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WHAT'S INSIDE

2016 Year-End E-Discovery Update

by: Phillip Shane and Kenneth J. Treece*

"How did it get so late so soon? It's night before it's afternoon. December is here before it's June. My goodness how the time has flewn. How did it get so late so soon?"

Dr. Seuss

What a year 2016 was. We lost Mohammed Ali and Gordie Howe, Willy Wonka and Mrs. Brady, Prince and Princess Leia. We signed a global climate agreement with China and watched Great Britain politely leave the EU. Mexican authorities captured the fugitive drug lord Joaquín "El Chapo" Guzmán (again). In sports, the US women's gymnastics team mined gold in Brazil and Cleveland competed in the NBA Finals and World Series, losing the latter in a Game 7 for the ages that brought the Chicago Cubs their first championship in 108 years. We worried about Zika and wept for Aleppo. Oh, and that guy from The Apprentice won the presidency.

In the ever-evolving world of e-discovery, 2016 brought us the first of what are sure to be many published opinions interpreting and applying the December 1, 2015 amendments to the Federal Rules of Civil Procedure. U.S. Supreme Court Chief Justice John Roberts wrote in his 2015 Year-End Report on the Federal Judiciary that:

> I am hardly the first to urge that we must engineer a change in our legal culture that places a premium on the public's interest in speedy, fair, and efficient justice. But I am motivated to address the subject now because the 2015 civil rules amendments provide a concrete opportunity for actually getting something done.

So, what got done in 2016? Here are some of the highlights on proportionality and sanctions, two of the main discovery issues that the 2015 Amendments addressed.

Proportionality

According to the Rules Committee, the December 2015 amendment to Rule 26 "restores the proportionality factors to their original place in defining the scope of discovery. This change reinforces the Rule 26(g) obligation of the parties to consider these factors in making discovery requests, responses, or objections."[1] Amended Rule 26(b)(1) now provides that:

> Unless otherwise limited by court order, the scope of discovery is as follows: Parties may obtain discovery regarding any non privileged matter that is relevant to any party's claim or defense and proportional to the needs of the case, considering the importance of the issues at stake in the action, the amount in controversy, the parties' relative access to relevant information, the parties' resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the proposed discovery outweighs its likely benefit. Information within this scope of discovery need not be admissible in evidence to be discoverable.

In *Ciufitelli v. Deloitte Touche, LLP,* a securities fraud class action, defendants successfully argued that the proportionality factors in Rule 26(b)(1) should be applied in a novel way, influencing the court's decision on a motion to stay discovery.[2] Plaintiffs had served full merits discovery requests while defendants' motions to dismiss were pending, and the defendants moved for a protective order, seeking a complete stay of discovery until the court ruled. Defendants argued that responding to the discovery would take "substantial time and cost hundreds of thousands of dollars" that could be unnecessary if their motions were granted. They also argued

that under Rule 26(b)(1), full merits discovery while their motions were pending was "disproportionate to the needs of the case at this stage." The court applied the multi-factor test for staying discovery applicable in its jurisdiction. The last factor required the court to consider "any other relevant circumstances," and the court found that the proportionality factors in Rule 26(b)(1) fit within this "catch all" factor:

> For Rule 26(b)(1)'s proportionality mandate to be meaningful, it must apply from the onset of a case. Imposing proportionality only after motion practice establishes the viability of the parties' claims or defenses would thwart that purpose. Therefore, with amended Rule 26(b)(1) now in place, the court must consider proportionality when determining whether a stay of discovery is appropriate pending resolution of a potentially dispositive motion. In a complex case where pending motions to dismiss raise credible legal and factual issues, "the needs of the case" have not yet been finally established. Delaying discovery or limiting its scope until those issues are decided is appropriate and implements the 2015 Amendment's mandate for a renewed consideration of the time and money litigants must expend on discovery.

Finding that the defendants' motions to dismiss were credible, the court ordered a partial stay of discovery.

In another noteworthy case, *Hespe v. City of Chicago,* the court upheld a magistrate judge's ruling denying a motion to compel forensic inspection of plaintiff's electronic devices.[3] The court found that forensic inspection of the plaintiff's computer was not proportional to the needs of the case because "the burden and expense of inspecting plaintiff's devices and online accounts likely outweigh any benefit because copies of the documents and communications are sufficient to defend [against] plaintiff's claims." The court also explained that "inspection of plaintiff's electronic devices is not 'proportional to the needs of this case' because any benefit the inspection might provide is 'outweighed by plaintiff's privacy and confidentiality interests.'"[4]

Sanctions

Amended Rule 37(e) addresses sanctions for a party's failure to preserve ESI. Before the 2015 amendments, Rule 37(e) provided that "[a]bsent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system." According to the Rules Committee, this version of the rule failed to address issues associated with the "continued exponential growth" of ESI and its impact on litigation, and permitted the federal circuits to establish "significantly different standards" for sanctions against parties who failed to preserve ESI.[5] Negligent failure to preserve ESI in one jurisdiction may have resulted in a slap on the wrist or no sanctions at all. The same conduct in another jurisdiction may have warranted adverse inference instructions or even case-terminating sanctions.

The new rule attempted to resolve these circuit splits by providing a national standard for courts to apply when ESI that should have been preserved is lost, foreclosing the courts' reliance on inherent authority or state law to issue sanctions in these instances.[6] We say "attempted" because despite the Committee's clear intentions, several courts have stated that their inherent authority to sanction parties for ESI spoliation persists in 2016 and beyond.

In *CAT3 LLC v. Black Lineage, Inc.,* the court considered the application of amended Rule 37(e) in a case where ESI was not "lost," but manipulated.[7] The court held that Rule 37(e) still applied, and even if it didn't, it had inherent authority to sanction the plaintiffs for their misconduct.[8] In doing so, the court relied on *Chambers v. NASCO, Inc.,* a 1991 Supreme Court case which provides that "'[c]ertain implied powers must

necessarily result to our Courts of justice from the nature of their institution,' powers 'which cannot be dispensed with in a Court, because they are necessary to the exercise of all others.'"[9] The court acknowledged the Advisory Committee's admonition that Rule 37(e) "forecloses reliance on inherent authority" for spoliation of ESI. But, the court interpreted that admonition as directed only to precluding the imposition of case terminating sanctions "for merely negligent destruction of evidence, as would have been the case [under prior law.]" That is, as long as the court follows the rubric of Rule 37(e) it can use its inherent authority to impose sanctions in cases where Rule 37(e) does not apply.

In *InternMatch, Inc. v. Nxtbigthing, LLC,* the court considered plaintiff's motion for case terminating sanctions, alleging that defendants intentionally destroyed relevant ESI.[10] Citing Ninth Circuit precedent, the court noted that its authority to sanction a party for spoliation of evidence derives from two sources: "the inherent power of federal courts to levy sanctions in response to abusive litigation practices, and the availability of sanctions under Rule 37 against a party who 'fails to obey an order to provide or permit discovery.'"[11] In footnote 6 of its opinion, the court recognizes:

> Different courts have applied different tests in determining the appropriate sanction for the spoliation of electronic evidence. The recent amendments to Rule 37 were "designed to provide a uniform standard in federal court for use of these serious measures when addressing failure to preserve electronically stored information." Advisory Committee Notes, Fed. R. Civ. P. 37.

But the court goes on to state:

> Whether a district court must now make the findings set forth in Rule 37 before exercising its inherent authority to impose sanctions for the spoliation of electronic evidence has not been decided. Here, the Court determines both that the Defendants' conduct was willful and in bad faith, and that defendants "acted with the intent to deprive another party of the information's use in the litigation." Fed. R. Civ. P. 37(e)(2). Accordingly, it need not resolve the question of the relationship of the recent amendments to the existing case law.

Another court from a different jurisdiction seemed more willing to tackle this question, though. In a Seventh Circuit case, *Cohn v. Guaranteed Rate, Inc.,* the District Court for the Northern District of Illinois, Eastern Division quoted amended Rule 37(e) in its entirety but went on to note that "[t]he Court also has broad, inherent power to impose sanctions for failure to produce discovery and for destruction of evidence, over and above the provisions of the Federal Rules."[12] Unless and until a Circuit Court of Appeals weighs in on this issue, we won't know for sure if and how much "inherent authority" will undermine the intended effect of Rule 37(e) in situations where ESI that should have been preserved is lost. Perhaps a future circuit split may even "motivate" Chief Justice Roberts and seven or eight of his colleagues to address an e-discovery issue in the highest court of the land. Who knows what 2017 holds?

ENDNOTES

1 Advisory Committee Notes, Fed. R. Civ. P. 26.

2 *Ciuffitelli v. Deloitte & Touche LLP,* No. 3:16-cv-0580-AC, 2016 WL 6963039 (D. Or. Nov. 28, 2016).

3 *Hespe v. City of Chicago,* No. 13 C 7998, 2016 WL 7240754 (N.D. Ill. Dec. 15, 2016).

4 *Id.* at *3.

5 Advisory Committee Notes, Fed. R. Civ. P. 37.

6 *Id.*

7 *CAT3, LLC v. Black Lineage, Inc.,* 164 F.Supp.3d 488 (S.D.N.Y. 2016). Defendants later withdrew their Motion for Sanctions in connection with a stipulated dismissal of the case. *Cat3, LLC v. Black Lineage, Inc.,* No. 14-CV-5511, 2016 WL 1584011 (S.D.N.Y. Apr. 6, 2016).

8 *Id.*

9 *Chambers v. NASCO, Inc.,* 501 U.S. 32, 43 (1991) (quoting *United States v. Hudson,* 11 U.S. (7 Cranch) 32, 34 (1812)).

10 *InternMatch, Inc. v. Nxtbigthing, LLC,* No. 14-cv-05438-JST, 2016 WL 491483 (N.D.Cal. Feb. 8, 2016).

11 *Id.* at *3 (quoting *Leon v. IDX Sys. Corp.,* 464 F.3d 951, 958 (9th Cir. 2006)).

12 *Cohn v. Guaranteed Rate, Inc.,* No. 1:14-cv-9369, 2016 WL 7157358 (N.D. Ill. Dec. 8, 2016).

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Restricting the Use of Vacation Homes and Short-Term Rentals in Michigan

*by: James Spurr, Esq**

Michigan's thousands of miles of Great Lakes shoreline, together with at least as many along pristine inland lakes and rivers, are irresistible. When the snow flies and boats and rods are stored and hung for the season, skiers use the highlands and ridges instead of waterways. Gorgeous scenery and healthy activities are abundant, making for a vibrant real estate market and tourism industry. Yet amid the splendor, zoning, restrictive covenants and strongly held views of short-term vacation renting can turn the dream of vacation home ownership into a nightmare. Many vacation homeowners close the purchase of second homes without reading local zoning ordinances or reviewing the title work for any applicable restrictive covenants. A homeowners or condominium association ("HOA"), if such exists, may send out welcome baskets and possibly packets of documents, but few spend the time educating new owners as to any rules, regulations or forbidden practices. Some HOA's have authority to govern and enforce, others do not. Of those that do not, few openly admit their "voluntary" nature and lack of authority.

This article objectively addresses the common dynamics and interplay between important dynamics of vacation home ownership in Michigan.

Zoning May Restrict the Use of Vacation Homes

Renting a home in which to relax and vacation is hardly novel. From an owner's perspective, renting one's unoccupied home and lands is a common law accepted use of real property dating back centuries; an integral right of fee title ownership.[1] More recently, in an age where community master plans and districts and the rights of neighbors are at least as important as the Master's rights over "Blackacre," zoning can easily complicate if not prohibit the short-term rental of a home; which may well generate significant revenue for the owners (definitions of "profit" vary wildly). Buyers should always check to determine if short-term renting is a permitted use, for two reasons: (1) Buyers often want to rent to others in order to help defray the mortgage payments, tax payments, maintenance or association dues, and (2) Buyers will want to ascertain if they will be residing in close proximity to the short-term renters of other owners.

Although most renters are respectful and responsible, short-term renting may diminish the opportunity to come to know and feel comfortable with neighbors. Definitions of "Commerce," "Home Business" and "Non-Owner Occupied" homes may lead to language within the zoning ordinance that is of concern, although enlightening. Local zoning varies, with some districts welcoming the tourist dollars and some strongly favoring permanent owners, quiet surroundings and discouraging the generation of revenue from residential homes. It is far better to conduct the analysis as an important part of due-diligence before the closing than learn later through harsh experience the permitted uses are far different than assumed.

Calling the local zoning administrator before closing is a good idea, but not conclusive. As just one example of use restrictions, "renting" may be permitted while "short-term" renting may be specifically prohibited. Further, the opinion of a local zoning administrator is not final or binding upon local courts. Many townships, villages and other municipalities are currently struggling with

short-term renting, including from the perspective that if permitted, registration and fees will be required and maximum bedrooms and occupants may be limited.[2]

Restrictive Covenants may Prohibit the Use of Vacation Homes as Short-Term Rentals

Many larger tracts of land or older plats, from the early development of Michigan's most scenic acreage, carry simple prohibitions where the wording is problematic and the intent is unclear. "Commercial" uses are most often prohibited. But commerce in the 1890's, for example, was possibly thought of and referred to as something far different than today. Industry and manufacturing would certainly not mix well with vacationers seeking a week of respite, but historically, renting a home for a week to another family as a residence may not have been thought of as operating a commercial enterprise so many decades ago. Times have changed. Marketing by internet or social media, with landscaping and cleaning services, looks more like a business operation, even where the atmosphere at the cottage may remain quiet and relaxing. Courts are examining the concept of whether frequent vacation rentals are a form of "commerce," even where the intent is unclear as to how the word was used by the original drafter of the covenants

While not yet documented in any court opinion, a distinction may be possible between the geographic location of the commercial activity (such as advertising, renting, arranging for ancillary support services, banking, etc.) taking place far from the vacation home, which continues to remain quiet and residential in nature. A court may consider the commercial aspect distinct from the object or purpose of the commercial activity, which remains no different than the daily activities of the owner, were they on site. Like zoning, buyers must pay careful attention to what are sometimes historically fascinating and possibly cryptic handwritten restrictions in the title work.

Home Owners Association or Condominium Board By-Laws and Rules

Condominium bylaws or HOA rules combined with zoning provisions may also present a problem even if no other form of restrictions address prohibited uses.[4]

Condominium bylaws, for instance, can often be modified by a simple majority of owners. Prohibiting a use originally permitted (such as renting), however, may require unanimity. Several reasons combine to protect what was initially permitted, including the interest of the mortgage lenders, who may have relied upon the possibility of rental income to assist the owner in making monthly payments. Thus, short-term renting may be difficult to abolish once it is expressly permitted. Other practical restrictions, however, such as to whom owners may rent, the minimum age of the renters, the total renters per unit, the requirement of renting only to single families, security deposits, insurance, indemnification of other owners and the HOA may be possible to enact after the fact so as to reduce the likelihood of intense rental activity simply by making it more difficult and less profitable in any given market.

Easements to the Beach or Shore

Even if short-term renting is permitted, easements to the shoreline can present other problems. Easements are often drafted by owners further down the chain of title from the original instruments conveying title. The purpose, factual circumstances and intent are often unclear. The typical prospect of permitting non-waterfront owners from enjoying a shoreline, beach or docks is fraught with possible controversy, such as increased use and burden on the servient estate.[5] Quite often the dominant parties in later-created easements assert rights that may not be consistent with the earlier-created restrictive covenants.

Equitable Defenses to Claims of Commercial Use or Violations Pertaining to Renting

If short-term renting is under attack, equity can come to the rescue.

1. Former or Current Commercial Uses

A court may well conclude that short-term rentals of a residential home, even with no office, sign, increased density from customers or other indicia of operating a business is on-site, is a commercial use.[6] Decades ago, such holdings may have been the exception. But recently cases concluding short-term rental operations are tantamount to operating a business are far more common. One difference may be that it is far easier and more common for owners to fill an entire season or more with renters, as opposed to an occasional friend or relation visiting for a week amid longer periods of owner occupancy and use. Social media permits owners to reach larger markets of potential tenants far greater in number and more distant than the local newspaper of just a couple of decades past. Advertising and modern marketing can bring more renters into a subdivision or development than was ever the case in years past. Additional volume may prompt complaints.

Larger developments and older vacation neighborhoods often permitted some commercial uses in the past. A former gasoline station, small engine repair, café, pub, party store, coffee hut, small boat rental, all comprise conveniences that may have been once provided to local owners that could support arguments of a waiver of the commercial prohibition, to the extent that the neighborhood may have changed its character. *Id.* That does not mean a neighborhood has to turn into a high intensity hub of businesses or heavy industry, but merely that the former owners tolerated convenient businesses among the residential properties and never enforced a total prohibition. Further, if some commerce or short-term vacation renting appeared and was tolerated right from the start, an argument could be made that no change occurred because the development waived the prohibition right from the onset and there never was a time when the restrictive covenant was honored, except by its breach.

The battle over whether a use is "commercial", which prohibition may be found in restrictive covenants may well be worth fighting on individual facts, but if lost, other dynamics may come into play to thwart the enforcement of the restrictions as written.

2. Historical Inconsistencies

Owners who wish to rent their homes on a short-term basis could make a strong argument that renting has been permitted for years, in a manner that was open and obvious to all and was never objected to by any previous owners. If the facts support the argument, the long standing principle of estoppel may apply to bar the enforcement of a contrary restrictive covenant

Owners have individual rights, however. One neighbor cannot waive for the others. Certain practices are obvious to all, but estoppel is difficult to apply against those who seek to enforce covenants and who were unaware of a violation. Questions of credibility will abound at trial when certain owners claim never to have witnessed or understood what was so open and nearly assumed to be permitted by so many.[8]

3. Agency Relationships May Complicate Enforcement

Condominium Boards or other HOAs quite often have more knowledge of what practices are found throughout a development. They often deal with individual requests and complaints and try

to promulgate "rules." If bylaws or restrictive covenants are not amended in accordance with practices that will resist challenge, the actions of "leaders" within a development may later complicate the efforts of other owners for enforcement of restrictions despite what has become well known and represents the status quo. A smaller body, such as a Board or Committee, can sometimes speak for all. [9] Those speaking ostensibly for others can, if not silenced, come to be cloaked with apparent authority.[10]

Confusion caused by an HOA as to what is permitted could weigh in favor of newcomers, who relied to their detriment after observing current practices or inquired of the Board about so-called rules.[11] Owners may have a duty to disavow or disagree with their elected leaders, who whether on a Board or Committee, appear to be letting practices that are otherwise prohibited continue with impunity. Silence may be argued as assent. The law of agency as applied to short-term renting practices is not particularly well developed, however and cases often involve dissimilar facts.

Where a development has a restrictive covenant prohibiting commercial use, but the HOA has permitted short-term rentals over the decades and the practices are known to the owners, equity may rescue those who have relied to their detriment.

Conclusion

The number of vacation homes offering some degree of short-term rentals is increasing. Communities are grappling with complaints about the density of renters in neighborhoods where not long ago owners knew each other quite well and felt secure in their familiarity.

Whether near a beach or ski slope, short-term vacation rentals in an established residential neighborhood are most often regulated as a form of "commercial" activity. Zoning may prohibit practices which really do not fit very well the definitions of hotel or bed and breakfast. If zoning is silent, enforcing restrictive covenants is often complicated by inconsistent practices permitted by other owners or their representatives over decades. Detrimental reliance often clouds the fairness of strict enforcement.

There is no substitute for i.) due diligence before the closing and ii.) checking whether a HOA Board or Committee has, by promulgating rules or permitting violations, lent support to what is very different than what use a buyer may assume. A thorough understanding of whether short-term vacation renting is permitted is essential to a favorable vacation rental experience and a positive experience owning a vacation home.

ENDNOTES

1 *Attorney General v. Pere Marquette Ry. Co.,* 263 Mich. 431, (1933); *Mooney v. Village of Orchard Lake,* 333 Mich. 389, (1952).

2 *See e.g.* South Haven Michig*an Zoning Ordinance No. 1026, Sec. 10-243 and 10-244.*

3 *See, e.g., Laketon Township v. Advanse, Inc.,* No. 276986, 2009 WL 763447, (Mich. Ct. App. March 24, 2009.

4 *See, e.g., Enchanted Forest Property Owners Assoc. v. Schilling,* No. 287614, 2010 WL 866148(Mich. Ct. App. March 11, 2010).

5 *Cabal v. Kent County Road Commission,* 72 Mich. App. 532 (1976).

6 *See, e.g., Cooper v. Kovan,* 349 Mich. 520 (1957).

7 *Rolfe v. Robinson,* 126 Mich. App. 151 (1983).

8 *Scott v. Armstrong,* 330 Mich. 504 (1951).

9 *Richards v. General Motors Corp.,* 876 F. Supp. 1492 (E.D., Mich. 1995).

10 *Faber v. Eastman, Dillon & Co.,* 271 Mich. 142, (1935).

11 *Flat Hots Co. v. Peschke Packing Co.,* 301 Mich. 331, (1942).

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Merger and Integration Clauses and Fraud: What Dies with the Deal?

*by: Daniel D. Quick and Ariana D. Pellegrino**

Introduction

In commercial transactions, parties regularly use merger and integration clauses[1] in their final contracts to try and prevent parties from later alleging extra-contractual promises. Although these clauses may provide a sense of finality and security to the parties, they do not operate as a total ban on claims of fraud for pre-contractual representations. However, courts have struggled to clearly distinguish promises that will survive a merger and integration clause from those that will not, often using vague language resulting in opinions with different results despite similar-looking facts. A closer look suggests that the law is more settled than it might seem; Michigan courts have refused to give bad actors *carte blanche* to hide their malfeasance behind merger and integration clauses, but a carefully-crafted clause can protect even the ill-intentioned.

UAW-GM: The Basics

Nearly two decades ago, in *UAW-GM,*[2] the Michigan Court of Appeals set forth the basic rules regarding the interaction between merger and integration clauses and fraud claims. In *UAW-GM*, the plaintiff entered into an agreement with a management company for the use of a resort and country club. Although the agreement contained a merger and integration clause, stating that the agreement constituted a merger of all "proposals, negotiations and representations," the plaintiff alleged that the management company made a collateral promise to provide the plaintiff with a union represented hotel.[3] Thereafter, the management company sold the hotel to the defendants, who replaced the hotel's union employees with a non-unionized workforce. The plaintiff, in turn, canceled the contract and filed suit, alleging that the management company fraudulently represented that it would provide union employees. The lower court granted the plaintiff's motion for summary disposition, and the defendants appealed.

The Court of Appeals noted that, in the context of a merger and integration clause, only certain types of fraud can vitiate a contract. Specifically, a party cannot subvert a merger and integration clause by merely claiming that an antecedent agreement exists.[4] Rather, "the only fraud that could vitiate the contract is fraud that would invalidate the merger clause itself, *i.e.*, fraud relating to the merger clause or fraud that invalidates the entire contract including the merger clause."[5] Thus, where, as in *UAW-GM,* a plaintiff fails to allege fraud demonstrating that it was induced to enter into the agreement, or that it was defrauded into believing that the written agreement included a provision that it did not, the fraud claim is barred.[6]

The Aftermath of *UAW-GM:* Confusion and Clarity

In the wake of *UAW-GM,* courts have reached seemingly inconsistent determinations regarding what circumstances are properly barred by a merger and integration clause, while using overly-broad summaries of the law which provide little practical or prospective guidance.[7] For example, some cases have held that reliance on oral promises made prior to entering a fully integrated written agreement is "per se unreasonable," thus barring a claim for fraud.[8] Other cases, in turn, hold that Michigan courts "do not take the point so far" as adopting a per se rule.[9] While these cases

have generated confusion, careful analysis reveals that the case law is not (totally) inconsistent and that, under the right circumstances, a fraud claim may survive a merger and integration clause.

Courts sparingly apply the first exception under *UAW-GM*—fraud relating solely to the merger and integration clause. To succeed under the first exception, a litigant must demonstrate that (1) it requested the inclusion of a particular clause, and (2) as a result of the other party's misrepresentations, "it was induced to forget about the clause and sign an agreement omitting the clause while describing the writing as complete."[10] In other words:

> [A] merger clause will not preclude proof of fraud . . . that consists of tricking the other party into signing a document thinking it is something other than it is . . . or of misreading the contents of the document to the signor, or of inducing the signor not to read the contents of the document at all.[11]

Understandably, courts have been reluctant to sustain a fraud claim on the basis of the first *UAW-GM* exception where the parties to the transaction are sophisticated business entities or are represented by counsel.[12]

Conversely, where the "common indicia" of fraud are present—including one-sidedness, a familial relationship, and manipulation based on age or infirmity—the first *UAW-GM* may apply.[13] For example, in *Tocco v Tocco,* the court addressed whether a fraud claim survived a merger and integration clause where the plaintiff, the defendant's grandfather, suffered from various ailments and was unrepresented by counsel in a transaction that granted his grandson significant assets. In holding that the merger and integration clause did not preclude the fraud claim, the court considered (1) the nature of the parties' relationship, (2) the significant assets bestowed upon the grandson, with the plaintiff receiving very little in return, (3) that the plaintiff was not represented by counsel, and (4) that the grandson's attorney made a number of representations to the plaintiff about the contents of the agreement, many of which were not included in the written contract. Accordingly, sufficient circumstances existed to demonstrate that the plaintiff ultimately entered into an agreement "thinking it [was] something other than it [was]," and so the plaintiff's "allegations of fraud in the inducement invalidate[d] the integration clause itself."[14]

In contrast, the second *UAW-GM* exception — fraud that invalidates the entire contract, including the merger and integration clause — has generated significant litigation. While courts have not always done so with clarity or precision, case law demonstrates that, in determining which representations survive a merger clause and which do not, Michigan courts have recognized a distinction between (1) representations of fact made by one party to induce another party to enter into a contract, and (2) collateral agreements or understandings between two parties not expressed in a written contract.[15] "It is only the latter that are eviscerated by a merger clause, even if such were the product of a misrepresentation."[16] In that regard, the Court of Appeals consistently holds that a merger clause bars a claim for fraud where the alleged pre-contractual representation constitutes a collateral agreement or understanding. Stated differently, a claim for fraud based on pre-contractual representations fails where the representations are within the scope of the written agreement and vary, add to, or contradict the terms of the written contract.[17]

In contrast, a merger and integration clause will not bar pre-contractual representations that were false when made[18] and made to induce the other party to enter into a contract.[19] The Michigan Court of Appeals recognized that to hold otherwise "would provide protection to disreputable parties who knowingly submit false accountings, doctored credentials and/or otherwise already encumbered properties as security to unknowing parties as long as they were savvy enough to include a merger clause in their contracts."[20]

Illustratively, in *Abbo v Wireless Toyz,* the plaintiff sought to purchase a franchise from Wireless Toyz, a retail store that sells electronic communications devices and other telephone services.[21] Accordingly, the plaintiff undertook an investigation of the company to determine whether to purchase a franchise, including correspondence with Wireless Toyz's vice president of franchise development, Richard Simtob. During those communications, Simtob represented that the franchisees experienced only very minor "hits," or certain discounts provided to customers, and only 5 to 7 percent of commissions were lost to "chargebacks," or revocations of commission that occur when a customer prematurely cancels a contract. Simtob further represented that Wireless Toyz had "great" relationships with cellular carriers, low inventory costs, a "formidable" training program for incoming franchisees, and a "national presence." Based on these representations, the plaintiff purchased a franchise, and these representations were not encompassed by the purchase agreement.[22]

After purchasing the franchise, the plaintiff realized a 40 percent loss in commissions due to chargebacks and a loss of $75 to $100 on every phone sold due to hits. Additionally, the plaintiff discovered that Verizon would not deal directly with Wireless Toyz and that Wireless Toyz had no relationship at all with Cingular. Moreover, the plaintiff did not enjoy low inventory costs, nor did he ever receive training as a franchisee. Accordingly, after Wireless Toyz rejected the plaintiff's offer to repurchase the franchise, the plaintiff filed suit, alleging, among other things, that Simtob's representations induced the plaintiff to enter into the contract.[23] In reversing the lower court, the Court of Appeals held that the alleged misrepresentations were outside the scope of the contract and affected the ability of the plaintiff to make an informed economic decision to enter into the contract. Accordingly, the misrepresentations arguably induced the plaintiff to enter into the contract and the court would not permit the defendants to use the merger clause as "an impenetrable shield[.]"[24]

Consistent with the holding in *Abbo,* the Court of Appeals has repeatedly recognized that pre-contractual representations that (1) were false when made, (2) fall *outside* the scope of the written contract, and (3) are made to induce the other party to enter into the contract are not barred by merger and integration clauses.[25] In addition to the foregoing line of cases, Michigan courts have also sustained fraud claims under the second *UAW-GM* exception where a party induces another party to enter into a contract by agreeing to terms with which it does not intend to comply. [26]

Thus, contrary to some suggestions, Michigan courts have not adopted a "per se" ban on fraud claims in the face of merger and integration clauses. But it is also overly broad to state that "only" "collateral agreements or understandings between two parties not expressed in a written contract" can be "eviscerated by a merger clause."[27] Several courts have held that a contracting party may be able to limit its liability for pre-contractual representations by ensuring that any merger and integration clause extends not only to prior agreements, negotiations, and understandings, but also to prior representations and inducements.[28] Thus, a broadly-drafted merger clause can bar even allegations of extra-contractual representations made to induce a party to enter into a contract.[29] Accordingly, the survival of fraud claims for pre-contractual representations may lie at the mercy of artfully-drafted merger and integration clauses and whether the parties draw a judge willing to plow through a sea of less-than-helpful case law to adjudicate the dispute.

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ENDNOTES

1 An integration, or merger, clause is "[a] contractual provision stating that the contract represents the parties' complete and final agreement and supersedes all informal understandings and oral agreements relating to the subject matter of the contract. – Also termed *merger clause; entire-agreement clause." Black's Law Dictionary* (10th ed 2014). The cases set forth herein use the terms "integration clause" and "merger clause" interchangeably.

2 *UAW-GM Human Resource Center v KSL Recreation Corp,* 228 Mich App 486 (1998).

3 *Id.* at 488.

4 *Id.* at 503.

5 *Id.,* citing 3 Corbin, Contracts, § 578.

6 *See UAW-GM,* 228 Mich App at 505-506.

7 *See, e.g., Galeana Telecomms Invests, Inc v Amerifone Corp,* Docket No. 15-cv-14095, 2016 WL 4205997, *9 (ED Mich, Aug. 10, 2016) (collecting cases).

8 *See, e.g., Lorenz v Jeannot,* Docket No. 319802, 2015 WL 1931726, *4 (Mich Ct App, Apr. 28, 2015).

9 *See Llewellyn-Jones v Metro Prop Grp, LLC,* 22 F Supp 3d 760, 784 (ED Mich, 2014). *See also Skillnet Sols, Inc v Entm't Publ'ns, LLC,* Docket No. 12-12173, 2012 WL 6047514, *6 (ED Mich, Dec. 5, 2012) ("Michigan courts, likewise, have not adopted a per se rule making reliance on prior statements unreasonable after a contract containing a merger clause is signed.").

10 *Newburgh/Six Mile Ltd P'ship II v Adlabs Films USA, Inc,* 724 F Supp 2d 740, 755 (ED Mich, 2010), citing *Hamade v Sunoco, Inc,* 271 Mich App 145, 170; 721 NW2d 233 (2006).

11 *Tocco v Tocco,* 409 F Supp 2d 816, 828-29 (ED Mich, 2005), quoting 11 Williston, Contracts (4th ed), § 33.21.

12 *See, e.g., Reliance Mediaworks (USA) Inc v Giarmarco Mullins & Horton,* PC, Docket No. 11014486, 2012 WL 5929940, *6 (ED Mich, Nov. 27, 2012) ("[Plaintiff] never explains why it, a sophisticated business entity, failed to read or understand the lease. Was it given the wrong lease to read? How was it compelled to 'forget' the terms of the agreement? Why does it not know whether it signed a lease it thought had a termination clause or it instead 'forgot' to add a termination clause?"); *Presidential Facility, LLC v Debbas,* Docket No. 09-12346, 2010 WL 3522450, *6 (ED Mich, Sept. 8, 2010) ("[T]he parties here are sophisticated businessmen engaging in highly complex financial arrangements. . . . If Pinkas expected that a conveyance of warranties was to be part of the bargain, he should have demanded the inclusion of such terms in the Agreement.").

13 *See Presidential Facility,* 2010 WL 3522450, *5; Tocco, 409 F Supp 2d at 827-29.

14 409 F Supp 2d at 826-29.

15 *See Abbo v Wireless Toyz Franchise, LLC,* Docket No. 304185, 2014 WL 1978185, *6 (Mich Ct App, May 13, 2014); *Jenson v Gallagher,* Docket No. 312739, 2014 WL 667790, *4 (Mich Ct App Feb, 18, 2014).

16 *Jenson,* 2014 WL 667790, *4, quoting *Star Ins Co v United Commercial Ins Agency, Inc,* 392 F Supp 2d 927, 929 (ED Mich, 2005).

17 *See, e.g., UAW-GM, 2*28 Mich App at 504-505 (holding that merger clause barred fraud claim where the injury suffered by the plaintiff resulted from his failure to include a pertinent term in the agreement); *Lieghio v Loveland Invests,* Docket Nos. 285393, 285394, 2009 WL 3491620, *12 (Mich Ct App, Oct. 29, 2009) (holding that alleged pre-contractual misrepresentation that hotel had a certain rating was barred by merger clause because contract provided that sale was "as is," subject to defined exceptions, and thus rating would have added term to contract); *Lancia Jeep Hellas SA v Chrysler Grp Int'l, LLC,* Docket No. 329481, 2016 WL 1178303, *8 (Mich Ct App, Mar. 24, 2016); Lorenz, 2015 WL 1931726, *4; *Ram Int'l, Inc v ADT Sec Servs, Inc,* 555 Fex Appx 493, 500 (CA 6, 2014); *Fleet Business Credit, LLC v Krapohl Ford Lincoln Mercury Co,* Docket No. 249825, 2004 WL 2179235, *3 (Mich Ct App, Sept. 28, 2004); *ABC Barrel & Drum Sites v Detrix Corp,* Docket No. 220784, 2002 WL 264985, *2 (Mich Ct App, Feb. 19, 2002).

18 Importantly, such representations must have been false when made; consistent with traditional fraud principles, alleged misrepresentations relating to future conduct are not actionable except in limited circumstances. *See Savas v Yaker,* Docket No. 288991, 2010 WL 1565534, *10 (Mich Ct App, Apr. 20, 2010) (in addition to merger clause, alleged misrepresentations were merely "forward-looking" statements and, as such, could not support a claim for fraud).

19 *See, e.g., Abbo,* 2014 WL 1978185, *5-6; *Barclae v Zarb,* 300 Mich App 455, 482-83 (2013) (holding that merger clause did not bar fraud claim where plaintiff expressed an interest in a particular product and defendant failed to inform plaintiff that the product had been sold); *LA Ins Agency Franchising, LLC v Montes,* Docket No. 14-14432, 2016 WL 922946, *9 (ED Mich, Mar. 11, 2016) (fraud claim not barred where defendant may have induced plaintiff into entering agreement by representing that it had negotiated certain rates with insurance carriers, had dozens of authorized carriers, had an aggressive marketing and advertising program, and a comprehensive system of support and assistance, which assertions were untrue when made); *Whitesell Corp v Whirlpool Corp,* Docket No. 1:05-CV-679), 2009 WL 3270265, *3 (ED Mich, Oct. 5, 2009); *Chimko v Shermeta,* Docket No. 264845, 2006 WL 2060417, *4 (Mich Ct App, July 25, 2006).

20 *Barclae,* 300 Mich App at 481, quoting *Star Ins,* 392 F Supp 2d at 929.

21 *Abbo,* 2014 WL 1978185, *1.

22 *Id. at *1-2.*

23 *Id.*

24 *Id.* at *6-7.

25 *See supra* notes 18-19.

26 *See Custom Data Sols, Inc v Preferred Cap, Inc,* 274 Mich App 239, 244-45 (2006); *Diamond Comput Sys, Inc v SBC Commc'ns, Inc,* 424 F Supp 2d 970, 981-83 (ED Mich, 2006); *Mediaform LLC v Suszko,* Docket No. 290482, 2010 WL 2399363, *1 (Mich Ct App, June 15, 2010).

27 *Jenson,* 2014 WL 667790, *4, quoting *Star Ins,* 392 F Supp 2d at 929.

28 *Abbo, 2014 WL 1978185, *6; Stout v Withrow,* Docket No. 271632, 2008 WL 400695, *8 (Mich Ct App, Feb. 14, 2008); *Ehlert v Wiser,* Docket No. 239777, 2003 WL 22928814, *2 (Mich Ct App, Dec. 11, 2003).

29 *See VSI Holdings, Inc v SPX Corp,* Docket No. 03-CV-70225-DT, 2005 WL 2417638, *9 (ED Mich, Sept. 30, 2005).

Review of Michigan Supreme Court 2016 Decisions Concerning Arbitration

*by: Lee Hornberger**

This article reviews the three decisions that the Michigan Supreme Court issued in 2016 concerning arbitration. Both *Altobelli v Hartmann*[1] and *Beck v Park West Galleries, Inc.,*[2] concerned the scope of the agreement to arbitrate. The third decision, *Ronnisch Construction Group, Inc v Lofts on the Nine, LLC,*[3] concerned attorney fees in a construction lien arbitration case.

In *Altobelli* the Supreme Court ruled that plaintiff's tort claims against the individual principals of a law firm fell within the scope of an arbitration clause that required arbitration for any dispute between the firm and a former principal. The plaintiff, a former principal of the firm, challenged actions that the individual defendants had performed in their capacities as agents carrying out the business of the firm. The plaintiff was attempting to bypass the arbitration clause by suing the principals in a court proceeding rather than the law firm in an arbitration proceeding. The Supreme Court ruled that this was a dispute between the firm and a former principal that fell within the scope of the arbitration clause and was subject to arbitration. The Supreme Court reversed those portions of the Court of Appeals opinion[4] which had held the matter was not subject to arbitration. **The lesson from *Altobelli* is that the wording of the agreement to arbitrate is crucially important and regardless of how much work goes into the drafting of the agreement to arbitrate, there is the risk of unintended consequences.**

Beck considered whether an arbitration clause contained in invoices for artwork purchases applied to disputes arising from previous artwork purchases when the invoices for the previous purchases did not refer to arbitration. The Supreme Court held that the arbitration clause contained in the later invoices cannot be applied to disputes arising from prior sales with invoices that did not contain the arbitration clause. The Supreme Court reversed that part of the Court of Appeals judgment that extended the arbitration clause to the parties' prior transactions that did not refer to arbitration.

The Supreme Court specifically recognized the policy favoring arbitration of disputes arising under collective bargaining agreements but said this does not mean arbitration arising under an agreement to arbitrate between parties outside of the collective bargaining context applies to any dispute arising out of any aspect of their relationship.[5] ***Beck* is another lesson that the wording of the agreement to arbitration is very important and must be given very important consideration.**

Both *Altobelli* and *Beck* are consistent with prior Supreme Court decisions concerning the importance of the provisions of the agreement to arbitrate. In *Wireless Toyz Franchise, LLC v Clear Choice Commc'n, Inc,* 493 Mich 933 (2013), in lieu of granting leave to appeal, the Supreme Court reversed the Court of Appeals for the reasons stated in the Court of Appeals dissent. The Court further reinstated the Circuit Court order confirming the arbitration award. The Court of Appeals dissent, approved by the Supreme Court, said the stipulated order to arbitrate intended that the arbitration would include claims beyond those already pending in the case because the stipulated order allowed further discovery, gave the arbitrator powers of the Circuit

Court, and the award would represent a full and final resolution of the matter. According to the Supreme Court, this meant that claims not pending at the time the order to arbitrate was entered were not outside the scope of the arbitrator's powers.

In *Hall v Stark Reagan, PC,* 493 Mich 903 (2012), a 4-3 majority decision of the Supreme Court reversed the part of the Court of Appeals decision which had held the matter was not subject to arbitration. The Supreme Court reinstated the Circuit Court order ordering arbitration concerning the motives of the defendant shareholders in invoking the separation provisions of the Shareholders' Agreement. According to the Supreme Court majority, this was a "dispute regarding interpretation or enforcement of . . . parties' rights or obligations" under the Shareholders' Agreement, and was subject to arbitration pursuant to Agreement. The dissents said the Shareholders Agreement provided only for arbitration of violations of the Agreement, not for allegations of discrimination under the Civil Rights Act.

The Supreme Court ruled in *Ronnisch Construction Group, Inc.* (Justices Viviano, Markman, McCormack, and Bernstein), **a construction lien and attorney fee case,** that the plaintiff can seek attorney fees under MCL 570.1118(2), of the Construction Lien Act (CLA), where the plaintiff received a favorable arbitration award on a related breach-of-contract claim but did not obtain a judgment on its construction lien claim. The arbitrator did not address the attorney fee claim but reserved that issue for the Circuit Court. According to the Supreme Court, the Circuit Court may award attorney fees to the plaintiff because the plaintiff was a lien claimant who prevailed in an action to enforce a construction lien through foreclosure.

Justices Young, Zahara, and Larsen dissented. The dissent said the Legislature communicated that recovery of CLA attorney fees is permitted only to parties who prevail on a construction lien. The CLA attorney fees provision only allows a court to award fees to a lien claimant who is a prevailing party. Because the plaintiff did not meet the definition of a CLA lien claimant, and because it voluntarily extinguished its lien claim before the Circuit Court could have so determined, the plaintiff was not entitled to attorney fees.

The lessons from *Ronnisch Construction Group, Inc* are: (1) that a licensee can be subject to CLA attorney fees in an arbitration proceeding, and, (2) according to the dissent, there is a risk in accepting payment after the award but before confirmation.

ENDNOTES

1 499 Mich 284 (2016).

2 499 Mich 40 (2016).

3 499 Mich 544 (2016).

4 *Altobelli v Hartmann,* 307 Mich App 612 (2014).

5 See generally *Kaleva-Norman-Dickson Sch Dist No 6 v Kaleva-Norman-Dickson Sch Teachers' Ass'n,* 393 Mich 583 (1975).

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Litigating the Declaratory Action

by: Hal O. Carroll

Members of this Section don't need instruction in how to litigate, but declaratory actions to resolve insurance coverage disputes have some differences that every litigator should keep in mind.

Target: Dispositive Motion

In a declaratory action, the dispositive motion usually takes the place of the trial. This gives the declaratory action a different focus and requires different steps along the path to coverage. This means the litigator needs a different orientation toward the litigation. The jury will play no part in the resolution of the dispute, so how certain evidence will strike a jury is not important. The argument will be written, not oral, which calls for a different set of skills.

Complaint

Like all litigation, the action starts with the complaint. If you are seeking coverage, the complaint need not go into detail regarding which policy provision applies. It is sufficient to allege that the claimant is an insured, that the loss is a covered loss, and that no exclusion applies. Let the insurer go into detail about why coverage does not apply. On the other hand, if you are representing the insurer, the complaint is a good place to come out strong and lay out your position at the beginning, by citing policy language.

The person seeking coverage will probably want a jury trial, just in case the dispositive motion does not resolve the dispute. In the unlikely event that it goes to trial because of a claimed ambiguity, the party seeking coverage may want a jury to resolve the ambiguity (see below).

Discovery

Discovery is different in a coverage dispute. The focus is on the documents, and there is no need to wait. As soon as the answer is filed, the coverage plaintiff should send a short set of interrogatories and requests for production.

The interrogatories should ask for three things: (1) the reasons for denial of coverage or reservation of rights, with citations to page and paragraph of each provision they rely on, (2) the identity of every person who contributed to the answers, and (3) the identity of the person who made the decision to decline coverage or reserve rights.

There should also be a short request for production, asking for (1) a certified copy of the policy, (2) the underwriting file, and (3) the insurer's contract with the agent. You should get a certified copy of the policy to be on the safe side because even if the insured has a copy, it may not be complete. Why the underwriting file? It contains information about the kind of risk the insurer was insuring against. If the underwriting file describes the same kind of risk of loss that the insured suffered, it will be harder for the insured to argue for its interpretation of the policy.

You should also attempt to get the broker's file and the broker's contract with the insurer. In theory the broker is the agent of the insured, so a simple r equest should be sufficient. But a subpoena may be necessary. The broker's file should reflect the underwriting file, since the broker is the one who supplied the information. But it is best to be certain.

Why the contract with the agent? Agents don't always play a role in coverage disputes, but sometimes they do, and they can be wild cards. The law says that independent agents are usually agents of the insured and not the insurer. "An independent insurance agent, or broker, is ordinarily the agent of the insured, not the insurer." *Mayer v Auto-Owners Ins Co,* 127 Mich App 23 (1983) (quotation omitted). In theory this means the agent is on the side of the insured and would help to find coverage. But brokers get their compensation from the insurer, so their loyalty is not always what it should be. If it becomes necessary to counteract a statement of the agent, it may help to how that the agent has a contract with the insurer. Statutory law requires "a written contract with the insurance producer" before an agent can work with an insurer. MCL 500.1211; see also MCL 500.1208a re the requirement that the agent file a notice of appointment.

Expert Witness?

Should you use an expert witness? If the trial court issues the usual scheduling order setting dates to list experts, each party is concerned the other party might list one, so both of them list experts. This usually comes to nothing because coverage disputes depend on contract language, and interpreting contract language is what lawyers and judges do.

But sometimes a litigator may want the help of an expert. If so, here are two suggestions. First, hire the potential expert as a consultant first. If you like the consultant's analysis, then you can list him or her as an expert. Second, if you think the expert may actually get involved in the litigation, do some screening. Check the CV of course, but find out if the proposed expert is fluent in language usage and grammar as well as the intricacies of insurance coverage. If the dispute centers on how a particular clause should be interpreted, it helps if the expert is fluent in how language structure works, and grammar equals structure. If the proposed expert is not comfortable with arcanities like restrictive and nonrestrictive clauses, he or she will be much less persuasive.

An expert may play a useful role is there is an argument about an ambiguity in the policy. The traditional rule ("contra proferentem") is that ambiguities are interpreted against the drafter, which means for the insured. In practice it often happens that the trial court applies that rule, but our supreme court has held that ambiguities create questions of fact, which must be resolved by the trier of fact. *Klapp v United Ins Group Agency, Inc,* 468 Mich 459, 468 (2003).

Case Evaluation

Conventional case evaluation is seldom helpful in coverage disputes, because there are no disputes of fact whose strength can be weighed. It is better to have some sort of facilitation. The question here is whether conventional facilitation with a facilitator whose skills are procedural rather than substantive is the better way, or whether a facilitator with substantive knowledge would be more effective.

For example, a common misunderstanding is that a "certificate of insurance" can expand coverage. It cannot. Only the policy itself with its endorsements can do that. "The certificate is no part of the insurance contract." *Chrysler Corp v Hardwick,* 299 Mich 696, 700 (1941). In the usual "shuttle diplomacy" model of facilitation, an argument that the certificate expanded coverage would simply be conveyed to the other side.

The parties might consider selecting a neutral facilitator with expertise in the law of insurance, and asking the facilitator to play an active role in evaluating the parties' positions.

The Dispositive Motion

Obviously the dispositive motion requires a lot of work, because it is the functional equivalent of a trial. The dispositive motion also requires a different set of skills than trials. Tort concepts are different from contract concepts. Tort trials are fact-intensive, but dispositive motions are language-intensive. In a tort case, the underlying issue is whether conduct was reasonable; in contract disputes, the question is simply what the words mean.

Being persuasive in writing requires a different skill set than being persuasive in oral examination or closing argument. That's true in general, but especially in disputes over insurance policy language. Policies are necessarily written in a carefully structured way, where even punctuation and simple words can be significant. For example, this is an area where the distinction between "the insured" and "an insured" can determine the result. "While plaintiff dismisses this distinction [between "an insured" and "the insured"] as being irrelevant semantics, we conclude that the distinction is dispositive." *Vanguard Ins Co v McKinney,* 184 Mich App 799, 804-805 (1990), citing *Allstate v Freeman,* 432 Mich 636, 694-695 (1989).

A good technique is to apply the rule "explain to persuade." For example, if a case involves a tractor-trailer, each will have its own policy, and each is called an "auto." This can be confusing, so it will help the court to explain why this is so. Your argument will be more persuasive if you can explain to the court how the policy language relates to the real world. The fewer distractions that there are in the path you are making to your desired result, the better your chances of success.

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