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WHAT'S INSIDE

Letter from the Chair

by: Jeffrey A. Crapko

This is my first Letter from the Chair, and I have big shoes to fill. Last year was a great year for the Litigation Section. Thanks to the leadership of Brandon Evans, we were much more active than in previous years. We had a great Summer Conference at the Grand Hotel in Mackinaw Island, and welcomed many new members to our fold. I can't thank Brandon enough for leading the section as well as he did, and for inspiring a new generation of Governing Council members.

As the incoming Chair, I see it as my duty to carry forward the energy that Brandon brought to this position and hopefully, bring even more new events and new opportunities to our membership. So far we are off to a great start — at our annual meeting at the State Bar Conference in September the Governing Council resolved to branch out with a variety of new events. Our progress on this goal has already begun. In December, we broadcast a webinar on the 2018 Amendments to the Federal Rules of Civil Procedure and the Federal Rules of Bankruptcy Procedure, led by our very own council members, Anthony Kochis and Fatima Bolyea. We hope to offer more programming of this nature in the future.

In March, we will be partnering with ICLE to put on our annual Masters in Litigation Seminar, at the Inn of St. John's in Plymouth. We have a truly excellent speaker on deck: the legendary Larry Pozner (flying all the way from sunny Hawaii) will be delivering a seminar on advanced techniques for cross-examination. Larry is well-known for his informative and entertaining seminars, so this should be quite an interesting event, particularly on what will in all likelihood be a blustery March weekday. I encourage you to register and attend, and you can find all the information you need to register for this event in this issue of the Litigation Journal.

But wait — there's more! We are currently finalizing the details for a signature event in May that you won't want to miss. We are not yet in a position to announce details, but trust me when I say that it will be an exceptional event in a truly unique and interesting venue. This will be on top of our annual summer conference, which we again anticipate holding at the majestic Grand Hotel on Mackinaw Island.

Last, but not least, we have the current Litigation Section Journal. If you have ever wanted to see your name in print on literally any litigation-related topic you can think of, I encourage you to submit your articles to our Editor-in-Chief, Joel Bryant.

If any (or all) of these ideas sound great to you, please consider participating. We would love to meet you in person. And if you have any ideas of your own, please don't hesitate to reach out to me and make your pitch.

Jeffrey A. Crapko
Chair
Litigation Section, State Bar of Michigan

Using Root Cause Analysis to Settle a Business Oppression Case

by: Jonathan B. Frank

The existence of a business oppression case means that a once-productive relationship has broken down. Trust has been eroded. Money has been diverted. Suspicions have mounted — and names have been called. Like a marital divorce, the business partnership has been severely damaged, possibly irreparably (for this article, "partnership" refers to all forms of business combinations). The future of the business is now in doubt. Michigan law, like the law in most other states, allows a partner to sue, to present evidence of oppression, and to ask the judge to fashion a remedy that matches the specific facts of the case. Remedies include the payment of damages, restructuring of the business relationship, appointment of a receiver, and/or a mandatory buyout.

Nearly all oppression cases (like nearly all cases in general) settle. The cost of oppression litigation, especially with accounting, fraud, and valuation experts, can be high. The daily grind is more intense than most cases. And in the end, business owners prefer certainty; the long list of possible remedies makes the outcome in court uncertain.

So why is it so hard to settle an oppression case? Because unlike most cases, which are primarily about money, oppression cases are multi-faceted. Indeed, the remedy or settlement may or may not be about money. Settlement negotiations in oppression cases are not as simple as "I start high, you start low, and we agree in the middle."

To settle oppression cases, it is critical to identify the underlying cause of the problem, isolate the precipitating event, and work to repair or at least stabilize the relationship. Unlike a marriage, a business partnership was built on an economic foundation. If the partners can make a reasoned economic decision, they should be able to separate from each other and move on.

Root Causes for Oppression Cases

In industry, "root cause analysis" is a widely-used method for understanding and solving problems which focuses on solutions that are specific to the particular problem. The five basic steps of root cause analysis are: (1) define the problem; (2) collect information; (3) identify causal factors; (4) identify the root cause(s); and (5) develop and implement solutions. In multi-faceted business oppression cases, root cause analysis is a useful tool to develop a framework for settlement, especially because of the recurring nature of certain root causes:

- **Unrealistic or imperfect expectations at the outset of the business relationship.** Taking on a partner sounds like a great idea, and often it is. But, like marriage, partnership is most successful when there is a combination of optimism, practicality and the ability to grow and adapt. Optimism alone will carry a partnership through the early, hopeful stages, but no further.
- **Incomplete / inaccurate documents.** Many business partners are hesitant to fully document their relationship, in part for fear of introducing negative "what if" scenarios. They may substitute simple boilerplate documents (often found online) for well-tailored agreements drafted by lawyers.

- **Misunderstanding of legal rights**. I use this analogy: business partners can be like third-graders playing football at recess. They may think they know the rules, but they really don't. When a dispute arises, there may be no mechanism to resolve it on the playground. Someone picks up the ball and runs off. Others push and shove. Someone runs off to get the gym teacher to be the referee. If and when order is restored, the game can continue. But sometimes it's too late and the game disintegrates.
- **Imperfect communication.** Over time, partners get busy. They neglect the care and feeding of the partnership itself. Issues that one partner deems important may be irrelevant to the others. Regular, periodic reports devolve into random, event-based, or crisis-based emails or texts.
- **Abuse of power/information.** Especially in cases where there is a majority in control, questions about the use/misuse of power arise. Certain legal rights related to the use of power may not square with perceived principles of ethics/morals/fair dealing.
- **Mounting suspicions/lack of respect**. As problems grow and are unaddressed, all partners are likely to construct an overarching theme that captures their view of the other side's actions ("she's being greedy," "he's getting lazy," "she's trying to ruin me and drive me out," "he's broke and he's stealing from me," etc.). Regardless of whether the theme actually matches the actions, the theme supports a growing sense of suspicion, disrespect, and distrust.
- **Unstable family dynamics**. On top of everything else, long-standing family grudges become magnified. The goofy brother becomes the brother who's just trying to capitalize on everyone else's efforts. The rigid mother becomes domineering and secretive.
- **Different goals/we've grown apart**. This one is the least combative, and therefore the easiest to resolve. Sometimes partners, like spouses, simply decide they would rather be doing something else. No yelling. No threats. No need for a referee.

Case Studies

Some case studies will help to illustrate these concepts.

- A minority partner in a long-standing successful business began to feel that the other partners were ganging up on him and concealing information. Communication between partners became non-existent. None of the partners had a good sense of their legal rights. When the minority partner expressed his unhappiness (probably not as diplomatically as he could have), the majority fired him and stopped paying him distributions due to him as an owner; they believed he had lost interest in the business, had taken and used confidential information, and was secretly competing (none of which was true). Early efforts to mediate were unsuccessful because there were still high levels of misunderstanding, suspicion, disrespect and distrust. A year of litigation helped to clarify the legal rights, tenuously re-establish the personal relationships, and put the dispute in a clear economic context. On the courthouse steps, the partners agreed to a fair buyout of the minority.
- Long-time friends became successful business partners by expanding their retail locations, but did not properly document their relationship, relying instead on a series of loose oral agreements. The minority misunderstood his legal rights regarding the new retail locations and believed the majority was mistreating him, concealing information, and diverting revenue.

There were serious gaps in the flow of information. Their friendship, and their spouses' friendship, completely broke down. A series of pre-litigation meetings with all partners and counsel allowed the partners to understand the true legal structure of their relationship, gather relevant information, rebuild their personal relationship, and agree to a fair buyout of the minority.

- 50/50 partners who came together based on complementary business skills began to lose confidence in the other's ability to operate the business. The partner in charge of financial issues began to exert control in a way that offended the other partner, who was in charge of operational issues. The financial partner began to question the operational strength of the business. The operating agreement did not address 50/50 control issues. Without a clear understanding of their legal rights, each partner took action that inflamed the situation. Productive communication ceased. After a lawsuit was filed and order was restored over finances and operations, the partners attended two mediation sessions, re-established lines of communication, but could not agree on terms for a buyout. A third party who knew both partners intervened to buy out one partner and enter the business. The interesting win/win aspect of this case was that the selling partner had grown increasingly pessimistic about the business, while the partner who stayed and the third party were optimistic. As a result, they were willing to pay a price that all partners thought was fair.
- Three family members ran a retail business, but one became distracted by other ventures and stopped contributing in any way to the business. Issues arose regarding the fairness of payments for income and/or distributions. Although there was constant communication, it was mostly hostile. When the distracted partner started to actively interfere with the operation of the business, the other two invoked the well-drafted operating agreement to expel him. After a lawsuit was filed, a court-ordered mediator worked with the partners to engage in productive communication and better manage the business, which was operating profitably. Once the partners' legal rights were clarified, the partners reached an agreement regarding terms of a buyout with the assistance of someone who had a relationship with all the family members, allowing all partners to resolve their issues with some measure of dignity.
- Two long-time partners in a series of real-estate investments now were in different financial circumstances and could not agree on whether and how to dispose of their investments. Without a clear understanding of their legal rights regarding termination of their partnership, one partner took steps to market the properties without informing the other. The other partner constructed a theme around "corporate bullying." Both partners stubbornly refused to cooperate with the other — they could not agree on buyout terms or even a structure. Before litigation, the partners and counsel attended a mediation session that allowed both partners to express their different goals in a respectful setting. That accomplished, they quickly agreed to a mediator-run auction between the two of them on a property-by-property basis.
- Two friends in a software business stopped communicating effectively with each other about ownership and development of their intellectual property. Both became suspicious of the other. Instead of revealing or

addressing their suspicions, they each took actions that ultimately threatened the business. Their operating agreement, developed from an online form, did not properly address the nature of their business and contained harsh provisions that neither partner intended or understood, but that both partners decided to take advantage of in a series of emails to each other. Before a lawsuit was filed, but after they understood their legal rights, they agreed to terms of a buyout. As with a case noted above, a win/win solution was possible because the selling partner had grown increasing pessimistic about the business, while the buying partner was optimistic. As a result, the buying partner was willing to pay a price that both partners thought was fair.

Root Cause Analysis Works

I would submit that in each of these cases, the ultimate solution was not immediately obvious. Successful resolution depended on a thorough and time-consuming root cause analysis. If partners stopped communicating effectively, some work was required to restore trust and re-open lines of communication. If partners misunderstood their legal rights, some work — often through motion practice — was required to clarify those rights. If partners had unequal access to information, some work was required to equalize access and enable verification. If partners had differing views about the future of the business, some work was required to understand the magnitude of the difference and translate that difference into an economic solution. And since in most cases there was a fractured personal relationship, some work was required to let all partners express themselves in an honest and productive way so that they could at least try to salvage some aspect of the relationship. On the other hand, in three recent oppression cases that did not settle, the primary root cause was one partner's stubbornness and inability/unwillingness to accurately assess the potential risk, along with thematic explanations for the other's behavior that went unchecked. As a result, it was impossible to construct an appropriate settlement structure.

The beauty of root cause analysis in industry is that it provides a repeatable structure to identify and solve problems. In the context of oppression litigation, root cause analysis allows business partners, who at some point in the past had a productive personal and/or business relationship, to respectfully retain control over their outcome.

*Jonathan B. Frank is a graduate of Stanford University, with distinction, and the University of Michigan Law School, cum laude. He is of counsel to Maddin Hauser Roth and Heller in Southfield, focusing his practice on resolution of business and real estate disputes. He is a member of the OCBA Business Court and Counsel Committee and is a past chair of the OCBA Circuit Court Committee. He is also a SCAO-trained mediator and a neutral arbitrator for the AAA. His articles about solving business problems have appeared in *Laches* and the *Michigan Bar Journal*.

Defending Corporate Oppression Claims in Michigan

by: David Hansma

Under Michigan law, MCL 450.1489 and MCL 450.4515 give minority shareholders of corporations and minority members of limited liability companies statutory causes of action for conduct that is illegal, fraudulent, or willfully unfair and oppressive. These statutes, which provide a wide range of possible remedies, have created a groundswell of shareholder litigation over the past twenty years. While there are still relatively few published appellate court opinions interpreting the statutes, there have been numerous unpublished opinions, federal court opinions, and business court opinions that give us a robust and sometimes conflicting body of case law to draw upon. Below, I provide several tips gleaned from these decisions, and over eleven years of practice, on how to defend shareholder oppression cases.

Consider Early Motions to Dismiss for Failure to Comply with the Statutes

The language of the oppression statutes can create ready grounds for a motion to dismiss. For example, MCL 450.1489 provides that oppression claims may only be brought by "a shareholder."[1] Thus, if the plaintiff is not *currently* a shareholder, he may not bring an oppression claim.[2]

The statutes also limit the categories of possible defendants. The statutes only provide a cause of action against directors/managers "or those in control" of the company. Michigan courts have required plaintiffs plead facts showing that the defendant is actually in control of the corporation.[3]

The statutes also limit what constitutes oppression. Specifically, the statutes define "willfully unfair and oppressive conduct" as a "continuing course of conduct or a significant action or series of actions that substantially interferes with the interests of the shareholder as a shareholder"[4] (or of a member as a member in an LLC). In *Franchino v Franchino,* the Court of Appeals emphasized that minority shareholders could bring suit for oppression only for "conduct that substantially interferes with the interests of the shareholder *as a shareholder."*[5] The *Franchino* court explained that the "rights that automatically accrue to shareholders . . . are typically considered to include voting at shareholder's meetings, electing directors, adopting bylaws, amending charters, examining the corporate books, and receiving corporate dividends."[6] A complaint asserting interference with an interest that is not an interest of a shareholder "as a shareholder" does not state a claim for oppression.[7]

Defense counsel in an oppression case should consider an early motion for summary disposition if the plaintiff's complaint does not plead facts to satisfy these statutory requirements.

Distinguish Employment from Shareholder Interests

As just mentioned, the oppression statutes only protect the interests of a shareholder as a shareholder. But shareholders in closely held companies often work for the company. As a result, plaintiffs in oppression cases often argue that termination of their employment or salary constitutes oppression against them as a shareholder. The *Franchino* decision briefly eliminated this theory of oppression when it held that "employment and board membership are not generally listed among rights that automatically accrue to shareholders."[8]

The Legislature partially abrogated *Franchino* when it amended the oppression statutes to provide that "willfully unfair and oppressive conduct may include the termination of employment or limitations on employment benefits to the extent that the actions interfere with distributions or other shareholder interests disproportionately as to the affected shareholder."[9] Thus, interference with employment can be oppression in some circumstances.

In a recent unpublished decision in *Castle v Shoham,*[10] the Court of Appeals held that a shareholder's salary is not necessarily equivalent to a distribution, and for-cause termination does not interfere with shareholder interests. As in *Castle*, defense counsel should consider how to demonstrate that the plaintiff's termination was for cause or pursuant to contract, and that the plaintiff's salary was separate from his distributions as a shareholder.

Determine if the Allegedly Oppressive Conduct is Allowed by Contract

The shareholder oppression statute specifically states that oppressive conduct "does not include conduct or actions that are permitted by an agreement, the articles of incorporation, the bylaws, or a consistently applied written corporate policy or procedure" (the member oppression statute contains a similar safe harbor).[11] Defense counsel should review all applicable contracts and corporate documents to determine if the conduct at issue falls within this safe harbor. However, counsel should be aware that general authority to make business decisions such as setting salaries and approving contracts does not allow exercising that authority in an unfair and oppressive manner.[12]

Be Prepared to Address Freeze-Out Allegations

A common allegation in oppression cases is that the plaintiff has been frozen out of the company through removal from a role in management or from the corporate decision making process. Plaintiffs rely on various unpublished opinions to support these claims. For example, in *Berger v Katz,* the Court of Appeals affirmed a finding of oppression where, among other things, "[t]here was also evidence that defendants refused to allow plaintiff to participate in corporate decisions[.]"[13] In *Bromley v Bromely,* the court suggested that the conduct prohibited by statute includes "removing minority shareholders from positions in management[.]"[14]

These theories of corporate freeze-out cannot be squared with *Franchino,* in which the Court of Appeals held that removal from employment or the board of directors does not interfere with the interests of a shareholder as a shareholder. At most, the removal of the plaintiffs from management in those cases merely corroborated the oppressive nature of financial transactions that were also at issue. Without more, removal from management or the decision-making process is not oppressive under *Franchino.*[15]

Apply the Business Judgment Rule

The business judgment rule "protects a disinterested director from liability with respect to any business decision on behalf of the corporation which was made 'on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'"[16] Certain types of allegedly oppressive conduct are quintessentially business judgments. For example, decisions not to pay distributions or dividends often give rise to oppression claims. But the decision whether to pay a dividend is within the discretion of the directors and will not be interfered with unless it "is clearly made to appear that [the directors] are guilty of fraud or misappropriation of the corporate funds, or . . . a breach of . . . good faith[.]"[17] Thus, defense counsel should be prepared to show how the conduct at issue arises from good faith business judgment. Defense counsel should also be prepared to move to dismiss the plaintiff's claims if the plaintiff does not plead facts in avoidance of the business judgment rule.[18]

Directors and managers should not assume, however, that the business judgment rule is an automatic path to dismissal. Certain types of allegations, such as misappropriation of assets, will easily state a claim in avoidance of the business judgment rule. Further, if the alleged

oppressive action is an interested party transaction,[19] the business judgment rules does not apply. Instead, the defendant will have the burden of showing the entire fairness of the transaction. "Entire fairness" requires not just a fair price, but that the transaction advances a legitimate corporate interest.[20]

It should be noted at this point that no binding Michigan authority explicitly states that the common law business judgment rule applies to statutory oppression claims. However, this should not deter defense counsel from asserting the business judgment rule. First, nonbinding precedent supports the argument that the traditional business judgment rule analysis applies to oppression cases. For example, the plaintiff in *Blankenship v Superior Controls, Inc*[21] alleged oppression based on, among other things, the nonpayment of distributions. In considering whether the plaintiff stated a claim for relief, the Eastern District of Michigan applied the business judgment rule to the plaintiff's claim.

Second, the Business Corporation Act and the Limited Liability Company Act require directors and managers to exercise business judgment. Specifically, both statutes require corporate actions be taken in good faith with ordinary care.[22] It would be anomalous to hold that the business judgment rule does not apply to parties bound to exercise business judgment. As the Supreme Court of Texas held in construing its similar oppression statute, "because a director is duty-bound to exercise business judgment for the sole benefit of the corporation, and not for the benefit of individual shareholders, we cannot construe the term 'oppressive' in a manner that ignores that duty."[23]

Third, there is no inconsistency between the oppression statutes and the business judgment rule. The oppression statutes set forth a standard of liability. The business judgment rule, however, is a standard of review.[24] Just as this standard of review has applied to common-law shareholder claims such as breach of fiduciary duty, the same framework should apply to shareholder claims under the oppression statute.

Dispute The Plaintiff's Requested Remedy

The oppression statutes give the court broad discretion to craft an award. Among the nonexclusive list of remedies set forth in the statutes include, damages, injunctive relief, and a buyout of the plaintiff's equity. Quite often, the plaintiff shareholder will request several forms of relief. However, even if the plaintiff proves oppression, that does not mean the plaintiff is necessarily entitled to the exact relief requested.

The Michigan Supreme Court has held that the oppression statutes are equitable.[25] It is well settled that a court of equity is not bound to award the relief requested by the plaintiff. In *Chamberlain v Nipigon,* the Court of Appeals held in a shareholder case, "[i]n granting equitable relief, a court is not bound by the prayer for relief but may fashion a remedy as warranted by the circumstances."[26]

More recently, in *Hirmiz v Jaust,* the Court of Appeals affirmed a trial court's decision not to award damages under the oppression statute.[27] The trial court ordered dissolution of the company and directed the distribution of the proceeds between the parties, but did not award additional damages requested by the plaintiff. The Court of Appeals affirmed, holding that "the statute clearly states, 'the circuit court *may* ... grant relief to a member' that it considers appropriate in the matter; noticeably absent is the word 'shall.'"[28] Accordingly, defense counsel should be prepared to dispute the appropriateness of the relief sought by the plaintiff.

ENDNOTES

1 MCL 450.4515 limits standing to current members of a limited liability company.

2 *Estes v Idea Eng'g & Fabricating, Inc,* 250 Mich App 270, 282 (2002).

3 *Talaski v Carpenter,* Oakland County Circuit Court No. 14-138663-CK, Oct 9 2014, p 2; *Polizzi v Dimerurio,* Macomb County Circuit Court No. 15-4609-CB, Sept 30 2016, pp 3-4.

4 MCL 450.1489(3).

5 *Franchino v Franchino,* 263 Mich App 172, 184 (2004) (emphasis in original).

6 *Id.*

7 See *Id.*

8 *Id.* at 184-85.

9 MCL 450.1489(3); see MCL 450.4515(3).

10 *Castle v Shoham,* unpublished opinion per curium of the Court of Appeals, issued August 7, 2018 (Docket No. 337969); 2018 WL 3746550.

11 MCL 450.1489(3); see MCL 450.4515(3).

12 *Berger v Katz,* unpublished opinion per curium of the Court of Appeals, issued July 28, 2011 (Docket Nos. 291663 & 293880); 2011 WL 3209217.

13 *Id.*

14 *Bromley v Bromley,* unpublished opinion of the Eastern District of Michigan, issued Oct 4, 2006 (Docket No. 05-71798); 2006 WL 1662552.

15 The outcome may be different if there were a shareholder agreement recognizing a right to participate in management. *Madugula v Taub,* 496 Mich 685, 718-20 (2014)

16 *In re Dalen,* 259 BR 586, 609 (Bankr WD Mich 2001)(quoting *Aronson v Lewis,* 473 A2d 805, 812 (Del 1984)).

17 *Matter of Estate of Butterfield,* 418 Mich 241, 255 (1983).

18 *Churella v Pioneer State Mut Ins Co,* 258 Mich App 260, 272 (2003).

19 *Christner v Anderson, Nietzke & Co,* 156 Mich App 330, 340 (1986), *rev'd in part on other grounds,* 433 Mich 1 (1989).

20 *Fill Bldgs, Inc v Alexander Hamilton Life Ins Co,* 396 Mich 453, 461 n7 (1976).

21 135 F Supp 3d 608 (ED Mich 2015).

22 MCL 450.1541a(1); MCL 450.4404(1).

23 *Ritchie v Rupe,* 443 SW3d 856, 869 (Tex 2013) (citations omitted).

24 *Chen v. Howard-Anderson,* 87 A.3d 648, 666-67 (Del. Ch. Ct. 2014).

25 *Madugula,* 496 Mich at 714-715.

26 *Chamberlain v Point Nipigon on the Straits Resort Club,* unpublished opinion of the Court of Appeals, issued May 26, 1998 (Docket Nos. 189719 & 189893); 1998 WL 1992520.

27 *Hirmiz v Jaust,* unpublished opinion per curium of the Court of Appeals, issued September 11, 2018 (Docket No. 337269); 2018 WL 4339529.

28 *Id.* at *6.

*David F. Hansma is an attorney with Seyburn Kahn, P.C. He handles all manner of commercial litigation, including shareholder disputes, before Michigan state and federal courts and arbitration panels. He regularly writes about and speaks on topics relating to corporate governance, fiduciary obligations, and shareholder oppression.

With non-competes under attack, what role for the Courts?

by: Daniel D. Quick & Ariana F. Pellegrino

Non-competition agreements have seen increased scrutiny in recent years. Non-competes entered the public sphere in 2014 with gusto, with the now infamous revelation that Jimmy John's required its sandwich makers and delivery drivers to sign non-competes. Once challenged, Jimmy John's quickly back-pedaled, first discontinuing use of the non-competes going forward, and then ultimately agreeing not to enforce existing ones.[1] The White House issued a report in 2016 opining that non-competes are over-used and a threat to the economy, which report was followed by a "call to action and set of best practices for state policymakers to enact reforms to reduce the prevalence of non-compete agreements that are hurting workers and regional economies."[2]

In Michigan, academics have opined that non-competes can be counterproductive to the economic goals they were meant to achieve; instead of encouraging innovation and higher wages within a state, their findings suggest, enforcing non-competes lowers workers' earning power and motivates them to take their skills elsewhere.[3] Other states are taking action. For example, the Massachusetts legislature discussed non-compete reform for a decade, and in 2018 substantially amended the statute.[4] Other states are moving as well.[5]

Where is Michigan in this pendulum swing? In terms of black-letter law, neither the statute nor the case law has shown any sign of meaningful departure from the status quo. Given that non-competes are authorized by statute in the employment context, do the courts have latitude to evolve the law on their own? This article explores two areas where courts, within the framework of the statute, might elect to shift the law toward more restrictive enforcement of non-competes.

HOW WE GOT HERE

Non-competes in Michigan have an interesting history. Before 1905, "a common law rule of reason governed what constituted a permissible restraint of trade" in Michigan.[6] However, in 1905, the legislature enacted what became an 80-year prohibition of non-competes as "against public policy, illegal and void."[7] Effective March 29, 1985, MARA, MCL 445.771 *et seq.,* repealed a variety of earlier statutes, including 1905 PA 329. MARA did not specifically address the status of noncompetition covenants in light of the removal of the long-standing prohibition. Instead, it provided that the "rule of reason" analysis, based on federal antitrust law developed under the Sherman Act, would be given "due deference" in developing Michigan antitrust law. Despite MARA's silence on the issue of noncompetition covenants, case law established that, since March 29, 1985, covenants were enforceable in Michigan to the extent they are "reasonable," which is in accord with the law of most other states.[8] On December 28, 1987, the legislature enacted 1987 PA 243, MCL 445.774a, to clarify the legality of noncompetition agreements in Michigan after MARA's repeal of the former prohibition.

In the intervening 22 years, the courts — in Michigan and elsewhere — grew increasingly friendly to non-competes. Courts — especially business courts — regularly enforced such agreements when they were deemed reasonable in light of

case precedent. However, it remains the case that, the statute notwithstanding, "noncompetition agreements are disfavored as restraints on commerce."[9] In light of the fact that non-competes are sanctioned by statute, but face judicial hostility, how much latitude do Michigan courts have to move the needle on enforcement?

The realpolitik answer is that many non-competes are litigated only through the preliminary injunction stage, and if courts stop granting injunctions — whether due to lack of irreparable harm or otherwise — then reliance on non-competes would drop precipitously. Beyond that, at least two aspects of non-competes, where other states have moved away from the Michigan position, might catch the attention of the courts.

ADEQUATE CONSIDERATION

Michigan courts have repeatedly held that the mere continuation of employment is sufficient consideration to support a non-compete in an at-will employment setting, tracing the proposition back to a published opinion in 2004, *QIS, Inc.*[10] The principle has been upheld repeatedly, even when questioned by a dissenting appeals judge.[11]

There is a credible argument that this principle rests upon a thin reed. *QIS, Inc* cited as its sole authority a 1991 federal district court opinion applying Michigan law.[12] But that federal case contained little analysis and cited only a 1983 Iowa Court of Appeals opinion which, in fact, questioned whether continued employment was adequate consideration, but upheld the non-compete on the basis of a sale of the business.[13]

Many jurisdictions do recognize continued employment as adequate consideration.[14] But this is an area of increased controversy. Some courts require employment for "a significant period" after execution of the non-compete,[15] while others require *some* independent consideration.[16] But in such states it is often not hard to demonstrate some additional consideration, be it merely holding a job long enough after execution of the agreement, a raise, a bonus, or some other perk.[17] Other states, such as Massachusetts under its new statute, require that an employee be given "garden leave" or other mutually agreed-upon consideration during the term of the non-compete.[18]

Is there room in Michigan law for a shift? Given that the *QIS, Inc* holding rests upon shaky ground, perhaps. Generally, courts do not inquire into the adequacy of consideration and the proverbial peppercorn will suffice.[19] But where Michigan public policy disfavors non-competes, can courts require more? In *Teachout Security Services, Inc,* the party seeking to enforce a non-compete argued that the employee should not be permitted to challenge whether the non-compete was reasonable because the agreement he signed purported to stipulate that it was.[20] The court refused to apply Michigan law, which might otherwise uphold the acknowledgment, on the basis that Michigan law disfavors non-competes. Could the same logic support departure from the "peppercorn" rule of consideration? In addition to the dissent in *Posselius,* there was the attempt of a litigant in a federal case to invoke the Michigan Supreme Court's logic in *Sands Appliance Services, Inc.,* which questioned the traditional consideration analysis in the context of employment agreements.[21] It would likely take a ruling from the Michigan Supreme Court, but this issue is not conclusively settled.

"GOOD WILL" AS A COMPETITIVE BUSINESS INTEREST

Non-competes are only permissible to the extent that they protect "an employer's reasonable competitive business interests."[22] Michigan courts recognize that "goodwill" represents a fundamental competitive business interest.[23] The concept of "goodwill" often applies to salespersons, who are the "face" of the employer to the customer. Because the company, rather than the employee, owns that goodwill, Michigan law recognizes an employer's entitlement to "time to regain goodwill" with its customers, who might otherwise depart with the employee.[24]

Even so, an employer does not have unlimited time during which it can attempt to recapture the relationship it might otherwise have lost.[25] And if a non-competition agreement goes beyond

reasonable bounds, courts have discretion to modify the terms, or refuse to enforce it altogether.[26] In that regard, Michigan courts have not conclusively addressed the permissible boundaries of client-solicitation restrictions. For example, Michigan law is seemingly clear that relationships by the departing employee *in the course or because of his or her employment are fair game.*[27]But Michigan courts have not addressed whether and to what extent non-competition agreements can prevent a departing employee from taking with him or her the "personal clients" of the employee, or those clients with which the employee did not have contact during his or her employment. One federal court, ostensibly applying Michigan law,[28] found that a non-competition agreement was unreasonably broad where it applied "to customers with whom [the employee] had no contact" during her employment.[29] Thus, in accordance with MARA, the court limited the agreement to only those customers "for which [the employee] was the sales representative."[30]

Other courts have applied a finer analysis to goodwill. In Massachusetts, for example, courts distinguish between goodwill with customers established by the employee before beginning employment and during employment, and in the case of the latter, whether that goodwill was created essentially through the employee's own industry or via the resources of the employer.[31] Other courts have excluded from the reach of non-competition agreements those relationships that were personal to the employee, and which were not created during the employment or supported by the employer.[32]

Michigan law still awaits a holistic, thorough analysis of when goodwill is sufficient to support a non-compete, and how it should be defined. Moreover, even where the court finds a legitimate business interest, it can judicially reform the agreement, imposing its own interpretation of reasonableness. All of this discretion can be exercised under the penumbra of the existing statute.

CONCLUSION

With non-competes under attack, courts have significant discretion as to whether and how they are enforced. There is plenty of room within the existing legal framework for exercise of discretion by courts, and other states have vibrant and markedly different bodies of case law on various aspects of non-competes (not just the two topics addressed here). As society's view of non-competes evolves, will the courts' evolve with it?

*Daniel Quick is a business trial attorney with Dickinson Wright PLLC in Troy, MI. He is the author of *Michigan Business Torts* (ICLE) and frequent author on non-competes, shareholder litigation and trade secrets.

*Ariana Pellegrino is a business trial attorney with Dickinson Wright PLLC in Troy, MI. She was named "Nonpartner Associate of the Year" by Crain's Detroit Business in 2017 for her advocacy on behalf of the University of Michigan in the Michigan Court of Appeals.

ENDNOTES

1 Sarah Whitten, *Jimmy John's drops noncompete clauses following settlement,* http://www.cnbc.com/2016/06/22/jimmy-johns-drops-non-compete-clauses-following-settlement.html.

2 The White House, *Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses,* https://obamawhitehouse.archives.gov/sites/default/files/non-competes_report_final2.pdf; *State Call to Action on Non-Compete Agreements,* https://obamawhitehouse.archives.gov/sites/default/files/competition/noncompetes-calltoaction-final.pdf.

3 See J.J. Prescott, Norman D. Bishara, and Evan Starr, U*nderstanding Noncompetition Agreements: the 2014 Noncompete Survey Project,* 2016 MICH. ST. L. REV. 369, *available at* https://repository.law.umich.edu/cgi/viewcontent.cgi?article=2795&context=articles.

4 Katharine O. Beattie and Jennifer R. Budoff, *New Massachusetts Non-Compete Law Goes Into Effect October 1, 2018, NAT'L L. REV. (Aug. 14, 2018), available at* https://www.natlawreview.com/article/new-massachusetts-non-compete-law-goes-effect-october-1-2018.

5 See *id.*

6 *Bristol Window & Door, Inc. v. Hoogenstyn,* 250 Mich. App. 478, 486 (2002) (citing *Hubbard v. Miller,* 27 Mich. 15, 19 (1873)).

7 1905 PA 329, MCL 445.761 et seq. (repealed by Michigan Antitrust Reform Act, 1984 PA 274, MCL 445.771 et seq. ("MARA")).

8 See *Bristol Window & Door, Inc.,* supra (under MARA, common-law rule of reason governs agreements in restraint of trade); see also *Lowry Computer Prods, Inc. v. Head,* 984 F. Supp. 1111 (E.D. Mich. 1997).

9 *Thermatool Corp. v. Borzym,* 227 Mich. App. 366, 372 (1998).

10 *QIS, Inc. v. Industrial Quality Control, Inc.,* 262 Mich. App. 592 (2004).

11 See, e.g., *Posselius v. Springer Publishing Co., Inc.,* No. 306318, 2014 WL 1514633, *8 (Mich. Ct. App. April 17, 2014) (Ronayne Krause, J., dissenting).

12 See *QIS, Inc., supra* at 594 (citing *Robert Half, Inc. v. Van Steenis,* 784 F. Supp. 1263, 1273 (E.D. Mich. 1991)).

13 See *Robert Half, supra* at 1273; *Ins. Agents, Inc. v. Abel,* 338 N.W.2d 531, 534-35 (Iowa App. 1983) ("While as a general legal principle it might be said that employment does provide consideration for a non-competition agreement in an employment contract, here the defendant's employment was part of the prior 1977 sale of business agreement. The sale of defendant's business was the major inducement to plaintiff to employ defendant. Plaintiff was obligated to employ defendant under the 1977 agreement for at least three years. The promise of continuing employment does not provide consideration for the 1978 agreement.").

14 See generally 3 CALLMANN ON UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES § 16.41 (4th ed., December 2018 Update).

15 See, e.g., *Premier Rides, Inc. v. Stepanian,* No. MJG-17-3443, 2018 WL 1035771 (D. Md. February 23, 2018), *Brashear v. CCG Systems, Inc.,* No. 18-cv-00059, 2018 WL 5044348 (M.D. Tenn. October 17, 2018).

16 E.g., *Midwest Sports Mktg Inc. v. Hillerich & Bradsby Of Canada Ltd.,* 552 N.W.2d 254, 265 (Minn. App. 1996).

17 See, e.g., *Fancy Fox LLC v. Hanchey,* No. 1277 WDA 2017, 2018 WL 2126288 (Pa. Super. Ct. May 9, 2018).

18 See Beattie and Budoff, supra note 7.

19 See, e.g., *Edward Nowitzke Trust v. DeYoung,* No. 269597, 2008 WL 3007999 (Mich. Ct. App. 2008 August 5, 2008).

20 *Teachout Security Servs., Inc. v. Thomas,* No. 293009, 2010 WL 4104685 (Mich. Ct. App. October 19, 2010).

21 See *Sherrod v. Genzyme Corp.,* 170 F. App'x. 375 (6th Cir. 2006); *Sands Appliance Servs., Inc. v. Wilson,* 463 Mich. 231 (2000).

22 MCL 445.774a(1).

23 See, e.g. *St. Clair Med, P.C. v. Borgiel,* 270 Mich. App. 260, 268 (2006) ("A physician who establishes patient contacts and relationships as the result of the goodwill of his employer's medical practice is in a position to unfairly appropriate that goodwill and thus unfairly compete with a former employer upon departure.").

24 *St. Clair Med, supra* at 268.

25 *Mid Michigan Med Billing Serv, Inc. v. Williams,* No. 323890, 2016 WL 682989, at *5 (Mich. Ct. App. February 18, 2016) ("[T]o the extent that plaintiff's employee handbook permanently prohibits a former employee from obtaining employment from any current or previously contract client of plaintiff, that restriction is an unreasonable restraint on trade and unenforceable as written.").

26 See *id.* (judicially limiting the non-competition period to 12 months); see also MCL 445.774a; *Innovation Ventures, LLC v. Liquid Mfg, LLC,* No. 315519, 2014 WL 5408963, at *7-8 (Mich. Ct. App. October 23, 2014) (refusing to enforce non-competition agreement allegedly intended to protect goodwill where the agreement was overbroad and plaintiff offered no basis for modification of its terms).

27 *St Clair Med,* supra at 268 (upholding restrictive covenant where "it prevented defendant from using patient contacts g*ained during the course of his employment* . . . .") (emphasis added); *Teachout Sec Servs, Inc., supra* ("[A]n employee who establishes client contacts and relationships *as the result of the goodwill of his employer's business* is in a position to unfairly appropriate that goodwill and thus unfairly compete with a former employer upon departure.") (emphasis added); *Gene Codes Corp v. Thompson,* No. 09-14687, 2011 WL 611957 (E.D. Mich. February 11, 2011) ("Plaintiff has a legitimate business interest, beyond mere competition, in preventing Defendant from using the goodwill she developed *at Plaintiff's expense* to solicit Plaintiff's customers on behalf of [the new company].") (emphasis added).

28 Although the Court stated that it was applying Michigan law, it cited to Indiana law for its holding. *Frontier Corp. v. Telco Communs Group, Inc.,* 965 F. Supp. 1200, 1209 (S.D. Ind. 1997).

29 *Id.*

30 *Id.*

31 See, e.g., *First E. Mortg. Corp. v. Gallagher,* 2 Mass. L. Rptr., 1994 WL 879546, at *1 (Mass. Super. Ct. 1994) ("Here, however, defendants' affidavits establish that the good will sought to be protected is not that which the plaintiff had previously acquired and which was misappropriated by the defendant, but was the defendant's own making, which he had developed with customers as a result of his own enthusiasm, personality and abilities."). See also R. Beck, *Business Torts in Massachusetts,* Ch. 8.2.5(a) (Mass. CLE, Inc., 2016); A. Botti, *Who Owns Customer Goodwill, After All?,* N.E. IN-HOUSE, May 31, 2007, *available at* **https://newenglandinhouse com/2007/05/31/who-owns-customer-goodwill-after-all063/.**

32 See *Scott, Stackrow & Co., CPAs, P.C. v. Skavina,* 9 A.D.3d 805, 806 (N.Y. App. Div. 2004) ("A covenant will be rejected as overly broad, however, if it seeks to bar the employee from soliciting or providing services to clients with whom the employee never acquired a relationship through his or her employment or if the covenant extends to personal clients recruited through the employee's independent efforts."); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dunn,* 191 F. Supp. 2d 1346, 1353 (M.D. Fla. 2002) (rejecting employee's argument that clients were his personal clients because employee presented no evidence that he "obtained any of his clients solely as a result of his own independent recruitment efforts, which Plaintiff neither subsidized nor otherwise financially supported as a part of a program of client development").

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