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January 25, 1985

RECEIVED

JAN 28 1985

WAYNE STATE UNIVERSITY
LIBRARY OFFICE

Ms. Louise Bugg
Assistant Director Library System
Purdy Library
Wayne State University
Detroit, MI 48202

RE: DALNET

Dear Ms. Bugg:

Pursuant to our phone conversations during this past week, we prepared a Memorandum in some detail discussing the organizational options which DALNET should consider. Principally we have discussed two options, a joint venture and a non-profit corporation. At the core committee meeting I talked a little bit about voluntary associations, but that is really a hybrid of a non-profit corporation and it does not make any sense to form that kind of group in light of the obvious advantages of a non-profit corporation which we discussed in the Memorandum.

I have enclosed an original and one copy of that Memorandum and assume you will distribute it to your members. I have also enclosed an original and one copy of a brief Firm Description which outlines the areas of our work and expertise.

With regard to the expertise of our firm, both Bruce Kahn and Alan Harnisch are charter members of the Computer Law Section of the Michigan Bar Association. Mr. Kahn in particular is involved in some very complex computer acquisition negotiations at this time. His expertise in the review and renegotiation of any computer vendor contracts would be extremely beneficial to DALNET. I know that your initial concern is putting together governance documents, but I am sure that because of the size of your intended dollar investment in the system you are equally concerned with protecting DALNET in that regard.

Ms. Louise Bugg
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January 25, 1985

If you have any questions between now and your February 7th meeting, I would be happy to answer them by phone. You can expect that Mark Cohn and I will be in attendance at the DALNET meeting on that day for the purpose of answering any questions from the members at large. We can take a few minutes between now and then if you want to discuss the nature of our retainer agreement between your group and your firm.

Again, thank you for considering us to handle this matter for you.

Sincerely,

SEYBURN, SMITH, BESS,
HOWARD, KAHN AND HARNISCH, P.C.


Gerald B. Alt

GBA/car
enclosures

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DESCRIPTION OF FIRM

I. Introduction.

Seyburn, Smith, Bess, Howard, Kahn and Harnisch, P.C., is a corporate, real estate, tax and litigation oriented law firm located in Southfield, Michigan, a suburb of Detroit. The firm currently consists of seven principals and eight associates. The ages of the attorneys range from 26 to 55, with more than half of the lawyers being under 40 years old.

II. Nature of Practice and Clientele.

The major areas of the firm's practice are real estate, partnership and corporate work, (including attendant securities work), tax and business planning, estate planning, preparation and administration of wills and trusts, employee benefit plans (including pension and profit sharing plans), probate work and commercial litigation. Certain members of the firm have developed an expertise in each of these areas based upon having received advanced degrees in accounting, taxation and business administration, as well as years of experience in the practice.

In the real estate area, the firm's tax and real estate expertise combine to offer its clients especially effective counsel. Among the firm's clients in this area are numerous builders, real estate brokers, leasing and management agents, and small and large developers of residential, commercial and industrial property. The firm has also handled matters involving oil, gas and other mineral rights, as well as cattle, farming and nursery operations. Many of the attorneys have had substantial experience in the structuring, financing and documentation of transactions, by joint ventures or limited partnerships, involving large residential subdivisions, condominiums, industrial parks, shopping centers, office and medical office buildings and other real estate related projects. Members of the firm have assisted their clients with zoning problems and the administrative process involved in obtaining changes in zoning and/or variances.

In addition, the firm has had substantial experience in working with commercial developers and other property owners to develop and implement leasing programs and enforcing landlord's rights. The firm has also had substantial experience in representing tenants in the course of lease negotiations and protection of tenant's rights.

In the corporate area, the firm has represented a variety of publicly held and private manufacturing and retail business concerns, several insurance agencies, a mortgage company, bank, numerous closely held and/or professional corporations, brokers, manufacturers' representatives and many other individuals and entities involved in a variety of corporate and business activities. In connection with its representation of clients, the firm has developed particular expertise in the negotiation and consummation of the purchase and sale of businesses, and more particularly mergers, acquisitions and consolidations. Further, the firm's attorneys are familiar with the day to day legal problems encountered by both small and large business entities.

In the area of taxation, the firm has substantial expertise in corporate and partnership taxation, estate planning and employee benefit plans. Further, the firm has represented individual and corporate taxpayers at the District Conference and Appellate levels, and has also handled numerous requests for private letter rulings in connection with tax-free reorganizations and other complex transactions. The firm has had considerable experience in establishing and counseling tax-exempt organizations, such as public and private charitable foundations. In view of its substantial expertise in business and tax affairs, the firm is often asked by many of its clients to evaluate and structure proposed investments and business opportunities. The firm also is routinely called upon by other attorneys and accountants to act as special tax counsel in particularly complex divorce and related matters, and in other cases involving significant tax ramifications.

The firms' litigation section is comprised of attorneys with five to twenty years experience each in commercial transactions, employment law, bankruptcy and creditor rights and contract disputes. They provide litigation support to the firm's other areas of expertise as well. The attorneys handling these matters are not only highly competent to advocate their clients' position in court, but are also able to skillfully and aggressively negotiate favorable settlements in many cases. The firm's caseload encompasses a trial practice in federal and state courts across Michigan, as well as appellate advocacy, and the representation of clients before administrative and regulatory agencies.

DATED: November, 1984

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MEMORANDUM

TO: DALNET

DATE: January 21, 1985

FROM: GERALD B. ALT, ESQ. and MARK S. COHN, ESQ.
Seyburn, Smith, Bess, Howard, Kahn & Harnisch, P.C.

RE: Organizational Options

Your inquiry of January 15, 1985 requested a review of the viable organizational options available to DALNET, and our recommendation of the most appropriate vehicle to meet your stated goals and functions. As background our firm has drawn on your Summary Report dated November 30, 1984. I have also included our discussions at the core committee meeting of January 9th, and my prior experience dealing with SMALNET.

The options expressed in our meeting break into two relatively distinct choices: (1) joint venture; (2) non-profit corporation. To the extent a joint venture resembles a partnership, or that non-profit corporations overlap with voluntary associations, we have distinguished the differences in our discussion.

In summary of the following commentary, we recommend that DALNET form a non-profit corporation under Michigan law. Specific recommendations regarding by-law structure, membership qualifications/limitations and the like should wait until we can discuss the details with your committee.

A. Joint Venture Option

A "joint venture" under current Michigan law is nothing more than a common law partnership of limited scope and duration. As such its structure, and the liability of participants to each other or the public are controlled by two factors: (1) the venture agreement; (2) prior Michigan court authority. If interpretation of the joint venture is at issue and neither of the two sources address the issue, reference to the Michigan partnership law is likely by courts and third parties. A significant problem is that few Michigan courts have squarely addressed joint ventures as separate legal entities since the mid-1940's, and the current cases dealing with joint venture issues still refer to standards some forty years out of date. As recently as 1983, however, Michigan courts agree that all joint ventures are composed of six common elements:

- (a) An agreement indicating an intention to undertake a joint venture;
- (b) A joint undertaking of;
- (c) A single project for profit;
- (d) A sharing of profits as well as losses;
- (e) Contribution of skills or property by the parties;
- (f) Community of interest or control over the subject matter of the enterprise.

Beyond the threshold issue of whether or not DALNET fits within the definition of a joint venture, DALNET's use of that structure exposes its members to potential liability in several areas. Courts have commonly held that the rights and liability of joint venturers, both with respect to third parties and each other are governed by partnership law. Under the Uniform Partnership Act each partner is an agent of the partnership and has the implied authority to bind the partnership by any act which is apparently within the ordinary scope of the partnership's business. In addition, all partners are jointly and severally liable for the wrongful act or omission of a partner acting within the ordinary course of business or with the authority of his co-partners.

All partners are jointly liable for all other debts and obligations of the partnership.

If DALNET employs a joint venture format, all joint venture participants would be jointly liable for any breach of contract or negligence committed by another member who is expressly or apparently engaged in DALNET's business.

Although a venture agreement can be drafted to minimize the risk by providing for indemnification and contribution among your members, DALNET or one member may become involved in unwanted and expensive litigation as a result of actions taken by a single errant co-venturer.

The relationship between joint venturers may require that one member disclose information or make decisions for the mutual benefit of all DALNET members, even if it might result in actions adverse to the individual's best interests. This heightened responsibility creates potential for conflict between joint venturers, unlike a corporate structure where each member or shareholder is free to vote for their own interest relatively free from such fiduciary duties.

Frankly, there is simply no effective way to limit the liability of any member of a joint venture with respect to the claims of third parties. Although rights of "indemnification", by which a wrongdoer among the venturers can be required to compensate the other venturers who may have had to pay more than their appropriate share of liabilities, can be built into a Joint Venture agreement, such rights are often difficult to enforce and are only as good as the entity standing behind the obligation to indemnify. In addition, such rights as among joint venturers do not prevent a third party from suing and obtaining a judgment against any or all of the joint venturers.

Although joint ventures are often perceived to be a flexible means of doing business, in fact, in most instances where such ventures are utilized, there is an overriding tax rationale for their use, such as the typical real estate development situation where one entity is contributing the property and another is contributing money, time and/or services to the venture. In such instances, to allow for pass through of tax advantages to each separate entity, joint ventures are excellent vehicles.

In this situation, however, the use of a joint venture is unnecessary (and even less advantageous than a corporation) for DALNET's particular tax purposes, and the use of a joint venture will require a potentially complex Agreement regulating the management and control of the venture.

In addition, and as a technical matter, DALNET's purposes do not coincide with the definitional elements stated above, particularly since DALNET will not be a "single" project "for profit".

For all of the foregoing reasons, and for the additional reasons stated in the following discussion, a non-profit corporate structure would be a safer, easier vehicle for accomplishing DALNET's purposes.

B. Non-Profit Corporation Option

A non-profit corporation is a legal entity separate from its members. Unlike a joint venture or partnership the corporation provides a shield against personal liability arising out of ordinary business operations. Absent gross negligence or malice of the officers and shareholders, which might provide a basis for "piercing" the corporate veil, thus rendering the shareholders liable, the only true amount at risk is each member's capital investment.

The Michigan Non-Profit Corporation Act, M.C.L.A. § 450.2101 et seq. (The "Act"), grants a wide range of powers to such corporations. The corporation may be organized either on a stock or membership basis. A stock basis corporation is relatively rigid, with each owner being able to vote only in proportion to its percentage of stock. On a membership basis, the Act allows great latitude in prescribing the number, qualifications, liquidation rights, and preferences among classes of members, or limitations with respect to members. The by-laws may provide for separate classes of membership, some of which are not entitled to vote except in extraordinary situations such as sale of assets, liquidation or dissolution. Under the Act, non-profit or profit corporations, partnerships, trusts and any other person may be members of DALNET without threatening its non-profit status.

The manner of administering the daily affairs of a corporation, i.e. through a Board of Directors and officers, is well established in Michigan. Agreements with third parties (vendors, consultants, subscribers, etc.) can typically be executed by one or more officers of the corporation without consensus from the entire membership body. Further, the public is generally aware of the authority of corporate officers and will accept that apparent authority without the necessity of disclosing all of the terms of the

governing corporate documents. With a joint venture there are no hard and fast rules; third parties such as banks and major suppliers will usually require an examination of the joint venture documents to determine the scope of management's authority before formalizing any business relationship.

Given the stated purposes of DALNET we recommend organizing as a non-profit corporation. Drafting the necessary documents will be easier than in a joint venture, and ultimately the structure will be less complex and cumbersome. The degree of certainty in how DALNET will be treated for tax purposes, combined with the insulation from personal liability make this a much more viable and attractive choice.

C. Administrative and Tax Implications

One issue raised in our committee meeting was the relative administrative burden imposed by organizing as a corporation. There will be some filing or reporting requirement imposed on any type of entity you establish.

A joint venture is an expense sharing relationship for tax purposes. Though not taxed as a separate entity, a Form 1065 partnership information return would be required annually at a minimum. If DALNET contemplates seeking exempt status from the IRS, we would recommend seeking a

determination letter from the Internal Revenue Service as soon as possible to inquire whether a joint venture format would jeopardize a future exempt status application. On a state or local level no returns would be required.

A trade association or non-profit corporation must file an annual report with the Michigan Department of Commerce. This is a simple two-page questionnaire. From a tax standpoint either a Form 1120-NP (non-profit) or Form 990 (tax exempt) would be required. The trade-off is that the organizational documents themselves are easier to draft and change in a corporate structure. More of the structure is governed by statute and fewer "holes" exist which a joint venture agreement would have to cover.

A non-profit corporation that makes a profit reports that profit in the same way as any other entity, but is not taxed so long as this profit is derived from its stated activity. It is limited by the requirement that the profit be used to further its non-profit purposes and not be distributed to members as dividends. Michigan law would not prohibit DALNET from making a profit or charging subscribers a fee greater than its cost of providing the service.

Section 501(c)(3) of the Internal Revenue Code exempts entities primarily organized for "religious, charitable, educational, literary or scientific purposes". If you elect to become a tax exempt organization for Federal tax purposes

your non-profit corporate structure is actually an advantage, since by the nature of its charter the non-profit corporation is more easily presumed to fall within the exempt purposes necessary under Section 501. A joint venture is generally presumed to be organized as a profit-making entity and does not, by definition, fit the exempt purposes test. We have researched this matter and located a published revenue ruling dealing specifically with a library computer network. This ruling states that DALNET's type of organization clearly falls within 501(c)(3). Of interest is a holding in the ruling that members of the organization need not be exempt organizations themselves. It appears this would open the door for DALNET to provide subscriber services to the public. The rationale is that the information you provide is related to your exempt purpose, and its character does not change merely because someone outside your group wants to use it. This is important because of other provisions of the Internal Revenue Code which would make DALNET liable for taxes on "unrelated business income" [Section 511]. Where income is derived from both exempt and unrelated functions, the profit and expenses must be allocated to appropriately reflect taxable income.

In summary of the foregoing discussion, DALNET should utilize the structure of a non-profit corporation, rather than a joint venture, for the following reasons:

1. Unlike a joint venture which exposes its participants to potentially unlimited liability to third parties, a non-profit corporation typically shields its members from personal liability to third parties;

2. DALNET's purposes do not fit squarely within the general definitional elements of a joint venture;

3. The Michigan Non-Profit Corporation Act allows for great flexibility in structuring DALNET's operations and forms of membership and provides guidance in matters not specifically dealt with in DALNET's Articles of Incorporation and Bylaws.

4. Third parties are usually more comfortable dealing with officers of a corporation than with representatives of a joint venture;

5. Given the purposes of DALNET, the documentation which would be necessary for the formation of a non-profit corporation would be easier to draft and less cumbersome than the documentation necessary for a joint venture;

6. The difference in administrative burdens between a non-profit corporation and a joint venture is minimal;

7. For purposes of tax exemption, a non-profit corporation is usually presumed to fit within the statutory exemption of the Internal Revenue Code, whereas a joint venture is usually presumed to be organized for profit.

In conclusion, although other organizations with which you have spoken may be using joint venture formats, based upon your circumstances, a non-profit corporate structure is a more advantageous means of achieving those goals and objectives which are stated in DALNET's Summary Report, dated November 30, 1984.