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CONTENTS

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The editorial staff of the *Michigan Business Law Journal* welcomes suggested business law topics of general interest to the Section members, which may be the subject of future articles. Proposed business law topics may be submitted through the Publications Director, D. Richard McDonald, *The Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, Michigan 48304, (248) 203-0859, drmcdonald@dykema.com, or through Daniel D. Kopka, ICLE, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, (734) 936-3432, dan@icle.org. General guidelines for the preparation of articles for the Michigan Business Law Journal can be found on the Section's website at http://michbar.org/business/bizlawjournal.cfm.

Each issue of the *Michigan Business Law Journal* has a different primary, legal theme focused on articles related to one of the standing committees of the Business Law Section, although we welcome articles concerning any business law related topic for any issue. The primary theme of upcoming issues of the *Michigan Business Law Journal* and the related deadlines for submitting articles are as follows:

Issue	Primary Theme/Committee	Article Deadline
Fall 2016	Financial Institutions Committee	July 31, 2016
Spring 2017	Regulation of Securities Committee	November 30, 2016
Summer 2017	In-House Counsel Committee	March 31, 2017
Fall 2017	Corporate Laws Committee	July 31, 2017

ADVERTISING

All advertising is on a pre-paid basis and is subject to editorial approval. The rates for camera-ready digital files are $400 for full-page, $200 for half-page, and $100 for quarter page. Requested positions are dependent upon space availability and cannot be guaranteed. All communications relating to advertising should be directed to Publications Director, D. Richard McDonald, the *Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, MI 48304, (248)203-0859.

MISSION STATEMENT

The mission of the Business Law Section is to foster the highest quality of professionalism and practice in business law and enhance the legislative and regulatory environment for conducting business in Michigan.

To fulfill this mission, the Section shall: (1) expand the resources of business lawyers by providing educational, networking, and mentoring opportunities; (2) review and promote improvements to Michigan's business legislation and regulations; and (3) provide a forum to facilitate service and commitment and to promote ethical conduct and collegiality within the practice.

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Volume XXII, Issue 1, and subsequent issues of the *Journal* are also available online by accessing http://www.michbar.org/business/bizlawjournal.cfm

From the Desk of the Chairperson

By Douglas L. Toering

As you may recall from my last column, our theme for 2016 is "Extending Our Reach—And Yours." By that, I mean that as the Business Law Section extends its reach, your practice can grow too. But how?

One way the BLS can accomplish this is through our committees and directorships. Below is a list of the committees and the chairpersons along with some of the things they have been doing. Watch for a future issue on the activities of the directorships.

Business Courts Committee (Douglas L. Toering, Chair). This committee serves as a liaison between Michigan's business court judges and the BLS and as a resource for the business court judges.

Commercial Litigation Committee (Douglas L. Toering, Chair). Focused on business litigation issues, the committee has recently emphasized developments in Michigan's business courts. On November 12, 2015, the BLS and the ADR Section co-sponsored a program on business courts and early ADR. Eight business court judges from five counties attended. The sold-out program will be repeated in the near future.

Corporate Laws Committee (Justin G. Klimko, Chair). When it comes to amendments to the Michigan Business Corporation Act, the Corporate Laws Committee is right there. Presently, the committee is preparing another set of proposed amendments to the act, following the amendments it developed and that became law in 2013. In addition, the committee (along with the Commercial Litigation Committee) drafted the BLS's amicus brief in *Madugula v Taub*, 496 Mich 685, 853 NW2d 75 (2014), which is a seminal case on shareholder oppression.

Debtor/Creditor Rights Committee (Judy B. Calton and Judith Greenstone Miller, Co-Chairs). On January 13, 2016, the Debtor/Creditor Rights Committee, along with the Eastern District of Michigan's bankruptcy judges, presented a seminar on the amendments to the Federal Rules of Civil Procedure applicable to the bankruptcy court and the significant amendments to the bankruptcy court's local rules. Other recent seminars dealt with electronically stored information and municipal bankruptcies. Also, the committee had a strong role in drafting MCR 2.622 on receiverships.

Financial Institutions Committee (David W. Barton and DJ Culkar, Co-Chairs). Are you involved in any of the myriad of issues that affect banks, brokerage firms, and other financial institutions? If so, this committee may be for you.

In-House Counsel Committee (MaryAnn P. Kanary and Dawn A. Reamer, Co-Chairs). You've probably heard of Crain's General and In-House Counsel Summit. The BLS has helped co-sponsor this. The committee is working with Crain's to plan this year's in-house counsel event. If you are an in-house attorney, check out this committee.

Law Schools Committee (Mark E. Kellogg, Chair). The Law Schools Committee presents programs at Michigan law schools on topics of interest to future business lawyers. Recent programs discussed business planning and succession planning along with franchise law. On February 29, 2016, the Law Schools Committee and the Antitrust, Trade Regulation & Franchise Section will present at the Western Michigan University Cooley Law School.

LLC and Partnerships (James L. Carey, Chair). At the invitation of the Michigan Supreme Court, the Business Law Section recently filed an amicus brief in *Allard v Allard* (dkt. no. 150891). The brief addressed whether real estate held by limited liability companies, and income generated by those properties, could be treated as marital assets. Thank you to the authors, James R. Cambridge, James L. Carey, Donald A. DeLong, and Daniel H. Minkus. In addition, the committee is active in legislative activities involving the Michigan Limited Liability Company Act and the partnership acts.

Nonprofit Corporations (Jane Forbes and Jennifer M. Oertel, Co-Chairs). The main focus of this committee over the past several years has been the amendments to the Michigan Nonprofit Corporation Act, which were effective January 2015. In fact, the summer 2015 issue of the Michigan Business Law Journal focused heavily on nonprofits and the amendments to the nonprofit act, and Co-Chair Jennifer Oertel presented for ICLE on the amendments.

Regulation of Securities Committee (Patrick J. Haddad, Chair). This committee focuses on various securities issues ranging from crowdfunding to insider trading to proposed legislation on local stock exchanges, with an emphasis on Michigan laws regulating securities. In 2015, LARA's Corporations, Securities & Commercial Licensing Bureau asked the Regulation of Securities Committee to review and comment on draft securities rules.

Small Business Forum (Bruce W. Haffey, Chair). This group emphasizes issues involving small businesses and their owners. Some of the topics the Small Business Forum's evening programs have addressed include crowdfunding and the JOBS Act, exporting, Michigan's tax structure, internal corporate investigations, the Detroit bankruptcy, and the legal and accounting issues involved in shareholder litigation.

Uniform Commercial Code (Darrell W. Pierce, Chair). When amendments to the UCC might affect Michigan, the UCC Committee is there. Most recently, the committee focused on changes to Article 9. In the absence of new legislation, the committee monitors significant case law developments.

Do any of these issues sound interesting to you? If so, please get involved. In doing so, you can help the Business Law Section extend its reach while you extend yours.

Thank you to all those involved in these committees. And thank you to our other officers, Vice Chair Judy B. Calton, Treasurer Mark W. Peters, and Secretary Kevin T. Block. Finally, thank you to Gerard V. Mantese and Daniel D. Quick, who co-edited this issue of the Journal.

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Corporations Online Filing System (COFS)

The Corporations, Securities & Commercial Licensing Bureau's Corporations Division is set to launch a new software program and online filing system in Spring 2016. The new system, called the Corporations Online Filing System (COFS), will drastically improve the Corporations Division's filing system and add new online services to serve the business community.

The system was chosen for its success in other states, and it provides many benefits and widens the range of services available to the public.

COFS allows businesses to submit documents and annual filings online, pay filing fees electronically, and order certificates and certified copies online. Online submissions will substantially reduce the amount of paperwork and manual, check-payment processing currently handled by the Division, which will generate much faster results for business entities and customers.

Additionally, COFS provides expanded search functionality. Customers will be able to search the Corporations Division's database by individual name; search trademark, service mark, and insignia records; search rejected submissions; and, search the Corporations Division's Card Files, which contains the record of business entities that were dissolved prior to January 1, 1978.

COFS provides a subscription-based e-mail notification service, which allows customers to elect to receive business entity record update notifications. When a document is filed for a business entity that is included in the subscriber's profile, the subscriber will receive an email to notify the subscriber of the filing. Prior to COFS going live log-in instructions will be mailed to the resident agent. These instructions will include a new Entity Identification Number as well as a Customer Identification Number (CID) and PIN. The CID and PIN are similar to a username and password.

The new system will modernize the Corporations Division's important functions and improve its capabilities and customer service.

Fairness Hearing Procedures

Michigan is now one of a handful of states that offers the opportunity to take advantage of the section 3(a)(10) exemption from registration under the Securities Act of 1933, 15 USC 77c(a)(10).

Section 202(1)(i) of the Michigan Uniform Securties Act (2002), 2008 PA 551, MCL 451.2101 (the "Act"), authorizes the administrator to approve the terms and conditions of a transaction in a security, whether or not the securitiy or transaction is otherwise exempt, in exchange for one or more bona fide outstanding securities, claims, or property interests, or partly in exchange and partly for cash at a hearing to determine the transaction's fairness.

A "fairness" hearing allows applicants the opportunity to seek an exemption from federal registration as provided by section 3(a)(10) of the Securities Act of 1933; setting forth the federal exemption from registration for offers and sales of securities in specified exchange transactions, it provides the following:

> Except with respect to a security exchanged in a case under title 11, any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval.

On January 8, 2016, Administrative Order 2016-1 was issued and entered by the Acting Administrator and Acting Corporations, Securities & Commercial Licensing Bureau Director.

The order provides that fairness determinations under MCL 451.2202(1)(1) shall be made by the acting administrator or administrator. The order outlines eligible applicants and requirements related to the application, notice of hearing, and hearing. The administrator or acting administrator may in his or her sole discretion rejection any application. The administrator or acting administrator will only consider an applicaton for a proposed exchange transaction where:

1. The applicant is a domestic business entity formed, organized, or incorporated under the laws of Michigan;
2. The applicant is a business entity that has its headquarters or principal place of business located in Michigan;
3. The entity to be acquired or merged has its headquarters in Michigan; or
4. That a minimum of 50 percent of the securities, claims, or property interests to be exchanged are owned by persons residing in Michigan.[1]

A copy of Administrative Order 2016-1 may be found on the Corporations, Securities and Commericial Licensing Bureau website.[2] The application must be submitted with a nonrefundable fairness proceeding filing fee of $500.

Questions regarding Administrative Order 2016-1 may be directed to the Securities Regulation Division of the Corporations, Securities and Commercial Licensing Bureau (CSCL) at (517) 335-5237.

Regulation Crowdfunding & the MILE

On October 30, 2015, the Securities & Exchange Commission ("SEC")

released final rules implementing Title III of the Jumpstart Our Business Startups Act ("JOBS Act"). The final rules, known as "Regulation Crowdfunding," govern the offer and sale of securities under section 4(a)(6) of the Securities Act of 1933.[3] The rules and forms are effective as of May 16, 2016, except that forms and instructions related to registration of funding portals are effective January 29, 2016.[4]

Regulation Crowdfunding has no direct impact on the Michigan Invest Locally Exemption ("MILE"), as it is a new federal exemption created pursuant to section 4(a)(6) of the Securities Act of 1933, whereas the MILE is an exclusively intrastate exemption with the associated federal exemption from registration being ule 147, 17 CFR 230.147.

The Regulation Crowdfunding rules offer a new capital-raising mechanism for small businesses seeking to raise relatively small amounts of investment capital, while also offering investment opportunities to a broader class of investors. The states are largely preempted from having authority over crowdfunded interstate securities or the funding portals involved in their sales.

Securities issued pursuant to Regulation Crowdfunding will be considered "federal covered securities," meaning that the state is preempted from requiring registration of the securities under MCL 451.2301.[5] The JOBS Act preserved notice-filing authority for the states if the issuer's principal place of business is in the state, or 50 percent or more of the aggregate amount of securities are sold to residents of a state.[6] The JOBS Act preserved state anti-fraud authority, so MCL 451.2501 is applicable to all offers and sales of securities made in Michigan.[7]

Funding portals are required to register with the SEC, and states are preempted from requiring their registration.[8] States retain examination and enforcement authority over funding portals if the funding portal's principal place of business is located in that state.[9] States may require a funding portal with its principal place of business in the state to notice-file in that state. Employees of funding portals are exempt from state registration requirements applicable to agents under MCL 451.2402.[10] States also retain anti-fraud authority over funding portals.[11]

Regulation Crowdfunding largely preempts the states, but does allow states to require notice-filings by issuers and the newly-created "funding portals" under certain circumstances.

Questions regarding Regulation Crowdfunding & the MILE may be directed to the Securities Division within CSCL at (517) 335-5237.

Unarmed Combat

2015 PA 183, effective February 10, 2016, makes significant changes to the Michigan Unarmed Combat Regulatory Act. The Department of Licensing and Regulatory Affairs (LARA) in conjunction with the Unarmed Combat Commission is charged with the administration of the Michigan Unarmed Combat Regulatory Act ("Act") and the regulation of boxing and mixed martial arts.

The amended act expands the regulatory authority of the Michigan Unarmed Combat Commission (the "Commission") and the Director of the Department of Licensing and Regulatory Affairs (LARA) by vesting both with jurisdiction over all professional boxing, professional or amateur mixed martial arts, and unarmed combat contests or events conducted in Michigan. The amended act exempts from its regulation professional or amateur wrestling; an event that is conducted by or participated in exclusively by an agency of the United States government or by a school, college, or university or an organization that is composed exclusively of those entities if each contestant is an amateur; an event that is sponsored by or under the supervision of the United States Olympic Committee in which all of the contestants are amateur boxers; and an amateur boxing event that is sponsered by or under the supervision of USA Boxing or any of certain organizations affiliated with USA Boxing.[12]

The amended act defines "unarmed combat" as meaning "any of the following, professional boxing, professional or amateur mixed martial arts, and any other form of competition in which a blow is usually struck or another fighting technique is applied that may reasonably be expected to inflict injury."[13]

LARA, in consultation with the Commission, is currently considering the necessity of promulgating new rules or revising existing rules for the purposes of administering and enforcing the new Act. Applications effective for unarmed combat events to be held after February 10, 2016, are currently available online.[14]

Questions regarding Public Act 183 of 2015, or unarmed combat in general, may be directed to the Licensing Section within CSCL at (517) 241-9221.

NOTES

1. AO 2016-1.
2. Administrative Order No. 2016-1 (Jan 8, 2016), http://www.michigan.gov/documents/lara/Administrative_Order_2016-1_510302_7.pdf.
3. The SEC's Rule Release is available at http://www.sec.gov/rules/final/2015/33-9974.pdf.
4. See Rule Release at pp. 1 and 157.
5. 15 USC 77r(b)(4)(C). MCL 451.2301(a) states that federal covered securities need not comply with the registration requirements of that section.
6. 15 USC 77r(c)(2)(F). MCL 451.2302(5) allows the administrator to require by rule or order the filing of any document filed with the SEC and a $100 filing fee for any federal covered security.
7. 15 USC 77r(c)(1).
8. 15 USC 77o(i)(2)(A).
9. 15 USC 77o(i)(2)(B).
10. See Rule Release at p. 158.
11. 15 USC 77r(c)(1).
12. *See* MCL 338.3612.
13. *See* MCL 338.3611(m).
14. Application materials are available at http://www.michigan.gov/lara/0,4601,7-154-61343_35414---,00.html.

Julia Dale is the Director of the Corporations, Securities & Commercial Licensing Bureau for the State of Michigan; Department of Licensing and Regulatory Affairs. She is a member of the State Bar of Michigan and serves on the Business Law Section Council.

By Eric M.N emeth

New Partnership Audit Procedures and Important Tax Enforcement Changes for U.S. Passport Holders with Tax Delinquencies

Under provisions in the Bipartisan Budget Act of 2015[1] ("BBA"), major changes will be forthcoming in how the IRS audits partnerships. Many practitioners are no doubt familiar with the "TEFRA" rules and "Electing Large Partnership Rules" under current law. The complex procedural issues are often baffling to practitioners, IRS agents, and attorneys alike. Beginning with the years after December 31, 2017, with certain early options, the rules of the game are changing. Practitioners drafting partnership agreements now should take note and consider changes to new and perhaps existing agreements.

In a nutshell, under the new procedures, the IRS will examine the partnership for a particular year or "reviewed year." The adjustments, whether agreed or by judicial determination, will be taken into account in the review year by the *partnership*. It is the partnership that will be liable for penalties and interest.

The situation becomes more complicated if the partnership seeks to have partners file amended tax returns for the reviewed tax year, or lower tax rates other than maximum tax rates are appropriate. Additionally, the audited partnership can elect to issue adjusted Form K-1s to the reviewed year partners. The partners would be required to amend their respective tax returns. This election would be made by the partnership. An important practice note to keep in mind is that the partners in the partnership could be different at the respective times.

An affected partnership will be required to designate a partner or other person as the representative with sole authority to act on behalf of the partnership. If no such person exists, the IRS may select any person as the partnership representative. All partners and the partnership are bound by the determinations made at the partnership level. *Practitioner note,* should the attorney for the "partnership" consider being the partnership representative? What about potential conflicts of interest or other liability?

Expect more questions, and hopefully guidance, to be published as the effective date approaches. The Internal Revenue Manual is sure to have updated guidance for examiners. Read the IRS playbook. Now is not too early to think about provisions and clauses in partnership agreements to address IRS examination adjustments in the future. These include such topics as indemnification, partnership entry and departure provisions, and special allocation rules, to name a few. The time to sort out financial and legal responsibility is not after the examination commences.

Urgent: Address Your Tax Issues or Risk Losing Your Passport!

American passport holders now have another reason to get their tax affairs in order. New IRC 7345 was added with the passing of the "FAST Act" or Fixing America's Surface Transportation Act.[2] A goliath of a law, the new tax collection provisions are not mentioned until page 1,113 of the FAST Act.

Briefly, the FAST Act allows the U.S. Department of State to revoke, deny, or suspend a U.S. passport for anyone the IRS certifies as having a seriously delinquent tax debt. Currently, that amount is over $50,000, including penalties and interest. Since interest compounds *daily* on the tax, penalty, and interest, the amount due can creep up quickly.

The new law applies to Americans living and working abroad as well. There are still many administrative details to be worked out and regulations to be issued to answer procedural issues. Taxpayers with installment agreements or pending offers in compromise would generally not be subject to the provisions.

For U.S. passport holders living and/or working overseas, getting U.S.-tax compliant and ensuring communications with the IRS are critical. A U.S.-based power of attorney can help in this regard. A suspended passport can prevent simple acts like flying between overseas countries, opening a bank account, and, in some circumstances, even getting a hotel room. If a valid passport is a condition of your employment, the stakes are really high.

The simple takeaway is that the U.S. is serious about collecting tax debts, and U.S. passport holders traveling internationally are on the frontline.

NOTES

1. 114 Pub L No 74, 129 Stat 584.
2. 114 Pub L No 94, 129 Stat 1312.

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EU Data Privacy Developments

Late 2015 and early 2016 brought many new developments to the forefront related to the issues involving data privacy in the European Union. The first major issue came up when the European Court of Justice ruled that the U.S.-EU Safe Harbor Agreement, used by many U.S. companies to facilitate compliance with data transfers, was unenforceable. Then, the European Commission finally enacted the new General Data Privacy Regulation (GDPR),[1] replacing the 1995 Data Protection Directive. Finally, in early February 2016, the European Commission announced an agreement for a new framework for transatlantic transfer of personal EU data. Below is a summary of each of these developments.

Safe Harbor Invalidity

The European Court of Justice issued its decision in the *Shrems*[2] case, finding that the U.S.-EU Safe Harbor Agreement that had been relied on by U.S. companies to comply with the 1995 EU Data Protection Directive was invalid. This left many companies scrambling. Other mechanisms for data privacy compliance were available, but several were difficult or cumbersome (more on that below) and many companies just waited to see what would happen. The promised replacement for the Safe Harbor Agreement did not occur until several months later, but companies that were (or are) moving data across the Atlantic or to other jurisdictions are essentially at risk as a result of this ruling to the extent that they were previously relying on the Safe Harbor Agreement.

The New GDPR

The GDPR approved by the European Commission has major differences from the 1995 Data Protection Directive. First, it is applicable to all member states without the requirement of local enabling legislation. This has the benefit of adoption across all EU jurisdictions without the concern of non-uniform variations. When it comes into full force in 2018, GDPR will require major changes to companies' handling the data of EU citizens. Following are some significant provisions of the GDPR.

Security

One major change is the obligation of all parties involved in the collection or dissemination of data to maintain the security of the processing of that data. The GDPR specifically suggests standards for encryption of data, the ability to ensure confidentiality and availability of data, and the requirement for testing the effectiveness of measures on a regular basis.

Data Breach Notification

While the 1995 directive was silent on the issue of notification requirements, the GDPR adopts a standard requiring notification to individuals when their personal data has been compromised. Those responsible for controlling data must also promptly notify the appropriate supervisory authority if there is any likelihood of a risk to individuals.

Data Privacy Officer

A significant change is the required designation of a data protection officer (DPO) who will be responsible for complying with the GDPR. While regulations may alter the requirements, the early draft appears to apply the requirement to all governmental agencies and companies. In the U.S., it is common for large companies to designate a chief privacy officer in the organization, but these requirements are broader.

Consent

Another significant change is the requirement that the collection of data must be with the affirmative consent of the person whose data is being collected. Implicit consent is no longer acceptable, explicit consent is required. There are also special parental consent requirements for the processing of children's data. This section of the GDPR imposes significant penalties.

Cross-Border Data Transfers

For data transferred from the EU (including storing data on systems outside of the EU), companies must meet specific requirements to ensure compliance. The first category requires an EU determination of adequacy of privacy protections in a different jurisdiction. How this will be applied is uncertain, leading to some concern that the Privacy Shield discussed below may be lacking. The second category requires that appropriate "safeguards" be in effect. These safeguards can include the adoption of standard data collection contractual clauses or the use of binding corporate rules within an organization. Both of these safeguards require affirmative steps by the company and, in the case of binding corporate rules, the approval of at least one data privacy authority.

Right to be Forgotten

The GDPR now recognizes a "right to erasure," expanding the right to be forgotten that was previously recognized in the European courts. The GDPR requires that data controllers erase personal data promptly if the data is no longer needed or the data subject objects to the processing of the data. This area is likely to require further development.

These are some of the more significant aspects of the GDPR, and further developments are likely. The important point is that EU remains serious about protecting the privacy of its citizens and the ability to transfer data and information outside of the EU without restriction.

The EU-US Privacy Shield

In February 2016, the European Union and the United States announced an agreement had been reached on a new framework to replace the Safe Harbor Agreement. While details are still sketchy and many are taking a wait and see approach, the "Privacy

Shield" is supposed to provide for new obligations on companies that wish to move data. It will also require federal legislative changes to allow EU citizens to have redress in the U.S. courts. Finally, the Privacy Shield will also require a commitment from the U.S. government to restrict the collection of data by law enforcement and national security agencies.

While the details are still in flux, companies should assume that the requirements under the Privacy Shield will be more onerous and restrictive than the Safe Harbor Agreement. Many organizations are reviewing the standard contractual clauses or binding corporate rules as an alternative for compliance, but this entire area will remain uncertain for the time being.

As this article was going to press, the U.S. Department of Commerce released details about the Privacy Shield.[3] The 130 pages of the Privacy Shield details are being reviewed and analyzed, but there are many concerns being expressed in all quarters, mostly the EU. Hopefully, this will lead to a workable solution for U.S. companies.

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NOTES

1. http://europa.eu/rapid/press-release_IP-15-6321_en.htm

2. *Maximillian Schrems v Data Protection Commissioner* (European Court of Justice), http://curia.europa.eu/jcms/upload/docs/application/pdf/2015-10/cp150117en.pdf.

3. https://www.commerce.gov/privacyshield.

 By Kim Yapchai

I'm So Glad You're Here

How long has it been since you started a new job? Can you remember wondering whether you made the right choice, and what it was like to not know the company acronyms or your co-workers' names? I experienced this when I recently joined Whirlpool.

The way that a company onboards new employees can tell you a lot about whether or not you've made the right choice. Here are three elements to help you decide if you accepted the right offer and one to consider before you accept.

Are You Welcomed?

"I'm so happy that you are here" is a phrase I repeatedly heard as I traveled globally for the past year. The first time, I thought that the employee was just being kind. After hearing it from many employees in multiple countries, I realized that it isn't just kindness. People truly are happy to hear my thoughts and ideas. When you are greeted like this, it changes what you can accomplish. For example, during the past year, we successfully launched Compliance Week in several countries and conducted more than 200 in-person training events. These events would not have been possible without the support and participation of many throughout the company. We created custom videos, taught through storytelling, engaged the FBI to teach us how to protect against corporate espionage, built a "choose your own adventure" app filled with ethical decision-making, and had a lot of fun doing it.

What Is the Company Culture?

At Whirlpool, we have a saying, "There's no right way to do a wrong thing." I heard that statement throughout the interview process and continue to hear it from employees at all levels around the globe. If your company still has not fully embraced compliance, there have been several significant events during the last year that may help them to understand the importance: the Yates memo that focuses on individual accountability, the Volkswagen recall, and the creation of the chief compliance role at the U.S. Department of Justice. If anyone in your company still doubts the need to have a serious compliance program, these events are great teaching tools. Lessons learned from the experiences of others can be much cheaper and less painful than learning from your own mistakes.

Do Employees Feel Comfortable Speaking Up?

It's hard to be perfect. Conversations can be misunderstood, and sometimes people make mistakes. What happens at your company when something goes wrong? What do you see when someone challenges an idea or expresses a concern? When a speak-up culture is strong, it means that you have a strong community of support to keep the company in compliance and quickly address any issues. With a strong speak-up culture, if an employee decides to pursue something illegal, someone will say something—not only to the employee, but to the manager, the management, or even the company's hotline, if needed. Employees are more likely to speak up when they feel valued and know that you will take action, even if it is not always the action that they request.

Research Before You Accept the Offer

Now that you have some ideas about how the initial reactions help you to determine whether you made the right decision to take a new job, let's take a step back and look at how you can ensure you are making the right choice before you accept. First, be sure to ask questions in the interviews about the key elements above. Also, reach out to your connections on LinkedIn or other networks and ask their opinions. These people are a valuable source of information. Finally, reach out to vendors, including law firms. They can give you a really interesting view. Hopefully, through these sources, you will have a good sense of how welcome you will be before you even start.

In the In-House Counsel Committee, we have a couple new people starting. Bharat Gandhi is passing the baton to two new co-chairs: MaryAnn Kanary of Toyoda Gosei North America and Dawn Reamer of Aisin Holdings. They plan to partner again with ACC-MI and Crain's on the In-House Counsel Awards, so get your nominations ready. They are looking forward to hearing from you and learning about what you would like to see the committee do during the next year. Feel free to reach out to them at businesslaw@mi.rr.com. Please join me in thanking Bharat and in welcoming MaryAnn and Dawn to their new roles. MaryAnn and Dawn, I am so happy that you are here!

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What Happens When You Cannot Tell Apples From Oranges? The Impact of Murky Definitions on Trade Secrets and Noncompetition Agreements

By Daniel D. Quick

Introduction

It has been 18 years since the Michigan legislature adopted the Uniform Trade Secrets Act, MCL 445.1901 et seq ("MUTSA"). Before the adoption of MUTSA, Michigan courts looked to the common law, as reflected in the Restatement and Michigan precedent, to define trade secrets and to distinguish information that may be protected from misuse, whether under an agreement or through a tort action, from "general knowledge" that is owned by an employee and is his or her property.

We are also approaching the 31st anniversary of MCL 445.774a, part of the Michigan Antitrust Reform Act (MARA), MCL 445.771 et seq., which clarified that noncompetition agreements entered into after March 29, 1985, are legal under certain circumstances. Since at least 1984, the law in Michigan has distinguished noncompetition agreements that seek to protect an employer's legitimate business interests from those that would unfairly impose on an employee's "general knowledge and skills."

The line between trade secrets, confidential information, legitimate business interests, and general knowledge and skills is of critical import to both of these areas of the law. Beyond the academic issue, they are also vitally important questions, on one hand, to businesses that seek certainty in their business dealings with employees and other recipients of (what they believe to be) confidential information, and, on the other hand, employees and other "recipients" of such information, who may find their rights to employment in their chosen field or to compete unexpectedly eliminated, limited, or restrained.

The reality, however, is that the line between these various legal categories is anything but well-defined. This has been recognized throughout the country,[1] and the elusiveness of clear definitional boundaries has led courts and commentators to opine that each case turns on its own facts.[2] What is not often recognized is that the failure to establish bright lines and a default to a case-by-case fact-bound inquiry itself has a significant effect on the handling of these cases in the judicial system and on both the businesses and employees who are subject to this ill-defined area of the law.

This article will survey Michigan court opinions that have sought to define these overlapping legal categories and to review corresponding efforts outside of Michigan. This article will also raise questions about how the law is being applied and what its true impacts are on those subject to it.

The Genesis of Michigan's Definitions

The Michigan Supreme Court began taking up these issues in its infancy. As the court first struggled with the rights that existed at common law, its exploration into the roots of certain rights also served to provide early definitions for various doctrines.

In 1875, the Supreme Court was faced with the validity of a noncompetition agreement made as part of the sale of a business.[3] In upholding the agreement, the court framed some of the objections to validity.

> It is said, however, that the public is a third party in such cases, and that the public is concerned to prevent such contracts, because:
>
> 1. They tend to prevent competition, which the public interest favors; and
> 2. They deprive the state of the services of a citizen by binding him to idleness or emigration.[4]

Parsing largely English opinions, the Supreme Court upheld the covenant under a basic theory of respect for contract: "And it may well be asked, who in general are the best judges of these circumstances, the parties concerned, who have an interest in making them the subject of their contracts, or the courts, who can obtain of the circumstances only such partial and unsatisfactory views as conflicting and imperfect evidence can give them?"[5]

Later, it was recognized that the ability to impose restrictions upon employees arose both out of contract (whether express or implied) or out of a duty of loyalty.[6] Both of these strands of thought can be seen in early Michigan jurisprudence in the trade secrets context.[7]

> Here processes and machinery have been invented which the owners believe would be of great value to them if they could be used upon a large scale. To use them upon a large scale required the employment of a number of persons, to some of whom some of the secrets of the business and the machinery must be disclosed. If these secrets were disclosed to others, who might use them to establish a business of like character, they would cease to be valuable to the owner. Is there anything unreasonable in enforcing an agreement that such secrets shall not be disclosed by the employé? It has been repeatedly held that contracts for the exclusive use of a secret art are not in restraint of trade, for the public has no right to the secret. See *Taylor v. Blanchard*, 13 Allen, 372, and cases cited; *Cloth Co. v. Lorsont*, L. R. 9 Eq. 345. We cannot see how it can be against public interest to allow an employer to make such conditions of employment with his employés as will give him the fullest protection to his property right in his process or invention, and at the same time enable him to employ a great many employés in its production. To enable one to do this would be a benefit to the public in many ways. It would secure employment to more persons than would otherwise be employed, and a larger output would be made of a useful article. The evidence discloses that it does not require a man of special skill to do the work done by defendant when in the employ of the predecessors in business of the complainants. To restrain him from making use of what he has not discovered is not an injustice to him, and does not abridge his right to work along those lines which would not be harmful to those to whom he has sustained a position of confidence. It is to the advantage of both parties that such a contract should be allowed. By means of it the defendant secured employment which he could not have secured without it, and at the same time his employers were secured against competition which might be ruinous.[8]

But outside of the trade secret misappropriation context, a statute[9] prohibiting restraints of trade blocked general enforcement of noncompetition agreements or injunctions accomplishing the same thing. In *Grand Union Tea Co v Dodds*[10], the court upheld an injunction against a former employee's use of a misappropriated customer list, but, based on the statute, struck down the broader portion of the trial court's order that had restrained "defendant from soliciting any one to purchase his wares, notwithstanding he may remember that they were his patrons while he was employed by the complainant."[11] In upholding that statute against constitutional challenge, the Supreme Court presaged the eventual evolution of Michigan law:

> Originally, at the common law, all contracts in restraint of trade were held to be invalid as against public policy. But considerations of public policy vary with the times and the progress of civilization, and contracts in restraint of trade have been very much limited by decisions of the courts and by statutes, and 'A doctrine has been introduced in some of the later cases, both English and American, which may be called the doctrine of the reasonableness of the restraint.' 9 Cyc. 529. The history of the doctrine indicates that it has been, from the beginning, a proper subject for legislative consideration, and only in case of a clear violation of constitutional rights ought the courts to interfere with legislative discretion.[12]

As for the definition of trade secrets, it evolved slowly and, arguably, consistently with the rate of actual "secrets" utilized in business. Trade secrets were originally defined in contradistinction to patents: "An inventor, desiring to secure to himself the

The line between trade secrets, confidential information, legitimate business interests, and general knowledge and skills is of critical import to both of these areas of the law.

fruits of his invention, has two courses open to him: First, to patent the same, thus securing an absolute monopoly for a limited time; or, second, to keep his invention a secret, by which means he gets an imperfect monoply [sic] for an indefinite period."[13] But the definition of a trade secret remained very general: "A secret is something known only to one, or a few, and kept from others; anything hidden from general knowledge or observation; something not to be told."[14] The law moved slowly from there. In *Glucol Mfg Co v Schulist*, the court provided this definition, which also distinguished more normal course "confidential" information:

> The term "trade secret," as usually understood, means a secret formula or process not patented, but known only to certain individuals using it in compounding some article of trade having a commercial value, and does not denote the mere privacy with which an ordinary commercial business is carried on.
>
> It is a "plan or process, tool, mechanism, or compound known only to its owner and those of his employees to whom it is necessary to confide it."[15]

As for the definition of trade secrets, it evolved slowly and, arguably, consistently with the rate of actual "secrets" utilized in business.

In *Manos v Melton*, the Michigan Supreme Court set forth further guidelines:

> [T]his Court has also recognized that the law does not provide protection for knowledge which is common property in the trade, or for an idea which is well-known or easily ascertainable.[16]

Eventually, the Restatement (First) of Torts, §757 gained wide recognition in Michigan.[17] First published in 1939, the Restatement tracked the increase in so-called "confidential" business information and drew a relatively bright line between "trade secrets" and "confidential information." On one hand, there were trade secrets:

> It differs from other secret information in a business (see § 759) in that it is not simply information as to single or ephemeral events in the conduct of the business, as, for example, the amount or other terms of a secret bid for a contract or the salary of certain employees, or the security investments made or contemplated, or the date fixed for the announcement of a new policy or for bringing out a new model or the like. A trade secret is a process or device for continuous use in the operation of the business. Generally it relates to the production of goods, as, for example, a machine or formula for the production of an article. It may, however, relate to the sale of goods or to other operations in the business, such as a code for determining discounts, rebates or other concessions in a price list or catalogue, or a list of specialized customers, or a method of bookkeeping or other office management.[18]

On the other hand, the Restatement also provided in §759 that "[o]ne who, for the purpose of advancing a rival business interest, procures by improper means information about another's business is liable to the other for the harm caused by his possession, disclosure or use of the information."

> Examples of information, other than trade secrets, included in this Section are: the state of one's accounts, the amount of his bid for a contract, his sources of supply, his plans for expansion or retrenchment, and the like. There are no limitations as to the type of information included except that it relate to matters in his business. Generally, however, if the improper discovery of the information is to cause harm, the information must be of a secret or confidential character. Thus, if one freely gives full information about the state of his accounts to trade associations, credit agencies or others who request it, the possession, disclosure or use of the same information by one who procured it through improper means can hardly cause him harm. On the other hand, if one has a closely guarded trade secret, another's discovery of it may reduce its sale value even before any other disclosure or use is made of the secret.[19]

The evolution—in just a few short decades—from defining "trade secrets" in only the most general terms to more elaborate definitions with a hierarchy of information and concomitant protections reflects and tracks the industrial revolution and the increased role of ideas and information in the economy. However, the reality remained that trade secret cases were fairly rare; the Supreme Court addressed the issue only four times between 1939 and 1984 (the plaintiff lost each time).[20] And given that Michigan law prohibited noncompetition agreements, it was largely unnecessary for the courts to work to

better delineate "confidential information" from "trade secrets."

From *Folmer/Hayes-Albion* to MUTSA

The Supreme Court's opinions in *Folmer* and *Hayes-Albion*, delivered on December 28, 1984, summarized, modernized, and advanced Michigan law on these topics. At the same time, the loose definitions employed in these opinions set the table for much confusion moving forward, especially once noncompetes became legal and many hitherto "regular" jobs became drenched in information and data.

In *Hayes-Albion*, the Supreme Court addressed the definition of a "trade secret" and, while citing to the Restatement, immediately departed from it. Noting that the Restatement "provides useful guidelines that have been widely adopted," the court also stated that earlier "guidelines" from the court remained "valid, and may be relied upon in appropriate circumstances." The court went on to state (with its own emphasis) that, "If a secret *process* is involved, a plaintiff is entitled to the protection provided trade secrets…."[21] This clearly corresponds to the Restatement's distinction between a trade secret involving a process as opposed to "information as to single or ephemeral events." Yet, the court went on to hold, in the very same paragraph, that "[s]pecific information regarding resolution of the problems of particular customers is a trade secret," which does not sound very much like a "process" at all.

At the same time, in *Folmer*, the court established broad principles for protection of confidential information not quite amounting to a trade secret. The court's key holding is contained in two sentences supported by five footnotes, but most of those citations are to authorities outside of Michigan, and it is not hyperbole to note that this formulation of Michigan law was imported almost *in toto*:

> While an employee is entitled to the unrestricted use of general information acquired during the course of his employment or information generally known in the trade or readily ascertainable, confidential information, including information regarding customers, constitutes property of the employer and may be protected by contract. Even in the absence of a contract, an employee has a duty not to use or disclose confidential information acquired in the course of his employment. Such information is often treated as a "trade secret".[22]

Shortly on the heels of these opinions, the legislature modified the law permitting reasonable noncompetition agreements, and that law was applied consistent with the precepts espoused in *Folmer*. While that legislative change resulted in an explosion in the use and litigation of noncompetes, the following 30 years have not brought any greater clarity to the definitional issues. *Folmer* set broad poles: on one hand, "general information acquired during the course of his employment or information generally known in the trade or readily ascertainable" is fair game, although no guidance is given on how to define terms like "general information." At the same time, confidential information became defined by its value rather than by its inherent qualities: "An employee who possesses confidential information regarding a client is in a position to exploit that information for the purpose of obtaining the patronage of the client after leaving his employer's service."[23]

In a world in which ideas and information more and more saturated the work place, increasingly the employee was a repository of some of that information in the course of his or her normal work day, and, as a result, employers perceived their employees, even lower level ones, as essentially vessels of company information, forever ready to walk out the door and threaten the business. The balance irrevocably had shifted from a workplace dominated by labor to a workplace dominated by information. While the demarcation between trade secrets and confidential information became less relevant (and less distinct, as discussed below), the line between confidential information and general knowledge and skills should have become more important.

The breadth of what the court did in *Folmer* deserves appreciation. It took an incredibly broad swath of information and authorized companies to sue employees to prohibit their use of it following their employment or to enforce noncompetition agreements. The combination of the breadth of *Folmer* and the modification of the Michigan statute exponentially expanded the ability of employers to limit what their ex-employees did in the marketplace. At the same time, the fuzzy definitions inevitably led to fact-bound inquiries, with the employer claiming nearly anything of value in the business constituted protect-

The combination of the breadth of *Folmer* and the modification of the Michigan statute exponentially expanded the ability of employers to limit what their ex-employees did in the marketplace.

able information while the employee argued just the opposite. If one then factors in the well-documented procedural aspects of the judicial process—namely, its expense—the vicissitudes in Michigan law would appear, at first blush at least, to favor the employer/business.

Various developments since 1984 have not much moved the needle in terms of greater clarity. MUTSA was adopted in 1998 and defined trade secrets as:

> "Trade secret" means information, including a formula, pattern, compilation, program, device, method, technique, or process, that is both of the following:
>
> (i) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use.
>
> (ii) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[24]

Noticeably missing from this formulation was the original line drawn in the Restatement between a "process" and "single" information. Courts in other UTSA states have held that the UTSA purposively altered this restrictive requirement.[25]

Another noticeable aspect of MUTSA is section 7, which purports to displace any conflicting common law causes of action. The majority of jurisdictions have held that, therefore, there is no common law protection provided to "confidential information" not rising to the level of a trade secret (although confidential information may be protected by contract).[26] While one federal court opinion applying Michigan law ruled this way,[27] other recent decisions from both federal district courts in Michigan indicate that this rationale may not be followed.[28]

The latest effort to draw these lines is the Restatement (Third) of Unfair Competition (RUC), first published in 1995, and recently adopted by the Sixth Circuit Court of Appeals (albeit in a case applying Texas law, but nevertheless telling, perhaps, of future consideration in Michigan cases as well).[29] The RUC purports to define trade secrets in line with the UTSA[30] and recognizes the abandonment of the "continuous use" requirement of the prior Restatement formulation, but notes that Restatement (Second) of Agency § 396 "protects both trade secrets and 'other similar confidential matters' from unauthorized use or disclosure following the termination of an agency relationship."[31] The RUC continues the fact-bound paradigm for distinguishing trade secrets from general skills and knowledge: "Whether particular information is properly regarded as a trade secret of the former employer or as part of the general skill, knowledge, training, and experience of the former employee depends on the facts and circumstances of the particular case."[32]

This standard was applied by the Sixth Circuit to three sets of information taken by a sales employee to his new employer that was also a competitor: (1) an account-by-account breakdown of his sales at the former employer; (2) 46 orders made on behalf of his former employer but then converted to his new employer; and (3) "his knowledge of his former customers' prescribing habits, schedules, and contact information" to introduce new employer's representative to these customers. For this last category, the court found it probative that the employee admitted it could take six months for a sales person "to acquire his level of detailed knowledge about a surgeon." For all three categories, the Court of Appeals reversed the trial court, which had conducted a bench trial, and had entered judgment for plaintiff. None of these three categories of information is crystal clear; for example, the first and third categories are arguably equally available from the actual customer and thus not truly confidential information. Yet, it took a case to go to a full trial, and through an appeal, for the courts to get the facts into the right legal box. And the underlying facts demonstrate that while employees are regularly required to sign broad confidentiality agreements without any real ability to bargain over the language, the courts will heavily defer to the contract rather than make hard calls as to what is, in fact, confidential information.

The main issue is the ascendancy of "information" as saturating the employment environment and thus giving rise to constant claims of ownership by the employer.

Do Definitions Matter?

The definitional issue is of interest on various levels. The main issue is the ascendancy of "information" as saturating the employment environment and thus giving rise to constant claims of ownership by the employer. Clearly it is easier to distinguish between the general skills and knowledge of a blacksmith and a discrete formula for an alloy than it is to distinguish between the general skills and

knowledge of an engineer who has spent her entire career in the design of transmissions, from information belonging to her employer—in such a case, given the abundance of inchoate ideas and information, one cannot readily distinguish between "general skills" and "confidential information."[33] Thus, while courts initially showed some hesitation to recognize claims by employers to information that cannot be easily segregated from the general skill and knowledge of former employees,[34] the explosion in "information" in the workplace has shifted the balance toward the employer. The fact that many jobs have become more specialized over time in our technology-focused culture only exacerbates the problem.

This has led to two results. First, courts have leaned over time to include more and more information under the tent of protectable information. Thus, the amount of information known by our transmission engineer is more and more characterized as property belonging to the employer rather than the general skills of the employee, resulting in a situation where the employee can be easily barred under a noncompete agreement from pursuing her life-long professional career for a competitor. Second, even in the absence of a noncompete, employers use the court system to sue first and prove misappropriation later, and, in the process, shift the de facto burden to the employee, who must engage in expensive and prolonged litigation without an easy path to early resolution or a narrowing of the issues.

Another issue implicated by this area of the law is the role of the court as policy maker. Although our Supreme Court often speaks against perceived judicial activism,[35] the evolution of Michigan law discussed briefly herein makes clear that how courts handle these issues—both in terms of establishing substantive principles but equally in terms of the process for adjudicating claims—can make a tremendous difference in the shifting of rights and burdens among constituent groups. And clearly there is room for debate as to whether some of the basic principles that allow for relatively easy lawsuits and enforcement of noncompetes continue to be good policy. For example,

> It has been contended…that the Silicon Valley phenomenon of high labor mobility and rapid diffusion of new technology occurred in California, rather than elsewhere, for two reasons. First, California's restrictive law of trade secrets was not enforced as it is written. Second, California's flat prohibition on post-employment restrictive covenants was enforced exactly as written.[36]

This broad question—do non-competes and loose definitions of confidential information help or hurt our overall economy?—is not one easily answered. Recent media attention to noncompetes being used for sandwich makers[37] has led some to recognize that the agreements may be over-used, and a recent study suggested that noncompetes hurt Michigan's economy.[38] While the courts do not make (most of) the law in this area given statutes, they do greatly dictate how the balance swings between employers and employees in these cases, and they have room to define undefined terms since judges are not impervious to recognizing the forces going on around them in the economy.

It is beyond the scope of this article to deliver a panacea for these issues. But recognition of the facts on the ground must reckon with the fact that the combined effect of indefinite rules and an expensive judicial process greatly favor those with the means to engage in time-consuming litigation. Such a process is clearly not only a detriment to the traditional employee, who is disadvantaged in such a contest, but also business. Businesses seek and desire certainty in the rules of commerce, and the law itself benefits from clarity. As noted by Justice Scalia:

> [A]nother obvious advantage of establishing as soon as possible [clear and definite rules]: predictability. Even in simpler times uncertainty has been regarded as incompatible with the Rule of Law. Rudimentary justice requires that those subject to the law must have the means of knowing what it prescribes. […] As laws have become more numerous, and as people have become increasingly ready to punish their adversaries in the courts, we can less and less afford protracted uncertainty regarding what the law may mean. Predictability, or as Llewellyn put it, "reckonability," is a needful characteristic of any law worthy of the name. There are times when even a bad rule is better than no rule at all.[39]

This lack of definition and recognition of expense has led some courts to consider bifurcating cases in various ways, including re-

Another issue implicated by this area of the law is the role of the court as policy maker.

quirements that plaintiff first specify in some detail its purportedly misappropriated trade secrets.

> As noted by another court, "Trade secret cases present unique and difficult problems with respect to the timing and scope of discovery." Much of this difficulty arises from the competing policies found in trade secret cases. To deal with these difficulties courts have adopted a number of different approaches. For example, some courts have bifurcated discovery so that discovery of non-confidential information takes place first, followed by the discovery of the confidential information that forms the basis for a plaintiff's trade secret claim. In contrast, other courts have ordered simultaneous discovery of trade secret information. What is apparent from the various approaches is the fact that what may be the proper approach in one case is not the proper approach in another. "Unfortunately, there is no talismanic procedure the Court may apply in order to obtain the best result in any given case."[40]

The practical problem remains that taking up these issues, and determining the correct approach on a case-by-case basis, requires significant resources of the parties and rolled up sleeves by judges facing significant case administration demands. In this vein, it is possible that, at least in the federal courts, the recent changes to the Federal Rules of Civil Procedure with the focus on "proportionality" of discovery will lead to continued active case management, but that is hardly a complete answer and of no help at all to state courts burdened with (typically) higher caseloads and less staff support. Perhaps brighter lines drawn by the courts, tighter discovery, and early evidentiary hearings, rather than relying on yesteryear's paradigm of letting each case turn on its own facts, would assist the courts and allow all litigants to realize significant benefits.

NOTES

1. See, e.g., *Ingersoll-Rand Co v Ciavatta*, 110 NJ 609, 638, 542 A2d 879 (1988).

2. For example, "Whether particular information is properly regarded as a trade secret of the former employer or as part of the general skill, knowledge, training, and experience of the former employee depends on the facts and circumstances of the particular case." Restatement (Third) of Unfair Competition § 42 (1995).

3. *Beal v Chase*, 31 Mich 490 (1875).

4. *Id.* at 521.

5. *Id.* at 522.

6. *Follmer, Rudzewicz & Co, PC v Kosco*, 420 Mich 394, 404 n6, 362 NW2d 676 (1984).

7. See, e.g., *O & W Thum Co v Tloczynski*, 114 Mich 149, 158, 72 NW 140 (1897).

8. *Id.* at 158.

9. Section 1 of Act No. 329 of the Public Acts of 1905.

10. *Grand Union Tea Co v Dodds*, 164 Mich 50, 128 NW 1090 (1910).

11. *Id.* at 54-5.

12. *Grand Union Tea Co v Lewitsky*, 153 Mich 244, 252-53, 116 NW 1090 (1908).

13. *Dow Chem Co v American Bromine Co*, 210 Mich 262, 288, 177 NW 996 (1920).

14. *Id.* (citation omitted).

15. 239 Mich 70, 75, 214 NW 152, 153 (1927).

16. 358 Mich 500, 508, 100 NW2d 235 (1960), citing *Russell v Wall Wire Prods Co*, 346 Mich 581, 78 NW2d 149 (1956); *Insealator, Inc v Wallace*, 357 Mich 233, 98 NW2d 643 (1959).

17. Although cited as early as 1956 in *Russell v Wall Wire Prods Co*, 346 Mich 581, 585, 78 NW2d 149 (1956), it came into broader use much later, as reflected in *Kubik, Inc v Hull*, 56 Mich App 335, 346, 224 NW2d 80 (1974), and, a decade later, *Hayes-Albion v Kuberski*, 421 Mich 170, 184, 364 NW2d 609 (1984).

18. Restatement (First) of Torts § 757 (1939) (comment b).

19. Restatement (First) of Torts § 759 (1939) (comment b).

20. *Russell, supra; Manos, supra; Insealator, Inc v Wallace, supra; Dutch Cookie Mach Co v Vande Vrede*, 289 Mich 272, 286 NW 612 (1939).

21. *Hayes-Albion*, 421 Mich at 184.

22. *Folmer*, 420 Mich at 402-404.

23. *Id.* at 406.

24. MCL 445.1902(d).

25. *See State ex rel Besser v Ohio State Univ*, 89 Ohio St 3d 396, 400–401, 732 NE2d 373 (2000) ("The Commissioners on Uniform State Laws who drafted the Uniform Trade Secrets Act, as adopted in Ohio, noted '[t]hat the definition of "trade secret" [in the Uniform Act] contains a reasonable departure from the Restatement of Torts (First) definition which required that a trade secret be "continuously used in one's business."' Uniform Trade Secrets Act, Sec. 1, Comment (1990), 14 ULA 437, 439.").

26. Robert C. Denicola, *The New Law of Ideas*, 28 Harv J L & Tech 195, 217 (2014).

27. *Bliss Clearing Niagara, Inc v Midwest Brake Bond Co*, 270 F Supp 2d 943 (WD Mich 2003).

28. *See Appalachian Railcar Servs v Boatright Enters*, 602 F Supp 2d 829, 852-854 (WD Mich 2008) (finding that breach of fiduciary duty claims based on the sharing of potentially confidential information are not preempted by MUTSA); *McKesson Med-Surgical, Inc v Micro Bio-Medics, Inc*, 266 F Supp 2d 590 (ED Mich 2003) (because breach of fiduciary action was based on misappropriation of confidential information, not trade secrets, cause of action not displaced by MUTSA).

29. *Orthofix, Inc v Hunter*, No. 15-3216, 2015 US App LEXIS 20111 at *1 (6th Cir Nov 17, 2015).

30. Restatement (Third) of Unfair Competition § 39 (1995)(comment b)("principles of trade secret law described in this Restatement are applicable to actions under the Uniform Trade Secrets Act as well as to actions at common law.").

31. *Id.*, comment d. See also RUC §42, comment b. Restatement (Second) of Agency §396 simply pro-

vides that an employee, following employment, "has a duty to the principal not to use or to disclose to third persons, on his own account or on account of others, in competition with the principal or to his injury, trade secrets, written lists of names, or other similar confidential matters given to him only for the principal's use or acquired by the agent in violation of duty. The agent is entitled to use general information concerning the method of business of the principal and the names of the customers retained in his memory, if not acquired in violation of his duty as agent"; notably, the provision is short on definitions. This provision has been cited with authority several times by Michigan courts. See, e.g., *Follmer*, 420 Mich at 404 n4.

32. RUC §42, comment d.

33. An example from the commentary of the Restatement makes this point well: "Thus the skill with which an iron worker can determine the exact moment for pouring molten iron, and the skill of the glass moulder in handling his tools, although the result of the master's directions, become part of the personality of the servant which he is entitled to use freely. Likewise the skill which comes from aptitude plus training in selling goods becomes the agent's to use for himself, unless prevented by his agreement not to do so." Restatement (Second) of Agency § 396 (1958)(comment c).

34. See, e.g., *AMP Inc v Fleischhacker*, 823 F2d 1199, 1202 (7th Cir Ill 1987).

35. E.g., *Mack v City of Detroit*, 467 Mich 186, 649 NW2d 47 (2002).

36. Catherine L. Fisk, *Working Knowledge: Trade Secrets, Restrictive Covenants in Employment, and the Rise of Corporate Intellectual Property,* 1800-1920, 52 Hastings L J 441, 447-48 (2001).

37. http://www.huffingtonpost.com/2015/04/10/jimmy-johns-noncompete-agreement_n_7042112.html

38. http://michiganradio.org/post/non-compete-clauses-contribute-michigan-brain-drain-study-says#stream/0. See also http://www.wsj.com/articles/SB10001424127887323446404579011501388418552.

39. Antonin Scalia, *The Rule of Law As a Law of Rules*, 56 U Chi L Rev 1175, 1179 (1989).

40. *Storagecraft Tech Corp v Symantec Corp*, No. 2:07 CV 856 CW, 2009 US Dist LEXIS 10608, at *2 (D Utah Feb 11, 2009)(citations omitted); see also *DeRubeis v Witten Tech., Inc.,* 244 FRD 676, 679 (ND Ga 2007).

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Can't We All Just Get Along? Fiduciary Duties in the Corporate and LLC Context

By Gerard V. Mantese and Jordan B. Segal

Introduction

In business, litigation disputes often arise out of questionable actions of a shareholder, officer, or manager that harm the business entity or others. To redress wrongful conduct in this context, a claim of breach of fiduciary duty is frequently made, often in a suit brought by the entity and one or more individuals.[1] Increasingly, however, fiduciary duty claims are brought by individual shareholders or members alleging that the control group has breached its duty to *them*.

The contours of the duties owed by a majority shareholder to a minority shareholder of a corporation, and owed by a manager to members in a limited liability company (LLC), are far from settled, both nationally and in Michigan. The Michigan legislature has created statutory causes of action for shareholder or member oppression that overlap with common law principles of fiduciary law. Whether Michigan law imposes a fiduciary duty on majority shareholders/controlling members towards minority shareholder/non-controlling members, outside the scope of oppression statutes, depends on the facts of the case. This article will review some of the national trends in fiduciary duty caselaw. It will then review recent caselaw in Michigan discussing fiduciary duties between majority and minority shareholders, and between LLC members.

Fiduciary Duties in the Corporate Context

It is settled under Michigan statutory law that corporate officers and directors owe a duty to the corporation. MCL 450.1541a imposes a duty of care on corporate officers and directors who possess discretionary authority. Michigan courts have interpreted this duty of care to mean that a corporate director or officer "must answer for ordinary neglect, and that 'ordinary neglect' is understood to be omission of that care which every man of common prudence takes in regard to his own affairs."[2] Officers and directors also owe a duty of loyalty to the corporation; they must act "in a manner [that the officer] reasonably believes to be in the best interests of the corporation."[3] The corporate fiduciary duty may be breached intentionally, as where a director engages in self-dealing and conceals relevant information from the corporation, or negligently, by failing to disclose information that the director knew or should have known was relevant and material to the corporation.[4]

Judge Denise Langford Morris' 2002 circuit court opinion in *Pinnacle Express, Inc*[5] illustrates some of the contours of the fiduciary duties owed by officers to the corporation. At issue in *Pinnacle* was whether a corporate officer could negligently usurp a corporate opportunity. Trout, the President of Pinnacle Express (a trucking company), testified that when he formed Bogie's Express—a competing trucking company—he was under the belief that he would soon become the sole owner of Pinnacle Express, and that Pinnacle would benefit from the creation and operation of Bogie's Express. Therefore, he argued, he never intended to usurp a corporate opportunity, nor did he divert any trucking jobs from Pinnacle to Bogie's for his own personal gain.[6] The court ruled that the argument was unavailing because if Trout usurped the opportunity unintentionally, he would have violated his duty of care. On the other hand, if he knew that he was not going to become the sole owner of Pinnacle Express, he violated his duty of loyalty. Either way, he breached his fiduciary duty to the corporation.[7]

The National Debate on Shareholders' Fiduciary Duties in Close Corporations

The more difficult question is what duty, if any, a majority shareholder of a closely held corporation owes *to other shareholders*. On this question, there has been much debate nationally. On one end of the spectrum, some jurisdictions hold that majority shareholders in a close corporation owe a duty to minority shareholders akin to the duties owed in

a partnership. On the other end of the spectrum, some jurisdictions hold that majority shareholders owe a duty only to the corporation, and no duty to other shareholders.

For example, Massachusetts courts have held that a majority shareholder's duty to other shareholders is almost the same as a partner's fiduciary duty to other partners.[8] The Massachusetts Supreme Judicial Court ruled that even in a close corporation, with a specific and clear operating agreement, the existence of a contract "does not relieve stockholders of the high fiduciary duty owed to one another in all their mutual dealings."[9] However, the court also ruled that "where the parties have defined in a contract the scope of their rights and duties in a particular area, good faith action in compliance with that agreement will not implicate a fiduciary duty."[10] When acting within the ambit of an operating agreement, the guiding principle is good faith. Yet, even beyond the operating agreement, the majority owes a fiduciary duty to the minority shareholders, as the court held:

> Although a shareholder in a close corporation always owes a fiduciary duty to fellow shareholders, good faith compliance with the terms of an agreement entered into by the shareholders satisfies that fiduciary duty. A claim for breach of fiduciary duty may arise only where the agreement does not entirely govern the shareholder's actions.[11]

Therefore, in Massachusetts, the relationship among shareholders in a corporation may be viewed as a *fiduciary* relationship, even though those duties may be amended or limited by agreement.

Delaware, on the other hand, does not recognize that a majority shareholder has any common law fiduciary duty to minority shareholders in a closely held corporation, unless specified in the operating agreement.[12] The Delaware Court of Chancery held in *Blaustein*, that the minority shareholder cannot assert more rights than those to which the parties had agreed. The court stated, in very stark terms:

> [Blaustein's] predicament is not enviable, but she must live with the Shareholders' Agreement for which she bargained. She had an opportunity to negotiate specific buyout terms. Her attorneys were sophisticated and well-regarded. The Court cannot read into the Shareholders' Agreement obvious terms that she did not secure during the bargaining process. Nor can the Court, on these facts, utilize fiduciary principles to help her case.[13]

The Delaware rule, then, is *contractual*—that is, in close corporations, the fiduciary duty owed by majority shareholders is specified and defined in the corporate governance documents.[14] In either context—the Massachusetts/fiduciary approach or the Delaware/contractual approach—shareholders may owe a fiduciary duty to the other shareholders. The difference between the two views is whether the common law recognizes a duty that may be disclaimed by agreement, or whether there is no duty by default, and any duty must be imposed by agreement.[15]

Recent Michigan Cases

While older caselaw holds that a common law fiduciary duty exists between the majority and minority shareholders,[16] Michigan law continues to evolve. More recent disputes between shareholder groups are typically brought under the shareholder oppression statute, MCL 450.1489.[17] The Michigan legislature may have been attempting to temper the harsh Delaware contractual approach when it enacted the shareholder oppression statute. Indeed, the wrongful actions that might have previously given rise to a minority shareholder's breach of fiduciary duty suit may well be the predicate for a shareholder oppression suit.[18] However, the difference between a breach of fiduciary duty claim and a shareholder oppression claim can be important under certain circumstances.[19]

The Michigan legislature has created statutory causes of action for shareholder or member oppression that overlap with common law principles of fiduciary law.

The recent decision in *Antakli v Antakli*[20] illustrates the interplay between fiduciary duty law and shareholder oppression law. In that case, the plaintiff-minority shareholder, who was also the president, COO, and director of defendant Intraco Corporation, brought suit against the majority Intraco shareholders (who were the plaintiff's mother, sister, and brothers).[21] The plaintiff sued for, among other claims, shareholder oppression and breach of fiduciary duty.[22] With regard to the shareholder oppression claim, the plaintiff argued that she was oppressed because the majority shareholders interfered with:

- her voting rights;
- full access to corporate financial information;
- her distribution and dividend rights;

- her rights to expense reimbursements;
- her shareholder management rights; and,
- a tax liability distribution.

With regard to the breach of fiduciary duty claim, the plaintiff alleged that she had been "frozen...out of Intraco;" had "[her] salary [halved] and…her total compensation [reduced] by over 80 percent;" and that the she was repeatedly denied expense reimbursement—while the other shareholders reimbursements were readily paid.[23]

While the underlying acts of the majority shareholders were the same as in the oppression claim, in the breach of fiduciary duty claim the court focused on how the treatment of the minority shareholder was different from the treatment of the other shareholders.[24] The court agreed with the plaintiff's argument that "it is the 'differential treatment' that she receives relative to other shareholders that constitutes a breach of fiduciary duty." Implicitly the court was looking to a fiduciary standard that is (1) owed by the majority shareholder group to the minority shareholder; and, (2) distinct from the standards imposed by the shareholder oppression claim, namely, the "differential treatment" she received, which was not a focus of the court's shareholder oppression analysis. Ultimately, since the plaintiff had adduced voluminous documentary evidence, the court denied summary disposition to the defendants, and allowed the claim to proceed to trial.[25]

While older caselaw holds that a common law fiduciary duty exists between the majority and minority shareholders, Michigan law continues to evolve.

Cavaliere v DRSN Assocs[26] provides an excellent parallel for the interplay between oppression and breach of fiduciary duty in the LLC context. Unlike corporations, caselaw involving limited liability corporations (LLCs) is generally less developed. This may be because LLCs have only been in existence since the mid-1970s. Regardless, under the text of the Michigan LLC Act, a manager's statutory fiduciary duties appear to be owed to the company, not the individual members.[27]

It is probable that, for this reason, the plaintiff in *Cavaliere* did not pursue a claim for breach of fiduciary duty, and only proceeded on a member oppression claim.[28] In *Cavaliere*, the parties were involved in the business of building and operating skilled nursing and related health-care facilities, and affiliated office and residential facilities. The plaintiffs collaborated with others to create defendant DRSN Associates. At the end of his involvement with DRSN, Cavaliere was employed as the director of development. Plaintiffs claimed, among other things, that the majority members of DRSN embarked on a course of "willfully unfair and oppressive conduct" to punish them for refusing to sell their minority interest to the other members.[29] The defendants argued that the operating agreement authorized the alleged conduct. Since the exclusive management authority was vested in DRSN's managers in accordance with the operating agreement, they argued, there could be no member oppression.

The court disagreed, holding that "although the Operating Agreement may allow certain actions, said actions cannot be done in a willfully unfair and oppressive manner."[30] The court cited to *Salvadore v Connor*,[31] in which the Michigan Court of Appeals held that "[the] law requires the majority in control of the corporation the utmost good faith in its control and management as to the minority." The court's reliance on *Salvadore* is noteworthy, both because the court was applying corporate common law to an LLC,[32] but, more importantly, because the court was adopting a view more akin to the "fiduciary" view described by Massachusetts' jurisprudence.[33] The court rejected the defendant's argument that the LLC's operating agreement controlled over any presumed fiduciary duty, and held that, at least for the purposes of member oppression, there were duties owed to the non-controlling members beyond the LLC's operating agreement.[34] The court, however, did not discuss whether that duty extended beyond the member oppression context.[35]

Perhaps no other recent decision walks the fiduciary duty tightrope more finely than *Castle v Shoham*.[36] The court summarized the facts of the case by noting that "in his complaint, Plaintiff alleges that [defendant Midwest Air Filter ("MAF")] at the direction of the Shoham Defendants has engaged in various improper activities." The court then stated: "[t]he core issue of the parties' dispute with respect to Plaintiff's breach of fiduciary duty claim against MAF is whether a majority member of an LLC owes a fiduciary duty to the minority member(s)."[37] The Shohams, as majority members of MAF, argued that under the holding of *Dawson v Delise*,[38] "a majority member of an LLC, unlike a ma-

jority shareholder of a corporation, does not owe minority members a fiduciary duty."[39]

The court noted that *Dawson* does not go so far as to hold that there is *no* fiduciary duty outside of the requirements of the member oppression statute, but rather that *Dawson* holds that there were *limited* situations where an individual member or shareholder may bring a direct action: "(1) When [a shareholder or member] has sustained a loss separate and distinct from that of other [owners] generally,[40] and (2) when he can show a violation of a duty owed directly to him that is independent of the [corporation or LLC]."[41] The court concluded that, in *Dawson*, the plaintiff failed to establish a factual basis for a breach of fiduciary duty claim; nevertheless, "under certain circumstances a minority member may maintain a breach of fiduciary duty claim against a majority member."[42] Thus, the court recognized that a minority member may bring an action for breach of a fiduciary duty against a controlling member outside of the context of an oppression action. But those actions are limited to the two exceptions described in *Christner* and *Belle Isle Grill Corp*, *i.e.*, when the shareholder sustains a loss separate and distinct from the other owners (*Christner*), or a violation of a duty owed that is independent of the corporate entity (*Belle Isle Grill Corp*).[43] Because Castle alleged that the defendants breached a duty independent of the corporation by allegedly taking Castle's share of profits for itself and other entities owned by MAF principals, the case fell within the *Christner* exception. As such, the defendants' motion for summary disposition was denied.[44]

Conclusion

In Michigan corporate litigation, the debate between the contractual and fiduciary views of duties owed between members or shareholders may be viewed as a microcosm for a similar debate nationally. At one end of the spectrum, majority shareholders owe a duty akin to the partnership duty described by Judge Cardozo's famous line in *Meinhard v Salmon*,[45] "[n]ot honesty alone, but the punctilio of an honor the most sensitive…," as they do in Massachusetts.[46] On the other end, majority shareholders have no direct common law duties to minority shareholders, outside of agreed upon contractual requirements, as in Delaware. Michigan law appears to lie somewhere in between these two views, with the oppression statutes providing the clearest imposition of fiduciary standards on those in control not to abuse their power.

NOTES

1. *Cf., Coppola v Manning,* No 323994, 2015 Mich App LEXIS 2152 (Nov 17, 2015) (unpublished) (receiver, on behalf of the corporation, could sue former directors and officers for breach of fiduciary duty).

2. *Dykema v Muskegon Piston Ring Co*, 348 Mich 129, 136, 82 NW2d 467 (1957)(quoting *Martin v Hardy*, 251 Mich 413, 232 NW 197 (1930).

3. MCL 450.1541a(1)(c).

4. *Pinnacle Express, Inc v Trout*, No 01-441 CZ, 2002 WL 1547540, at *1 (Mich Cir Ct June 26, 2002).

5. *Id.*

6. *Id.* at *3.

7. *Id.* ("Although Trout may not have intended to usurp an opportunity belonging to Pinnacle, it is clear nonetheless that he violated either his duty of loyalty or his duty of care, or both.")

8. See, e.g., *Merriam v Demoulas Super Markets, Inc*, 985 NE2d 388, 464 Mass 721 (2013).

9. *Blank v Chelmsford Ob/Gyn, PC*, 420 Mass 404, 408–409, 649 NE2d 1102 (1995).

10. *Merriam*, *supra*, at 395 (discussing *Blank*).

11. *Id.*

12. *Blaustein v Lord Baltimore Capital Corp*, No CIV A 6685-VCN, 2013 Del Ch LEXIS 108, at *56 (Apr 30, 2013) aff'd 84 A3d 954 (Del 2014) (citing *Riblet Prods Corp v Nagy*, 683 A2d 37, 39 (Del 1996); *Nixon v Blackwell*, 626 A2d 1366, 1381 (Del 1993); and *Ueltzhoffer v Fox Fire Dev Co*, No CIV A 9871, 1991 Del Ch LEXIS 204 (Dec 19, 1991) *aff'd*, No 208, 1992 Del LEXIS 459 (Nov 24, 1992)).

13. *Id.* at *18.

14. *Nixon v Blackwell*, 626 A2d 1366 (Del 1993); see also, e.g., *In re Wayport, Inc Litig*, 76 A3d 296 (Del Ch 2013); *Arnold v Society for Sav Bancorp*, 678 A2d 533 (Del 1996); *Thorpe by Castleman v CERBCO,* 676 A2d 436, 444 (Del 1996); *Blaustein supra* ("Delaware law does not recognize that a majority stockholder has a special fiduciary duty to minority stockholders in a closely-held corporation.")

15. Most states fall somewhere in-between; see, *Fix v Fix Material Co,* 538 SW2d 351 (Mo Ct App 1976). While there may not be a specific "fiduciary" relationship, the Missouri courts use the concepts of fiduciary law as a prism in which they view majority shareholder actions and decide whether minority shareholders may be deserving of compensation or equitable relief under the state's oppression statutes.

16. *Salvadore v Connor*, 87 Mich App 664, 675, 276 NW2d 458 (1978) ("the law requires the majority in control of the corporation the utmost good faith in its control and management *as to the minority* and it is the essence of this trust that it must be so managed so as to produce *to each shareholder*, the best possible return upon his investment.")(emphasis added); *Veeser v Robinson Hotel Co*, 275 Mich 133, 138, 266 NW 54 (1936); *Kearney v Jandernoa*, 979 F Supp 576, 579 (WD Mich 1997) (citing *Pepper v Litton*, 308 US 295, 306 (1939)) ("A controlling shareholder of a corporation is a fiduciary."); *Fenestra Inc v Gulf Am Land Corp*, 377 Mich 565, 599-600, 141 NW2d 36 (1966) ("[I]t is unlawful for a majority stockholder to use its fiduciary capacity to obtain access to the resources of the company for the benefit of that majority stockholder, and which is not to the best interests of all of the stockholders. If a majority stockholder is in control and management of a corporation then the

principle is valid.")(internal quotations omitted).

17. MCL 450.1489(1) ("A shareholder may bring an action…to establish that 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…").

18. *See Bromley v Bromley*, No 05-71798, 2006 US Dist LEXIS 72398, at *16 (ED Mich Oct 4, 2006) ("[I]t is reasonable to conclude that the type of conduct amounting to a breach of fiduciary duties in close corporations is the type of conduct prohibited by § 450.1489"). The interplay between the two causes of action was the subject of an opinion by the New York Federal District Court, which discussed Michigan law in *Fox v Idea Sphere, Inc,* No 12 Civ 1342, 2013 US Dist LEXIS 42674, at *48 (SDNY Mar 21, 2013) ("Michigan courts appear to allow plaintiffs to pursue parallel claims of breach of fiduciary duty and minority shareholder oppression under Section 450.1489. All of the [oppressive actions taken by the defendants] are things that qualify as breaches of fiduciary duty under *Bromley*.") (internal citations omitted).

19. As just one example, a judgment for shareholder oppression could warrant an exception from a bankruptcy discharge, whereas a judgment for a breach of fiduciary duty might be subject to the discharge. *Kasishke v Frank (In re Frank)*, 425 BR 435 (Bankr WD Mich 2010). Under 11 USC 523(a)(6), debts arising from a "willful and malicious injury by the debtor to another entity or to the property of another entity" are excepted from a discharge.

20. *Antakli v Antakli,* No 13-135553-CB (Oakland Cir Ct, Jan 15, 2015).

21. The defendant family majority shareholders described the situation as a "family dispute," and not a matter for the courts. *Id.* The court disagreed.

22. *Id.*

23. *Id.*

24. *Id.* The court rejected the defendant's defense under the business judgment rule, holding that the business judgment rule only protects actions taken in good faith.

25. The court had previously recognized a common law fiduciary duty between majority and minority shareholders in its earlier decision considering the same defendants' original summary disposition motion. *Antakli v Antakli*, No 13-135553-CB (Oakland Cir Ct, Jan 22, 2014). In the 2014 opinion, the court disagreed with the defendants' contention that plaintiff only had a statutory claim against officers and directors under MCL 450.1541(a), and explained that Salvador "recognizes a common law claim for breach of fiduciary duty owed from majority shareholders to other shareholders." *See also Wojcik v McNish*, No 267005, 2006 Mich App LEXIS 2386, at *6-7 (July 25, 2006) (unpublished).

26. *Cavaliere v DRSN Assocs,* No 13-138079-CZ (Oakland Cir Ct, May 20, 2015)(Alexander, J).

27. MCL 450.4404(1) ("A manager shall discharge the duties of manager in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner the manager reasonably believes to be in the best interests *of the limited liability company*") (emphasis added).

28. *Cavaliere, supra*. The plaintiff, however, also included a claim for breach of contract.

29. *Id.* Specifically, plaintiff alleged that the defendant refused to send the plaintiff agendas for member meetings; defendant made "misleading statements about the business;" defendant refused to send plaintiff financial statements regarding the business; and one of the defendants threatened "to squash" the plaintiff if he withheld approval to sell the business.

30. *Id.* (*quoting Berger v Katz,* No 291663, 2011 Mich App LEXIS 1408 (July 28, 2011) (per curiam).

31. *Salvadore v Connor*, 87 Mich App 664, 675, 276 NW2d 458 (1978).

32. This is also in accord with Massachusetts law, where the court often equivocates between corporations and LLCs, to the point where the distinction may have become judicially meaningless. *See* Thomas M. Madden, *Do Fiduciary Duties of Managers and Members of Limited Liability Companies Exist as with Majority Shareholders of Closely Held Corporations?* 12 Duq Bus L J 211. (citing *Pointer v Castellani,* SJC-10352 (2009)). Madden goes on to conclude, "[t]his corporate common law has, in part, directly informed, if not controlled, certain decisions regarding fiduciary duties in limited liability companies." *Id.*

33. *Cavaliere* is not the first case in which a Michigan court has looked to Michigan corporate common law to determine questions regarding member oppression. In *BSA Mull, LLC v Garfield Inv Co*, Nos 310989, 311911, 315359, 315544, 2014 Mich App LEXIS 1834 (Sept 30, 2014) (unpublished), the Michigan Court of Appeals applied Michigan shareholder oppression law to assist the court in understanding the Michigan LLC Act's definition of "willfully unfair and oppressive conduct." The court applied *Franchino v Franchino*, 263 Mich App 172, 687 NW2d 620 (2004), a case involving shareholder oppression, and held that "only conduct that substantially interferes with rights that automatically accrue to a member by virtue of being a member will be considered for purposes of determining whether such conduct was willfully unfair and oppressive." *BSA Mull*, *supra* at *10. The court went on to use *Franchino* as setting the standard for what it means to be a "shareholder," and, therefore a "member." *Id.* ("Shareholder interests typically include actions like voting at shareholder's meetings, electing directors, adopting bylaws, amending charters, examining the corporate books, and receiving corporate dividends. *Franchino*, 263 Mich App at 184. Again, by association, these same interests could be deemed typical of a member in an LLC.")(internal quotations removed.). *See also Brikso v Shirinian*, No 2014-3977-CB (Macomb Cir Ct, Aug 18, 2015) (Viviano, K) (same).

34. For membership oppression actions, whether the alleged oppressor is actually in "control" is a key requirement. *See e.g., Sargent Docks and Terminal, Inc v Thomas Weber,* (Saginaw Cir Ct, Aug 7, 2015) (Jurrens, R). ("[W]ithout control, conduct is not actionable regardless of how unfair or oppressive it may be.")

35. *See also Wayne v Lodden*, No 14-144499-CZ (Oakland Cir Ct, May 27, 2015) (Alexander, J) (citing *Salvadore* and stating that a dominant or controlling stockholder is a fiduciary).

36. *Castle v Shoham* ("*Castle*"), No 2014-3568-CK (Macomb Cir Ct, Feb 10, 2015) (Foster, J).

37. *Id.*

38. *Dawson v DeLisle*, No 283195, 2009 Mich App LEXIS 1553 (July 21, 2009)(unpublished).

39. *Castle*, supra.

40. Citing *Christner v Anderson, Nietzke & Co, PC*, 433 Mich 1, 9, 444 NW2d 779 (1989).

41. Citing *Belle Isle Grill Corp v Detroit,* 256 Mich App 463, 464, 666 NW2d 271 (2003).

42. *Castle*, supra.

43. While the *Castle* court highlighted the *Dawson* distinctions, other courts addressing the issue have held that *Dawson* mandates an outright holding that "a manager's fiduciary duties are owed to the company, not the individual members." *Talaski v Carpenter*, No 14-138663-CK (Oakland Cir Ct, Oct 09, 2014) (Potts, W) ("Talaski owed no fiduciary duties to the Carpenters and because he was not the managing member he owed no fiduciary duties to CTP.")

44. *See also Blankenship v Superior Controls, Inc*, No 13-CV-12386 2015 US Dist LEXIS 132328, at *21-22 (ED Mich Sept 30, 2015) (applying Michigan law) ("Moreover, Michigan courts have historically held...sharehold-

ers [in a close corporation] to a higher degree of fiduciary duties, stating '[t]he law requires of the majority the utmost good faith in the control and management of the corporation as to the minority, and it is the essence of this trust that it must be so managed as to produce to each stockholder the best possible return upon his investment.' *Veeser v Robinson Hotel Co,* 275 Mich 133, 138, 266 NW 54 (1936).").

45. *Meinhard v Salmon*, 249 NY 458, 464, 164 NE 545 (1928).

46. *Genesis Tech & Fin, Inc v Cast Navigation, LLC*, 74 Mass App Ct 203, 905 NE2d 569 (2009).

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Choice of Law in Noncompetition Law and Litigation

By Maxwell Goss

Introduction

Freedom of contract is a bedrock principle of American contract law. Where parties have freely entered into an agreement, courts are generally loath to second-guess its fairness. However, noncompetition agreements are a major exception to this principle. A noncompetition agreement can be a powerful tool for protecting confidential information, customer relationships, and goodwill, whether in the employment setting, in the sale of a business, or otherwise. But because a noncompetition agreement restricts a person's alternatives for pursuing gainful employment—a result regarded as a restraint of trade—strict standards of enforceability are imposed. In no other area of contract law do courts so routinely scrutinize the adequacy of consideration and the reasonableness of a contract's terms as in relation to noncompetition agreements.

To make matters more complicated, the legal standards governing noncompetition agreements differ drastically from one jurisdiction to the next. On one end of the spectrum are states like Michigan that generally enforce noncompetition agreements, provided they protect a legitimate business interest, are reasonable in scope, and are appropriately supported by consideration. On the other end of the spectrum are states like California, which prohibits noncompetition agreements in all but the narrowest circumstances. In the middle are states like Illinois and Oregon that impose strict and sometimes idiosyncratic requirements as conditions of enforceability. As a result of such differences, an agreement that is clearly enforceable in one jurisdiction may range from questionable to clearly unenforceable in others.

Not surprisingly, then, choice of law takes on a magnified importance in the noncompetition arena. This article discusses choice-of-law provisions in noncompetition agreements. First, the article illustrates what is at stake by highlighting critical differences between the noncompetition law regimes in Michigan and other jurisdictions. Second, the article analyzes the criteria for determining when a choice-of-law provision will be enforced, with particular attention to recent notable cases applying these criteria to noncompetition agreements. Finally, the article offers some guidance for crafting choice-of-law provisions in noncompetition agreements and for challenging and defending such provisions in a litigation setting.[1]

Differences Across Jurisdictions

The most fundamental difference between jurisdictions concerns whether they will enforce a noncompetition agreement at all. While most jurisdictions permit noncompetition agreements in a range of circumstances, three states—California, Oklahoma, and North Dakota—generally prohibit them for employees. California's Business and Professions Code provides that, apart from specified exceptions (including a narrowly defined exception for an owner selling a business), "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."[2] In addition to the three states that ban employee noncompetition agreements across the board, Hawaii recently enacted a first-of-its kind statute that prohibits noncompetition and nonsolicitation agreements in any employment contract relating to a "technology business," which the statute defines as a business that "derives the majority of its gross income from the sale or license of products or services resulting from its software development or information technology development, or both."[3]

A second critical area of difference is enforceability standards. Michigan law permits employee noncompetition agreements under the following conditions:

> An employer may obtain from an employee an agreement or covenant which protects an employer's reasonable competitive business interests and expressly prohibits an employee from engaging in employment or a line of business after termination of employment if the agreement or covenant is reasonable as to its duration, geo-

graphical area, and the type of employment or line of business.[4]

In determining reasonableness, Michigan courts consider factors including hardship on the employee, the employer's interests, and the consideration supporting the agreement.[5] Other states have similar standards. Though set forth in a variety of different ways, most states at a minimum require adequate or legal consideration, a legitimate business interest, and a reasonable scope with respect to territory, duration, and line of business.[6]

Despite the similarity in general standards, each jurisdiction has a distinct body of rules and precedent governing how the standards are applied. The differences are too numerous to catalog, but they include differences in whether relationships with prospective customers are protectable, whether there is an absolute limitation on duration, and whether a customer limitation can take the place of a geographic one.[7] Some states also impose further conditions. One notable example is Oregon, which requires that an employer inform the employee two weeks in advance that a noncompetition agreement is required, and that the employee's salary equals more than Oregon's median income for a family of four, among other things.[8]

A third critical area in which jurisdictions differ—and one that is currently heavily litigated and evolving—relates to consideration. Unlike in other areas of contract law, courts will inquire closely into whether a noncompetition agreement is supported by legally adequate consideration. An issue that arises is whether continued employment of an existing employee is sufficient. That is, where an employer presents an employee who is already on the payroll with a noncompetition agreement, the question is whether the agreement may be valid and enforceable absent further consideration, such as a promotion or increased salary. In Michigan, and in a number of jurisdictions, the answer is yes—continued employment is generally sufficient, at least for at-will employees.[9] Just recently, the Wisconsin Supreme Court—a state that has historically taken a strict approach to noncompetition agreements—sided with these states, ruling that "an employer's forbearance in exercising its right to terminate an at-will employee constitutes lawful consideration for a restrictive covenant."[10] In other jurisdictions, however, the answer is no—additional consideration is needed to support a noncompetition agreement.[11]

Among states requiring additional consideration beyond continued employment, there are further variations regarding what constitutes legally adequate consideration. The Texas Supreme Court, for example, has held that a promise to provide confidential information to an employee is sufficient consideration, provided that the employer actually provides the information subsequent to execution of the agreement.[12] In a number of states, although continued employment alone is not sufficient, it can become sufficient if it continues for a substantial time following execution of the agreement. In Illinois, the required time has been a subject of controversy since 2013, when an appeals court ruled that, in the absence of other consideration, employment for two years following the execution of the noncompetition agreement is required for the agreement to be valid.[13] Subsequent opinions have wrestled with the decision and taken different positions on whether two years is a per se minimum under Illinois law.[14] The issue remains unresolved.

Finally, states take different approaches to judicial reformation of overly broad agreements. The enforceability of a noncompetition agreement can be hard to predict. Therefore, it makes a difference whether, and to what extent, a court will modify an agreement found to be unreasonable to make it enforceable. Michigan's statute provides: "To the extent any such agreement or covenant is found to be unreasonable in any respect, a court may limit the agreement to render it reasonable in light of the circumstances in which it was made and specifically enforce the agreement as limited."[15] This "reasonable alteration" approach, which provides a court with significant discretion in modifying or reforming an unreasonable agreement, represents perhaps the majority position among states. However, several states adhere to a strict "blue penciling" approach, under which a court may strike a severable provision but may not add terms or otherwise reform an agreement to render it enforceable.[16] And courts in some jurisdictions will neither reform nor "blue pencil" an agreement. In these states, if a noncompetition agreement is deemed unreasonable as written, it simply will not be enforced.[17]

There are other differences across jurisdictions as well, for example, regarding the burden of proof in establishing a right to injunctive relief and the assignability of an

In determining reasonableness, Michigan courts consider factors including hardship on the employee, the employer's interests, and the consideration supporting the agreement.

agreement that is silent on the matter. Arguably, the law governing noncompetition agreements varies more by state that any other area of law. Given the importance of the confidential information, relationships, and other business interests that noncompetition agreements are designed to protect, the importance of choice-of-law considerations is hard to overstate.

Recent Choice-of-Law Decisions

Most jurisdictions, including Michigan,[18] follow some version of the standards set forth in the Restatement (Second) of Conflicts of Law in deciding whether to enforce a contractual choice-of-law provision. The Restatement provides, in relevant part, that the law of the state specified in the choice-of-law provision will govern a contract unless:

a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188 [which governs choice of law absent an effective choice of law], would be the state of the applicable law in the absence of an effective choice of law by the parties.[19]

In short, if there is no reasonable basis for the parties' choice of law, or if the law of the chosen state is against a policy of another state that has a greater interest in the matter and whose law would otherwise apply, the court should disregard the parties' choice of law. Several recent cases address the Restatement rule in connection with noncompetition agreements.

A case applying Michigan law walks through the full analysis. In *Stryker Corp v Ridgeway*, a Michigan company sued a former employee in Louisiana for breach of a noncompetition agreement.[20] The agreement contained a Michigan choice-of-law provision. The defendant argued that he was entitled to summary judgment because the application of Michigan law would have violated Louisiana fundamental policy.[21] The United States District Court for the Western District of Michigan rejected the argument and enforced the provision. Regarding subsection (a) of the Restatement rule—the "reasonable basis" prong—the court explained:

> Subsection (a) does not apply because Michigan clearly has a substantial relationship to the parties and the transaction because Stryker is located in Michigan and the parties had a reasonable basis for choosing Michigan law, namely, to ensure that Stryker will have some certainty in defending its rights in suits with its employees all over the country.[22]

In support, the *Stryker* court cited an earlier case in which a Michigan choice-of-law provision had been enforced in a similar circumstance, explaining parenthetically that "a national company has a strong interest in the uniform interpretation of employment contracts."[23] The court's remarks are consistent with the comments to the Restatement rule, which states that a reasonable basis for a choice of law may exist where, among other things, the contract is to be performed in the chosen state, one of the parties is domiciled or has its principal place of business in the chosen state, or, in many cases, the chosen state is the state of contracting.[24]

Regarding the second prong of the Restatement rule, the *Stryker* court explained: "Under subsection (b), Michigan courts will only apply Louisiana law if application of Michigan law would be contrary to a fundamental policy of Louisiana, and if Louisiana has a materially greater interest than Michigan in determining the effect of the noncompete agreement."[25] The court observed that Louisiana has a "strong public policy against covenants not to compete,"[26] but it also emphasized that Louisiana "does not completely prohibit noncompetition clauses."[27] Reasoning that "Michigan law only allows non-competition agreements that are reasonable as to duration, geographical area, and the type of employment," and that Louisiana "will also enforce non-competition agreements that are limited in scope," the court concluded that enforcing Michigan law would not violate a fundamental policy of Louisiana."[28] Furthermore, even if the agreement did violate Louisiana policy, the court held that Louisiana did not have a materially greater interest than Michigan in the determination of the matter, as also required by subsection (b) of the rule. Though the defendant lived, worked, and covered a sales territory in Louisiana, the court found that Michi-

The enforceability of a noncompetition agreement can be hard to predict.

gan had an equally significant interest because the plaintiff "is a Michigan corporation with its principal place of business in Michigan," and the harm resulting from the defendant's breach "would be felt in Michigan by a Michigan company."[29] For these reasons, and because Michigan's public policy favors enforcement of choice-of-law provisions, the defendant could not defeat the presumption that Michigan law applied.[30]

Other recent cases show circumstances in which subsection (b) of the Restatement rule is not satisfied. In *Brown & Brown, Inc v Johnson*, a New York court considered a Florida choice-of-law provision in a customer nonsolicitation agreement. Though New York noncompetition law is not unusually stringent, the court nevertheless refused to apply Florida law because it was contrary to New York public policy.[31] Under Florida law, "a party seeking to enforce a restrictive covenant only to make a prima facie showing that the restraint is necessary to protect a legitimate business interest, at which point the burden shifts to the other party to show that the restraint is overbroad or unnecessary."[32] Moreover, "Florida law explicitly prohibits courts from considering the harm or hardship to the former employee."[33] Finally, Florida courts must "construe restrictive covenants in favor of protecting the employer's interests, and may not use any rules of contract interpretation that would require the construction of a restrictive covenant narrowly or against the restraint or drafter."[34] By contrast, the court noted that New York law strictly construes restrictive covenants and seeks to balance the interests of employer and employee.[35] Based on this disparity in substance and procedure, the court concluded that the application of Florida law would have contravened a fundamental policy of New York.[36]

A recent case from the Court of Appeals for the Fifth Circuit takes an interesting approach to the public policy analysis. In *Cardoni v Prosperity Bank*, agreements containing noncompetition and nonsolicitation provisions and calling for the application of Texas law were at issue.[37] The plaintiff, a Texas bank, had entered into the agreements with four bankers in Oklahoma. As the opinion explains, Texas generally allows noncompetition agreements, provided they are reasonably limited, while Oklahoma does not.[38] Nevertheless, the opinion emphasizes that Oklahoma treats nonsolicitation agreements differently from noncompetition agreements. After surveying Oklahoma law, the opinion concludes: "We see no indication that Oklahoma's policy concerning nonsolicitation agreements rises to the level of a fundamental one that would be violated by applying the parties' chosen Texas law to the covenant."[39] The court notes that Oklahoma actually allows nonsolicitation agreements, albeit less freely than Texas does, and reasons that the nonsolicitation clause at issue, because it does not purport to bar competition, does not implicate Oklahoma's policy interest in "allowing residents of the state to earn a living."[40] Applying the Restatement rule, the Fifth Circuit held that the Texas choice-of-law provision applied to the noncompetition provision but not to the nonsolicitation provision.[41]

Finally, a recent Delaware case sheds light on the "materially greater interest" element of subsection (b). In *Ascension Ins Holdings, LLC v Underwood*, the Chancery Court of the State of Delaware declined to enforce a noncompetition agreement between a California resident and a Delaware company, despite the inclusion of a Delaware choice-of-law provision.[42] The noncompetition agreement at issue may have been enforced under Delaware law, which strongly favors freedom of contract, but it could not be enforced under California law because it did not fit into any exception to California's general ban on noncompetition agreements.[43] Of particular interest here, the court concluded not only that the agreement was contrary to California policy, but that California had a materially greater interest in the determination of the matter because, while the plaintiff was incorporated in Delaware, its principal place of business was in California, the agreement was executed in California, the defendant resided in California, and the noncompetition area specified in the agreement was almost entirely limited to California.[44] Accordingly, the court ruled against the plaintiff, commenting that "[t]he entire purpose of the Restatement analysis is to prevent parties from contracting around the law of the default state by importing the law of a more contractarian state, unless that second state also has a compelling interest in enforcement."[45]

Takeaways for Practitioners

When drafting noncompetition agreements in any scenario that implicates more than one jurisdiction—for instance, where a business has one or more employees in other states, or

It can also be useful to bear in mind that, at least in Michigan, a company's interest in the uniform interpretation of its contacts with employees in different states can be significant.

where an owner sells a company that transacts business in more than one state—careful attention should be paid to choice of law. Appropriate questions to ask include the following:

- Which states have a connection to the parties or the transaction? Where are the parties located? Where will the agreement be executed? Where will it be performed?
- Of these states, which have an interest in the noncompetition agreement? Which state or states have a materially greater interest than others?
- Of these states, which have more favorable noncompetition laws for the client? How does each treat protectable business interests, reasonable scope, and consideration?
- Of these states, which permit judicial reformation or blue penciling?
- If the choice-of-law provision is not enforced, how will the default state treat the agreement? If courts there will not enforce the agreement as written, will they reform or blue pencil it?

It can also be useful to bear in mind that, at least in Michigan, a company's interest in the uniform interpretation of its contacts with employees in different states can be significant.[46]

The cases discussed in this article also offer important lessons for litigators. Those seeking to enforce a noncompetition agreement may emphasize that a choice-of-law provision can be enforced even where the noncompetition laws of an alternative state are relatively stringent. As the *Stryker* case suggests, if the chosen state and the alternative state both allow reasonable noncompetition agreements, the mere fact that the alternative state may impose more demanding reasonableness standards does not mean that a fundamental policy of that state would be violated by application of the chosen state's law.[47] Moreover, the *Cardoni* case illustrates the importance of closely examining the policy allegedly implicated by a noncompetition agreement. Once the policy is understood, the agreement may turn out to be broadly consistent with it.[48] For those challenging a noncompetition agreement, *Ascension Holdings* shows that merely being incorporated in the chosen state may not be enough to ensure that the state's laws will be applied. If the parties and the activities at issue are chiefly in another state, the court may not enforce the parties' contractual choice of law.[49] Moreover, *Brown & Brown* demonstrates that a choice-of-law provision can be successfully challenged even in a jurisdiction that is relatively friendly towards noncompetition agreements. A challenger may find it useful to contrast the substantive and procedural rules of the states at issue (for instance, regarding burdens of proof in demonstrating reasonableness or whether hardship to the individual subject to the agreement is considered) to try to establish that one state favors employers while the other favors employees.[50]

If the parties and the activities at issue are chiefly in another state, the court may not enforce the parties' contractual choice of law.

Conclusion

A court's determination of whether to uphold a choice-of-law provision in a noncompetition agreement will be fact-specific and sometimes hard to predict—just as in other areas of noncompetition law. Nevertheless, careful consideration of the choice-of-law criteria and the relationship of the parties and contract at issue to the implicated jurisdictions can help secure clarity, predictability, and, in some instances, important substantive advantages.

NOTES

1. Noncompetition agreements are most commonly used in connection with employment and sale of a business. This article focuses on the employment context, where standards tend to be both stricter and more clearly defined, with attention to the sale context where appropriate. Reference is also made to nonsolicitation agreements, which are typically subjected to similar scrutiny.

2. Cal Bus & Prof Code 16600. The statutory exceptions are set forth in Cal Bus & Prof Code 16601-16607. Notably, California's prohibition has also been held to apply to customer nonsolicitation agreements. *See, e.g., Edwards II v Arthur Anderson*, 44 Cal 4th 937, 189 P3d 285 (2008).

3. Haw Rev Stat 480-4 (rev effective July 1, 2015).

4. MCL 445.774a. Outside the employment context, Michigan courts scrutinize noncompetition agreements according to the common-law "rule of reason." *See, e.g., Godlan, Inc v Greg Whiteford & DCL, Inc*, Nos 227696, 23155, 2003 Mich App LEXIS 610, at *3 (Mar 11, 2003) (unpublished).

5. *See Superior Consulting Co v Walling*, 851 F Supp 839, 848 (ED Mich 1994).

6. By way of example, see *Mallory Factor, Inc v Schwartz*, 146 AD2d 465, 467, 536 NYS2d 752 (1989) (explaining that noncompetition agreements under New York law "must meet the following criteria: (1) the time and geographical scope of the restriction must be

reasonable; (2) the burden on the employee must not be unreasonable; (3) the general public must not be harmed; and (4) the restriction must be necessary for the employer's protection").

7. For discussion of recent developments in the "line of business" and "reasonable competitive business interest" requirements of MCL 445.774a, see generally Michael S. Callahan, *Recent Cases Regarding Noncompetition Agreements*, MI Bus L J, Summer 2015, at 56-58.

8. Or Rev Stat 653.295.

9. *See, e.g., Lowry Computer Prods v Head*, 984 F Supp 1111 (ED Mich 1997) (holding that continued employment may support noncompetition agreement under Michigan law); *Corson v Universal Door Sys, Inc*, 596 So2d 565, 568 (Ala 1991) (same under Alabama law); *Open Magnetic Imaging, Inc v Nieves-Garcia*, 826 So2d 415, 418 (Fla Ct App 3d Dist 2002) (same under Florida law).

10. *See Runzheimer Int'l, Ltd v Friedlen*, 2015 WI 45, 362 Wis 2d 100, 128 (2015).

11. *See, e.g., Sanborn Mfg Co v Currie*, 500 NW2d 161, 164 (Minn Ct App 1993) (holding that continued employment alone may not support noncompetition agreement under Minnesota law); *Charles T Creech, Inc v Brown*, 433 SW3d 345, 354 (Ky 2014) (same under Kentucky law).

12. See *Alex Sheshunoff Mgmt Servs, LP v Johnson,* 209 SW 3d 644, 650-51 (Tex 2006).

13. *See Fifield v Premier Dealer Servs*, 2013 IL App (1st) 120327, 993 NE2d 938, 943 (2013).

14. *See, e.g., Instant Tech, LLC v DeFazio*, 40 F Supp 3d 989, 1010 (ND Ill 2014) (Holderman, J) (applying "bright line two-year rule reaffirmed in *Fifield*"); *Bankers Life and Casualty Co v Miller*, No 14 CV 3165, 2015 US Dist LEXIS 14337 (ND Ill Feb 6, 2015) (declining to apply "bright-line rule that two years is required").

15. MCL 445.774a.

16. *See, e.g., Olliver/Pilcher Ins v Daniels*, 148 Ariz 530, 715 P2d 1218 (1986) (en banc) (permitting blue penciling of severable agreement under Arizona law); *Pathfinder Communications Corp v Macy*, 795 NE 2d 1103, 1114 (Ind Ct App 2003) (same under Indiana law).

17. *See, e.g., Pace v Retirement Plan Admin Serv, Ltd*, 74 Va Cir 201 (2001) (declining to blue pencil even where provided for in agreement).

18. *See Chrysler Corp v Skyline Indus Servs, Inc*, 448 Mich 113, 124, 528 NW2d 698 (1995).

19. Restatement (Second) of Conflict of Laws 187 (1971).

20. Nos 1:13-CV-1066, 1:14-CV-889, 2015 US Dist LEXIS 125567 (WD Mich, Sept 21, 2015).

21. *See id.* at *12.

22. *See id.* at *13-14 (citation omitted).

23. *Id.* (citing *Lowry Computer Prods, Inc v Head*, 984 F Supp 1111, 1114 (ED Mich 1997)).

24. *See* Restatement (Second) of Conflict of Laws 187(2) cmt f.

25. 2015 US Dist LEXIS 125567 at *14.

26. *Id.* (quoting *L&B Transp, LLC v Beech*, 568 F Supp 2d 689, 693 (MD La 2008) (internal quotations omitted).

27. *Id.* (citing La Rev Stat 23:921(C) (providing that noncompetition clause may be valid "within a specified parish or parishes, municipality or municipalities, or parts thereof . . . not to exceed a period of two years from termination of employment")).

28. *Id.* at *15-16.

29. *Id.* (citing *Kelly Servs v Marzullo*, 591 F Supp 2d 924, 938 (ED Mich 2008)).

30. *Id.*

31. 25 NY3d 364, 34 NE 3d 357 (2015). New York follows the Restatement approach to choice-of-law questions. *See Estee Lauder Cos v Batra*, 430 F Supp 2d 158, 170 (SDNY 2006).

32. 34 NE 3d at 360 (citing Fla Stat 542.335 [1] [c]).

33. *Id.* at 361 (citing Fla Stat 542.335 [1] [g] [1]).

34. *Id.* (citing Fla Stat 542.335 [1] [h]).

35. *See Id.* at 360.

36. *See Id.* at 361

37. 805 F3d 573 (5th Cir 2015).

38. *Id.* at 576.

39. *Id.* at 587.

40. *Id.* at 588.

41. *See Id.* at 589.

42. No 9897-VCG, 2015 Del Ch LEXIS 19 (Jan 28, 2015).

43. Specifically, though the agreement putatively related to the sale of a business, California's "sale of business" exception did not apply because the agreement was not actually part of the purchase of the business at issue. *See id.* at *11 (citing Cal Bus & Prof Code 16601).

44. *See id.* at *3. As the *Ascension Holdings* court notes, in determining "the state of the applicable law in the absence of an effective choice of law by the parties," several factors set forth in Restatement 188, including the place of contracting and the place of performance, are to be examined. *See id.* at *3 n.11.

45. *Id.* at *5.

46. *See, e.g.,* Nos 1:13-CV-1066, 1:14-CV-889, 2015 US Dist LEXIS 125567, at *14 (WD Mich Sept 21, 2015).

47. *See Id.* at *15-16.

48. *See* 805 F3d 573, 588 (5th Cir 2015).

49. *See* No 9897-VCG, 2015 Del Ch LEXIS 19, at *17-18 (Jan 28, 2015).

50. *See* 25 NY3d 364, 34 NE 3d 357, 360-61 (2015).

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Think You Know the Common Interest Privilege? Guess Again!

By Joseph K. Grekin and Jeffery J. Sattler

Introduction

Attorneys cannot afford to assume that they understand the common interest privilege.[1] Federal courts even within the same circuit—*especially within the Sixth Circuit*—sometimes view and apply the privilege differently, which can end up having million, and sometimes billion, dollar implications.

As a result, attorneys should recognize that there is no certainty when it comes to the common interest privilege, and that waiver[2] of the attorney-client privilege[3] may result from a failed attempt to preordain the scope of the doctrine that a court may adopt. Attorneys should take practical steps to minimize this risk, if they choose to take it at all.

The Varying Scope of the Common Interest Privilege

The common interest privilege is not a privilege in and of itself.[4] Instead, it extends the attorney-client privilege to cover privileged information exchanged by two or more parties with a common interest.[5] The common interest privilege allows parties to share such information without waiving the attorney-client privilege.[6]

The broadest view of the common interest privilege comes from the Eighth Circuit.[7] "It provides that, if two or more entities with a common interest in a matter are represented by counsel and agree to share information concerning that matter, then privileged matters will retain that privilege as to outside parties. *This common interest may be legal, factual, or strategic*."[8]

The ruling in *Safco Products Co v Welcom Prods, Inc*,[9] typifies the Eighth Circuit's broad view.[10] In *Safco*, an original patentee received a patent on a pushcart used in moving boxes, and thereafter sold the patent to Safco Products Company (Safco).[11] After Safco filed a patent infringement action, one of the defendants in the litigation, Welcom Products, Inc., sought the disclosure and production of attorney-client communications shared by employees of Safco and the original patentee.[12]

Welcom argued that the communications could not be privileged because Safco waived any privilege when its employees shared the communications with employees of a third party.[13] The court disagreed and found that the caselaw relied upon by Welcom:

> suggests a narrower view of the common interest doctrine, requiring entities to share 'an identical, not similar, legal interest, and *not merely a commercial interest*.' … But as this Court observed from the outset, the applicable law here is that of the Eighth Circuit. And its view of the common interest doctrine cannot be reconciled with the narrow view… .[14]

The court ruled that Safco and the original patentee shared a legal, factual, or strategic interest sufficient to support the application of the common interest privilege, and it found that the communications therefore remained privileged.[15]

The Third and Fourth Circuits have a more limited take on the common interest privilege. The scope of the privilege in these circuits only permits the sharing of attorney-client privileged information between clients with *similar legal interests*, excluding factual, strategic, or commercial interests.[16]

In re Tribune Co,[17] llustrates the scope of this version of the privilege. Tribune was a large chapter 11 bankruptcy of a national media company, which had previously been the subject of an $8 billion leveraged buyout (LBO).[18] In *Tribune*, certain parties, including some with adverse interests, came together and proposed a chapter 11 plan aimed at, among other things, resolving LBO-related causes of action.[19]

Proponents of a competing plan subsequently sought to discover the communications among the proponents of the former plan regarding the LBO.[20] In denying the requested discovery, the court relied on *Teleglobe*, and ruled that "[e]ven though the [plan p]roponents' interests are not completely in accord, they share the common legal interest of obtaining approval of their settlement and confirmation of the[ir plan], thereby resolv-

ing the legal disputes between and among them."[21]

The Second Circuit has adopted an even stricter interpretation of the common interest privilege. "The Second Circuit follows a strict interpretation of the common interest rule, under which only those communications made in the course of an ongoing common enterprise and intended to further the enterprise are protected."[22] It requires that communications under the common interest privilege pertain to an *identical legal interest*.[23]

The case of *United States v United Techs Corp*,[24] shows the kind of identical legal interest that the Second Circuit's standard requires. In *United Techs*, five aerospace companies decided to form a consortium to produce an engine to compete with one produced by General Electric.[25] They shared a number of documents arising from their consultations and negotiations aimed at developing a corporate structure for the consortium "that would minimize the U.S. tax liability of all consortium members."[26]

Approximately a decade after the consultations and negotiations took place, the IRS investigated the tax liabilities of one of those companies, United Technologies Corp. (UTC), and subsequently sought the production of the aforementioned documents.[27] One of the documents sought was a "June 1982 memo from the head of UTC's tax department to the company's in-house counsel. The memo discusse[d] the tax consequences of [the consortium's] structure."[28]

The court applied the common interest doctrine, and denied the IRS access to the requested documents, including the 1982 memorandum.[29] In doing so, "[t]he court [found] that nearly all the documents pertain[ed] to the development of a common legal strategy regarding the tax structure of [the consortium]. In formulating this strategy, the members acted…as collaborators, legally committed to a cooperative venture and seeking to make that venture maximally profitable."[30] In other words, the companies all had the same (and therefore identical) legal interest—to create a joint venture with an advantageous tax structure.

The differences in the scope of the common interest privilege, exemplified by the Eighth, Fourth, Third, and Second Circuit caselaw, create a patchwork of different standards. This patchwork is, unfortunately, more complicated than merely determining which circuit's law applies. Interpretations of the privilege within each circuit vary a great deal, making it difficult to predict exactly how its standard will apply.

For example, some courts in the Second Circuit have interpreted that circuit's narrow standard even more narrowly than the court in *United Techs*, and, in effect, severely limited what actually constitutes a "legal interest." A prime example of this most narrow interpretation of the privilege is *Schaeffler v United States*.[31] In *Schaeffler*, a manufacturer and distributor of automotive and industrial components made a tender offer to acquire a components supplier.[32] The offeror did so on July 30, 2008, and did not foresee the nosedive that the stock market would take in the days that followed.[33] As a result of that dramatic downturn, the offeror ended up with about 90 percent of the outstanding shares, as opposed to the 70 to 75 percent that it expected, at an $11 billion cost.[34]

Significant solvency concerns for the offeror immediately arose.[35] The offeror retained Ernst & Young LLP to address the complex tax consequences of these events and an anticipated IRS audit.[36] In a 321-page memorandum, Ernst & Young recommended a refinancing and restructuring course for the offeror, and a "detailed legal analysis of the federal tax issues implicated by each step" (EY Memo).[37]

The bank consortium that funded the tender offer also feared that tax implications could materially affect the offeror's net cash flow and assets that would otherwise be available to repay the consortium's debt.[38] After executing a common interest agreement, the offeror and the consortium shared their documents and analyses, including the EY Memo.[39]

The *Schaeffler* court recognized that the bank consortium had an enormous stake in the tax consequences of the offeror's refinancing and restructuring decision.[40] In fact, this common interest of the consortium and the offeror is strikingly similar to the interest that the Second Circuit found to constitute a common legal interest in the *United Techs* case. Nevertheless, the *Schaeffler* court concluded that a common economic interest dependent on the resolution of legal issues regarding tax treatment does not equate to a common "legal" interest.[41] The court opined, "If the [b]ank [c]onsortium could have been named as a co-defendant in the anticipated dispute with the IRS, the result would undoubtedly be different."[42] Due to the inappli-

The common interest privilege is not a privilege in and of itself. Instead, it extends the attorney-client privilege to cover privileged information exchanged by two or more parties with a common interest.

cability of the common interest privilege, the *Schaeffler* court ordered the offeror to provide the IRS with a free 321-page Ernst & Young roadmap to its collection of tax on an $11 billion deal.[43&44]

The *Schaeffler* decision is only one example of a court's interpretation of the common interest doctrine seemingly at odds with the law in its own circuit. The doctrine is particularly prone to re-interpretation and varying construction, even with seemingly clear circuit court guidance.[45] This variation and unpredictability are magnified in the Sixth Circuit, where similar guidance is absent.

Sixth Circuit Law—A Muddled Picture

"[T]he Sixth Circuit does not appear to have directly adopted the requirements of the common interest doctrine[.]"[46] As a result, courts in the Sixth Circuit have ruled on issues related to claims of a common interest privilege in a "complicated and contradictory" manner, creating an unpredictable hodge-podge of lower court rulings.[47]

One square in the resulting patchwork of holdings is *United States v Lucas*,[48] which involved the prosecution of a special agent of the Drug Enforcement Agency. In *Lucas*, the court considered whether the special agent's sharing of attorney-client work product[49] with other defendants was covered by the common interest privilege.[50] The court defined the doctrine broadly, stating that, "[t]he common interest privilege applies…where multiple clients share a common legal or *commercial interest* and share legal advice based on that interest."[51] The court then ordered an evidentiary hearing to determine whether the common interest privilege applied.[52]

In contrast, in *William F Shea, LLC v Bonutti Research, Inc*,[53] the court described the doctrine more narrowly. In *Shea*, an agent sued its principal over commissions due and owing from the sale of certain patents.[54] During discovery, the principal turned over legal memoranda that it had previously shared with the purchaser of the patents at issue, but claimed that the memoranda were protected by the common interest privilege.[55] The *Shea* court explained the scope of the privilege as follows:

> The purpose of the common interest doctrine is to permit persons with *similar legal interests* to enjoy the same ability to communicate confidentially about their common interests with multiple attorneys that each client enjoys separately. A communication is privileged under the common interest doctrine as long as it deals a matter on which parties have agreed to work toward a mutually beneficial goal, even if those parties are in conflict on some points [sic].[56]

The court recognized, "not only did [the principal and purchaser] share an interest in the existence of 'strong and enforceable' patents, there were also a number of patents for which [the purchaser] had an interest in either commencing or continuing litigation."[57] The court ruled that the common interest privileged extended the attorney-client privilege to cover the sharing of the memoranda.[58]

The district court in *Abrams v First Tennessee Bank Nat'l Ass'n*,[59] adopted yet another interpretation of the common interest privilege. In *Abrams*, the purchaser of a cabin rental development sued certain banks and related entities involved in the sale for fraud.[60] During the litigation, the purchaser came to an agreement with one of the defendants/counter-plaintiff, but refused to disclose the terms of the agreement to the other defendants.[61] In finding that the common interest privilege did not cover the agreement (and thus compelling its production), the court observed that "the parties are fundamentally adverse to one another and do not share identical legal interests."[62] The court held, "The common interest privilege allows for two clients to discuss their affairs with a lawyer, protected by the attorney-client privilege, so long as they have an *identical (or nearly identical) legal interest* as opposed to a merely similar interest."[63]

Given the Uncertain Legal Landscape, What Should Attorneys Do?

First and foremost, attorneys should carefully consider whether to share otherwise privileged information under the guise of the common interest privilege. The inconsistent views taken by the courts, particularly in Sixth Circuit, make relying on the common interest privilege risky, if not an outright gamble. If more traditional and less risky means of sharing strategies and information can be effectively employed, it may well be worth sacrificing the convenience that document sharing under the common interest privilege provides in return for eliminating the risk of waiving the attorney-client privi-

First and foremost, attorneys should carefully consider whether to share otherwise privileged information under the guise of the common interest privilege.

lege that sharing documents under a claim of common interest brings.

If attorneys determine that trying to share privileged information under the common interest privilege is a risk worth taking, a best practice is reducing agreements for such sharing to writing.[64] Reducing agreements to writing in advance of actual sharing at least constitutes strong evidence that parties intended from the beginning to protect privileged communications from disclosure.[65]

Any common interest agreement should incorporate the elements of the most stringent views permitted under the facts of each case. Obviously, the agreement should explicitly state that the parties share common interests. The parties should cite to as many common interests as possible, and, in particular, as many common legal interests as possible. If the parties are currently co-defendants or co-plaintiffs in litigation, the agreement should state this and explain their common interests in the litigation. If the parties expect to become parties to litigation, the agreement should both state and explain this expectation.

In general, the more detail parties put in a common interest agreement explaining their common interests, the better. The parties should anticipate that a court is reviewing the agreement under a challenge to their claim of privilege and provide the court a roadmap through their factual recitals to find that a common interest exists.

A common interest agreement should also contain stringent protections that prevent the parties to the agreement from sharing any of the documents with third parties. These protections can take a form similar to the protections included in many confidentiality agreements and protective orders. Emphasizing the confidentiality of the documents that are exchanged can reinforce the argument that the parties exchanging the documents have a common legal interest in the highly sensitive documents, which no other parties share. In other words, treating the documents as confidential provides the parties with an argument that the court should do so as well.

In this vein, parties exchanging documents under a common interest agreement may also find it advantageous to date-stamp and number the documents exchanged, so that they can be easily identified. Correspondence enclosing date-stamped documents pursuant to a common interest agreement should reference the agreement, caution the receiving party of the confidentiality protections and obligations contained in the agreement, and remind the receiving party that these protections are meant to protect against a waiver of the attorney-client privilege.

However, parties should not be lulled into a false sense of security through entering into a common interest agreement. Having written agreements available to reference is certainly better than trying to argue after-the-fact that the parties intended to shield shared information from disclosure.[66] But common interest agreements are not in any way a guaranty that a court will apply the common interest privilege and hold that the attorney-client privilege applies to documents shared under the agreement.[67]

As a result, even if a common interest agreement exists, attorneys should exchange as few documents in reliance on the common interest privilege as possible. Whenever it is possible for counsel to effectively address a concept through oral discussion, or if the concept can be summarized in a less risky manner than distributing a privileged document, attorneys should strongly consider doing so. While this may make litigation more onerous, it will also make a privilege waiver less likely. For each document, counsel should carefully consider whether, when balancing the potential strategic advantages with the potential risk of disclosure, the benefit outweighs the risk.

In the end, attorneys should not assume that they know the scope of the common interest privilege. The scope is not settled, particularly in the Sixth Circuit. Moreover, the differences between the competing interpretations of the privilege are not merely academic—the standard a court applies may be the difference between protecting critical documents from disclosure.

As a result, attorneys should recognize that there are no unequivocal answers, and that reliance on the common interest privilege involves significant risk. Whether the strengths and weaknesses of a case necessitate the taking of such a risk is one of the strategy calls that can make or break a case. Understanding the risk, and hedging against it, is one of the best ways to give your client a valuable service.

Any common interest agreement should incorporate the elements of the most stringent views permitted under the facts of each case.

NOTES

1. Federal Rule of Evidence 501 provides that "state

law governs privilege regarding a claim or defense for which state law supplies the rule of decision." For purposes of brevity here, however, only the federal privilege is discussed.

2. "The law governing the waiver of the attorney-client privilege provides that the attorney-client privilege is lost if the client discloses the substance of an otherwise privileged communication to a third party." *United States v Wade*, No 05-4160, 2006 US App LEXIS 27110, at *6 (10th Cir Oct 30, 2006) (citation, quotation, and internal punctuation marks omitted).

3. Under the attorney-client privilege, "A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client." Jack B. Weinstein & Margaret A. Berger, *Weinstein's Federal Evidence*, § 503.01 (Joseph M. McLaughlin, ed, Matthew Bender 2d ed 2014) (citing Supreme Court Standard 503(b)); *see generally Geissal v Moore Med Corp*, No 4:94 cv 1263 DDN, 2000 US Dist LEXIS 4638, at *5-6 (D Mo Mar 31, 2000) ("When a plaintiff sues a defendant for a violation of federal law, the federal law of privilege applies. Proposed Federal Rule of Evidence 503, also referred to as Supreme Court Standard 503, generally describes the federal common law attorney-client privilege.").

4. *Caifornia Sportfishing Prot Alliance v Chico Scrap Metal, Inc*, No 2:10-cv-1207 GEBAC, 2014 US Dist LEXIS 20694, at *22 (ED Cal Feb 18, 2014).

5. *See United States v BDO Seidman, LLP*, 492 F3d 806, 815-16 (7th Cir 2007).

6. See *id*.

7. A few courts outside of the Eighth Circuit recognize this view as well. *See, eg, Caifornia Sportfishing Prot Alliance,* 2014 US Dist LEXIS 20694, at *23 ("The shared interest may be only financial or commercial in nature." (citation and quotation omitted); *United States v Lucas*, No 1:09 CR 222, 2009 US Dist LEXIS 123884, at *14 (ND Ohio Dec 23, 2009) ("The common interest privilege applies…where multiple clients share a common legal or commercial interest and share legal advice based on that interest." (citation omitted)).

8. *Safco Prods Co v Welcom Prods, Inc*, No 08-4918, 2010 US Dist LEXIS 145172, at *8 (D Minn Feb 18, 2010) (citing *In re Grand Jury Subpoena Duces Tecum*, 112 F3d 910, 922 (8th Cir 1997)) (emphasis added).

9. 2010 US Dist LEXIS 145172 (complaint ¶¶ 10 & 11) (D Minn Feb 18, 2008).

10. Another case recognizing the Eighth Circuit's broad view is *Petco Animal Supplies Stores, Inc v Insurance Co of N Am*, No 10-682, 2011 US Dist LEXIS 70748, at *71-72 n15 (D Minn June 10, 2011) ("[T]here are three situation [sic] where [the common interest privilege] is deemed to apply. . . . [T]he third situation arise [sic] when two or more clients share a common legal *or commercial interest* and, therefore, share legal advice with respect to that common interest." (citation and quotation omitted) (emphasis added)).

11. *Id*.

12. 2010 US Dist LEXIS 145172, at *7.

13. *Id*.

14. *Id* at *8-9 (identifying *Duplan Corp v Deering Milliken, Inc*, 397 F Supp. 1146 (DSC 1975), as the movant's relied upon case) (emphasis added).

15. *Id* at *9.

16. *See United States v Okun*, 281 Fed Appx 228, 231 (4th Cir 2008) ("[T]he common interest privilege 'allows attorneys representing different clients with *similar legal interests* to share information without having to disclose it to others.'") (adopting and quoting *Teleglobe Commc'ns Corp v BCE, Inc* (*In re Teleglobe Commc'ns Corp*), 493 F3d 345, 364 (3d Cir 2007)).

17. No 08-13141, 2011 Bankr LEXIS 299, at *13-15 (Bankr D Del Feb 3, 2011).

18. *Id* at *32.

19. *Id* at *3 n4, *9-10.

20. *Id* at *9-10.

21. *Id* at *13-15.

22. *Mobile Med Int'l Corp v Advanced Mobile Hosp Sys, Inc*, No 2:07-cv-231, 2015 US Dist LEXIS 23110, at *5-6 (D Vt Feb 24, 2015) (relying upon *US v Schwimmer*, 892 F2d 237, 238 (2d Cir 1989)).

23. 2015 US Dist LEXIS 23110, at *5 (citation omitted).

24. 979 F Supp 108, 110-11 (D Conn 1997).

25. *Id* at 110.

26. *Id*.

27. *Id*.

28. *Id* at 112-13.

29. *Id*.

30. *Id*.

31. 22 F Supp 3d 319 (SDNY 2014). Prior to sending this article to print, the Second Circuit Court of Appeals reversed this most narrow interpretation of the privilege, which demonstrates the uncertainty that exists in this area of the law. *See* 806 F3d 34, 42-43 (2d Cir 2015).

32. *Id* at 323.

33. See *id*.

34. *Id*.

35. *Id* at 323-24.

36. *See id* at 324-25.

37. *Id* at 337.

38. *Id* at 325.

39. *Id*.

40. 22 F Supp 3d at 331.

41. *Id*.

42. *Id* at 333.

43. *See id* at 331.

44. Another good example of this very narrow interpretation is *Cohen v Cohen*, No 09 Civ 10230, 2015 US Dist LEXIS 21319, at *10 (SDNY Jan 29, 2015) ("Ms. Napp is not a party to this litigation, and there has been no suggestion that she has any legal claim against Defendants whatsoever. She thus cannot possibly share any legal interest with Plaintiff sufficient to invoke the common interest doctrine.").

45. *See eg, JE Dunn Constr Co v Underwriters at Lloyd's London Syndicate # 2623*, No 05-0092-CV-W-FJG, 2006 US Dist LEXIS 26694, at *4 (WD Mo Apr 25, 2006) (interpreting the common interest privilege to require a legal interest, not merely a commercial interest, in contrast to the Eighth Circuit standard under which commercial interests are sufficient); *Beyond Sys, Inc v Kraft Foods, Inc*, No PJM-08-409, 2010 US Dist LEXIS 78689, at *9-10 (D Md Aug 3, 2010) (requiring the production of shared communications because sharing parties did not have an *identical* legal interest, in contrast with the Third Circuit standard which merely requires a *similar* legal interest).

46. *United States v Suarez*, No 5:13 CR 420, 2014 US Dist LEXIS 63687, at *17 (ND Ohio May 8, 2014) (footnote omitted).

47. *See State Farm Mut Auto Ins Co v Hawkins*, No 08-10367, 2010 US Dist LEXIS 55260, at *17 (ED Mich June 4, 2010).

48. No 1:09 CR 222, 2009 US Dist LEXIS 123884, at *1 (ND Ohio Dec 23, 2009).

49. The *Lucas* case pertains to the work product privilege and not the attorney-client privilege. However, the *Lucas* Court used the common interest analysis to analyze the parties' rights to withhold the documents that were the subject of the dispute, so it is nonetheless instructive.

50. *Id.* at *12.

51. *Id.* at *14-17 (citation omitted).

52. *Id.* at *15-17.

53. No 2:10-cv-615, 2013 US Dist LEXIS 48819 (SD Ohio Apr 4, 2013).

54. *Id.* at *2-3.

55. *Id.* at *3-6.

56. *Id.* at *6 (citations, quotations, and internal punctuation omitted) (emphasis added).

57. *Id.* at *9-10.

58. *Id.*

59. No 3:03-cv-428, 2006 US Dist LEXIS 21837 (ED Tenn Mar 28, 2006).

60. *Id.* at *27.

61. *Id.* at *28.

62. *Id.* at *32.

63. *Id.* at *30-33.

64. *See Rosser Int'l, Inc v Walter P. Moore & Assocs, Inc*, No 2:11-cv-1028, 2013 US Dist LEXIS 108561, at *57 (WD Pa Aug 2, 2013) (discussing the best practice under Pennsylvania state law).

65. *Id.* at *57-58.

66. *Cf Integrated Global Concepts, Inc v j2 Global, Inc*, No 5:12-cv-03434-RMW, 2014 US Dist LEXIS 7294, at *5-6 (ND Cal Jan 21, 2014) (recognizing the benefits of having a common interest privilege agreement in writing) (footnotes, quotations, and internal punctuation omitted).

67. *Cf Schaeffer*, 22 F Supp at 334 (holding that "[w]hile a written agreement [a common interest agreement] can be relevant to demonstrating actual cooperation toward a common legal goal, the mere assertion of a common legal interest in a written agreement cannot create such an interest"); *but see* footnote 31.

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Applying Claim Preclusion in Michigan: A Call for Clarity

By Joseph K. Grekin, John J. Stockdale, Jr., and Jeffery J. Sattler

Introduction

The doctrine of *res judicata* is intended to "relieve parties of the cost and vexation of multiple lawsuits, conserve judicial resources, and, by preventing inconsistent decisions, encourage reliance on adjudication."[1] "The doctrine bars a second, subsequent action when (1) the prior action was decided on the merits, (2) both actions involve the same parties or their privies, and (3) the matter in the second case was, or could have been, resolved in the first."[2] *Res judicata* bars not only claims already litigated, but also claims that the parties, exercising reasonable diligence, could have raised but did not.[3]

The third prong of the *res judicata* standard has caused some confusion over the years, because at least two different tests are used to interpret the third prong—the "same transaction" test and the "same evidence" test. The Michigan Supreme Court had adopted the "same transaction" test for *res judicata* standard. Yet, many Michigan courts continue to misapply the "same transaction" test or apply the "same evidence" test. This has created uncertainty for litigants and courts.

This article discusses the two tests courts generally considered in analyzing the third prong of the *res judicata* standard, followed by discussion of the Michigan Supreme Court's effort to clarify that the "same transaction" test is applicable under Michigan law when analyzing the third prong of the *res judicata* standard. The article then identifies two recent cases bookending the continued application of different tests for *res judicata*. Finally, the article identifies how other states have clarified their *res judicata* standards and concludes with proposed language codifying the "same transaction" test.

The Same Transaction Test and the Same Evidence Test

"The 'same transaction' test and the 'same evidence' test are alternative approaches used in determining the applicability of *res judicata*."[4]

The "same evidence" test bars only those claims in the second suit where the evidence or essential facts are identical.[5] "Under the same evidence test the definition of what constitutes a cause of action is narrower than under the transaction test."[6] As a result, one commentator noted that "the same evidence test served best as a 'test for inclusion' rather than a 'test for exclusion.'"[7]

By contrast, the "same transaction" test results in a broader prohibition. The "same transaction" test bars the claims in the second case that arose as part of the same transaction or occurrence as the claims in the first case.[8] The "same transaction" test is approached pragmatically by considering whether the facts in the two cases are related in time, space, origin, or motivation and whether they form a convenient trial unit.[9]

The Michigan Supreme Court Has Adopted the Same Transaction Test

In 2004, the Michigan Supreme Court recognized that "there appears to be some confusion regarding the relationship between the same transaction test and the same evidence test, [and] we take this opportunity to provide clarification."[10]

Adair v State considered whether *res judicata* applied to re-litigation of similar issues by similar parties under the Headlee Amendment, Mich Const. 1963, art 9, § 29.[11] In doing so, the court acknowledged that it "has taken a broad approach to the doctrine of *res judicata*, holding that it bars not only claims already litigated, but also every claim arising from the same transaction that the parties, exercising reasonable diligence, could have raised but did not."[12]

The court then recognized that because its decision in *Dart* used the narrower "same evidence" test, clarification regarding the proper test was necessary.[13] After a discussion of the "same transaction" test and the "same evidence" test, the Michigan Supreme Court adopted the "same transaction" test, stating:

> Because this Court has accepted the validity of the broader transactional

> test in Michigan, we need not consider as dispositive plaintiffs' assertions that the evidence needed to prove this case is different than was needed in [the first case]. Although that fact may have some relevance, the determinative question is whether the claims in the instant case arose as part of the same transaction as did the claims in [the first case]. "Whether a factual grouping constitutes a 'transaction' for purposes of res judicata is to be determined pragmatically, by considering whether the facts are related in *time, space, origin or motivation*, [and] whether they form a convenient trial unit… ." *46 Am Jur 2d, Judgments § 533*, p 801 (emphasis added).[14]

Michigan Appellate Courts Continue to Apply Different Tests for *Res Judicata*

Despite *Adair*'s efforts at clarification, the Michigan Court of Appeals recently issued two unpublished decisions highlighting the continued confusion over application of the "same transaction" test.

In *Marketplace of Rochester Hills Parcel B, LLC v Comerica Bank*,[15] Marketplace allegedly defaulted on a $25 million promissory note, which caused the mortgagee of its shopping center to sue Marketplace and the guarantors (the "First Suit"), alleging the loan was in default and the guarantees had been breached, and asking for appointment of a receiver.[16] The parties accepted case evaluation and dismissed the First Suit with prejudice.[17]

After First Suit was dismissed, the mortgagee noticed the rents from Marketplace's tenants under the mortgage under its assignment of rents.[18] As a result, Marketplace sued the mortgagee for conversion and tortious interference, using *res judicata* offensively—as a sword instead of a shield.[19] Under its *res judicata* theory, Marketplace argued that the mortgagee could no longer enforce the mortgage, including the assignment of rents, because the mortgagee had already sued Marketplace seeking the appointment of a receiver and the guarantors for breach of the guarantees in the First Suit.[20] Marketplace claimed that the mortgagee's failure to include a claim under the mortgage in the First Suit precluded it from noticing "Marketplace's tenants to make payments to it under the mortgage."[21]

The appellate court disagreed.[22] It initially considered whether the compulsory joinder rule, MCR 2.203(A), required that a judicial foreclosure action be brought together with the breach of guaranty claim and the request for an appointment of a receiver.[23] It reasoned that "[t]wo claims arise out of the same transaction or occurrence [for compulsory joinder purposes] if 'the same facts or evidence are essential to the maintenance of the two actions.'"[24] The appellate court concluded that "while some facts may have overlapped (such as whether Marketplace defaulted on the mortgage), the *same facts and evidence were not essential to both actions*" and, therefore, compulsory joinder was not required.[25]

The appellate court then turned to the issue of whether *res judicata* could be applied defensively to bar the second action. In doing so, the appellate court reasoned that "[j]ust as with compulsory joinder, claims arise from the same transaction for the purposes of *res judicata* if they concern identical evidence or essential facts."[26] The appellate court then concluded that *res judicata* did not apply because "[t]he guaranty action did not arise from the same transaction or occurrence as the bank's potential actions under the mortgage."[27]

A review of *Adair* shows that the *Marketplace* court misapplied *Adair*. The *Marketplace* court relied on the first sentence in this section of *Adair* for its definition of *res judicata*:

> This Court has noted that "res judicata bars a subsequent action between the same parties when the evidence or essential facts are identical." … This statement refers to what is generally called the "same evidence" test. Because there appears to be some confusion regarding the relationship between the "same transaction" test and the "same evidence" test, we take this opportunity to provide clarification.[28]

However, *Adair* later clarifies that the appropriate standard is not the "same evidence" test, but the "same transaction" test.[29] The *Marketplace* court applied the "same evidence" test.[30] If the *Marketplace* court applied the "same transaction" test as required by *Adair*, the outcome might have been different.

In stark contrast to *Marketplace,* the Michigan Court of Appeals in *Green v Ziegelman*[31] applied the "same transaction" test recited in *Adair*. As a result, the *Green* court held that a

Res judicata bars not only claims already litigated, but also claims that the parties, exercising reasonable diligence, could have raised but did not.

claim in a subsequent suit did not arise out of a transaction or occurrence that was the subject of a prior suit.

In *Green*, investors formed a limited liability company ("LLC") to develop 13 acres of land in Washtenaw County into industrial office space.[32] To achieve those ends, the investors brought in an architectural firm to serve as architect and construction manager for the project, and they made the architectural firm's principal a member of the LLC.[33]

The relationship between the investors and the architectural firm's principal soured after the architectural firm's principal made an unsuccessful play to seize control of the project, and thereafter caused the architectural firm to stop performing.[34] In 2006, the LLC sued the architectural firm and its principal and received a $156,313 judgment against the architectural firm.[35]

During post-judgment discovery, the investors learned that the principal had materially misrepresented the architectural firm's experience and transferred the architectural firm's assets to a new entity ten days after entry of the judgment.[36] The investors commenced a second suit against the principal and the architectural firm under piercing the corporate veil and fraudulent transfer theories. The trial court concluded in 2013 that *res judicata* did not prohibit the second suit and that the principal was jointly and severally liable for the $156,313 judgment.[37]

The principal appealed, arguing that *res judicata* applied to bar actions against him personally that could have been brought in the 2006 suit, and that the failure of the investors to do so precluded them from bringing it in the 2013 case.[38] The appellate court disagreed. First, it reasoned:

> Michigan courts have broadly applied *res judicata* to bar "not only claims already litigated, but every claim arising from the same transaction that the parties, exercising reasonable diligence, could have raised but did not." This Court will not, however, use *res judicata* to "lighten the loads of the state court by precluding suits whenever possible"—we employ it to promote fairness.[39]

The appellate court then went on to apply the "same transaction" test recited in *Adair*:

> Accordingly, this Court applies the same transaction test "pragmatically, by considering whether the facts are related in time, space, origin or motivation, and whether they form a convenient trial unit." If the new claim or claims arise from the same group of operative facts as the previously litigated claim or claims, even if there are variations in the evidence needed to support the theories of recovery, we will treat the claims as the same and *res judicata* will apply.[40]

The *Green* court concluded, "[W]hether a claim could have been litigated is subject to a reasonable person standard: whether a party 'exercising reasonable diligence' could have raised the claim, even if the actual party or parties neglected to do so."[41] The court held that a reasonable person could not have raised the misrepresentation claim against the principal in 2006 because the principal did not fraudulently transfer the architectural firm's assets until after the court entered its 2006 judgment and because the transfer was not discovered until post-judgment discovery.[42]

Green and *Marketplace* are examples of a wider problem. Despite the Supreme Court's attempt in *Adair* to settle this area of the law, Michigan courts continue to use different tests (or different versions of the same test) to define the scope of *res judicata*. For instance, numerous courts are combining or mixing the definitions of the same transaction and the same evidence tests.[43] Others are recognizing the validity of both tests.[44]

The widespread disparity in the *res judicata* standards used by Michigan appellate courts results in uncertainty among litigants and trial courts.

Other States Have Codified the "Same Transaction" Test

The widespread disparity in the *res judicata* standards used by Michigan appellate courts results in uncertainty among litigants and trial courts. In any particular case, it is difficult, if not impossible, to determine which test for the application of *res judicata* will be applied.

This uncertainty is anathema to the central purpose of *res judicata.* The doctrine is intended to prevent inconsistent decisions and encourage reliance on adjudication.[45] When the doctrine itself is inconsistently applied, the inconsistency cuts against the very reason for its existence.

At least two states have addressed conflicts arising from the different tests for *res judicata* by codifying a standard in a statute or court rule. The legislative history in each case illustrates that the purpose, in part, was to add certainty to the application of *res judicata*.

First, Louisiana codified the doctrine of *res judicata* in 1990 in La. R.S. §13:4231.[46] The Louisiana legislature specifically adopted the "same transaction" test to "requir[e] the plaintiff to seek all relief and to assert all rights which arise out of the same transaction or occurrence."[47] Part of the reason for the statute was that, "by focusing on the transaction or occurrence which would be comparatively easy to determine, this proposal avoids the much more difficult problem of defining what constitutes 'cause of action.'"

In 2006, the Virginia Supreme Court adopted Rule 1:6,[48] which also codified the "same transaction" test.[49] The codification was in response to the court's decision in *Davis v Marshall Homes, Inc*,[50] which adopted the "same evidence" test.[51] The *Davis* decision was widely thought to be a judicial anomaly, and commentators remarked that it confused experienced litigators and trial judges.[52] Two years after *Davis*, the Virginia Supreme Court reversed itself and adopted Rule 1:6, which incorporated the "same transaction" test "on the ground that it best furthered the traditional goals of *res judicata*."[53]

Recommendation—Codifying the Standard

The Michigan Supreme Court attempted in *Adair* to clarify that Michigan law applies the "same transaction" test and not the "same evidence" test in determining whether *res judicata* precludes bringing a claim.[54] But despite its efforts at clarification, many Michigan appellate courts continue to use different tests.[55] As a result, black-letter law is needed to rectify the continuing confusion regarding these tests and to bring consistency and certainty to a doctrine that is intended to provide these much needed attributes to trial courts and litigants.

To that end, the authors suggest that the legislature follow Louisiana and codify the *res judicata* standard or, in the alternative, the Michigan Supreme Court follow Virginia and adopt a court rule clarifying the standard. The authors propose the following language for a statute or court rule:

Res Judicata—Claim Preclusion

A. A second or subsequent action is barred when
   1. There was a previous action which involved the same parties or their privies;
   2. The first action was decided on the merits; and
   3. The matter contested in the second action (i) arises from the same transaction or occurrence, and (ii) was or, had such claimant exercised reasonable diligence, could have been resolved in the first action.[56]

B. For the purposes of (A)(3) above, whether a factual grouping constitutes a 'transaction or occurrence' is determined pragmatically, by considering whether the facts are related in time, space, origin or motivation and whether they form a convenient trial unit, and regardless of whether the evidence, legal elements or essential facts of the first action are necessary to maintain the second action.[57]

C. The law of privity as articulated in Michigan caselaw is unaffected by this Rule and remains intact.

This proposed language, which adopts the Michigan Supreme Court's test from *Adair*, would resolve the differences between the appellate courts regarding how *res judicata* is applied. It would provide a clear standard that could guide trial courts and future litigants. In short, it would help the *res judicata* doctrine provide what it was intended to provide all along—the conservation of judicial resources, the prevention of inconsistent decisions, and encouragement of the reliance on adjudication.[58]

NOTES

1. *Pierson Sand & Gravel, Inc. v Keller Brass Co.*, 460 Mich 372, 380, 596 NW2d 153 (1999) (citation and quotation omitted).

2. *Adair v State*, 470 Mich 105, 121, 680 NW2d 386 (2004).

3. *Id.* (citation omitted).

4. *Adair*, 470 Mich at 124.

5. *Dart v Dart*, 460 Mich 573, 597 NW2d 582 (1999).

6. *Adair*, 470 Mich at 124, *quoting River Park v City of Highland Park*, 184 Ill 2d 290, 307-309, 703 NE2d 883 (1998).

7. D. Arthur Kelsey, *The Thing Decided: Rule 1:6's Rediscovery of Res Judicata in Virginia*, 18 Va B Assoc News J June/July 2008, *citing* Robert C. Casad & Kevin M. Clermont, *Res Judicata: A Handbook on its Theory*, Doctrine & Practice 66 (2001).

8. *Adair*, 470 Mich at 125.

9. *Id.*, *quoting* 46 Am Jur 2d, Judgments § 533, p. 801.

10. *Adair*, 470 Mich at 124.

11. A discussion of the Headlee Amendment is beyond the scope of this article.

12. *Adair*, 470 Mich at 121, *citing Dart*, 460 Mich at

586.

13. *Id.* at 123-124.

14. *Id.* at 124-125.

15. 309 Mich App 579, __NW2d__ (2015).

16. *Id.* at 582.

17. *Id.*

18. *Id.* at 583.

19. *Id.* at 583, and 588-589.

20. *Id.* at 586 and 589.

21. *Id.* at 585.

22. *Id.* at 587.

23. *Id.* at 585.

24. *Id.* at 586, *citing Jones v State Farm Mut Auto Ins Co*, 202 Mich App 393, 401, 509 NW2d 829 (1993) (a pre-*Adair* case, relying on the following standard: "The test for determining whether two claims arise out of the same transaction and are identical for res judicata purposes is whether the same facts or evidence are essential to the maintenance of the two actions").

25. *Id.* at 587 (emphasis added).

26. *Id.* at 588, *citing Adair*, 470 Mich at 123.

27. *Id.* at 589.

28. *Adair*, 470 Mich 123-124.

29. *Id.* at 125.

30. *Id.*

31. 310 Mich App 436, __NW2d__ (2015).

32. *Id.* at 439-440.

33. *Id.* .

34. *Id.* at 440.

35. *Id.*

36. *Id.* at 441.

37. *Id.* at 438, 443.

38. *Id.* at 443-445.

39. *Id.* at 445 (citations and quotations omitted).

40. *Id.* (citation and quotation omitted).

41. *Id.* at 446-447 (citation omitted).

42. *Id.* at 447-449.

43. *See*, *e.g.*, *Citizens Ins Co of America v National Union Fire Ins Co of Pittsburgh*, No 313827, 2014 Mich App LEXIS 746, *7 (Apr 22, 2014) (unpublished) ("Claims arise from the *same transaction* if they concern identical evidence or essential facts.") (citation omitted) (emphasis added); *Matthews v Wells Fargo Bank, NA*,No 14-11232, 2014 US Dist LEXIS 57611, *7-8 (ED Mich Apr 25, 2014) ("The test for determining whether two claims arise out of the *same transaction* or occurrence for *res judicata* purposes is whether the same facts or evidence are essential to the maintenance of the two actions.") (citation omitted) (emphasis added); *Eager v Credit Bureau Collection Servs, Inc*, No 1:13-CV-84, 2013 US Dist LEXIS 150033, *11 n. 3 (ED Mich Oct 18, 2013) ("The test for determining whether two claims arise out of the *same transaction* and are identical for *res judicata* purposes is whether the same facts or evidence is essential to the maintenance of the two actions.") (citation and quotation omitted) (emphasis added).

44. *See*, *e.g.*, *Cook v City of Detroit*, Nos 308561, 310509, 2014 Mich App LEXIS 2, *8 (Jan 2, 2014) (unpublished); *Bloch v Bloch*, No 290086, 2010 Mich App LEXIS 1647, *5-6 (Sept 2, 2010) (citation omitted) (unpublished); *Charter Township of Chesterfield v Kent*, No 293795, 2010 Mich App LEXIS 2325, *10 (Dec 7, 2010) (citation omitted) (unpublished); *Rehab Mgmt Solutions v Diversa Care Therapeutics*, No 11-11990-BC, 2011 US Dist LEXIS 104156, *11-12 (ED Mich Sept 14, 2011) (citations omitted).

45. *Pierson Sand & Gravel, Inc*, 460 Mich at 380.

46. La R.S. § 13:4231 codified claim preclusion and issue preclusion. La.R.S. § 13:4231 provides as follows:

> Except as otherwise provided by law, a valid and final judgment is conclusive between the same parties, except on appeal or other direct review, to the following extent:
>
> (1) If the judgment is in favor of the plaintiff, all causes of action existing at the time of the final judgment arising out of the transaction or occurrence that is the subject matter of the litigation are extinguished and merged in the judgment.
>
> (2) If the judgment is favor of the defendant, all causes of action existing at the time of final judgment arising out of the transaction or occurrence that is the subject matter of the litigation are extinguished and the judgment bars a subsequent action on those causes of action.
>
> (3) A judgment in favor of either the plaintiff or the defendant is conclusive, in any subsequent action between them, with respect to any issue actually litigated and determined if its determination was essential to that judgment.

47. La. R.S. §13:4231, Official Comment (a).

48. Va. C.R. 1:6 states in pertinent part as follows:

> *Definition of Cause of Action*. A party whose claim for relief arising from identified conduct, a transaction, or an occurrence, is decided on the merits by a final judgment, shall be forever barred from prosecuting a second or subsequent civil action against the same opposing party or parties on any claim or cause of action that arises from the same conduct, transaction or occurrence, whether or not the legal theory or rights asserted in the second or subsequent action were raised in the prior lawsuit, and regardless of the legal elements or the evidence upon which any claims in the prior proceeding depended, or the particular remedies sought. A Claim for relief pursuant to this rule includes those set forth in a complaint, counterclaim, cross-claim or third-party pleading.

49. *See Kelsey*, s*upra* at 18.

50. 265 Va 159, 576 SE2d 504 (2003). Coincidently, *Davis* was decided the same year as *Adair*.

51. *Id.*

52. *Id.* at 20.

53. *Id.*

54. *See Adair*, *supra*.

55. *See, e.g.,* 309 Mich App 579; *Watha v Talmer Bank and Trust*, No 308236, 2013 Mich App LEXIS 525 (Mar 21, 2013) (unpublished).

56. *See Adair*, 470 Mich at 121 (reciting the three elements of *res judicata*), *citing Sewell v Clean Cut Mgmt*, 463 Mich 569, 575, 621 NW2d 222 (2001).

57. *See Adair*, 470 Mich at 124-125, *quoting* 46 Am Jur 2d, Judgments § 553, p. 801.

58. *Pierson Sand & Gravel, Inc*, 460 Mich at 380.

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Receivership Forms Update

By Judy B. Calton[1]

The Spring 2015 issue of the *Michigan Business Law Journal* published an article "Receivership Forms" on the nine forms the Receiverships Forms Committee[2] had drafted and submitted to the Michigan Supreme Court's Administrative Office ("SCAO") for consideration and adoption.

On February 10, 2016, SCAO released the following four forms, which are listed below and follow, to be used in receivership estate cases:

MC 439 Notice of Order Appointing Receiver (Receivership Estate)

MC 440 Acceptance of Receivership Appointment (Receivership Estate)

MC 441 Notice of Receiver's Application for Fees or Expenses (Receivership Estate)

MC 442 Final Report and Accounting (Receivership Estate)

The forms can be downloaded from http://courts.mi.gov/Administration/SCAO/Forms/Pages/Recent-Form-Revisions.aspx. The other proposed forms were not adopted.

Judy B. Calton is a partner at Honigman Miller Schwartz and Cohn LLP in Detroit, Michigan, in its Bankruptcy and Restructuring, Workouts and Loan Sales Practice Groups. She counsels clients in commercial law, corporate reorganization, and transactions. Ms. Calton has particular experience in insolvency related litigation. She is currently Co-chair of the Business Law Section of the State Bar of Michigan.

NOTES

1. The author gratefully acknowledges the assistance of Michael Leib in working with SCAO.

2. The members of the Receiverships Forms Committee consist of Honorable Annette Berry, Wayne County Circuit Court; Judy B. Calton, Honigman Miller Schwartz and Cohn LLP; Honorable Robert J. Colombo, Jr., Chief Judge, Wayne County Circuit Court; Gregory J. DeMars, Honigman Miller Schwartz and Cohn LLP; Robert J. Diehl, Jr., Bodman PLC; David M. Findling, Findling Law Firm PLC; Honorable John C. Foster, Chief Judge, Macomb County Circuit Court (retired); Honorable Kirsten Frank Kelly, Judge, Michigan Court of Appeals; Kay Standridge Kress, Pepper Hamilton LLP; Michael S. Leib; Judith Greenstone Miller, Jaffe Raitt Heuer & Weiss, P.C.; and the Honorable Christopher P. Yates, Judge, Kent County Circuit Court.

Approved, SCAO

Original - Court
1st copy - Defendant

2nd copy - Plaintiff
3rd copy - Receiver

STATE OF MICHIGAN JUDICIAL CIRCUIT JUDICIAL DISTRICT COUNTY PROBATE	NOTICE OF ORDER APPOINTING RECEIVER (RECEIVERSHIP ESTATE)	CASE NO.

Court address **Court telephone no.**

Plaintiff(s) name(s), address(es), and telephone no(s).	v	Defendant(s) name(s), address(es), and telephone no(s).
Plaintiff's attorney, bar no., address, and telephone no.		Defendant's attorney, bar no., address, and telephone no.

☐ Probate In the matter of _____

YOU ARE NOTIFIED:

On _____ (Date), the court appointed _____ (Name of receiver)

as receiver for the receivership estate described below.

Description of Receivership Estate	Name and Address of Person/Entity with Recorded Interest in Receivership Estate

Date

Signature of receiver/authorized agent of receiver

Name (type or print)

Address

City, state, zip Telephone no.

CERTIFICATE OF MAILING

I certify that on this date I served a copy of this notice on the parties or their attorneys and all persons or entities named above as having a recorded interest in the receivership estate by first-class mail addressed to their last-known addresses in accordance with MCR 2.107(C)(3).

Date

Signature

Approved, SCAO

Original - Court
1st copy - Defendant

2nd copy - Plaintiff
3rd copy - Receiver

STATE OF MICHIGAN JUDICIAL CIRCUIT JUDICIAL DISTRICT COUNTY PROBATE	ACCEPTANCE OF RECEIVERSHIP APPOINTMENT (RECEIVERSHIP ESTATE)	CASE NO.

Court address **Court telephone no.**

Plaintiff(s) name(s), address(es), and telephone no(s).	v	Defendant(s) name(s), address(es), and telephone no(s).
Plaintiff's attorney, bar no., address, and telephone no.		Defendant's attorney, bar no., address, and telephone no.

☐ Probate In the matter of _____

1. I accept the appointment as receiver for the receivership estate identified in the order of appointment.
2. By accepting this appointment, I acknowledge the following:
   a. I am not disqualified under MCR 2.622(B)(6).
   b. I am submitting to the personal jurisdiction of the court.
   c. As receiver, I am a fiduciary for the benefit of all persons appearing in this action or proceeding.
   d. I agree to file reports as required by court rule, statute, and order of this court.
   e. I agree to perform the duties of a receiver as required by court rule, statute, and order of this court.

Date

Signature of receiver/authorized agent of receiver

Name (type or print)

Address

City, state, zip Telephone no.

CERTIFICATE OF MAILING

I certify that on this date I served a copy of this acceptance of receivership appointment on the parties or their attorneys by first-class mail addressed to their last-known addresses as defined in MCR 2.107(C)(3).

Date

Signature

Approved, SCAO

Original - Court
1st copy - Defendant

2nd copy - Plaintiff
3rd copy - Receiver

STATE OF MICHIGAN JUDICIAL CIRCUIT JUDICIAL DISTRICT COUNTY PROBATE	NOTICE OF RECEIVER'S APPLICATION FOR COMPENSATION, FEES, OR EXPENSES (RECEIVERSHIP ESTATE)	CASE NO.

Court address **Court telephone no.**

Plaintiff(s) name(s), address(es), and telephone no(s).	v	Defendant(s) name(s), address(es), and telephone no(s).
Plaintiff's attorney, bar no., address, and telephone no.		Defendant's attorney, bar no., address, and telephone no.

☐ Probate In the matter of _____

YOU ARE NOTIFIED:

1. I have been appointed receiver of the receivership estate identified in this case.
2. On _____ (Date), I filed an application for ☐ compensation ☐ payment of fees or expenses for my service as receiver. A copy of that application is attached to this notice.
3. You may object to this application. Any objection must be in writing and filed with the court within 7 days after service of this notice. You must serve a copy of your objection on the receiver in accordance with MCR 2.107.
4. If an objection is filed, the court will schedule a hearing on the objection and notify all parties of the scheduled hearing.

Date

Signature of receiver/authorized agent of receiver

Name (type or print)

Address

City, state, zip Telephone no.

CERTIFICATE OF MAILING

I certify that on this date I served a copy of this notice of receiver's application for compensation, fees, or expenses on the parties or their attorneys by first-class mail addressed to their last-known addresses as defined in MCR 2.107(C)(3).

Date

Signature

MCR 2.622(F)

Approved, SCAO

Original - Court
1st copy - Defendant

2nd copy - Plaintiff
3rd copy - Receiver

STATE OF MICHIGAN JUDICIAL CIRCUIT JUDICIAL DISTRICT COUNTY PROBATE	FINAL REPORT AND ACCOUNTING (RECEIVERSHIP ESTATE)	CASE NO.

Court address **Court telephone no.**

Plaintiff(s) name(s), address(es), and telephone no(s).	v	Defendant(s) name(s), address(es), and telephone no(s).
Plaintiff's attorney, bar no., address, and telephone no.		Defendant's attorney, bar no., address, and telephone no.

☐ Probate In the matter of _____

1. I have been appointed receiver of the receivership estate in this case. I submit this final report and accounting as required by MCR 2.622(D)(7). An accounting of the income and expenses of the receivership estate is included.

(**NOTE:** If there are surplus assets in the receivership estate after distributions are made and expenses are paid, the final report and accounting should contain a proposed distribution schedule of those remaining assets.)

2. **SUMMARY**

Balance on hand from first accounting (or value of inventory from first accounting)..... $ _____
Add income (total from Schedule A)..... $ _____
Total assets accounted for..... $ _____
Subtract disbursements (total from Schedule B)..... $ _____
Total balance of assets remaining (itemize and describe in Schedule C)..... $ _____

☐ The accounting is contained on separate attached sheets.

SCHEDULE A: Income		SCHEDULE B: Expenses and other disbursements, including distributions to a party or parties and creditors	
Source of income	Amount	Disbursement	Amount
Total Income		Total expenses and disbursements	

SCHEDULE C: Itemized assets remaining. If additional sheets are required, write “See attached sheets.”	
Asset	Value
BALANCE OF ASSETS REMAINING	

Total number of attached pages of supporting documentation: _____

_____
Date

_____
Signature of receiver/authorized agent of receiver

_____
Name (type or print)

_____
Address

_____
City, state, zip Telephone no.

CERTIFICATE OF MAILING

I certify that on this date I served a copy of this final report and accounting, including all attachments, on the parties or their attorneys by first-class mail addressed to their last-known addresses as defined in MCR 2.107(C)(3).

_____
Date

_____
Signature

Case Digests

Contracts—Force Majeure Clause

***Kyocera Corp v Hemlock Semiconduct LLC*, No 327974, 2015 Mich App LEXIS 2249 (Dec 3, 2015)**

The parties entered into four long-term contracts between 2005 and 2008 that required plaintiff to purchase a certain quantity of polysilicon annually over a ten-year period. Plaintiff contracted to secure a long-term, stable supply of polysilicon while the trade-off was a fixed price and an obligation to pay for polysilicon, even if that need later proved to be non-existent. The parties did not set a price floor or ceiling, meaning that plaintiff assumed all downside price risk and defendant assumed all upside price risk if the market price rose. Each agreement also contained an acceleration clause that made plaintiff liable for the full purchase price of all unordered polysilicon for the entire length of the contract if there was a default in payment.

At issue in this case was the November 13, 2008, long-term supply agreement under which plaintiff was to pay defendant over $514,848,000 in advance payments for set amounts of polysilicon to be purchased through 2020. The deliveries were scheduled to begin in 2011 and end in 2020. This agreement contained a force majeure provision, which stated:

> Neither Buyer nor Seller shall be liable for delays or failures in performance of its obligations under this Agreement that arise out of or result from causes beyond such party's control, including without limitation: . . . acts of the Government . . . .

Plaintiff alleged that after this agreement was executed the Chinese government provided illegal subsidies to Chinese companies and engaged in "large-scale dumping," i.e., "where a foreign producer aided by state support sells a product at a price that is lower than its cost of production to manipulate an industry and capture market share." Plaintiff alleged that this resulted in China gaining 75 percent of the global solar panel market and caused over 20 United States and European manufacturers to go out of business and solar panel prices to decline precipitously. In 2012, the United States imposed anti-subsidy and anti-dumping import tariffs on Chinese-manufactured components of solar panels. As a result of China's market interference, plaintiff alleged that the price of polysilicon to which the parties agreed in 2008 was significantly higher than the 2015 market price. Plaintiff maintained that as a result of the price change that defendant reduced its participation in the solar market and focused on enforcing its long-term contract, in many cases accepting cash settlements without having to provide polysilicon, which caused defendant to remain profitable despite the United States and China's lack of progress toward resolution of the dispute.

In 2011 and 2012, the parties agreed to a series of amendments to the agreement at issue, lowering the gross price and applying advance payments to shipments in 2011 and 2012 but leaving the gross prices from 2013 to 2020 unchanged. Plaintiff alleged that after the 2011 and 2012 amendments were signed, defendant began a strategy of abandoning long-term contracts by refusing amendments and keeping its customers' advance payments while charging them double the market prices, resulting in defendant's invocation of the acceleration clauses of the long-term contracts, lawsuits, and settlements. By 2014, defendant insisted that there would be no further amendments to the agreement in this case and that in December 2014, after the United States imposed further anti-dumping duties on Chinese solar panels and cells, defendant's Tennessee plant was permanently closed.

On February 2, 2015, plaintiff sent notice to defendant that it would be exercising its right under the force majeure clause to discontinue its contractual obligations because of the actions of the Chinese government. On February 13, 2015, plaintiff filed a complaint for declaratory judgment, seeking a declaration that the acts of the Chinese or United States governments constituted a force majeure event and that it was not liable for delays or failures to perform for so long as the force majeure event continued. Defendant filed a motion for summary disposition, alleging that plaintiff had failed to state a claim on which relief could be granted because the force majeure clause did not apply to changes in financial conditions and no governmental act prevented plaintiff from performing under the agreement. The trial court granted defendant's motion, ruling that the force majeure clause unambiguously indicated that even if the acts of the Chinese or United States governments constituted a force majeure event, economic hardship caused by market conditions "simply is not sufficient to invoke force majeure," particularly in the context of a take-or-pay contract. Also, the force majeure clause in the parties' contract "does not provide [plaintiff] any potential relief from its obligation to pay merely because the contract price is no longer financially advantageous."

The court of appeals affirmed the trial court's ruling. Observing that there is a paucity of Michigan cases interpreting force majeure clauses, the court stated that general rules of contract interpretation, such as that terms used in a contract are to be given their commonly used meanings unless defined in the contract, apply to the interpretation of force majeure clauses. Contracts are to be read as a whole, but force majeure clauses are generally narrowly construed. The clause "will generally only excuse a party's nonperformance if the event that caused the party's nonperformance is specifically identified." The court noted that most of plaintiff's complaint for declaratory relief consisted of allegations of bad behavior by the defendant, which, even if true, could not be the basis for relief under the force majeure clause since none of the alleged acts were "acts of God; acts of the Government or the public enemy; natural disasters; fire; flood; epidemics; quarantine restrictions; strikes; freight embargoes; war; acts of terrorism; [or] equipment breakage." The court held that the conduct alleged in this case did not constitute a force majeure event under the parties' contract and that the trial court should

have, had it considered the issue, granted summary disposition to defendant on that additional ground. Regardless of how the court analyzed whether a force majeure event occurred, or whether plaintiff's alleged inability to perform its contractual obligations arose out of or resulted from an assumed force majeure event, the court's holding would be the same: plaintiff failed to state a claim on which relief could be granted, and the trial court properly granted summary disposition to defendant. Permitting a force majeure clause to provide a party with relief from an unprofitable market downturn would defeat the purpose of a take-or-pay contract, under which a party (such as plaintiff in this case) obligated itself to purchase a set amount of a product at a set price per year, or to pay the other party the difference between the amount of product it purchased and the amount specified in the contract. Financial hardship or unprofitability do not constitute the type of delay or performance failure that are sufficient to warrant relief under a force majeure clause.

WARN Act—Aggregation of Layoffs

***Morton v Vanderbilt Univ*, 809 F3d 294 (6th Cir 2016)**

The university provided 279 employees with individualized letters on September 13, 2013, notifying them that their positions would be eliminated in 60 days. The letters stated that the employees would "'remain employed'" but were placed on "'paid leave,'" were no longer required to report to work, should gather their personal belongings and return all university property, and were taken to discuss career transition counseling, after which they were told to leave the campus. The university had previously laid off other employees on July 1, 2013, and aggregating the September layoffs would put the number over the 500 employee WARN Act threshold. The court held that the WARN Act is not triggered when an employer does what the university did in this case—provide employees with 60-day notice, continue to pay their wages and provide benefits, but not permit them to report for duty during the notice period. The employees remained employed on paid leave until they no longer received wages and accrued benefits in November 2013. The court stated that there is nothing illegal about an employer spacing out layoffs so that some occur beyond a relevant 90-day period.

Whistleblowers' Protection Act—Future Acts Not Protected

***Pace v Edel-Harrelson*, No 151374, 2016 Mich LEXIS 59 (Feb 1, 2016)**

Plaintiff brought suit against her former employer, its executive director and operations manager, claiming that she was wrongfully terminated on January 18, 2012 in violation of the Whistleblowers' Protection Act (WPA). Plaintiff alleged that the operations manager stated that she intended to use the employer's grant money to purchase a stove for her daughter. According to plaintiff, the manager implied that plaintiff should document the transaction in the name of a specific client to cover up the unauthorized purchase. The manager denied ever using grant funds for this purpose or ever discussing the purchase with plaintiff. Plaintiff testified that she contacted two of her supervisors to inform them of the manager's plans. When plaintiff's supervisors did not act on her warning, plaintiff reported this directly to the executive director in December 2011 or early January 2012. Although the director allegedly said that she would look into the matter, the director claimed in a later deposition that she had no recollection of this discussion with plaintiff. Plaintiff's employment was terminated on January 18, 2012, allegedly for harassing and intimidating behavior toward a fellow employee in violation of defendants' employment policies in a January 2012 incident. On April 10, 2012, plaintiff brought this action alleging that her termination violated the WPA. Defendants later moved for summary disposition, arguing that plaintiff could not establish a prima facie case under the WPA because (1) no conduct had occurred that could be considered a violation or suspected violation of a law, and, therefore, plaintiff did not engage in "protected activity" under the WPA and (2) plaintiff could not demonstrate a causal connection between her report of an alleged suspected violation of a law and her termination. The circuit court granted summary disposition in favor of defendants, ruling that plaintiff failed to establish that a violation or suspected violation of a law occurred. On February 24, 2015, the court of appeals reversed the circuit court's ruling. The court held that plaintiff presented sufficient evidence to establish a genuine issue of material fact that she had engaged in protected activity and that the alleged protected activity was causally connected to her later termination, which rendered summary disposition improper.

The WPA provides protection to an employee who reports "a violation or a suspected violation of a law" to a public body. MCL 15.362. Because "a violation or a suspected violation" refers to an existing violation of a law, the plain language of the statute envisions an act or conduct that has actually occurred or is ongoing. The statute does not contain language encompassing future, planned, or anticipated acts amounting to a violation or a suspected violation of a law. Because plaintiff in this case merely reported another's intent to violate a law in the future, plaintiff was not protected and had no recourse under the WPA.

Index of Articles

(ø I 30 and succeeding issues)*

**For cumulative index from volume 16, go to http://connect.michbar.org/businesslaw/newsletter.*

ICLE Resources for Business Lawyers

Books

Michigan Limited Liability Companies, Second Edition

By James R. Cambridge and George J. Christopoulos

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SECTION CALENDAR

Council Meetings

DATE	TIME	LOCATION
June 2, 2016	3:00 p.m.	Jaffe Raitt Heuer & Weiss PC, Southfield
October 7, 2016*		Amway Grand Plaza, Grand Rapids, MI

*Annual Meeting