STATE OF MICHIGAN

IN THE SUPREME COURT

INNOVATION VENTURES, LLC,
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
Lower Ct. No. 12-124554-CZ

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ANSWER OF LIQUID MANUFACTURING, LLC, K&L DEVELOPMENT OF MICHIGAN LLC, LXR BIOTECH, LLC, ETERNAL ENERGY, LLC, AND ANDREW KRAUSE TO INNOVATION VENTURES, LLC'S APPLICATION FOR LEAVE TO APPEAL

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STATEMENT OF JURISDICTION

Liquid Manufacturing, LLC, K&L Development of Michigan LLC, LXR Biotech, LLC, Eternal Energy, LLC, and Andrew Krause concur with Plaintiff's jurisdictional statement.

COUNTER-STATEMENT OF QUESTIONS INVOLVED

Eternal Energy is an "energy shot" that competes in an industry dominated by Plaintiff's 5 Hour Energy product. Plaintiff acknowledges that the only way to bottle competing products like Eternal Energy is to use Liquid Manufacturing, Inc., as their bottler. No other comparable bottling operation exists.

Plaintiff, through a series of anti-competition agreements, seeks to protect its 91% market share and healthy margins by picking and choosing which products it will allow Liquid to bottle. Niche products with limited distribution are approved. Products distributed more broadly are rejected.

Plaintiff sued attempting to enforce the anti-The trial court and Court of Appeals agreed that defendants were entitled to summary disposition of all claims against them. The courts decided that the anti-competition agreements that purported to restrain trade were invalid, that Plaintiff's alleged trade secrets were not infringed, and that all claims should be dismissed.

I. K&L Development was Plaintiff's vendor for three years under an oral agreement. Then, suddenly, K&L was presented with a new, written anti-competition agreement and promised continued work. The very next day, K&L had a new "boss," who started mining K&L for technical information and, less than two weeks later, K&L was discharged. Should leave be denied, where there was no new consideration given for the anti-competition agreement, where the recited consideration of continued work was not provided, and where the anti-competition agreement was unreasonable?

The Trial Court found that the anti-competition agreement lacked consideration and was unreasonable.

The Court of Appeals found that the anti-competition agreement's consideration failed, and did not address its reasonableness.

The Plaintiff answers, "No."

The Defendants answer, "Yes."

II. When Liquid was terminated as Plaintiff's bottler, Liquid executed an anti-competition agreement that required Plaintiff's approval for Liquid to bottle competing brands. Plaintiff admitted below that the business rationale for the anti-competition provision was to obtain "the right to evaluate, on a case-by-case basis, each brand of energy drink that Liquid Manufacturing sought to bottle. Products that were approved by Plaintiff were limited in distribution and production." Should leave be denied when the restraint of competition is not a legitimate business purpose as a matter of law, and where Plaintiff admitted that its purpose was to prohibit competition?

The Trial Court and Court of Appeals found that the restraints were unreasonable.

The Plaintiff answers, “No.”

The Defendants answer, “Yes.”

III. The trial court granted summary disposition of Plaintiff’s trade secret claim before discovery had concluded. Should leave be denied, where Plaintiff had an adequate time for discovery, where further discovery did not stand a fair chance of uncovering information likely to create an issue of fact precluding summary disposition, and where Plaintiff could never put forward the nature of the trade secret allegedly misappropriated?

The Trial Court and Court of Appeals found that no further discovery was warranted.

The Plaintiff answers, “No.”

The Defendants answer, “Yes.”

INTRODUCTION

Four judges have reviewed this case. Four judges have agreed that defendants were entitled to summary disposition. In an unpublished *per curium* opinion, the Court of Appeals affirmed the trial court's ruling that anti-competition agreements among Innovation Ventures, LLC ("Plaintiff"), defendant K&L Development of Michigan, LLC ("K&L"), and defendant Liquid Manufacturing, LLC ("Liquid") were invalid, and that no further discovery was needed to adjudicate Plaintiff's claims. *Ex. 1*. On application to this Court, Plaintiff makes new arguments that were not preserved below. It also seeks to create issues – like the purported "double standard" rule of reason – that don't exist. The trial court and Court of Appeals correctly decided this case. There are no issues presented that require the attention of this Court. The application should be denied.

* * *

Plaintiff is the goliath of the energy shot market. Its product, 5 Hour Energy, has a 91% market share and is sold in more than 100,000 retail outlets. *Ex. 2, Trial Ct. Op. 3/14/13, at 2.* Defendant/Appellees Eternal Energy, LLC and LXR Biotech, LLC are attempting to compete with 5 Hour by offering a less expensive alternative called Eternal Energy. Eternal Energy is bottled by Liquid. Liquid used to bottle 5 Hour Energy. Plaintiff seeks to control competition by controlling what competing products Liquid can manufacture.

When plaintiff terminated its bottling relationship with Liquid in 2010, it entered into an agreement with Liquid restraining Liquid from bottling competing brands without plaintiff's approval. Plaintiff admitted in discovery that its interest in doing so was to limit and control competition. According to plaintiff, the Liquid anti-competition agreement gave plaintiff:

> the right to evaluate, on a case-by-case basis, each brand of energy drink that Liquid Manufacturing proposed to bottle. **Products that**

> **were approved by Plaintiff were limited in distribution and production,** such that Plaintiff believed that the bottling of the product would not infringe on Plaintiff's legitimate business interests. *Ex. 3, Plaintiff's Fourth Supplemental Responses to Interrogatories*, at 31 (emphasis added).

Plaintiff initially approved Liquid's bottling of Eternal Energy. However, after Eternal Energy began making inroads at major retailer Wal-Mart, plaintiff decided that it needed to kill off its upstart rival. So it sued Liquid, Eternal Energy, LXR, and their principals, and attempted to revoke Liquid's authorization to bottle competing products. Plaintiff admits that it did so because Eternal Energy was getting too big, stating in answers to interrogatories that its business interests were "harmed by Liquid Manufacturing's bottling of Eternal Energy because it was ultimately distributed to a significantly broader area than originally proposed and provisionally approved." *Id.* at 31.

Anti-competition agreements made for the purpose of restraining trade are void. This has been the law in Michigan for well over 100 years. Enforcing that law and public policy will not drive business from the State. Rather, it will encourage fair competition, and protect consumers from anti-competitive practices and abusive lawsuits that attempt to stifle new business growth. The application should be denied.

COUNTER-STATEMENT OF FACTS

A. <u>Parties.</u>

Plaintiff is the manufacturer and distributor of the 5 Hour Energy Shot. *Ex. 2, Trial Court Op.* at 2. Plaintiff has sold more than 700 million units since 2004 and can be found in more than 100,000 retail outlets in the U.S. and Canada. *Id*. Plaintiff holds a 91% market share for energy shots in the U.S. *Id.*

Liquid bottled the 5 Hour Energy Shot under an Amended Manufacturing Agreement with plaintiff. *Id.* Defendant/Appellee Peter Paisley is the President and CEO of Liquid. *Id.* Liquid's contract with plaintiff was terminated in May, 2009. *Ex. 2, Trial Court Op.* at 4.

K&L was originally retained by plaintiff in 2007 under an oral agreement to design, manufacture and install the production and packaging equipment used by Liquid to manufacture 5 Hour Energy. *Id.* Andrew Krause was the principal of K&L. *Id.* K&L is no longer in business. *Id.* at 5. K&L and Krause's contracts with plaintiff were terminated on May 10, 2009. *Id.* at 4.

Defendants/Appellees Eternal Energy, LLC and LXR Biotech, LLC were formed in September, 2010 and May of 2011, respectively, well after K&L and Krause's contracts with plaintiff were terminated. *Second Amended Complaint* at ¶¶ 57-65. Krause was a member and minority owner of these LLCs. *Ex. 2, Trial Court Op.* at 3. Eternal Energy and LXR developed an energy shot called "Eternal Energy." *Id.* Eternal Energy is a lower cost competitor to 5-Hour, with a different formula. *Id.*

B. The Parties' agreements.

1. Contracts between Plaintiff, Andrew Krause, and K&L.

K&L and its owner, Krause, built and installed bottling and packaging equipment for Plaintiff beginning in 2007. *Second Amended Complaint* at ¶ *4.* After operating under oral agreements for several years, in late April, 2009, for the first time, Plaintiff presented K&L with two written agreements.

Krause was a party to one of those two agreements, the Equipment Manufacturing and Installation Agreement ("Manufacturing Agreement"). Although Plaintiff recited in the Manufacturing Agreement that "Company desires to further engage Contractor," Plaintiff terminated the parties' relationship just two weeks after the agreements were signed, on May 10, 2009. *Ex. 2, Trial Court Op. at 4.*

The K&L Manufacturing Agreement. Effective April 27, 2009, plaintiff, Krause, and K&L entered into a written Manufacturing Agreement, which purported to confirm their earlier oral agreement. *Ex. 4.* The Manufacturing Agreement contains an "Exclusivity" provision, under which K&L and Krause are precluded from designing or manufacturing particular bottling equipment within North America for a period of five-years. *Id.* at § 10. The manufacture and design of bottling equipment is not at issue in this case, and though cited in Plaintiff's application, the anti-competition provisions of the Manufacturing Agreement are irrelevant to this appeal.[1]

The K&L Anti-Competition Agreement. Also effective April 27, 2009, Living Essentials and K&L (but not Krause, individually) entered into a new agreement, titled Nondisclosure and Confidentiality Agreement (K&L Anti-Competition Agreement"). *Ex. 5.*

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[1] The K&L Manufacturing Agreement also contains a confidentiality provision that was relevant in the Court of Appeals, but the Court of Appeals finding that the agreement's confidentiality provisions were not breached has not been appealed to this Court.

Unlike the Manufacturing Agreement, the K&L Anti-Competition Agreement does not indicate that its purpose is to confirm in writing prior oral agreements. Indeed, its terms differ from what is found in the Manufacturing Agreement.

The K&L Anti-Competition Agreement purports to bar K&L from:

(A) Having an interest in, aiding, or assisting someone with an interest in, a business or enterprise in North America that competes with Plaintiff in any way, including the formulation, manufacture, production, or distribution of liquid energy supplements sold in 1-4 ounce bottles;

(B) Soliciting, diverting, interfering with, or accepting any business from plaintiff's customers or prospective customers;

(C) Employing or attempting to employ Plaintiff's employees. *Id.* at §6.

The K&L Anti-Competition Agreement (which Krause is not a party to) does not purport to bind employees of K&L.

2. <u>Contracts among Plaintiff, Liquid, and Paisley.</u>

The Liquid Termination Agreement. In 2010, plaintiff decided to take its bottling operation in-house, and discontinued its relationship with Liquid. On April 22, 2010, Plaintiff and Liquid entered into an "Agreement To Terminate the Manufacturing Agreement" (the "Liquid Termination Agreement"). *Ex. 6.*[2]

The Liquid Termination Agreement purported to impose a three year anti-competition provision. *Id*. at §1(a). Section 1(a) of the Termination Agreement provides: "LE hereby grants Liquid permission to manufacture the Permitted Products (as defined in Section 24 below) subject to each of the conditions of this Agreement. *Id*. Section 1(b) of the Termination Agreement precluded Liquid from bottling other energy drinks:

[2] The Court of Appeals held that Paisley signed the Termination Agreement in his capacity as corporate officer, and could not be personally bound by its terms. *Ex. 1, COA Op., at 6.* That decision has not been appealed by Plaintiff.

> (b) Other than the Permitted Products, for a period of 3 years from the Effective Date, Liquid shall not produce or formulate other than for LE (i) any Energy Drink (as defined in Section 24 below), in packaging of 4 fluid ounces or less, or (ii) any other Energy Drink containing glucuronolactone or tyrosine (in all its forms) regardless of package size. *Id.* at § 1(b).

The Termination Agreement thus authorized Liquid to bottle on behalf of "permitted" competitors, but then purported to grant plaintiff the absolute right to prevent Liquid from manufacturing for all other competitors without plaintiff's consent. *Id*. The Termination Agreement offered no rationale for why it was permissible for plaintiff to select the competitors for which Liquid could bottle.

Section 24(i) allowed Liquid to manufacture those "Permitted Products" identified on a schedule, exhibit C, to the Termination Agreement. *Ex.6 at Exhibit C thereto*. Exhibit C to the Termination Agreement originally listed 36 different competing Permitted Products that plaintiff expressly authorized Liquid to bottle. *Id.*

The Termination Agreement provided that the list of Permitted Products could be amended by the parties. *Ex. 6.* On September 20, 2010, Liquid requested that plaintiff amend the list of Permitted Products to add the Eternal Energy shot. *Ex. 7*. Liquid expressly disclosed in its request that Eternal Energy's formula included both glucuronolactone and tyrosine. *Id.* Plaintiff agreed, in writing, to approve the Eternal Energy shot as a Permitted Product. *Ex. 8.*

Plaintiff required that Liquid's customers for Permitted Products sign a Confidentiality Agreement that obligated them keep confidential only one single fact -- that their product was being bottled at a plant that previously bottled for plaintiff. *Ex. 6 at Exhibit D thereto*. This was the sole matter that plaintiff required Liquid's customers to keep secret. Plaintiff did not require that Liquid enter into a confidentiality agreement with its customers to protect other purported confidential information, even though plaintiff now contends that by the mere act of bottling energy drinks Liquid uses and discloses its confidential information and trade secrets.

Further, the Liquid Termination Agreement did not require that Liquid's customers agree to keep confidential, or not use, any of the information that Liquid previously obtained from plaintiff. *Id.* Plaintiff even expressly authorized Liquid to disclose to its customers that Liquid "previously bottled 5 Hour Energy," and it agreed that plaintiff's "president will confirm to prospective customers of Liquid orally that [plaintiff] did not terminate its Manufacturing Agreement with Liquid for reasons related to Liquid's performance." *Ex. 6 at § 4(c).*

The Termination Agreement contains a provision allowing plaintiff to revoke plaintiffs' authorization for Liquid to bottle Permitted Products "for Liquid's violation of this Agreement." *Id.* at § 1(a). However, the agreement also provided that Liquid had a 30-day cure period. *Id.*

The Liquid Equipment Purchase Agreement. The Termination Agreement also allowed plaintiff to purchase the bottling equipment from Liquid, and plaintiff did so, simultaneously leasing the equipment back to Liquid, so it could make energy shots for the Permitted Products. *Ex. 6 at §6.* Plaintiff later sold this same equipment back to Liquid pursuant to an Equipment Purchase Agreement dated March 8, 2011 between plaintiff and Liquid.

C. Plaintiff attempts to revoke the Liquid Termination Agreement and files suit.

By letter dated January 27, 2012, the same day the instant lawsuit was filed, plaintiff purported to revoke Liquid's authorization to produce Permitted Products under §1(a) of the 2010 Termination Agreement. *Second Amended Complaint* at ¶ 157. This revocation was inconsistent with the provisions of the Termination Agreement.

The Termination Agreement provided that it could be terminated upon a breach of a party, except that the defaulting party had the right to notice and a 30-day right to cure any breach and avoid revocation. *Ex. 6 at § 1(a).* It is undisputed that plaintiff did not provide Liquid with notice or an opportunity to cure before its January 9, 2012 termination letter. Regardless, by letter dated February 17, 2012, Liquid advised plaintiff that it had cured any claimed breach. *Ex. 9.*

D. **Trial Court Claims and Proceedings.**

Though plaintiff now complains that summary disposition was premature, the record reveals a case that was actively litigated for a year, with numerous hearings and conferences conducted by the trial court. Through the motions for a temporary restraining order, preliminary injunction, summary disposition, protective orders, and on procedural issues, the trial court became acutely aware of the facts, circumstances, and legal issues involved in the case, and had the benefit of extensive briefing when it issued its well-reasoned 37-page opinion dismissing plaintiffs' claims. *Ex. 2.*

1. **Plaintiff sues and obtains an ex parte temporary restraining order, which is later dissolved by the trial court.**

Plaintiff brought suit on January 27, 2012, and immediately obtained an *ex parte* temporary restraining order that essentially stopped Liquid's production and the production of Eternal Energy. Defendants filed a motion to dissolve the TRO. They argued that the TRO was going to put LXR and Eternal Energy out of business, because it did not allow them to ship product to its customers, including Wal-Mart. *Transcript of February 10, 2012 Hearing*, at 15. They pointed out that public policy did not favor allowing competitors to use lawsuits to stifle competition, noting that plaintiff had an admitted history of using litigation as a means of crushing competitors, and citing an interview in *Forbes* magazine with plaintiff's founder, Manoj Bhargava:

> In one corner of Manoj Bhargava's office is a cemetery of sorts…. His company, Living Essentials, is the biggest player by far in the energy-shot market, and not because 5-Hour is so delicious…. The reason Bhargava has won is that he plays tough. Sitting in that cemetery are a dozen or so neon copycats with names like 6-Hour Power and 8-Hour Energy. Each has been sued, bullied or kicked off the market by Living Essentials' lawyers. In front of each are little placards with a skull and crossbones drawn in felt-tip pen. Bhargava points to the gravestone of one of his late competitors and says with a chuckle, 'rest in peace.' *Ex. 10, Forbes Magazine, The Mystery Monk Making Billions with 5-Hour Energy*, 2/27/12.

Defendants also argued that plaintiff could not demonstrate irreparable harm, particularly given plaintiff's 91% market share. *Transcript of 2/10/12 Hearing* at 20.

In ruling that the TRO should be lifted, the trial court made plain that it had serious questions about whether Plaintiff's lawsuit had merit, and whether its true purpose was to stifle competition in violation of Michigan's public policy:

> THE COURT: ... I quite frankly think that you have a -- an action for money damages, if you have that, and I'm not seeing the irreparable harm that would come to your client, I'm not seeing the likelihood of prevailing on the merits, and in terms of public policy, to allow your client to -- to -- you know, to crush competitors is certainly something that's not supported by public policy. *Id.* at 59.

The trial court maintained a TRO that precluded the dissemination of certain information, but dissolved the portion that prevented Liquid, Eternal Energy, and LXR Biotech from conducting business. *Id.* at 58-59.

2. Plaintiff files a Second Amended Complaint.

Plaintiff ultimately filed a second amended complaint, setting out claims against Liquid and Paisley alleging violation of the noncompetition provisions of the Termination Agreement or the alleged improper use of confidential information or trade secrets. *Second Amended Complaint.*

Plaintiff's claims against K&L and Krause were based on the non-competition and confidentiality provisions of the K&L Manufacturing Agreement and K&L Anti-Competition Agreement.

Plaintiff's claims against Eternal Energy and LXR Biotech were various tort claims associated with the breaches of contract asserted by plaintiff against K&L, Krause, Liquid, and Paisley.

3. Defendants file initial summary disposition motions.

On June 15, 2012, before discovery began, defendants moved for summary disposition on all claims. The motions were fully briefed, and the trial court entered an Opinion and Order initially denying summary disposition motions filed by the defendants.

4. Discovery proceeds.

After the trial court denied the initial motions for summary disposition, it held a status conference on June 27, 2012. The parties agreed at the conference to bifurcate the proceedings and conduct discovery on liability. The scheduling order entered at the conference provided that discovery would end on October 31, 2012, four months later.

During discovery and on the record, plaintiff made several important admissions.

- Plaintiff stipulated that it has a 91% share of its market in the United States. *Transcript of October 10, 2012 Hearing* at 17-18.

- Plaintiff admitted that the purpose of the Liquid non-competition provisions was to control competition. In answer to an interrogatory requesting 5 Hour to detail why its legitimate business interests were harmed by Liquid bottling more than the Permitted Products, plaintiff stated:

  > Under the Agreement to Terminate, Plaintiff had the right to evaluate, **on a case-by-case basis, each brand of energy drink that Liquid Manufacturing proposed to bottle**. Products that were approved by Plaintiff were **limited in distribution and production**, such that Plaintiff believed that the bottling of the product would not infringe on Plaintiff's legitimate business interests…. Plaintiff's legitimate business interest in protecting its goodwill and confidential information was harmed. For example, Plaintiff's legitimate business interests in protecting its goodwill and confidential information are harmed by Liquid Manufacturing's bottling of Eternal Energy **because it was ultimately distributed to a significantly broader area** than originally proposed and provisionally approved. *Ex. 3 at 30-32* (emphasis added).

At a hearing on October 10, 2012, the parties agreed that an extension of the discovery deadline was warranted, and the Court set a discovery status conference for November 13, 2012. *Ex. 11 at 1*. At that conference, Liquid's counsel proposed that discovery be stayed and renewed motions for summary disposition be heard. *Id*. Both plaintiffs and defendants filed summary disposition motions.

5. The trial court dismisses plaintiff's claims.

The trial court granted defendants' motions in a well-reasoned, 37-page opinion. *Ex. 2.* The opinion fully analyzed each of plaintiff's claims. Its analysis will be set forth more fully below.

6. Proceedings on Appeal.

Plaintiff appealed as of right. The Court of Appeals affirmed the trial court in an unpublished, *per curium* opinion. *Ex. 1.*

ARGUMENTS

I. STANDARD OF REVIEW.

This Court reviews summary disposition decisions *de novo.* *Maiden v. Rozwood*, 461 Mich 109, 118 (1999).

II. THE K&L ANTI-COMPETITION PROVISION IS INVALID

A. <u>Plaintiff failed to preserve its argument below.</u>

Plaintiff failed to preserve its argument that the courts below reached erroneous legal conclusions that the non-competition provisions of the K&L Anti-Competition Agreement failed for want of consideration. "This Court has repeatedly declined to consider arguments not presented as a lower level." *Booth Newspapers, Inc., v. Univ. of Michigan Bd. of Regents,* 444 Mich 211, 234 n.23 (1993). The Court only deviates from that rule "in the face of exceptional circumstances." *Id. See, also, Butcher v. Dep't of Treasury,* 425 Mich 262, 276 (1986) (Court declines to consider arguments not raised in Court of Appeals).

The trial court held that the K&L Anti-Competition Agreement was unenforceable for two reasons. First, the agreement failed for lack of consideration. *Trial Court Op. at 25-26.* Second, the agreement was inherently unreasonable. *Id., at 27-28.* Plaintiff now attempts to characterize the trial court's first ruling as focusing on the sufficiency of consideration, rather than the lack of consideration.[3] *Pl. Application at 25-26.* This is a mischaracterization.

The trial court never analyzed or assessed the sufficiency of consideration. Rather, it found that the agreement "lacked" consideration, there was no consideration at all. *Id.* at 25-26. The trial court found that the agreements were signed "*after* Krause and K&L had completed all

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[3] Likewise, the plaintiff asserts that defendants did not address this issue in its Court of Appeals briefing. This statement is equally puzzling. As set out below, defendants argued in their response brief that "plaintiff gave no consideration for the [non-disclosure agreement]. *Def. Response at 31*. The Court of Appeals' conclusion was not reached *sua sponte.*

of the work they would ever perform for the Plaintiff." *Trial Court Op. at 26.* "Because the parties' relationship did not continue, it cannot provide consideration." *Id.*

In its briefing to the Court of Appeals, plaintiff virtually ignored the trial court's holding that the agreement failed for lack of consideration. It could have, but chose not to, make arguments that consideration was not required, or that it was sufficient, as it has attempted to in its briefing to this Court. Instead, in its initial brief, plaintiff ignored the trail court's legal conclusion entirely. *Pl. COA initial brief at 49.* It spent exactly one paragraph on the court's ruling, focusing only on the factual basis of the trial court's decision. Plaintiff's only arguments in the Court of Appeals were that there was an insufficient factual basis for the trial court's conclusion that K&L was not given any work after the agreement was signed, and that the trial court had failed to allow sufficient discovery. *Id.* Plaintiff cited no cases or other legal authority whatsoever in the section of its brief on this subject.[4]

Likewise, in its reply, plaintiff did not attempt to distinguish the cases cited by defendants in their response, or argue the law. Rather, Plaintiff continued to advance only that the trial court's legal conclusion was not supported by the evidence, and that further discovery was necessary. *Pl. COA Reply at 4-5.*

The Court of Appeals affirmed the trial court's decision on slightly different grounds. It found that the agreements, on their face, contained valid consideration. *COA Op. at 11.* However, the Court of Appeals held that there was a complete or substantial failure of that consideration because "Krause and K&L Development never received that which they were

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4 By contrast, in its response, the defendants argued in their response that a non-compete agreement required specific consideration, and cited numerous cases in support. *Def. COA Response at 31-32.*

promised under the agreements." *COA Op. at 11.* Plaintiff did not seek reconsideration of that ruling.

Now, in this Court, plaintiff, for the first time, argues that the courts below reached erroneous legal conclusions. That argument was not preserved and should not be considered by this Court.

B. <u>The Court of Appeals correctly found that consideration failed.</u>

The Court of Appeals properly held that there was a failure of consideration in this case. Plaintiff asserts only two errors: (1) that there was no factual support in the record for the Court of Appeals decision; and (2) that the Court of Appeals erred in purportedly requiring "substantial" continued employment as consideration for the non-competition agreements.

In *Adell Broadcasting v. Apex Media Services*, 269 Mich App 6, 12-13 (2005), the Court of Appeals adopted a definition of "failure of consideration" as "'a situation in which … a complete lack of consideration voids the contract.'" *Id. at 13.* The concept, the court said, really refers to a failure of *performance." Id.*, emphasis in original. The Court of Appeals found that, in contrast to the parties in *Adell*, K&L "never received that which [it] was promised." *COA Op. at 11*.

That is the distinction between *Adell* and this case. The agreements executed on April 27, 2009 were a sham. K&L provided services to plaintiff for three years with no written agreement. Then, suddenly, K&L was presented written agreements containing confidentiality and non-competition provisions.[5] Plaintiff represented that it desired to "further engage" K&L.

[5] It is important to distinguish the agreements. The K&L Manufacturing Agreement indicates that it was a written manifestation of previously agreed to oral terms. *Ex. 4 at 1.* That agreement names as parties K&L and "Andres" Krause. Its non-competition provision purports to bar K&L and Krause only from designing or manufacturing energy shot bottling equipment. *Id.* at 8, § 10. The second agreement, titled Nondisclosure and Confidentiality Agreement, was a new agreement, distinct from the Equipment Manufacturing Agreement. Only K&L, not Krause, is a party. Its non-competition provisions are broader, purporting to bar K&L from having an interest in, or assisting any person having an interest in, any competing business, including the

Ex 4 at 1. Then, the day after the agreements were signed, Krause suddenly had a newly hired "boss," who immediately started mining him for technical information about the bottling lines. *Ex. 12.* The trial court indicated that it was uncontested that the contracts were signed after the completion of the work contemplated by the agreements, and that K&L was discharged on May 10, 2009, just 13 days after agreements were signed.[6] *Ex. 2, Trial Ct. Op. at 4.* Plaintiff put forward no contrary facts.

The Court of Appeals primarily relied on *Adell* and other cases concerning failure of consideration. It also cited several foreign cases. But it announced no new rule and did not based its decision on the *sufficiency* of consideration, as Plaintiff contends.

Instead, the Court of Appeals rationale was based on a theme common to many opinions. A party cannot present an anti-competition agreement to another party in bad faith. "Legitimate consideration for the covenant exists as long as the employer does not act in bad faith by terminating the employee shortly after the employee signs the covenant." *Summits 7, Inc. v. Kelly,* 886 A2d 365, 373 (2005) (Vt); *Simko, Inc. v. Graymar Co.,* 464 A2d 1104 ,1107 (Md. App. 1983) ("Were an employer to discharge and employee … in an unconscionably short length of time after extracting the employee's signature … there would be a failure of consideration."). The issue in these opinions is not the adequacy of consideration of the length of time between execution of the non-compete and discharge, it is the Plaintiff's bad faith and failure to perform. Plaintiff's bad faith was supported by the record in this case.

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manufacture, production, or distribution of liquid energy supplements. The Nondisclosure and Confidentiality Agreement is a standalone agreement and cannot be construed as a "modification" of any existing agreement. It and the Equipment Manufacturing Agreement were signed on the same day, and have different terms. Therefore, MCL 566.1 cannot apply to the Non-Disclosure and Manufacturing Agreement.

[6] Plaintiff noted that one of the agreements, the Equipment Manufacturing Agreement, had a termination provision providing for termination on 14-days' notice. However, the agreement lasted only 13 days, and there is no evidence in the record that a 14-day notice of termination was ever sent.

C. **Alternatively, the K&L anti-competition provisions are unreasonable restraints.**

Alternative reasons support the Court of Appeals' ruling. *See, e.g., People v. Ross,* 465 Mich 909 (2001) (affirming on alternative grounds). The Court of Appeals did not address the trial court's second reason for dismissing Plaintiff's breach of contract claim.

At common law, a person's right to use their own labor was protected by the courts for centuries. *See, e.g., The Dyer's Case, Y.B. 2 Hen. V Pl. 26* (1415) ("The obligation is void because the condition is against the common law, and by God, if the plaintiff were present he should rot in gaol till he paid a fine to the King."). A 1905 Michigan statute similarly barred non-compete agreements, declaring contracts "by which any person … promises or agrees not to engage in any … trade, profession or business" to be against public policy and void. 1905 PA 329 § 1, 1948 CL 445.761. The Michigan Antitrust Reform Act ("MARA") while barring a "contract, combination or conspiracy … in restraint of … trade," MCL 445.772, repealed the absolute statutory bar against non-competition agreements, and replaced that bar with a "rule of reason" analysis. *Bristol Window and Door, Inc., v. Hoogenstyn,* 250 Mich App 478, 492; 650 NW2d 670 (2002).

However, "noncompetition agreements are disfavored as restraints on commerce and are only enforceable to the extent they are reasonable." *Coates v Bastian Brothers, Inc*, 276 Mich App 498, 507; 741 NW2d 539 (2007). The party seeking enforcement has the burden of demonstrating the validity of the covenant. *Id.* at 508. The reasonableness of a noncompetition provision is a question of law for the Court. *Id.* Non-competition agreements should be construed narrowly to avoid a threat to lawful competition. *United Rentals Inc. v. Keizer,* 355 F3d 399, 408 (CA 6 2004).

Noncompetition agreements are disfavored because the right to compete is a bedrock principle in our society. As the court declared in *Meyers v. Roger J. Sullivan Co*, 166 Mich 193, 197; 131 NW 521 (1911), it would be a "monstrous doctrine" if a company could prevent competition with the stroke of a pen. Therefore, it is well-settled that preventing competition is an impermissible purpose for a non-compete. *St. Clair Med. PC v Borgiel*, 270 Mich App 260, 266, 268; 715 NW2d 914(2006).

And, as this Court explained in *Follmer, Rudzewicz v Kosco,* 420 Mich 394, 402, n 4; 362 NW2d 676 (1984), an employee's "know-how" belongs to the employee (and not the employer) -- even if obtained from working for the employer:

> General knowledge, skill or facility acquired through training or experience while working for an employer appertain exclusively to the employee. The fact that they were acquired or developed during the employment does not, by itself, give the employer a sufficient interest to support a restraining covenant, even though the on-the-job training has been expensive and costly.

Thus, to be eligible for enforcement, the business interest justifying a restrictive covenant must be based on "some unfair advantage in competition." *St. Clair Medical,* 270 Mich App at 266, 268. The party seeking enforcement of a non-competition agreement must show a legitimate purpose for the covenant that is unrelated to preventing competition, and a duration and scope of the covenant that is reasonable:

> a restrictive covenant must be reasonable as between the parties, and it must not be specially injurious to the public. Because the prohibition on all competition is in restraint of trade, an employer's business interest justifying a restrictive covenant must be greater than merely preventing competition. To be reasonable in relation to an employer's competitive business interest, a restrictive covenant must protect against the employee's gaining some unfair advantage in competition with the employer, but not prohibit the employee from using general knowledge or skill. *St. Clair Medical, supra* at 266 (citation omitted).

Thus, a non-compete cannot bar competition -- it can only prohibit an "unfair advantage in competing." *See, generally,* Ryan Bewersdorf & Nicholas Ellis, *Protecting Competitive Business Interests Through Non-Compete Clauses: What Interests Can Legitimately Be Protected*, 30 Mich Bus L J (Issue 2) 40 (2010).

Under the "rule of reason":

> [A] restrictive covenant must protect an employer's reasonable competitive business interests, but its protection in terms of duration, geographical scope, and the type of employment or line of business must be reasonable. *St. Clair Medical*, 270 Mich App at 266.

The burden of demonstrating the validity of the agreement is on the party seeking enforcement. *Coates*, 276 Mich App at 508.

The K&L Anti-Competition Agreement purports to restrict K&L's ability to "engage in, have an interest in, or aid or assist any person or entity in conducting, engaging or having an interest in … any business or enterprise which is substantially the same as or is in competition with the business carried on by Living Essentials" anywhere in the United States, Canada, or Mexico for three years. *Ex. 5 at § 6.1.*

The K&L Anti-Competition Agreement serves no legitimate business purpose and is overbroad. K&L and Krause were retained as independent contractors to manufacture and maintain equipment used to bottle 5 Hour. They worked this type of agreement – indeed, without any written agreement – for about three years. Suddenly, on April 27, 2009, K&L and Krause were presented with an agreement that restrained them from competing with plaintiff in any way in all of North America for three years. A day later, Krause was introduced to his "new boss," Karl Smith, who asked Krause technical questions. *Exhibit 12, Email dated April 29, 2009.* Two weeks later, K&L and Krause were terminated.

K&L's and Krause's work "was limited to equipment design utilized in packaging a two pack for the 5 Hour Energy Product, and improving the efficiencies of the production line." *Krause Aff., ¶ 3.* Krause was not in customer development, or sales. He wasn't involved in pricing, hiring or firing employees, or product development. His job was to design and maintain the machinery that bottled and packaged the product.

Under these circumstances, the non-competition agreement is unreasonably overbroad. An agreement that unduly limits a former employee's freedom to go into business for himself is unreasonable and unenforceable. *Follmer, Rudzewiz,* 420 Mich at 408. The K&L Anti-Competition Agreement purports not to simply restrain Krause from designing, building and maintaining bottling equipment, but from *all* competition with plaintiff. It therefore is broader than needed to protect plaintiff's legitimate interests. See also, *Restatement (Contracts) 2d, Section 188(2)(b).*

The anti-competition provision of the K&L Anti-Competition Agreement does not prevent unfair competition. Rather, it purports to bar an equipment manufacturer, K&L, which had no involvement with Five Hour customers, business development, pricing, or personnel, from being employed by a competitor in areas for which they had no prior responsibility or knowledge while working for K&L or in association with Five Hour. Its breadth goes beyond the purpose of preventing K&L from unfairly competing with the Five Hour. Indeed, the covenant's restrictions are completely detached from any experience, expertise or knowledge that may have been gained by an employee's association with Five Hour. Given the over breadth of the anti-competition clause, it is void as against public policy and cannot be enforced.

D. <u>Alternatively, Andrew Krause is not individually liable.</u>

Finally, it is important to distinguish the different agreements, different anti-competition clauses, and different parties. While K&L (which is no longer in operation) is party to both agreements, Krause is not a party to the K&L Anti-Competition Agreement, nor are K&L's employees bound by it. The K&L Manufacturing Agreement and the K&L Anti-Competition Agreement have very different anti-competition provisions. The Manufacturing Agreement's provision bars K&L and Krause from designing or building competing bottling equipment, which is not relevant in this case, while the Anti-Competition agreement bars all competition. Andrew Krause, personally, is entitled to summary judgment on all of Plaintiff's remaining breach of contract claims because he is not a party to the K&L Anti-Competition Agreement, and because there is no allegation that he designed or built competing bottling equipment such that he could be liable under the K&L Manufacturing Agreement. As to Krause, individually, the Court of Appeals opinion should be affirmed, even were the Court were to reverse other portions of the Court of Appeals' decision.

III. THE COURT OF APPEALS CORRECTLY AFFIRMED THE TRIAL COURT'S DISMISSAL OF THE BREACH OF ANTI-COMPETITION PROVISIONS IN THE LIQUID TERMINATION AGREEMENT.

A. <u>The standard set out in *Hubbard* does not differ from the standard set out in *St. Clair Med.*</u>

Courts apply the same standard when analyzing anti-competition provisions in vendor contracts and employment contracts. That standard is the rule of reason, and it is the standard applied by the Court of Appeals in this case. There are not two separate standards, as Plaintiff asserts.

Plaintiff argues that the rule of reason is derived from *Hubbard v. Miller*, 27 Mich 15, 19 (1873). *Hubbard* instructs that contracts in the restraint of trade are void in the abstract, but, can be valid "if, considered with reference to the situation, business objects of the parties, and in the light of all the surrounding circumstances … the restraint contracted for appears to have been for a just and honest purpose, for the protection of the legitimate interest of the party in whose favor it is imposed, reasonable as between them and not specifically injurious to the public." *Id.*

Hubbard goes on to say that, among the circumstances to be reviewed are whether the restraint is commensurate with the interests being protected and the territorial reach of the restriction. *Id.* at 19, 21-22.

MCL 445.774a states that, to be valid, a restrictive covenant must protect "reasonable competitive business interests," must be reasonable "in terms of duration, geographical scope, and the type of employment or line of business," and must be "reasonable as between the parties, and it must not be specially injurious to the public."

There is virtually no difference between the standard set out in *Hubbard*, which the Plaintiff says applies to commercial dealings among vendors, and that set out in MCL 445.774a, except that the statute is couched in terms of an employer-employee relationship. Both *Hubbard* and the statute instruct the courts to view the entirety of the circumstances, and determine if the restraints are reasonable between the parties and not injurious to the public. The Court of Appeals thus was correct in *St. Clair Medical PC v. Borgiel*, 270 Mich App 260, 265-66 (2006). when it viewed MCL 445.774a as codifying the common law rule.

Therefore, the entire thrust of Plaintiff's argument on its application fails. The Court of Appeals did not apply the wrong standard in this case. The standards set out in *Hubbard*, MCL 445.774a, and *St. Clair* are one in the same. There is no split or double standard in the Court of Appeals that requires this Court's intervention.

B. **The Court of Appeals correctly applied the rule of reason.**

The Court of Appeals applied the rule of reason in determining that the Liquid anti-competition provision was void. "[W]e agree that the non-compete provision contained in the Termination Agreement was unreasonable and unenforceable." *Ex. 1, COA Op. at 7.* Its holding was correct.

Much of the law concerning restraints of trade and the rule of reason is set out in section II.C., above and will not be repeated here. But the key to the lower court decisions is the rule that preventing competition is an impermissible purpose for a non-compete. *St. Clair Med.,* 270 Mich App at 266, 268. The alleged "sophistication" of the parties to the non-compete is not relevant. Even in cases where both parties are sophisticated, the party seeking the restrain still has "an obligation to demonstrate a legitimate business interest." *Guardian Fiberglass, Inc., v .Whit Davis Lumber Co.,* 509 F.3d 512, 526 (CA 8, 2007) (interpreting Michigan law).

Plaintiff set out two interests that it says justify the anti-competition provision of the Liquid Termination Agreement: confidentiality and goodwill. These alleged interests are pretextual. By their own admission, what Plaintiff sought was a means to control competition, control where competing products were sold, and maintain their 90% plus market share of the 1-4 oz. energy shot market. In particular, Plaintiff sought to maintain its stranglehold on distribution through Walmart.

As Plaintiff admitted in answers to interrogatories, the "business purpose" it sought to advance was "the right to evaluate, on a case-by-case basis, each brand of energy drink that Liquid Manufacturing sought to bottle. Products that were approved by Plaintiff were limited in distribution and production…. Eternal Energy was ultimately distributed to a significantly broader area than originally proposed and provisionally approved." *Ex. 3.*

While protecting trade secrets can be a legitimate business purpose, Plaintiff failed to demonstrate that it entrusted Liquid with confidential information and trade secrets that it sought to protect. Liquid is a bottler. Plaintiff allowed Liquid to bottle products for 37 competitors. The confidentiality agreement Plaintiff asked Liquid to obtain from those 37 competitors required only that they not disclose that Liquid had once bottled for Plaintiff. To the extent that a competitor could glean any trade secrets or other confidential information from Liquid, Plaintiff chose not to attempt to keep such secrets safe from disclosure. To maintain trade secret protection, an entity must make reasonable efforts to maintain secrecy. MCL 445.1902(d); *Insealator Inc. v Wallace*, 357 Mich 233, 249; 98 NW2d 643 (1959) (no trade secrets existed because plaintiff's patent made them all public). As the trial court concluded, whatever information Plaintiff provided to Liquid, it was "generally known" because it was used, with Plaintiff's approval, "by 37 different manufactures of energy drink products," and because such information was readily ascertainable by "merely inquiring of those 37 approved manufacturers." *Ex. 2, Trial Ct. Op. at 29-30.*

As to goodwill, the Court of Appeals correctly rejected Plaintiff's claim. Plaintiff has not explained how its reputation or brand could be damaged by allowing competitors to use Liquid as its bottler. Indeed, the one thing that competitors could not do was disclose that their products were bottled in a facility that had previously bottled 5 Hour Energy.

Because Plaintiff has admitted that the purpose of the anti-competition provision of the Liquid Termination agreement was to allow Plaintiff to control competition, and because Plaintiff has not put forward a legitimate business reason for restraining trade, the provision is invalid.

IV. NO FURTHER DISCOVERY WAS NECESSARY.

Plaintiff's final argument is that it should have been afforded additional discovery on its trade secrets claim. The Michigan Uniform Trade Secret Act ("MUTSA") defines a "trade secret" as:

> "information … that … (i) derives independent economic value … from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use [and] (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." MCL 445.1902(d).

The trial court concluded that no trade secrets had been misappropriated in this case because the information at issue did not meet the definition of a trade secret. *Ex. 2, Trial Ct. Op.* at 29. The trial court viewed the issue before it as an allegation by plaintiff that the use of the equipment used to manufacture plaintiff Energy constituted a misappropriation of trade secrets. *Id.* The trial court reasoned that such information was "generally known" because it was used, with the approval of plaintiff, "by 37 different manufacturers of energy drink products" and because such information was readily ascertainable by "merely inquiring of those 37 approved manufacturers who came into possession of the information without being bound by a duty to disclose." *Id.* at 29-30. Further, the trial court found that authorizing disclosure to 37 different entities without confidentiality agreements was inconsistent with reasonable efforts to maintain the secrecy of the information. *Id.* at 30.

In the trial court, plaintiff presented only a limited, one paragraph argument (citing no case law) concerning its alleged need for additional discovery. R. at 1/9/13, Brf Filed Plf/In Oppse to Mtn for SD/POS ("*Krause Response") at 18-19; R. at 1/9/13, Brf Filed Plf/In Oppse to Mtn for SD/POS *("Liquid Response")* at 19. The <u>only</u> subject on which plaintiff even suggested that additional discovery was needed concerned "the scope of the Liquid Defendants' breach of the Confidentiality Provision." *Id.* at 18. Plaintiff complained that it had not been able to depose two witnesses, asserted that responses to written discovery requests were inadequate and that "while Plaintiff knows what information it disclosed to the Liquid defendants and the Krause defendants, it requires additional discovery to determine what information disclosed to the Krause Defendants was passed on to the Liquid Defendants." *Id.* Issues and arguments raised for the first time on appeal are not subject to review, absent manifest injustice. *In re Forfeiture of Certain Personal Property*, 441 Mich. 77, 84; 490 NW2d 322 (1992).

In its brief in the Court of Appeals, plaintiff provided virtually no analysis or rebuttal of the trial court's substantive decision. Plaintiff's only contention was that it asserted that "a variety of confidential information and trade secrets were misappropriated … far more than the bottling process for liquid energy shots, which was the only information addressed by the trial court." *Plaintiff/Appellant's Brief on Appeal* at 17. Plaintiff never explained why the trial court's analysis was wrong, what information the trial court should have considered, or how the MUTSA was violated. In a trade secret case, the burden of proof is on the plaintiff to plead and prove "the specific nature of the trade secrets." *Dura Global Technologies, Inc. v. Magna Donnelly Corp.*, 662 F. Supp. 2d 855, 859 (ED Mich 2009). "A party alleging trade secret misappropriation must particularize and identify the purported misappropriated trade secrets with specificity." *Id.*

The Court of Appeals agreed that the trial court correctly found that plaintiff's bottling process "cannot constitute a trade secret where plaintiff disclosed it by expressly authorizing [Liquid] to bottle for 37 companies" without confidentiality agreements. *Ex. 1, COA Op. at 13.* Further, the Court of Appeals stated that "although plaintiff claims that it alleged a variety of other trade secrets, it has, on several occasions, failed to state any trade secrets that were allegedly violated." *Id.*

As to claims that there was insufficient discovery, the Court of Appeals held that "plaintiff fails to provide any independent evidence that a factual dispute exists. Instead, plaintiff simply makes broad, unsupported allegations of what additional discovery could demonstrate. Plaintiff's claim that further discovery will lead to factual support … is nothing more than conjecture." *Ex. 1, COA Op. at 17.*

Both the trial court and Court of Appeals were correct in finding that no further discovery was warranted. "If a party opposes a motion for summary disposition on the ground that discovery is incomplete, the party must at least assert that a dispute does indeed exist and support that allegation by some independent evidence. Mere conjecture does not entitle a party to discovery, because such discovery would be no more than a fishing expedition." *Davis v. Detroit*, 269 Mich.App 376, 379–380; 711 NW2d 462 (2005) (internal citation and quotation marks omitted).

Pauley v. Hall, 124 Mich.App. 255, 263; 355 NW2d 197 (1983) is directly on point. A question in *Pauley* was whether defendants had knowledge of certain oil and gas leases. *Id.* at 259. Defendants moved for summary disposition, and plaintiff argued that the motion was premature because his discovery on the issue of the defendants' knowledge had not been completed. *Id.* at 263. The court rejected that argument because defendant failed to present independent evidence on the subject:

> If the party opposing a motion for summary judgment cannot present competent evidence of a disputed fact because his or her discovery is incomplete, the party must at least assert that such a dispute does indeed exist and support the allegation by some independent evidence, even if hearsay. An unsupported allegation which amounts solely to conjecture does not entitle a party to an extension of time for discovery, since under such circumstances

> discovery is nothing more than a fishing expedition to discover if any disputed material fact exists between the parties. *Id.*

However, plaintiff "alleged only that the Halls *may* have known about his leasehold interest and that he needed time to depose the parties to find out *if* anyone had told the Halls about the lease." *Id. (emphasis in original).* This court held that "[t]his amounts to an insufficient showing of a disputed fact, and the court did not err in refusing Pauley's request for additional time for discovery." *Id.*

Like the plaintiff in *Pauley*, all plaintiff presented to the trial court in this case was a conclusory statement, claiming that it needed discovery to show what trade secrets were at issue. *Response at 18.* Mere speculation that additional discovery "*might* be able to offer additional pertinent information" is insufficient. *Ensink v. Mecosta Co. Gen. Hosp.*, 262 Mich.App. 518, 540; 687 NW2d 143 (2004) (emphasis in original).

V. PLAINTIFF HAS ABANDONED ALL OTHER ISSUES DECIDED IN THE COURT OF APPEALS.

The Court of Appeals affirmed the trial court's grant of summary disposition on all of plaintiff's numerous contract and non-contract causes of action. MCR 7.105(B)(1) requires an applicant for leave to "concisely recite[] the appellant's allegations of error." Plaintiff cited only three allegations of error: (1) that the Court of Appeals erred in affirming dismissal of Plaintiff's claim that K&L and Krause breached a non-competition agreement; (2) the Court of Appeals erred in affirming dismissal of Plaintiff's claim that Liquid and Paisley breached a non-competition agreement; and (3) that further discovery was necessary on plaintiff's breach of trade secrets claim.

Plaintiff has abandoned all other issues and claims. Thus, the Court of Appeals should be affirmed as to summary disposition of Plaintiff's other claims, including alleged breaches of the confidentiality provisions of the agreements among the parties, tortious interference, conspiracy, unjust enrichment, conversion, and fraud.

CONCLUSION AND RELIEF

Defendants ask the Court to deny the application for leave to appeal. The Court of Appeals correctly affirmed the trial court's decision, and there are no issues that warrant this Court's review.

Respectfully Submitted,

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Dated: March 10, 2015

PROOF OF SERVICE

I hereby certify that on March 10, 2015, I electronically filed the foregoing paper with the Clerk of the Court using the TrueFiling system which will send notification of such filing to all counsel of record.

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