

STATE OF MICHIGAN
IN THE SUPREME COURT

INNOVATION VENTURES, LLC, d/b/a LIVING
ESSENTIALS,

Plaintiff-Appellant,

v

LIQUID MANUFACTURING, LLC., K & L
DEVELOPMENT OF MICHIGAN, LLC, LXR BIOTECH
LLC, ETERNAL ENERGY, LLC, ANDREW KRAUSE, and
PETER PAISLEY,

Defendants-Appellees.

Supreme Court No. 150591

Court of Appeals No. 315519

Oakland County Circuit Court
No. 12-124554-CZ

BRIEF AS AMICUS CURIAE BY MICHIGAN CHAMBER OF COMMERCE

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March 27, 2015

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STATEMENT OF QUESTIONS PRESENTED

As amicus, the Michigan Chamber of Commerce will only address the first question presented by plaintiff-appellant Innovation Ventures, LLC.

1. Whether a written contract, which memorializes an oral contract that existed for years, must be continued for a “substantial time” to make a non-compete provision enforceable in Michigan?

The Court of Appeals held “yes.”

Plaintiff-appellant says “no.”

Defendants-appellees say “yes.”

Application for leave to appeal, p. vi

The Michigan Chamber of Commerce believes the Court of Appeals erred by holding that a contract can become unenforceable for failure of consideration because a party terminates the agreement according to its express terms.

STATEMENT IDENTIFYING INTEREST AS AMICUS CURIAE

The Michigan Chamber of Commerce is a nonprofit corporation representing over 6,800 members, all of whom are private enterprises engaged in an array of civic, professional, commercial, industrial, and agricultural activity in Michigan. Since its founding in 1959, the Chamber has sought to engage decision-makers at all levels of government with the hope that the continual development of law and public policy will keep Michigan economically competitive and make the State attractive as a place to live and work. With this goal in mind, the Chamber has participated in lawsuits to ensure that courts are aware of how business is conducted in Michigan and are mindful of the impact court decisions have on the business operations and economic development in this State.

STATEMENT OF POSITION AS AMICUS CURIAE

The Chamber is concerned that the Court of Appeals' interpretation and application of the failure of consideration doctrine, unless reversed by this Court, may threaten the stability of contractual relationships between companies doing business in Michigan. The court held that a party's decision to terminate a contract—an action expressly permitted by the agreement's unambiguous language—resulted in a failure of consideration. As amicus, the Chamber submits that exercising a contractual provision accepted by both parties should not render other terms in the agreement unenforceable.

The decision is especially troubling because the business arrangements among Innovation Ventures, Liquid Manufacturing, and K & L Development are fairly common.

A business has a product it wants to sell, or in some cases, the idea for a product that it hopes to sell. In this case, Innovation Ventures developed 5-Hour Energy, a specialized drink that has been extraordinarily successful.

While a company may have considerable expertise and knowledge about its product and the marketplace, it may need to seek out help in other operations, such as manufacturing or processing. To accomplish its business objectives, the company will contract with a manufacturer or processor that has the needed facilities, equipment, personnel, and expertise. Liquid Manufacturing filled that role for Innovation Ventures by agreeing to provide bottling services.

Depending on the circumstances, there may be a need for assistance in other areas. For example, a consultant with specialized knowledge about adapting the manufacturing process to the specific product may be brought in to serve as an interface between the product company and the manufacturer. Here, Innovation Ventures retained K & L Development to help design and install the customized equipment and process for producing 5 Hour Energy.

From the Chamber's perspective, it is essential that businesses have the ability to determine what is needed to get the job done, what is the best way to pool their expertise and resources, and what contractual arrangements are acceptable to all parties. And, it is just as essential that businesses can depend on the contracts they negotiate and execute. This Court has firmly stated the bedrock principle: courts should respect the freedom of individuals and businesses to arrange their affairs through contract by enforcing their agreements as written. *Rory v Cont'l Ins Co*, 473 Mich 457, 468; 703 NW2d 23 (2005). Businesses in Michigan rely on that principle when planning their operations, committing their resources, and investing in their people.

The need for certainty and reliability is particularly true for the type of non-compete and non-disclosure agreements involved in this case. In many circumstances, cooperative

arrangements involve disclosure of confidential information that has considerable value and significant benefit for a business, and conversely, the risk of substantial detriment and harm if used by competitors. Understandably, businesses want to protect their interests through agreements with the other companies and individuals involved in their operations. Businesses must be able to trust that their contracts will be enforced before they can have sufficient confidence to disclose the critical information needed to carry out their plans.

The Chamber believes that the approach used by the Court of Appeals to invalidate the agreements in this case will undermine the assurance that individuals and companies can protect their interests through contracts with business partners. Businesses will face the risk that a court may look at their contracts in hindsight and rule that a party's judgment about their best interests was not the right choice. A court could decide after the fact that the other party's exercise of its rights under a contract caused the valid consideration supporting non-compete or non-disclosure agreements to "fail." A court could determine that an agreement reached between two sophisticated businesses about how to protect their respective interests should not be enforced.

The Chamber recognizes that contracts between employers and employees have sometimes been treated differently by the legislature and courts. There is no need to debate those differences, because they are not at issue here. This case involves sophisticated businesses entering into contractual relationships with their eyes open. The parties are businesses that knowingly agreed to specific terms based on judgments about the best way to accomplish their objectives.

As amicus, the Chamber asks this Court to grant Innovation Ventures' application for leave to appeal and reverse the Court of Appeals' decision.

ARGUMENT

I. A party's exercise of its rights under an agreement should not result in a failure of consideration and render other contract provisions unenforceable.

The Chamber believes that the Court of Appeals misapplied the failure of consideration doctrine to invalidate the non-disclosure and non-compete agreements between Innovation Ventures and K & L Development.¹

When structuring their business relationship, the companies negotiated two related agreements, *i.e.* the “Equipment Manufacturing and Installation Agreement” and the “Non-disclosure and Confidentiality Agreement.” In both, K & L Development agreed that it would protect the confidentiality of certain information, would not disclose the information to other persons, and would not compete with Innovation Ventures during the term of the agreement and for three years afterwards. K & L Development and Innovation Ventures also agreed that either could terminate the agreement at its discretion and without cause upon 14 days’ notice.

A. A court should not use failure of consideration to protect a party against the consequences of contract terms it knowingly accepted.

The Court of Appeals correctly held there was valid consideration supporting the agreements. Slip opinion, p. 10. “Mere continuation of employment is sufficient consideration to support a noncompete agreement in an at-will employment setting.” *QIS*,

¹ Andrew Krause, the president and owner of K & L Development, was a party to one of the agreements. For convenience, this brief uses “K & L Development” to refer to both Krause and his company.

Inc v Indus Quality Control, Inc, 262 Mich App 592, 594; 686 NW2d 788 (2004).² This holding should have ended the inquiry. “The law does not inquire into the adequacy of the consideration.” *Levitz v Capitol Sav & Loan Co*, 267 Mich 92, 97; 255 NW 166 (1934). See also, *GMC v Dep’t of Treasury*, 466 Mich 231, 239; 644 NW2d 734 (2002).

The Court of Appeals, however, chose to depart from this well-settled rule and instead follow a judicially devised principle applied in some states to non-compete provisions in at-will employment contracts. Some of the cases express concern about “the illusory nature of the promise of continued employment in an at-will relationship.” The employer can still fire the employee without cause while the employee’s situation “has dramatically changed in that the employee’s ability to leave and pursue the same line of work with a new employer is significantly restricted.” *Summits 7, Inc v Kelly*, 178 Vt 396; 886 A2d 365, 370-371(2005)(discussing cases). As a result, some courts require that employment must continue for a substantial time to suffice as adequate consideration. *Id.* at 371.

Whether these concerns in an employer-employee context are grounds for an exception to the general rule is not a question presented by this case.³ The Court of Appeals incorrectly stated that Innovation Ventures “employed defendants Krause and K & L on an at-will basis” and, as consideration, “would forgo its right to immediately

² A majority of jurisdictions adhere to the same rule and “hold that continued employment alone is sufficient consideration to support a covenant not to compete entered into after the commencement of an at-will employment relationship.” *Summits 7, Inc v Kelly*, 178 Vt 396; 886 A2d 365, 370 (2005).

³ However, “[o]ne should not think such cases of deceit common. Employers pay a price if they get a reputation for tricky dealings with their employees.” *Curtis 1000 v Suess*, 24 F3d 941, 946 (CA 7, 1994)(Posner, J.)

terminate the *employment relationship* in exchange for defendants signing” the two agreements. Slip op, p. 11 (emphasis added). K & L Development was not employed by Innovation Ventures. Rather, it was a company that provided consulting services for over a year under an oral agreement, and then accepted the terms of two detailed written agreements. Accordingly, the approach drawn from the out-of-state cases adopted by the Court of Appeals is not applicable.

From the Chamber’s perspective, the error by the Court of Appeals is more serious than a mistaken understanding of the parties’ relationship. The court held that the agreements were not enforceable “[w]here [Innovation Ventures] terminated the business relationship within two weeks after the agreements were signed” *Id.* The failure of consideration resulted because Innovation Ventures terminated the agreements according to the terms accepted by K & L Development. The contracts failed, according to the Court of Appeals, because one party exercised a right expressly and unambiguously granted by the parties’ mutual agreement. By doing what the contract allowed, Innovation Ventures rendered the contract unenforceable. That result cannot be reconciled with basic contract law principles.

Any business looks at the potential benefits and risks when considering a contractual arrangement with another individual or company. K & L Development presumably contemplated the possible “worst-case scenario,” where it agreed to various terms, including the non-compete and non-disclosure provisions, but did not obtain the hoped-for business because Innovation Ventures decided to look elsewhere for consulting services. K & L Development could have tried to negotiate with Innovation Ventures for appropriate terms to protect against that scenario. But it did not.

Instead, K & L Development decided to accept the non-disclosure and non-compete provisions, among many other terms, knowing that Innovation Ventures had the option to terminate the agreement at its discretion with 14 days' notice. K & L Development also had the right to terminate the agreement at any time. It knowingly accepted the practical disincentive that the non-disclosure and non-compete provisions could have on a decision to exercise its right to end the business relationship.

In hindsight, K & L Development may have made a poor decision. However, it was K & L Development's decision to make, and not one to be retroactively changed by a court. The option of making a bad decision is an inherent aspect of the "freedom of individuals freely to arrange their affairs via contract." *Bloomfield Estates Improvement Ass'n, Inc v City of Birmingham*, 479 Mich 206, 212; 737 NW2d 670 (2007).

The "substantial time" requirement adopted by the Court of Appeals is a thinly veiled effort to protect K & L Development against the consequences of enforcing the unambiguous terms of its agreements with Innovation Ventures. "The courts' willingness to depart in this area from the traditional refusal to inquire into the adequacy of consideration," *Curtis 1000 v Suess*, 24 F3d 941, 946 (CA 7, 1994)(Posner, J.), is nothing more than a decision not to enforce the parties' contracts based on a perceived sense of unfairness in at-will employment relationships.⁴

⁴ The Chamber acknowledges the concerns raised by the out-of-state cases cited by the Court of Appeals. However, adhering to the fundamental tenet that contracts should be enforced as written does not leave a party as helpless prey if the other party is dishonest. There are ample remedies for a party to a contract who is harmed when the other party takes unfair advantage or engages in wrongful conduct. A party can rescind a contract entered under duress or through coercion. *Lafayette Dramatic Productions, Inc v Ferentz*, 305 Mich 193, 215-218; 9 NW2d 57 (1943). If a party secures a non-compete provision by false representations about continued employment or future business, the other party can assert fraudulent inducement. *Kefuss v Whitley*, 220 Mich 67, 82-83; 189 NW 76 (1922).

B. Courts should not inject uncertainty into unambiguous contracts.

The Chamber believes that the Court of Appeals' decision infuses business relationships with an unacceptable degree of uncertainty. The court found a failure of consideration because the business relationship ended two weeks after the agreements were signed. Slip op, pp. 11-12. The court contrasted the situation to the one considered in *Adell Broad Corp v Apex Media Sales, Inc*, 269 Mich App 6, 12-13; 708 NW2d 778 (2005). In *Adell*, a television station and its media representative modified their existing agreement in an effort to resolve disputes over unpaid commissions. The new agreement, which satisfied the debt by partial payment and reduced future commission rates, had a 30-day termination provision. The renewed relationship ended after two months. *Adell* held there was no failure of consideration. *Id.* at 14.

Comparing the decisions in this case and *Adell*, it may be that two months is long enough while two weeks is too short. Or it may not be as simple as looking at how long a business relationship continues after an agreement is signed, according to the out-of-state cases cited by the Court of Appeals. The Tennessee Supreme Court says “[i]t is possible . . . that employment for only a short period of time would be insufficient consideration under the circumstances.” *Central Adjustment Bureau, Inc v Ingram*, 678 SW2d 28, 35 (Tenn 1984). The answer, however, “depends upon the facts and circumstances of each case.” *Id.* The Vermont Supreme Court focuses on a different question, finding legitimate consideration “as long as the employer does not act in bad faith by terminating the employee shortly after the employee signs the covenant.” *Summits 7*, 886 A2d at 405. Maryland looks at whether an employee is discharged “in an unconscionably short length of time” and whether the employer “extracted the employee’s signature . . . through a threat

of discharge.” *Simko, Inc v Graymar Co*, 55 Md App 561; 464 A2d 1104, 1107-1108 (1983).

The only state with a somewhat defined time requirement is Illinois, but even then, two years or more is only “generally held” to be sufficient. *Brown & Brown, Inc v Mudron*, 379 Ill App 3d 724; 887 NE2d 437, 441 (2008).

The Chamber believes it would be unwise and unworkable to judicially engraft an ill-defined “substantial period” requirement on an agreement between two businesses that contains an unambiguous termination provision. A business should not be forced to face the uncertain prospect of judicial hindsight when deciding how to contractually manage a business relationship with another company. Rather, a business should be able to make its own decisions by choosing the right partners and negotiating mutually acceptable terms. There is always some level of risk whenever a business discloses its valuable confidential information to others. It should not face an added risk that a court might later decide that the parties’ agreement was not the right one.

While this case involves non-compete and non-disclosure provisions, nothing in the Court of Appeals’ reasoning limits its decision to that context. Any contract that ends earlier than one party hoped—or a court thought it should last—could be invalidated even if terminated according to its express provisions. For example, an individual or business in Michigan may decide that the prospect of continued dealings with a company in a distant state is worth accepting choice-of-law or forum-selection clauses. From the other perspective, the out-of-state company may view those provisions as critical, wanting the familiarity of its state’s law or the protection against the cost of litigating in another state. Other provisions may be important to a party’s willingness to contract—an arbitration clause, an attorney fee provision, or an indemnification agreement. Individuals and

companies in other states may be reluctant to do business in Michigan if a decision to terminate an agreement according to its terms could result in losing the benefit of important contractual rights.

C. Consideration for a contract does not fail due to an event that was contemplated by the parties and governed by an agreed upon provision.

Beyond violating the “fundamental tenet of our jurisprudence” that respects the parties’ freedom to manage their own affairs, *Rory*, 473 Mich at 468, the Court of Appeals misapplied the failure of consideration doctrine. To be fair, other courts have confused the rule as well, which is discussed along with impossibility, frustration of performance, first material breach, and other contract principles.⁵ Indeed, the Restatement has jettisoned the term “failure of consideration” in favor of the more accurate “failure of performance.” Restatement Contracts 2d, § 237 cmt a. See *Adell*, 269 Mich App at 13 (“the term is misleading in that it really refers to a failure of *performance*”; emphasis in original and citing Black’s Law Dictionary (8th ed)).

In *Rosenthal v Triangle Development Co*, 261 Mich 462, 463; 246 NW 182 (1933), this Court said “rescission is permissible when there is failure to perform a substantial part of the contract or one of its essential items, or *where ‘the contract would not have been made if default in that particular had been expected or contemplated.’*” (emphasis added;

⁵ See, e.g. *Adell*, 269 Mich App at 13-14 (“the thing expected to be received by one party and given by the other party cannot be or has not been given without fault of the party contracting to give it”; citing Black’s Law Dictionary (5th ed)); *Baith v Knapp-Stiles, Inc*, 380 Mich 119, 126; 156 NW2d 575 (1968)(interchangeably discussing defenses of first material breach and failure of consideration); *McCarty v Mercury Metalcraft Co*, 372 Mich 567, 574; 127 NW2d 340 (1964)(further performance by other party is rendered ineffective or impossible).

internal citation omitted). *Rosenthal* demonstrates the basic error in the Court of Appeals' application of the doctrine. The consideration accepted by the parties does not "fail" when an event occurs that was "expected or contemplated" and addressed in the contract. In that circumstance, there is no "failure of consideration" or "failure of performance." Instead, the contract is enforced according to the terms agreed by the parties who knew and accepted the risk that a desired event might not come to pass.

This critical principle was applied in *Sunday v Novi Equipment Co*, 290 Mich 539; 287 NW 909 (1939). An inventor granted a license for manufacture, use, and sale of a heater. When the contract was executed, the inventor's patent application was pending. The manufacturer produced the heater and paid royalties while the U.S. Patent Office reviewed the application. The manufacturer refused to pay royalties after the patent was denied, leading to the litigation. This Court rejected the manufacturer's argument that "denial of the patent constituted failure of consideration for the contract, at least as to royalties which accrued subsequent to such denial." *Id.* at 546.

It is important to bear in mind that this license contract was not entered into under a claim of the licensor that a valid patent had theretofore been issued. In such a case it might well be urged that subsequent cancellation of the patent would constitute failure of consideration In the instant case *all parties concerned knew at the time the license contract was executed that [the inventor] had not yet obtained a patent but instead his application for a patent was being made simultaneously. It is a fair inference from the record that all parties concerned knew it was uncertain whether a patent could or would be obtained. . . . Id.* at 546-547 (emphasis added; internal citation omitted).

In this case, K & L Development knew that Innovation Ventures had not committed to continuing the business relationship for any specific period. When entering into the contract, the parties expressly understood and unambiguously agreed that either could

terminate their relationship for any reason with 14 days' notice. The Court of Appeals is wrong when stating K & L Development "never received that which they were promised under the agreements." Slip op., p. 11. To the contrary, both parties received what they agreed to—a contract with the possibility of an ongoing business relationship subject to termination at any time.

Failure of consideration cannot be used to rescind a contract because a court believes it would be unfair to enforce an agreement due to a later event that the parties knew about and addressed when reaching their agreement.

II. Granting leave would be appropriate even though the Court of Appeals' opinion is unpublished.

For several reasons, the Chamber is concerned by the rule adopted by the Court of Appeals even though the opinion is unpublished.

First, the "substantial time" requirement imported from cases in other jurisdictions is novel and unprecedented in Michigan. As discussed earlier, the type of business arrangements involved in this case are fairly common. Without guidance from this Court, lower courts will likely follow the unpublished opinion.

Second, this Court has not substantively considered the failure of consideration doctrine for many years, dating back to *Baith v Knapp-Stiles, Inc*, 380 Mich 119, 126; 156 NW2d 575 (1968).

Finally, many of these business arrangements involve contracts between companies in Michigan and other states, allowing for litigation in federal court based on diversity jurisdiction. When considering issues of state law, "a federal court may not disregard a decision of the state appellate court on point, unless it is convinced by other persuasive data that the highest court of the state would decide otherwise, . . . regardless of whether

the appellate court decision is published or unpublished.” *Ziegler v IBP Hog Market, Inc*, 249 F3d 509, 517 (CA 6, 2001). The Court of Appeals’ decision, as the only case addressing this important issue, is likely to be given far more weight than a typical unpublished decision.

CONCLUSION

In this case, a party did what was unambiguously allowed under the contract terms. The result, according to the Court of Appeals, was a failure of consideration that rendered the contract unenforceable.

If the risk and uncertainty created by that ruling prevails, the Chamber is concerned that individuals and companies will be reluctant to enter into the arrangements necessary to carry on business in Michigan.

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