Legislative Analysis

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BUSINESS CONVERSION PLANS & PROCEDURES

House Bill 5356 as enrolled
Public Act 402 of 2008
Sponsor: Rep. Bill Huizenga
House Committee: New Economy and Quality of Life
Senate Committee: Economic Development and Regulatory Reform

Second Analysis (2-2-09)

BRIEF SUMMARY: The bill revises certain procedures to be followed when converting a "domestic corporation" into a "business organization," or the reverse. The bill would allow a domestic corporation to convert into a business organization, or a business organization to convert into a domestic corporation; allow a voting shareholder to dissent from a domestic corporation's conversion plan, unless shareholders received cash and/or shares; and impose a $50 fee for filing a certificate of conversion.

FISCAL IMPACT: There is no fiscal impact on the State of Michigan or its local units of government.

THE APPARENT PROBLEM:

There are two major Michigan statutes under which corporations made up of professional occupations organize their business: the Business Corporation Act of 1972, and the Professional Service Corporation Act of 1962. The second of these—the Professional Services Corporation Act—was originally enacted 45 ago to make clear the" doctrine of the learned professions," but also to allow those professions—law, medicine, and divinity—to organize as corporations and provide services to patients, clients, and those being counseled.

The Department of Labor and Economic Development (and its predecessor agencies), and more specifically the Commercial Services Bureau, allowed many businesses to incorporate under either statute, following guidelines issued by the department. Those guidelines changed over time, resting upon the plain language of occupational licensing statutes, the evolving organizational structures of the learned professions, an emerging and increasingly broader conception of "professionals" in the changing world of work, and upon Attorney General Opinion No. 6592, issued on July 10, 1989, which sought to clarify provisions in the two statutes for the purposes of properly licensing businesses that enabled the various professions to provide service and earn a profit while doing so.

As the guidelines changed, officials generally reasoned that the Professional Service Corporation Act, enacted in 1962, enabled members of the learned professions (attorneys, physicians, and clergy) to form businesses rendering services in which *service* and not *corporate profitability* was the organizing principle, as outlined in the learned professions doctrine. See *BACKGROUND INFORMATION*.

However, over the years, the Commercial Services Bureau included other professionals in the learned professions doctrine. For example, osteopaths, ophthalmologists, and psychiatrists were included among the professions covered by the doctrine, and were permitted to incorporate only under the provisions of the Professional Service Corporation Act. In addition, certified public accountants, dentists, and psychologists were included because of language in their enabling acts. For a period of time, all remaining professional services could incorporate under *either* the Business Corporation Act or the Professional Service Corporation Act.

On May 31, 2007, in the case of *Miller* v *Allstate Insurance Company*, the Michigan Court of Appeals ruled that a corporation offering professional services to the public (that is, all services requiring an occupational license) must incorporate under the Professional Service Corporation Act and not under the Business Corporation Act.

The case arose when plaintiff William Miller brought an action in the Wayne Circuit Court seeking benefits from Allstate Insurance Company for physical therapy services he received from PT Works, Inc., after being injured in an automobile accident. Allstate refused to pay PT Works for the services, alleging that because PT Works was incorporated under the Business Corporation Act rather than the Professional Service Corporation Act, Miller's treatment was not lawfully rendered as required by the auto no-fault act. See *BACKGROUND INFORMATION*.

Following the Appeal's Court's 2007 ruling in *Miller* v *Allstate*, the Department of Labor and Economic Growth compiled a list of over 40 occupations having licensed professionals and noted that all of them would be required to incorporate (or, to re-incorporate) under the Professional Service Corporation Act, rather than the Business Corporation Act.

In response to *Miller,* and at the urging of the Corporation Division of the Commercial Services Bureau working together with the Corporate Laws Subcommittee of the Business Law Section of the State Bar of Michigan, legislation has been introduced to allow corporations to convert from licensure or certification under the Business Corporation Act as a "business organization" to a "domestic corporation," or the reverse, rather than to reincorporate.

THE CONTENT OF THE BILL:

The bill would amend the Business Corporation Act to do all of the following:

- Allow a "domestic corporation" to convert into a "business organization."
- Allow a "business organization" to convert into a "domestic corporation."
- Allow a voting shareholder to dissent from a domestic corporation's conversion plan, unless shareholders received cash and/or shares.
- Impose a $50 fee for filing a certificate of conversion.

- Specify that satisfying requirements that preclude an action regarding a transaction in which a director or officer has an interest would not preclude other claims.
- Provide that a certificate of dissolution filed with the administrator (the director of the Department of Labor and Economic Growth) would be effective at the time the certificate was first received by the administrator, not the date of filing, if certain conditions were met.

The bill also would repeal Chapter 7B (Control Share Acquisitions) of the Act. (That chapter is known as the "Stacey, Bennett, and Randall Shareholder Equity Act".) Generally, these provisions were enacted to address hostile takeovers of Michigan corporations.

[Currently under the Business Corporation Act, "business organization" means 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*. "Domestic corporation" means a corporation formed under the 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 the act.]

DETAILED DESCRIPTION OF THE BILL:

House Bill 5356 adds two new substantially similar sections to the act: the first governing the occasion when a domestic corporation converts to a business organization (Section 745), and the second governing the occasion when a business organization converts to a domestic corporation (Section 746). Under the bill, a conversion can occur if all of the following requirements are satisfied:

- The conversion is permitted by the law that will govern the internal affairs of the business organization or domestic corporation after conversion, and the surviving business organization complies with that law in making the conversion.

- The board of the domestic corporation or business organization proposing to convert adopts a plan of conversion that includes all of the following:

    - The name of the domestic corporation or business organization, the name of the business organization into which the domestic corporation is converted or the reverse, the type of business organization into which the domestic corporation is converting or the reverse, identification of the statue that will govern the internal affairs for the surviving business organization, the street address of the surviving business organization or domestic corporation, the street address of the domestic corporation or business organization if different, and the principal place of business of the surviving business organization or domestic corporation.
    - For the domestic corporation or the business organization, the designation and number of outstanding shares of each class and series, specifying the

classes and series entitled to vote, each class and series entitled to vote as a class, and, if the number of shares is subject to change before the effective date of the conversion, the manner in which they change may occur.

- The terms and conditions of the proposed conversion, including the manner and basis of converting the shares into ownership interests or obligations of the surviving business organization, into cash, into other consideration that may include ownership interest or obligations of an entity that is not a party to the conversion, or into a combination of cash and other considerations.
- The terms and conditions of the organizational documents that are to govern the surviving business organization.
- Any other provision with respect to the proposed conversion that the board considers necessary or desirable.

If the board of a domestic corporation adopts the plan of conversion, it is submitted for approval in the same manner required for a merger [under Section 7031(2)], including the procedures pertaining to dissenters' rights, if any shareholder has the right to dissent. If a plan of conversion is adopted by a business organization, the plan is submitted for approval in the manner required by the law governing the internal affairs of that business organization.

If a domestic corporation has not begun business, has not issued any shares, and has not elected a board, then the incorporators may approve of the conversion into a business organization by unanimous consent. To effect the conversion, the majority of the incorporators must execute and file a certificate of conversion. After the plan of conversion is approved, the domestic corporation files any formation documents under the laws governing the internal affairs of the surviving business organization.

The bill specifies that the certificate of conversion include five statements, including but not limited to: a statement concerning the manner and basis of converting the shares; whether the corporation has begun business, issued any shares, or elected a board; whether the corporation has furnished a copy of the plan of conversion to any shareholders; whether the plan was approved by the shareholders; and specifying each assumed name of the domestic corporation to be used by the surviving business organization.

When a conversion takes place under Section 745, all of the following (among other things) apply:

- The domestic corporation converts into the surviving business organization, and the articles of incorporation of the domestic corporation are canceled.
- The surviving business organization has all of the liabilities of the domestic corporation.
- The title to all real estate and other property and rights owned by the domestic corporation remain vested in the surviving business organization without reversion or impairment.

- The surviving business organization may use the name and the assumed names of the domestic corporation if the filings are made under the law.
- A proceeding pending against the domestic corporation may be continued as if the conversion had not occurred, or the surviving business organization may be substituted in the proceedings for the domestic corporation.
- The surviving business organization is considered to be the same entity that existed before the conversion and is considered to be organized on the date that the domestic corporation was originally incorporated.
- The shares of the domestic corporation that were to be converted into ownership interests or obligations of the surviving business organization or into cash or other property are converted.
- Unless otherwise provided in a plan of conversion, the domestic corporation is not required to wind up its affairs or pay its liabilities and distribute its assets on account of the conversion, and the conversion does not constitute a dissolution of the domestic corporation.

If the surviving business organization of a conversion is a foreign business organization, it is subject to Michigan laws. The surviving business organization is liable, and is subject to service of process in a proceeding in Michigan, for the enforcement of an obligation of the domestic corporation, and in a proceeding for the enforcement of a right of a dissenting shareholder of the domestic corporation against the surviving business organization.

When a plan of conversion is approved under Section 746, the business organization files a certificate of conversion with the administrator, and the bill specifies what that certificate must include. When a certificate takes effect, all of the following apply:

- The business organization converts into the surviving domestic corporation.
- The surviving domestic corporation has all of the liabilities of the business organization.
- The title to all real estate and other property and rights owned by the business organization remain vested in the surviving domestic corporation without reversion or impairment.
- The surviving domestic corporation may use the name and the assumed names of the business organization if the filings are made and the laws regarding use and form of names are followed.
- A proceeding pending against the business organization may be continued as if the conversion had not occurred, or the surviving domestic corporation may be substituted in the proceedings for the business organization.
- The surviving domestic corporation is considered to be the same entity that existed before the conversion and is considered to be organized on the date that the business organization was originally organized.
- The ownership interests of the business organization that were to be converted into shares or obligations of the surviving domestic corporation or into cash or other property are converted.

- Unless otherwise provided for in a conversion plan, the business organization is not required to wind up its affairs or pay its liabilities and distribute its assets on account of the conversion, and the conversion does not constitute a dissolution of the business organization.

Currently under the law, a shareholder is entitled to dissent from a conversion, and obtain payment of the fair value of his or her shares, in the event of any of seven corporate actions. House Bill 5356 would modify the list of corporate actions. It would eliminate as a reason for shareholder dissent "the approval of a control share acquisition." The bill would add as a reason for shareholder dissent the "consummation of a plan of conversion to which the corporation is a party as the corporation that is being converted, if the shareholder is entitled to vote on the plan." However, the bill specifies that any rights provided would not be available if the corporation was converted into a foreign corporation, and the shareholder received shares that had terms as favorable in all material respects, and represented at least the same percentage interest of the total voting rights of the outstanding shares of the corporation, as the shares held before the conversion.

Generally under the act, a document filed is effective at the time it is endorsed, unless a subsequent effective time (not later than 90 days after the date of delivery) is set forth in the document. However, the bill specifies that a certificate of dissolution filed with the administrator would be effective at the time the certificate was first received, *not* the date of filing, if all of the following criteria were met:

- the dissolution was undertaken in one of two ways, described in sections 488 or 804.
- the administrator received the certificate of dissolution after June 21, 2003 and before June 30, 2003.
- the corporation published notice of dissolution between those dates.
- the certificate did not indicate a subsequent effective time (not later than 90 days after the date the certificate was received by the administrator).

BACKGROUND INFORMATION:

Learned professions doctrine. Until 1962 and the enactment in Michigan of the Professional Service Corporation Act, the learned professions—law, medicine, and divinity—were prohibited from practicing as corporate entities by virtue of what is sometimes referred to the learned professions doctrine whose four principles hold: (1) laymen should not be permitted, directly or indirectly by virtue of the corporate form, to practice medicine; (2) necessary confidential, and professional relationships existing between a physician and a patient could be destroyed by lay shareholders interested only in a profit; (3) the limited liability of the corporate form is not appropriate where the client must place such a high degree of trust and confidence in the physician; and (4) it is impossible for a corporation to fulfill the licensing and ethical requirements that medical practice demands. OAG Opinion No. 6592 (July 10, 1989)

Miller v *Allstate Insurance Company*. COA docket No. 259992. The Appeals Court's final decision came after the Michigan Supreme Court vacated the Appeals Court's earlier judgment. The Appeals Court had earlier held that, regardless of whether the trial court's conclusion that PT Works was properly incorporated under the Business Corporation Act was correct, the treatment PT Works rendered was lawful, and therefore reimbursable under the no-fault act, because the treatment was performed by licensed physical therapists. Allstate appealed to the Supreme Court which vacated that judgment and then remanded the case to the Court of Appeals to determine whether PT Works could properly be incorporated solely under the Business Corporation Act, and not under the Professional Service Corporation Act, and then once that determination had been made, for consideration of whether the physical therapy provided by PT Works was lawfully rendered under the no-fault act.

To read the case-file in its entirety, visit http://www.courtofappeals.mijud.net Select "resources" from the top menu bar; then select "court opinions" followed by "opinion search options." Click on docket number, and type 259992.

ARGUMENTS:

For:

Proponents of the bill note that the May 2007 Appeals Court ruling in *Miller* v *Allstate* (COA docket No. 259992) would require that hundreds of corporations offering the services of more than 40 licensed professional occupations now incorporated under the Business Corporation Act be re-incorporated under the Professional Service Corporation Act. They argue that this extraordinarily broad requirement to re-incorporate would be disruptive, costly, and completely unnecessary. Instead, they favor giving corporations the option to convert, rather than requiring reincorporation.

Proponents of the legislation, including the Corporations Division of the Bureau of Commercial Services in the Michigan Department of Labor and Economic Growth, and the Corporate Laws Subcommittee of the Business Law Section of the State Bar of Michigan, point out that the court's determination, in *Miller* v *Allstate*, that PT Works, Inc. was improperly formed is unusual, since the act under which PT Works is incorporated provides no authority for a private party (in this case, William Miller) to challenge the validity of the formation of a corporation. Under the law, that power rests only with the Michigan attorney general. Indeed, the court's interpretation of the statutes is different from the interpretation followed for over 40 years by the Corporations Division, and relied on by the public. A holding that businesses providing a personal service that requires a license can incorporate only as a professional service corporation limits flexibility in choice of business entities, and will prohibit some businesses from organizing as corporations.

Proponents of the legislation note that the *Miller* decision creates uncertainty for corporations formed under previous interpretations; indeed, they may be considered to be operating illegally, even though the Bureau of Commercial Services has issued to them Certificates of Good Standing, and the attorney general has taken no action against them.

According to committee testimony, existing corporations are concerned about (1) an increase in litigation and expenses if third parties are permitted to challenge the validity of their incorporation; (2) their ability to continue to conduct business if they are required to re-organize as a professional service corporation; (3) the impact the *Miller* decision might have on malpractice litigation; (4) obtaining a Certificate of Authority if a multi-state corporation providing professional services wishes to expand to Michigan; (5) absent a Certificate of Authority and if a foreign corporation, a prohibition from transacting business in the state; (6) and for publicly traded companies, the possibility of having to include in their offering circulars and filings with the Securities and Exchange Commission, information regarding the potential risk of continuing to operate in Michigan.

In sum, proponents support these bills because they provide an orderly process to convert corporations, a process designed to protect the rights and responsibilities of shareholders.

Against:

Opponents of this legislation—in the main, insurance companies—argue that the legislation reverses a substantial ruling of the Michigan Appeals Court, and provides a remedy where one should not be offered.

Opponents also point-out that under Michigan's Auto No-fault law, insurance companies must reimburse their customers' claims by paying "a physician, hospital, clinic, or other person or institution lawfully rendering treatment to an injured person for an accidental bodily injury covered by personal protection insurance…and that the charge shall not exceed the amount the person or institution customarily charges for like products, services, and commodities in cases not involving insurance." (MCL 500.3157)

Opponents argue that in this instance, PT Works was not properly incorporated under the Professional Services Corporation, a fact corroborated by the Michigan Court of Appeals in May 2007, and further, that to pay insurance claims that are directed first to administrative bodies whose members are not, themselves, health care providers (in this instance, not physical therapists), forces up and substantially inflates the costs of reimbursements for injuries by paying for administrative overhead.

Response:

Although the Michigan Appeals Court (on remand by the Supreme Court) ruled that PT Works was improperly incorporated, the court also noted that treatment was lawfully rendered. Indeed, the parties in the case never argued the effects of business incorporation on health care cost-containment. In sum, the Court ruled that the treatment was legally offered since it had been given by licensed physical therapists, and it was, therefore, fully reimbursable.

Legislative Analyst: J. Hunault
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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.