
[44] Byker v. Mannes, 469 Mich. 881 (2003).
[45] *Byker*, 465 Mich. 637 at 640-641.
[46] *Byker*, 465 Mich. 637 at 643.
[47] Byker v. Mannes, No. 205266, 2003 WL 550011 at *3 (Mich. Ct. App. Feb. 25, 2003) (White, J., *dissenting*); *Byker*, 465 Mich. 637, 652-53 (2002).
[48] *Byker*, 469 Mich. 881.

The key determination, as evidenced by the Court's opinion in *Byker v. Mannes,* is whether the parties intended to jointly carry on a business by sharing its profits and losses.

AN OVERVIEW OF SELECT DOCTRINES AND STATUTES ON INTERNAL BUSINESS ENTITY GOVERNANCE

Whether an LLC, corporation, or sole proprietorship, many businesses start with a single owner. However, after a certain amount of growth, the introduction of other individuals or entities who later obtain some form of equity in the business is nearly unavoidable. Whether through a co-owner, venture capitalist funding, or a stock bonus plan, having multiple owners introduces another factor to the business dynamic – the legal relations among the owners.

Similar to compliance with the legal requirements for forming a particular entity, knowing the laws of internal governance can help business owners understand and subsequently obtain the full benefits of the law, prevent internal disputes between owners, and promote economic efficiency of their businesses.

Not only do Michigan's internal governance laws impact economic development of business, but they ultimately may impact the statewide economy. For one, having clear and established internal governance laws aids prospective owners (whether friends, family, or outside investors and whether located in Michigan, other states, or abroad) in properly evaluating whether they wish to become an owner of a Michigan entity. That is, before even evaluating the substance of the laws, it is important that owners and practitioners clearly understand what the laws are. This in turn assists attorneys in drafting governing documents or generally advising their business clients. Further, having established laws also minimizes the transaction costs by minimizing the time and resources spent evaluating the law. However, the substance of the law is important as well given that it will inevitably affect a prospective owner's decision to join a Michigan business.

The following sections highlight some of the more prominent features of the internal relationships between owners of Michigan corporations and LLCs. They include an overview of the internal affairs doctrine, the corporate opportunity doctrine, common law and statutory fiduciary duties, shareholder and member oppression, and a business's

ability to modify certain provisions of Michigan's Business Corporation and LLC Acts through governing documents.

MICHIGAN'S LLC AND BUSINESS CORPORATION ACTS – WHICH ENTITIES DO THEY APPLY TO?

Michigan's LLC and Business Corporation Act, MCL 450.4101[49] and MCL 450.1101,[50] respectively, provide the foundation for the internal relations and governance of these business entities. The Business Corporation Act "applies to every domestic corporation and to every foreign corporation which is authorized to or does transact business in this state except as otherwise provided in this act or by other law."[51] What this means is that foreign corporations have the same rights and privileges as domestic corporations, and unless the Act states otherwise, foreign corporations operating in Michigan are subject to the same duties, restrictions, penalties, and liabilities.[52] However, under Michigan law, foreign corporations operating in Michigan are generally not required to follow Michigan's laws governing the internal affairs of Michigan corporations.[53] This principle of corporate governance is called the internal affairs doctrine, defined as "a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders."[54]

For many years, this doctrine was found in common law. However, in 2008, Michigan codified the internal affairs doctrine into 450.2002 of the Business Corporation Act, which adopts the Model Business Corporation Act's express language.[55] It states, "[t]his act does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state."[56] That is, the internal affairs of corporations are determined in accordance with the law of the state in which the corporation is formed.

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[49] M.C.L. § 450.4101.
[50] M.C.L. § 450.1101.
[51] M.C.L. § 450.1121 (effective October 1, 1989); *see also* M.C.L. § 450.1106(1) (defining a corporation or domestic corporation as "a corporation formed under this act, or existing on January 1, 1973 and formed under any other statute of this state for a purpose for which a corporation may be formed under this act.").
[52] M.C.L. § 450.2002(1) (effective January 6, 2009).
[53] M.C.L. § 450.2002(2).
[54] Edgar v. Mite Corp., 457 US 624, 645 (1982).
[55] *See* M.C.L. 450.5001 (discussing the LLC Act's equivalent statute).
[56] M.C.L. § 450.2002(2).

As such, corporations that are headquartered in and operate entirely in Michigan may nonetheless be controlled by the internal governance laws of the state where the business is incorporated. The rationale for this doctrine is that a state has a right to control the internal affairs of corporations incorporated in that state.[57] The doctrine also provides stability to owners of corporations operating in numerous states since they can be sure that their corporations will be governed by the laws of where they are incorporated rather than the laws of various states. That is, corporations operating in multiple states have a right to know what laws will govern their behavior.[58]

Michigan, like most other states, however, has placed limitations on a corporation's ability to dictate which state's law should govern particular matters within its borders. One distinction that business owners must be aware of is the difference between the ***internal*** affairs and the ***external*** affairs of a corporation. In a case demonstrating this distinction, *Chrysler Corp. v. Ford Motor Co.*, 972 F. Supp. 1097 (1997), the question was whether Michigan or Pennsylvania's laws applied to the issues of corporate successor in interest and piercing the corporate veil.[59] There, a Pennsylvania corporation committed a wrong, and the corporation was subsequently acquired by a Michigan corporation.[60] The defendants argued that the successor in liabilities law of the state of incorporation should govern, since it was a question of what interest of the Pennsylvania corporation survived. [61] The *Chrysler Corp* court disagreed, relying heavily on The Restatement (Second) of Conflict of Laws.[62] The court found that if an act could be committed by a non-corporate entity, then the standard choice of law rules applied.[63] However, if the act was one of the corporation, then "the law of the state of incorporation will normally be applied, unless another state has a 'more significant relationship' to the lawsuit."[64]

The *Chrysler Corp* case highlights some important considerations for Michigan businesses choosing to incorporate in another state. The internal affairs doctrine only applies to matters of internal governance. Otherwise, courts may apply the standard choice of law analysis, and

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[57] McDermott Inc. v. Lewis, 531 A.2d 206, 215 (Del. 1987).
[58] *Id*. at 216.
[59] Chrysler Corp. v. Ford Motor Co., 972 F. Supp. 1097 (E.D. Mich. 1997).
[60] *Id*.
[61] *Id*.
[62] *Id*. at 1102.
[63] *Id*.
[64] *Id*.

examine which state has a greater interest in applying their own laws. This is not unique to Michigan, as even Delaware, a state lauded as one of the most business-friendly states, has had its own courts rule that a Delaware corporation's Delaware choice of law election was unenforceable.[65]

FIDUCIARY DUTIES

Although fiduciary duties stem from common law principles, they also arise under the Michigan Business Corporation Act.[66] (Fiduciary duties also apply in the LLC context; this will be discussed below.) Fiduciary duties are duties that directors, officers, and controlling shareholders of closely held Michigan businesses owe to the business itself and to other shareholders. While the statutes set forth some of the specific duties of officers and directors, the broader concept, which incorporates these statutory duties, is the fiduciary duty. Fiduciary duty is a combination of the duties of loyalty, care, good faith, and disclosure.[67]

The duty of loyalty requires the fiduciary to place the interests of his principal ahead of his own and prohibits the fiduciary "from acting in any antagonistic position whether for [his] own personal benefit or for the benefit of other competitive corporations."[68] A violation of this duty often arises when shareholders, officers, or directors engage in self-dealing, or when they take personal benefits not shared with all the shareholders.[69]

The duty of care requires the fiduciary to exercise prudence, be attentive to the affairs of the company, and make decisions as would a reasonable person in a similar situation.[70] This duty requires fiduciaries in control of a business to "answer for ordinary neglect"[71] in their decision-

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[65] Ascension Ins. Holdings, LLC v. Underwood, No. 9897-VCG, 2015 Del. Ch. LEXIS 19, *6 (Jan. 28, 2015) (finding that a non-compete agreement between a California resident and a Delaware LLC, which had a Delaware choice of law provision, was not enforceable, since California had the strongest contacts to the contract and the non-compete would conflict with a "fundamental policy" of California).

[66] M.C.L. § 450.1101.

[67] Gerard V. Mantese and Ian M. Williamson, *Fiduciary Duty in Business Litigation*, MICH. BAR J., (August 2014), https://www.manteselaw.com/assets/pdf/2014_August,_Fiduciary_Duty_in_Business_Litigation__Mantese_-_Williamson_.pdf.

[68] Wagner Electric Corp v. Hydraulic Brake Co., 269 Mich. 560, 566 (1934).

[69] Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 459 (2009).

[70] Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (1984).

[71] Martin v. Hardy, 251 Mich. 413, 416 (1930) (quoting 2 Thompson on Corporations (3d Ed.), § 1376).

making. Ordinary neglect can arise from the failure to inform themselves of all material information reasonably available to them.[72]

The duty of good faith stands for the principle that directors and officers must act with a conscious regard for their fiduciary obligations, and is typically addressed within the context of alleged breaches of the duties of loyalty and care.[73] A violation of the duty of good faith can help overcome a fiduciary's reliance on the business judgement rule.[74]

Fiduciary duties can be established by finding a common law fiduciary relationship between any two parties. However, fiduciary duties arising under the different sections of the business statutes have a more specific application with respect to who owes fiduciary obligations (and to whom) and what those duties are. While the specific applications of fiduciary duties might vary somewhat between LLCs and corporations, the underlying rationale and results between the two business entities are similar.

As a matter of Michigan common law, majority or controlling shareholders owe fiduciary duties to both the minority shareholder and the corporation itself.[75] As one of the earliest Michigan cases addressing shareholder litigation established, this includes a duty to provide minority owners the best possible return on their investment.[76] However, the fiduciary obligations arising under Michigan's Business Corporation Act impose a heightened fiduciary standard compared to those arising under common law.[77] Under MCL 450.1541a,[78] directors and officers of a corporation (who, in close corporations, are also typically the shareholders), owe a fiduciary duty to the corporation itself. On the other hand, under MCL 450.1489,[79] controlling shareholders of close corporations owe non-controlling shareholders a "higher standard of fiduciary responsibility, a

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[72] M.C.L. § 450.1541a(2).
[73] Gerald L. Pollack & Assoc., Inc v. Pollack, No. 319180, 2015 WL 339715, *21-22 (Jan. 27, 2015).
[74] Dodge v. Ford Motor Co., 204 Mich. 459, 500 (1919) (stating, "unless there has been bad faith, willful neglect, or abuse of discretion").
[75] Salvador v. Connor, 87 Mich. App. 664, 675 (1979).
[76] Veeser v. Robinson Hotel Co., 275 Mich. 133, 138 (1936).
[77] Estes v. Idea Eng'g & Fabricating, Inc., 250 Mich. App. 270, 281 (2002) ("[I]n contrast, because the shareholders participate in the management of the corporation, the relationship among those in control of a closely held corporation requires a higher standard of fiduciary responsibility, a standard more akin to partnership law.").
[78] M.C.L. § 450.1541a (effective October 1, 1989).
[79] M.C.L. § 450.1489 (effective March 20, 2006).

standard more akin to partnership law."[80] Thus, between MCL §§ 450.1541a and 450.1489, controlling shareholders owe both the corporation and non-controlling shareholders a heightened fiduciary duty.

As it pertains to fiduciary duties arising from the LLC Act, while the analysis is similar to that of the Business Corporation Act, it has not been identical. The LLC Act has sections that are substantively identical to the Business Corporation Act §§ 450.1541a and 450.1489, which are LLC Act §§ 450.4404(1) and 450.4515, respectively. Both the Business Corporation Act §1451a and LLC Act §4404 implicate fiduciary duties that are owed to the legal entity. On the other hand, while Business Corporation Act §1489 provides for heightened fiduciary duties between owners of Michigan corporations, some courts have been hesitant to find that the analogous LLC Act §4515 establishes fiduciary duties among members of manager-managed LLCs.[81] However, some courts appear to be changing in that approach as Michigan's LLC jurisprudence develops.

Three factors can potentially account for this discrepancy. First, Michigan LLCs may elect to be managed by either their members or by managers, an election unavailable to corporations. Second, most courts that have been leery of finding that LLC members owe each other fiduciary duties have focused on §4404, not §4515.[82] Third, the dates when the Business Corporation and the LLC Acts were enacted is an important consideration. Michigan's Business Corporation Act was enacted in 1972, whereas the LLC Act was enacted in 1993. In other words, there have been an additional 21 years of legal analysis and judicial opinions interpreting the Business Corporation Act.

In *Castle v. Shoham*, No. 337969, 2018 Mich. App. LEXIS 2975, *35 (Aug. 7, 2018)(unpublished), the appellate court clarified this matter, stating:[83] "[t]he language in MCL 450.4515 allowing for a minority member to bring an action against a controlling member for willfully unfair and oppressive conduct *clearly implicates a fiduciary duty among members*

[80] *Estes*, 250 Mich. App. 270 at 281.
[81] Alliance Associates, LLC v Alliance Shippers, Inc., No. 05-507573-CK, 2006 WL 1506687 (Mich. Ct. App. June 1, 2006).
[82] BSA Mull, LLC v. Garfield Inv. Co., Nos. 11-000720-CB, 11-001283-CZ, 11-001433-CB, 2014 WL 4854306, at *6 (Mich. Ct. App. Sept. 30, 2014) (unpublished).
[83] Castle v. Shoham, No. 337969, 2018 Mich. App. Lexis 2975, *34 (Aug. 7, 2018; unpublished). The trial court in Castle v. Shoham, No. 2014-3568-CK, 2015 Mich. Cir. LEXIS 137 at *5, was in fact consistent in this respect, finding that "the fact remains that under certain circumstances a minority member may maintain a breach of fiduciary duty claim against a majority member."

(emphasis added) and a common law duty of good faith among such members."[84] This appears to be the clearest statement in Michigan jurisprudence that members of a limited liability company owe fiduciary duties to each other and not just to the company itself.

CORPORATE OPPORTUNITY DOCTRINE

Like many other states, Michigan recognizes the corporate opportunity doctrine, a common law development arising from the fiduciary duty of loyalty.[85] Generally, the doctrine requires that if there is a business opportunity presented to a corporate officer or director, which (1) the corporation is financially able to undertake, (2) is in the line of the corporation's business, (3) is of practical advantage to it, and (4) if by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of the corporation, the law will not permit an officer or director to seize the opportunity for himself.[86] If he does, the corporation may claim the benefit of the transaction. One of the principal cases articulating this doctrine in Michigan is *Production Finishing Corp v. Shields*.[87]

One of the key ways to avoid a violation of this doctrine is through full disclosure. That is, before directors or officers may pursue a business opportunity for themselves within the corporation's line of business, they must disclose and present this opportunity to the corporation. If they fail to do so, they may be required to disgorge profits earned from the opportunity pursued while under a duty to the corporation.[88] In addition to this common law safeguard, the Michigan Business Corporation Act has established numerous means of avoiding liability under the corporate opportunity doctrine, such as section 450.1545a. Section 450.1545a states that a director or officer who has entered into a self-interested transaction, shall not have the transaction "enjoined, set aside, or give rise to an award of damages or other sanctions" if the interested person establishes any of the following: (a) the transaction was fair to the corporation; (b) the material facts of the transaction and self-interest were disclosed or known to the corporation, and the corporation's disinterested directors or shareholders authorized or

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[84] *Castle*, No. 337969, 2018 Mich. App. LEXIS 2975 at *35.
[85] Edwin J. Lukas, *Opportunity Knocks: Proposed Legislative Reform of the Corporate Opportunity Doctrine in Michigan*, THE MICH. BUS. L. J., Fall 2018, at 16-17.
[86] Production Finishing Corp. v. Shields, 158 Mich. App. 479, 486 (1987).
[87] *Production Finishing Corp.*, 158 Mich. App 479.
[88] Central Cartage Co. v. Fewless, 232 Mich. App. 517, 525 (1999).

approved the transaction; or (c) the material facts of the transaction and self-interest were disclosed to the shareholders, who approved the transaction.[89]

In addition to the established safeguards, Section 450.1488 of the Michigan Business Corporation Act[90] is another means of avoiding the corporate opportunity doctrine. Section 1488, which is discussed further in the next section, permits stockholders to waive certain corporate opportunities.

MODIFIABLE PROVISIONS OF THE LLC AND BUSINESS CORPORATION ACTS

While modern business entities provide considerable protections and benefits to businesses and their owners, certain statutory requirements must be met to retain those benefits. However, many of the statutory duties or requirements under the Business Acts are merely default requirements, which can be modified or waived entirely. The rights to modify and waive are specifically enumerated in the Business Corporation Act in MCL 450.1488, a section added in 1997.[91] Stockholders can accomplish this by inserting language directly into a shareholder agreement, often referred to as a Section 448 Agreement. There are a few modest requirements for these agreements to be enforceable. One is that the agreement must be approved by all persons who are stockholders at the time.[92] Additionally, for modifications that fall within §1488's catch all provision, the agreement cannot be contrary to public policy.[93] This includes modifying or eliminating the core statutory fiduciary duties that managers, officers, and owners of Michigan businesses owe to each other under the Michigan Business Corporation Act.[94] (Michigan codified the model act 7.32 by enacting 1488). This section provides stockholders with many of the flexibilities provided to members of Michigan LLCs.

However, the LLC Act does not have a single statute enumerating this right. Rather, some of the sections in Michigan's LLC Act state that the requirements are merely the default rules which can be modified pursuant to an agreement. For example, MCL 450.4502,[95] which deals with voting

[89] M.C.L. § 450.1545a (effective Jan. 6, 2009).
[90] M.C.L. § 450.1488 (effective Jan. 2, 2013).
[91] *Id*.
[92] M.C.L. § 450.1488(2).
[93] M.C.L. § 450.1488(1)(i).
[94] *See* Model Bus. Corp. Act §7.32, cmt. At 7-64.
[95] M.C.L. § 450.4502 (effective December 16, 2010).

rights in LLCs, states: "An operating agreement may establish and allocate the voting rights of members… If an operating agreement does not address voting rights, votes are allocated as follows…"

The flexibility to modify certain default provisions of the Acts through the governing documents is a significantly appeal to business owners and attorneys alike. In part, it is this flexibility which allows a corporation's legal counsel to draft governing documents to meet the specific needs of the business and its owners. Nevertheless, there is considerable benefit of having a shareholder agreement (or an operating agreement, in the case of an LLC) from the outset. That way, the owners know what their rights and responsibilities to each other are, and actions that are specifically permitted by agreement are generally not "willfully unfair or oppressive conduct."[96]

SHAREHOLDER AND MEMBER OPPRESSION

Section 450.1489 of the Michigan Business Corporation Act[97] provides shareholders (typically non-controlling or minority owners) an independent cause of action against the controlling shareholders or directors of a close corporation. Specifically, the statute gives a stockholder a cause of action, if the "acts of the directors or those in control of the corporation are illegal, fraudulent, or willfully unfair and oppressive to the corporation or to the shareholder."[98]

Generally, there are three categories of prohibited conduct: (1) Illegal, (2) fraudulent, or (3) willfully unfair.[99] The terms "illegal" and "fraudulent" are frequently used in law and are well defined. However, the phrase "willfully unfair and oppressive" found in Michigan's two oppression statutes is unique to Michigan, although the phrase has been refined by years of caselaw and the state legislature. In 2001, the Michigan Legislature amended the statute, adding subsection 1489(3), which defines willfully unfair and oppressive conduct as "a continuing course of conduct or a significant action or series of actions that substantially interferes with

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[96] Berger v. Katz, Docket Nos. 291663, 293880., 2011 WL 3209217, at *4 (July 28, 2018) (unreported) (application for leave for MSD denied) (stating that, in some instances, if an agreement grants broad authority and that authority is used oppressively, this could constitute "willfully unfair and oppressive conduct").

[97] *See* LLC Act § 450.4515 for the analogous version of the Michigan Business Corporation Act for LLC members and managers.

[98] M.C.L. § 450.1489.

[99] *Id*.

the interests of the shareholder as a shareholder."[100] The statute was amended a second time in 2006 and added that "willfully unfair and oppressive conduct may include the termination of employment or limitations on employment benefits to the extent that the actions interfere with distributions or other shareholder interests disproportionately as to the affected shareholder."[101]

This 2006 amendment was a helpful clarification because, for stockholders in closely held corporations, their ownership interests often relate to employment in the corporation. MCL 450.1489 is therefore an important provision for minority business owners, because it is a key way for a minority shareholder to protect their stockholding interest.

The 30+ years of case law interpreting the statute has been instructive for understanding what conduct is actionable. In *Bromley v Bromley*, No. 05-71798, 2006 WL 2861875, at *6 (E.D. Mich., Oct. 4, 2006), the court held that the actions of the majority violated MCL 450.1489 when the majority "removed [p]laintiffs from management positions, made it more difficult for them to exercise rights as shareholders … hindered access to corporate books and information" and used "their majority and control position to keep [p]laintiffs out of corporate affairs."[102] In *Madagula v. Taub*, 496 Mich. 685 (2014),[103] the Michigan Supreme Court held that a controlling shareholder's violation of corporate governance documents can constitute evidence of shareholder oppression under MCL 450.1489.[104]

Section 1489 presents an equitable claim to the court, giving judges broad flexibility to fashion relief as they find equitable. While the statute enumerates some types of relief available, it does not provide an exhaustive list of remedies. However, the enumerated remedies do represent some of the more commonly awarded forms of relief. These include the ability to award damages, issue injunctions, require a buyout at fair value, and

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[100] M.C.L. 450.1489(3).
[101] *Id.*
[102] Bromley v. Bromley, No. 05-71798, 2006 WL 2861875, at *6 (E.D. Mich., Oct. 4, 2006).
[103] Madagula v. Taub, 496 Mich. 685 (2014). Madagula is one of two cases that the Michigan Supreme Court has heard addressing Michigan's shareholder oppression statute, M.C.L. 450.1489. The other case is Frank v. Linkner, 500 Mich. 133 (2017). Gerard V. Mantese of Mantese Honigman, PC (where the author is an associate) argued both of these cases before the Michigan Supreme Court.
[104] Madagula, 496 Mich. 685 at 720.

dissolve the corporation and liquidate its assets.[105] Therefore while the range of remedies is broad, any combination of remedies is available.

Section 1489 is an important statute when it comes to the internal governance of Michigan corporations. It helps clarify and protect the rights of minority or non-controlling owners. At its core, it is meant to assure that non-controlling shareholders are treated equally and fairly. This also helps protect the value of minority interests in Michigan corporations.

CONCLUSION

For business owners, knowing the limitations and requirements of their business entity, its governing documents, and the laws on internal business relationships is essential to the long-term success of a business. Not all profitable businesses last perpetually. Often, this occurs because of economic factors—undercapitalization, change in consumer taste, or an economic recession. In some cases, however, the problem is poor legal and tax planning by the owners, or by the owners simply not observing the various laws or their own internal agreements. The most impactful time to effectuate the best preventative measures is at the beginning of a business relationship. Unfortunately, so many entrepreneurs fail to obtain adequate legal, tax, or accounting advice in the early stages of their business. Their reasons? Finances are tight in the earlier years of business; the owners understandably are optimistic ("Everything is fine. We can work out whatever problems we have"); and the owners get busy and "never get around to" obtaining the professional advice they need.

The laws governing Michigan's business entities are important matters, which can have significant economic implications for the business and the state. On the one hand, a business owner who fails to comply with the business entity structure and internal governance laws can risk losing the protections provided by the business entity. In addition, owners' noncompliance with these laws increases the risk of litigation or other internal disputes, which can further hamper financial growth. One of the most vital considerations is protecting the interests of Michigan businesses and their owners. These laws are designed to treat the owners of the business fairly.

What should new business owners do to guard against problems pertaining to internal governance matters? Develop a business plan; obtain

[105] M.C.L. §450.1489(1)(a-f).

quality tax, legal, and accounting advice as early as possible; be prepared to work hard; start with sufficient capital; and document the relationships among the business owners with a shareholder agreement, operating agreement, or the like. Then, continue to work hard, treat the business as a separate entity, and treat co-owners fairly.