STATE OF MICHIGAN

COURT OF APPEALS

CHARLES W. MORRIS, JR., Plaintiff-Appellant, v WILLIAM T. BALES, TIMOTHY J. LOCK, and PLAYDATA LLC, Defendants-Appellees.	UNPUBLISHED November 28, 2017 No. 334493 Washtenaw Circuit Court LC No. 14-001172-CK

Before: SAWYER, P.J., and HOEKSTRA and MARKEY, JJ.

PER CURIAM.

Plaintiff appeals as of right the trial court's grant of defendants' motions for summary disposition under MCR 2.116(C)(10) (no genuine issue of material fact) and its denial of plaintiff's motion for appointment of receiver as moot. We affirm.

I. FACTUAL AND PROCEDURAL BACKGROUND

Defendant Timothy Lock founded PlayData, a technology company that uses software to track the location of soccer players on the field, in 2005. PlayData licensed a similar program to track golf balls and clubs to AboutGolf beginning in December 2006. In July 2007, Lock and William Bales, who worked for About Golf, reformed PlayData as an Ohio limited liability company. Included in Lock's compensation were funds to repay a loan that Lock had with Wells Fargo in connection with his prior business. Lock and Bales were the original board of directors for PlayData, and Lock was PlayData's first general manager.

Around the time of PlayData's formation, plaintiff invested in PlayData as memorialized in a series of promissory notes. PlayData subsequently converted plaintiff's loans into 250,000 shares of Class A units, and plaintiff signed the PlayData operating agreement.

PlayData and AboutGolf entered into a software development and license agreement in May 2011 to clarify ownership and licensing of intellectual property developed singly and jointly. The agreement specifies a scale of royalty payments from AboutGolf to PlayData. After Bales's resignation from PlayData, effective January 1, 2010, Bales maintained ownership of PlayData units through his company and a family trust.

In August 2012, PlayData developed a business plan to expand into other sports when the AboutGolf revenue stream decreased substantially. Lock testified that AboutGolf faced bankruptcy and PlayData and AboutGolf were involved in a dispute. Plaintiff filed a complaint in December 2012. Lock testified that this lawsuit, in combination with AboutGolf's difficulties, forced PlayData to concentrate on golf and its business relationship with AboutGolf instead of pursuing opportunities in other sports.

On August 1, 2013, three PlayData employees, including Lock, resigned and entered into consulting agreements with PlayData. PlayData owed Lock back wages, loans he made to PlayData, and repayment of a Wells Fargo loan. PlayData agreed to retain Lock as a consultant to provide technical support through Lock's company, Track3-D. At a special meeting of the members of PlayData in May 2014, the members who were present, including plaintiff, unanimously elected Lock and Charles Drake to the board of directors and Drake as general manager.

Plaintiff mailed a demand for action on October 27, 2015, to defendants' attorneys in the pending lawsuit. Three days after mailing the demand letter, plaintiff filed an amended complaint. Each defendant separately answered the first amended complaint and denied wrongdoing. Plaintiff subsequently filed a motion for appointment of limited receiver and accounting, arguing that Lock redirected PlayData revenue to himself and other insiders. Drake, PlayData's general manager, responded to plaintiff's demand for action in March 2016 and declined to take legal action against Lock and Bales. Each defendant filed a motion for summary disposition under MCR 2.116(C)(10).[1] The trial court granted defendants' motions for summary disposition and denied plaintiff's motion to appoint a receiver.

II. ANALYSIS

This Court reviews de novo a grant of summary disposition. *Silberstein v Pro-Golf of America, Inc*, 278 Mich App 446, 457; 750 NW2d 615 (2008). The trial court granted defendants' motions for summary disposition under MCR 2.116(C)(10). A party is entitled to summary disposition under MCR 2.116(C)(10) if "there is no genuine issue as to any material fact, and the moving party is entitled to judgment . . . as a matter of law." Under this court rule, we "consider all the evidence submitted by the parties in the light most favorable to the nonmoving party" and will affirm a grant of summary disposition "only where the evidence fails to establish a genuine issue regarding any material fact." *Silberstein*, 278 Mich App at 457-458.

This Court reviews de novo choice-of-law issues, *Talmer Bank & Trust v Parikh*, 304 Mich App 373, 383; 848 NW2d 408 (2014), vacated in part on other grounds 497 Mich 857 (2014), and questions of contractual interpretation, *Turcheck v Amerifund Financial, Inc*, 272 Mich App 341, 345; 725 NW2d 684 (2006).

A. CHOICE OF LAW

[1] Plaintiff did not waive any claims as to defendant Bales on appeal because the trial court granted each defendant's motion for summary disposition for the same reason.

The parties first dispute whether Michigan or Ohio law governs this action. Michigan law permits a member of an LLC to "commence and maintain a civil suit in the right of a limited liability company" if the "plaintiff has made written demand on the managers or the members with the authority" to bring an action, and "[n]inety days have expired from the date the demand was made[.]" MCL 450.4510. The parallel Ohio statute governing derivative claims contains a similar demand requirement but has no 90-day waiting period for filing a complaint. See Ohio Rev Code 1705.49. Accordingly, the trial court signaled its application of Michigan law by finding that plaintiff did not comply with the 90-day waiting period.

Michigan law generally governs actions brought in Michigan courts. *Offerdahl v Silverstein*, 224 Mich App 417, 419; 569 NW2d 834 (1997). "However, parties may, in general, agree that all causes of action pertaining to a particular matter will be . . . subject to the law of a particular jurisdiction." *Id*. (citation omitted). This Court interprets and enforces the unambiguous language of a contract. *Quality Products and Concepts Co v Nagel Precision, Inc*, 469 Mich 362, 375; 666 NW2d 251 (2003). This Court enforces parties' agreements regarding forum selection and choice-of-law. *Offerdahl*, 224 Mich App at 420.

The parties do not dispute the validity of the operating agreement, which contains a choice-of-law provision stating that "the internal law, not the law of conflict, of the State of Ohio" governs this dispute. Even when foreign law applies pursuant to a valid contract, however, Michigan law governs procedure. *Rubin v Gallagher*, 294 Mich 124, 128; 292 NW 584 (1940). Thus, Michigan law governs whether plaintiff complied with the procedural requirements for filing a derivative shareholder claim.[2]

We also note that plaintiff filed this action in Michigan and cited Michigan law in his complaint. Applying Michigan's procedural rules, plaintiff did not comply with the 90-day waiting period for filing either complaint. Plaintiff mailed a demand letter to PlayData's first attorney in this litigation on October 27, 2015, nearly two years after filing the original complaint in December 2012 and three days before filing the amended complaint.

Plaintiff argues that defendants' answer to the 2012 complaint meets the exceptions to the 90-day requirement because it is the equivalent of rejecting plaintiff's demand and because Lock's misappropriation of royalty income constituted irreparable injury. MCL 450.4510(c) excuses the 90-day waiting period if "the member has earlier been notified that the demand has been rejected or" if "irreparable injury to the limited liability company would result by waiting for the expiration of the 90-day period." Plaintiff maintains that a demand would have been futile because PlayData refused to take action. However, the plain language of MCL

[2] Plaintiff's reliance on *Olmstead v Anderson*, 428 Mich 1; 400 NW2d 292 (1987), is unavailing. *Olmstead* examined conflicts of law in a wrongful death action involving different states. 428 Mich at 9-10. By contrast, this case arises from a contract, which does not follow the same conflicts of law rules governing a tort implicating different states' interests. See *Talmer Bank & Trust v Parikh*, 497 Mich 857; 852 NW2d 896 (2014). For the same reason, defendants' reliance on *Sutherland v Kennington Truck Service, Ltd*, 454 Mich 274; 562 NW2d 466 (1997) also fails.

450.4510(c) requires that the member was *earlier notified* that the demand was rejected, which did not occur in this case. The answers were filed *after* plaintiff's complaint. Accordingly, even were this Court to accept that answers denying wrongdoing may constitute a rejection of a demand letter, the answers in this case did not occur until after plaintiff filed his complaint. There was no earlier notification.

Regarding irreparable injury, paragraph six of the licensing agreement between PlayData and AboutGolf directs PlayData to pay for the development of new intellectual property and to reinvest 20% of the royalties earned to improve PlayData intellectual property. The August 2013 consulting agreements with PlayData listed maintenance and support of the AboutGolf contract as part of Lock's responsibilities. Consequently, plaintiff has identified no injury because payments to Lock are consistent with the royalty reinvestment provision because he is responsible for servicing AboutGolf software on behalf of PlayData. Accordingly, plaintiff has not demonstrated that MCL 450.4510(c) applies.

Plaintiff relatedly contends that the trial court erred by relying on the 90-day waiting period to dismiss the derivative count without permitting plaintiff to file an amendment. By the time the trial court granted summary disposition, 90 days had elapsed after plaintiff mailed the demand letter, and PlayData had responded to it by finding no reason to bring a lawsuit. Additionally, the trial court ruled on plaintiff's substantive claims when it granted defendants' motions for summary disposition. Thus, plaintiff has identified no error in the trial court's refusal to permit plaintiff to refile an amended complaint, particularly where the trial court found that an investigation into plaintiff's demands was not conducted fraudulently or in bad faith.

B. REASONABLE INVESTIGATION

Next, we affirm the trial court's dismissal of plaintiff's derivative claim under either Michigan or Ohio law. We agree with the trial court that PlayData's disinterested manager exercised business judgment to decline to bring an action and conducted a reasonable investigation.

The Michigan Limited Liability Company Act, MCL 450.4101 *et seq*., requires dismissal of a derivative action

> if, on motion by the limited liability company, the court finds that 1 of the groups specified in [MCL 450.4512(3)] has made a determination in good faith after conducting a reasonable investigation upon which its conclusions are based that the maintenance of the derivative proceeding is not in the best interests of the company. [MCL 450.4512(1).]

One of the specified groups is "a majority vote of the disinterested managers or members having the authority to cause the company to sue in its own right," if the disinterested managers

constitute a majority. MCL 450.4512(3)(a). MCL 450.4512(4) defines 'disinterested' in relevant part to mean "a person who is not a party to a derivative proceeding[.]"[3]

> Additionally, this Court has defined the business judgment rule as follows:
>
> > It is a well-recognized principle of law that the directors of a corporation, and they alone, have the power to declare a dividend of the earnings of the corporation, and to determine its amount. Courts of equity will not interfere in the management of the directors unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds, or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud, or breach of that good faith which they are bound to exercise towards the stockholders. [*Churella v Pioneer State Mut Ins Co*, 258 Mich App 260, 270-271; 671 NW2d 125 (2003) (internal quotations and citation omitted.]

Ohio's interpretation of the business judgment rule is similar:

> Under Ohio law, it is presumed that any action taken by a director on behalf of the corporation is taken in good faith and for the benefit of the corporation. The board of directors has the primary authority to file a lawsuit on behalf of the corporation. The shareholders may make a demand on the directors to bring a suit on behalf of the corporation, but no shareholder has an independent right to bring suit unless the board refuses to do so *and* that refusal is wrongful, fraudulent, or arbitrary, or is the result of bad faith or bias on the part of the directors. [*Drage v Procter & Gamble*, 119 Ohio App 3d 19, 24; 694 NE2d 479 (1997) (citations omitted).]

In this case, Drake summarized his investigation into plaintiff's written demand allegations when he declined to commission a forensic accounting or undertake litigation. Drake examined PlayData's records to determine whether loans that Lock made to PlayData were legitimate and concluded that they were. Drake also referred to a July 2007 e-mail between Lock and Bales showing that PlayData incorporated loan repayments into Lock's salary. Armstrong, PlayData's accountant, confirmed that assuming debt was an appropriate component of a compensation package. Plaintiff's citation to a single out-of-context statement that Drake made at his deposition does not create a genuine issue of material fact regarding Drake's business judgment.

We likewise reject plaintiff's reliance on a statement that Drake made at his deposition about consulting with Lock about payments. Lock was PlayData's first general manager and remained a member of the board of directors since PlayData's formation in 2007. At the time of

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[3] The Ohio statute governing limited liability companies, Ohio Rev Code 1705.01 *et seq*., does not contain a corollary provision for dismissal of derivative actions based on an investigation,

Drake's investigation, Lock and Drake were the only two members of the Board. Additionally, financial documents show that Lock was not the only one who received payments. Accordingly, Drake's consultation with Lock about payments does not show that Drake's investigation was fraudulent, unreasonable, or made in bad faith.

Finally, we reject plaintiff's argument that Drake's presence at a pitch meeting Lock made on behalf of his wholly-owned company, Perform3-D, with a potential competitor of PlayData demonstrated fraud or bad faith because the operating agreement permitted PlayData members to compete with PlayData. This permitted competition further supports Drake's refusal to void contracts with "insiders" at plaintiff's request. Similarly, Lock, as the owner of Track3-D, entered into a consulting agreement with PlayData that justified Drake's conclusion that Lock used intellectual property only for PlayData's benefit because that agreement gave ownership of all software developed under that agreement to PlayData. Thus, we affirm the trial court's dismissal of plaintiff's derivative claim because Drake conducted a reasonable investigation that was not fraudulent and was not made in bad faith.

C. PLAINTIFF'S SUBSTANTIVE CLAIMS

Plaintiff alleged five counts in the amended complaint: (I) minority member oppression with no defendants specified, (II) a derivative action on behalf of PlayData against Lock and Bales, (III) statutory and common law conversion against Lock and Bales, (IV) breach of fiduciary duty against Lock and Bales, and (V) breach of contract with no defendants specified.

We will consider the minority member oppression and breach of contract counts together because the operating agreement disposes of both. The trial court rejected the minority member oppression claim because the actions plaintiff challenged related to Lock's salary and back pay were not "illegal or fraudulent." The trial court similarly concluded that the operating agreement permitted the actions plaintiff complained of, thereby defeating plaintiff's breach of contract claim.

In Michigan, a "member of a limited liability company may bring an action . . . to establish that the acts of the managers or members in control of the limited liability company are illegal or fraudulent or constitute willfully unfair and oppressive conduct toward the limited liability company or the member." MCL 450.4515(1).

> As used in this section, "willfully unfair and oppressive conduct" means a continuing course of conduct or a significant action or series of actions that substantially interferes with the interests of the member as a member. 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 member interests disproportionately as to the affected member. The term does not include conduct or actions that are permitted by the articles of organization, an operating agreement, another agreement to which the member is a party, or a consistently applied written company policy or procedure. [MCL 450.4515(2).]

Ohio recognizes a comparable individual cause of action that is distinct from a shareholder derivative suit. In *Crosby v Beam*, 47 Ohio St 3d 105, 107-108; 548 NE2d 217 (1989), the Ohio Supreme Court recognized the peril of the oppression of minority shareholders in close corporations because minority members cannot easily sell shares, unlike in a publicly owned corporation with publicly traded shares. Because majority shareholders owe a heightened fiduciary duty to minority shareholders in a close corporation, "claims of a breach of fiduciary duty alleged by minority shareholders against shareholders who control a majority of shares in a close corporation, and use their control to deprive minority shareholders of the benefits of their investment, may be brought as individual or direct actions[.]" *Id*. at 109-110.

Plaintiff's challenges to PlayData's failure to pay distributions to Class A unitholders does not take into account the operating agreement's provision for cash flow distributions first to cover tax liabilities, then to Class A members, then to all interest holders in proportion to their ownership percentage. The agreement defines cash flow as

> all cash funds derived from operations of the Company (including interest received on reserves), without reduction for any non-cash charges, but less cash funds used to pay current operating expenses and to pay or establish reasonable reserves for future expenses, debt payments, capital improvements, replacements, and other working capital needs, as determined by the General Manager and approved by the Board of Directors. Cash Flow shall be increased by the reduction of any reserve previously established.

The payments plaintiff contests fall under the definition of cash flow that precedes distributions made to Class A unitholders. For example, when asked whether he still would have invested in PlayData if he had known Lock's compensation, plaintiff testified that it would not have "impacted his decision one way or another." That salary included repayment of Lock's Wells Fargo loan from the start. Plaintiff further agreed that Lock should be compensated for his work, so PlayData's payment of Lock's accrued wages does not reflect oppression of the minority members. In addition, two employees other than Lock accrued back wages in 2012 when PlayData's royalty income from AboutGolf dropped by two-thirds, and it is notable that plaintiff does not challenge payment of these accrued wages as inappropriate. Further, PlayData's accountant recommended against making non-tax distributions to Class A unitholders because of insufficient cash flow, "according to the terms provided for in the PlayData operating agreement." Despite plaintiff's criticism, Lock testified that PlayData's goal in August 2012, which shifted from expanding into other sports markets to remaining solvent, reflects the precipitous drop in PlayData's incoming revenue stream in 2012.

Therefore, we agree with the trial court's conclusion that there was no genuine issue of material fact regarding whether legitimate business expenses precluded distributions to plaintiff and warranted summary disposition of the minority member oppression claim under Michigan or Ohio law. Likewise, PlayData's actions comport with the terms of the operating agreement governing cash flow distributions, so the trial court correctly disposed of plaintiff's breach of contract claim.

We also affirm the trial court's grant of summary disposition as to plaintiff's derivative, conversion, and breach of fiduciary duty counts, which plaintiff discusses together. As a

preliminary matter, the trial court properly considered all of these claims as derivative claims. "[W]here the alleged injury to the individual results only from the injury to the corporation, the injury is merely derivative . . . ." *Mich Nat'l Bank v Mudgett*, 178 Mich App 677, 680; 444 NW2d 534 (1989). We also note that the trial court properly granted summary disposition under MCR 2.116(C)(10) because it relied on facts outside the pleadings when deciding defendants' motions. Thus, we apply the (C)(10) standards to review the trial court's grant of the summary disposition.

We affirm the trial court's application of the economic loss doctrine to dispose of the conversion and breach of fiduciary duty claims because the operating agreement defined the relationship between the parties. Our Supreme Court adopted the economic loss doctrine in *Neibarger v Universal Coops, Inc*, 439 Mich 512, 527-528; 486 NW2d 612 (1992), to dispose of tort claims arising from contractual disputes. This Court has relied on the doctrine to explain that "an action in tort may not be maintained where a contractual agreement exists, unless a duty, separate and distinct from the contractual obligation, is established." *Sherman v Sea Ray Boats, Inc*, 251 Mich App 41, 52; 649 NW2d 783 (2002). The Ohio Supreme Court also applies the economic loss rule to "prevent[] recovery in tort of damages for purely economic loss[,]" premised on the distinction between tort and contract law. *Corporex Dev & Constr Mgt, Inc v Shook, Inc*, 106 Ohio St 3d 412, 414; 835 NE2d 701 (2005).

In this case, the operating agreement defines plaintiff's and defendants' relationship and governs the actions plaintiff complained about. Once plaintiff converted his loans into Class A units and signed on to the operating agreement, he redefined his relationship to PlayData as a Class A unitholder. Plaintiff makes no claim that defendants owe him a duty beyond their existing contractual relationship. Accordingly, the economic loss doctrine bars plaintiff's tort claims.

Finally, we affirm the trial court's denial of plaintiff's motion to appoint a receiver. A matter is moot if this Court's ruling "cannot for any reason have a practical legal effect on the existing controversy." *Gen Motors Corp v Dep't of Treasury*, 290 Mich App 355, 386; 803 NW2d 698 (2010). Having dismissed all of plaintiff's claims, the trial court did not err by denying plaintiff's motion to appoint a receiver as moot.

Affirmed.

/s/ David H. Sawyer
/s/ Joel P. Hoekstra
/s/ Jane E. Markey