State Bar of Michigan
BLS
Business Law Section

The Michigan Business Law JOURNAL

Volume 41
Issue 3
Fall 2021

CONTENTS

SBM
State Bar of Michigan

Published by THE BUSINESS LAW SECTION, State Bar of Michigan

The editorial staff of the *Michigan Business Law Journal* welcomes suggested business law topics of general interest to the Section members, which may be the subject of future articles. Proposed business law topics may be submitted through the Publications Director, Brendan J. Cahill, *The Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, Michigan 48304, (248) 203-0721, bcahill@dykema.com, or through Max H. Matthies, ICLE, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, matthies@icle.org. General guidelines for the preparation of articles for the Michigan Business Law Journal can be found on the Section's website at http://connect.michbar.org/businesslaw/newsletter.

Each issue of the *Michigan Business Law Journal* has a different primary, legal theme focused on articles related to one of the standing committees of the Business Law Section, although we welcome articles concerning any business law related topic for any issue. The deadlines for submitting articles are as follows:

Issue	Article Deadline
Summer 2022	March 31, 2022
Fall 2022	July 31, 2022
Spring 2023	November 30, 2022
Summer 2023	March 31, 2023

ADVERTISING

All advertising is on a pre-paid basis and is subject to editorial approval. The rates for camera-ready digital files are $400 for full-page, $200 for half-page, and $100 for quarter page. Requested positions are dependent upon space availability and cannot be guaranteed. All communications relating to advertising should be directed to Publications Director, Brendan J. Cahill, the *Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, MI 48304, (248) 203-0721.

MISSION STATEMENT

The mission of the Business Law Section is to foster the highest quality of professionalism and practice in business law and enhance the legislative and regulatory environment for conducting business in Michigan.

To fulfill this mission, the Section shall: (1) expand the resources of business lawyers by providing educational, networking, and mentoring opportunities; (2) review and promote improvements to Michigan's business legislation and regulations; and (3) provide a forum to facilitate service and commitment and to promote ethical conduct and collegiality within the practice.

The *Michigan Business Law Journal* (ISSN 0899-9651), is published three times per year by the Business Law Section, State Bar of Michigan, 306 Townsend St., Lansing, Michigan.

Volume XXII, Issue 1, and subsequent issues of the *Journal* are also available online by accessing http://connect.michbar.org/businesslaw/newsletter

From the Desk of the Chairperson

By John T. Schuring

As you read this column, summer will have fully given way to fall, and likewise, the Business Law Section will have moved into a new fiscal year. At our Annual Section Meeting in Novi on September 28, 2021, your new officers (myself as Chair, Mark Kellogg as Vice Chair, Judge Christopher Yates as Treasurer, and Ian Williamson as Secretary) took office, and we are all honored and excited to serve this Section for the next year.

The September annual meeting marked the first time since December 2019 that our members had the opportunity to gather together. It was very nice to see people again. We have ably conducted the business of the Section through virtual means for nearly two years, but I know many agree with me that the opportunity to connect with our fellow business lawyers is a major reason why the Section is such a valuable part of our practices. For many of us, there is no substitute to live meetings. I hope conditions continue to permit a steady return to in-person activities for the Section.

The Section owes a debt of gratitude to Julia Dale, who has lead the Section for the last year and now moves into the coveted title of "former Chair." Julia did an exceptional job leading the Section through the pandemic-induced turbulence, and we are stronger because of her steady hand. I know that she will continue to be a resource for the Section and our Council in the coming years. Thank you, Julia!

Congratulations to Douglas L. Toering, a partner with Mantese Honigman, P.C., who was recognized at the Annual Meeting as the recipient of the 15th Annual Stephen H. Schulman Outstanding Business Lawyer Award. Doug served as the Chair of the Section in 2015-16 and continues to be a mainstay of the Business Law Section, serving as chair of the Commercial Litigation and Business Courts Committees, and recently leading our Section's committee that prepared an amicus brief for the *Murphy v. Inman* Michigan Supreme Court case. Congratulations, Doug!

The Section officers have developed several goals for the 2021-22 fiscal year, generally organized around the theme of **outreach**. Here are this year's primary goals:

1. **Outreach to Membership**: Given the changes to the practice of law since the onset of COVID, conduct a comprehensive survey of the membership to ensure that the Section continues to provide relevant services to its members.
2. **Outreach to Newer Members**: Ensure that Section membership is valuable to lawyers in their first five years of practice by:
   a. establishing a formal mentoring program, paring new attorneys with established business lawyers, and
   b. encouraging newer lawyers to enhance their career through active participation in the Section.
3. **Outreach to Communities Underrepresented in our Section**: Support the work of the Diversity Committee of the Section through meaningful efforts to increase opportunities in business law for lawyers currently underrepresented in our Section.

Additionally, 2022 marks the five-year anniversary of our 2017 Strategic Plan. The plan was adopted with the idea of being revisited and refreshed every five years. If you are interested in joining a committee to take on this important project, please let me know.

The articles for this issue of the Business Law Journal have been provided under the guidance of the Section's Uniform Commercial Code Committee. Thank you to all of the authors who have submitted thoughtful, well-written articles, and in particular, thank you to Brendan Cahill, our Section's publications director, for producing such a great resource for our Section and our state's business lawyers. I know you will enjoy the issue.

I'm honored to serve the section, and I look forward to hearing from you. Please contact me at jschuring@dickinsonwright.com or by phone (616-336-1023) with any ideas you may have to make the Business Law Section an even more valuable resource for your practice, or to discuss how you might further your involvement with the Section.

2021-2022 Officers and Council Members
Business Law Section

Chairperson: John T. Schuring, Dickinson Wright, PLLC
200 Ottawa Ave. NW, Ste. 1000, Grand Rapids, MI 49503 (616)336-1023

Vice-Chairperson: Mark E. Kellogg, Fraser Trebilcock PC
124 W. Allegan St., Ste. 1000, Lansing, MI 48933 (517)482-5800

Treasurer: Hon. Christopher P. Yates, 17th Circuit Court
180 Ottawa Ave. NW, Ste. 11A, Grand Rapids, MI 49503 (616)632-5026

Secretary: Ian M. Williamson, Mantese Honigman, PC
1361 E. Big Beaver Rd., Troy, MI 48083 (248)457-9200

TERM EXPIRES 2022:

Patrick J. Haddad—500 Woodward Ave., Ste. 2500, Detroit, 48226
Mark E. Kellogg—124 W. Allegan St., Ste. 1000, Lansing, 48933
Ian M. Williamson—1361 E. Big Beaver Rd., Troy, 48083
Hon. Christopher P. Yates—180 Ottawa Ave. NW, Ste. 11A, Grand Rapids, 49503
Eric A. Zacks— 471 W. Palmer St., Detroit, 48202

TERM EXPIRES 2023:

Brendan J. Cahill—39577 Woodward Ave., Ste. 300, Bloomfield Hills, 48304
Bruce W. Haffey—101 W Big Beaver Rd., Ste. 1000, Troy, 48084
Laura E. Johnson—41000 Woodward Ave., Bloomfield Hills, 48304
Shanna M. Kaminski—160 W. Fort St., 5th Fl., Detroit, 48226
J. Scott Timmer— 281 Seminole Rd. Fl. 2, Norton Shores, 49444

TERM EXPIRES 2024:

Amber D. Beebe—PO Box 3491, Grand Rapids, 49501
Carrie Leahy—201 S. Division St., Ste. 400, Ann Arbor, 48104
Michael K. Molitor—111 Commerce Ave., SW, Grand Rapids, 49503
Ryan Opel—222 N. Washington Sq., Ste. 400, Lansing, 48933
John T. Schuring—200 Ottawa Ave. NW, Ste. 1000, Grand Rapids, 49503

EX-OFFICIO:

Diane L. Akers—1901 St. Antoine St., 6th Fl., Detroit, 48226
Jeffrey S. Ammon—250 Monroe NW, Ste. 800, Grand Rapids, 49503-2250
G. Ann Baker—P.O. Box 30054, Lansing, 48909-7554
Harvey W. Berman—201 S. Division St., Ann Arbor, 48104
Bruce D. Birgbauer—150 W. Jefferson, Ste. 2500, Detroit, 48226
Kevin T. Block—500 Woodward Ave., Ste. 2500, Detroit, 48226
James C. Bruno—150 W. Jefferson, Ste. 900, Detroit, 48226
Judy B. Calton—660 Woodward Ave., Ste. 2290, Detroit, 48226
James R. Cambridge—500 Woodward Ave., Ste. 2500, Detroit, 48226
Thomas D. Carney—820 Angelica Circle, Cary, NC, 27518
James L. Carey—23781 Point o' Woods Ct., South Lyon, 48178
Jennifer E. Consiglio—41000 Woodward Ave., Bloomfield Hills, 48304
Julia Ann Dale—PO Box 30736, Lansing, MI 48909-8236
Timothy R. Damschroder—201 S. Division St., Ann Arbor, 48104
Alex J. DeYonker—850 76th St., Grand Rapids, 49518
Marguerite M. Donahue, 27777 Franklin Rd., Ste. 2500 Southfield, 48034
Lee B. Durham, Jr.—1021 Dawson Ct., Greensboro, GA 30642
David Foltyn—660 Woodward Ave, Ste. 2290, Detroit, 48226
Richard B. Foster, Jr.—4990 Country Dr., Okemos, 48864
Tania E. Fuller—751 Kenmoor Ave., Ste. C, Grand Rapids, 49546
Connie R. Gale—P.O. Box 327, Addison, 49220
Mark R. High—500 Woodward Ave., Ste. 4000, Detroit, 48226
Michael S. Khoury—31350 Telegraph Rd., Ste. 201, Bingham Farms, 48025
Justin G. Klimko—150 W. Jefferson, Ste. 900, Detroit, 48226
Eric I. Lark—500 Woodward Ave., Ste. 2500, Detroit, 48226
Tracy T. Larsen—171 Monroe Ave., NW, Ste. 1000, Grand Rapids, 49503
Edwin J. Lukas—1901 St. Antoine St., Ste. 2500, Detroit, 48226
Hugh H. Makens—111 Lyon St. NW, Ste. 900, Grand Rapids, 49503
Charles E. McCallum—111 Lyon St. NW, Ste. 900, Grand Rapids, 49503
Daniel H. Minkus—151 S. Old Woodward Ave., Ste. 200, Birmingham, 48009
Aleksandra A. Miziolek—39550 Orchard Hill Place Dr., Novi, 48375
Cyril Moscow—660 Woodward Ave., Ste. 2290, Detroit, 48226
Ronald R. Pentecost—124 W. Allegan St., Ste. 1000, Lansing, 48933
Mark W. Peters—201 W. Big Beaver, Ste. 500, Troy, 48084
Donald F. Ryman—313 W. Front St., Buchanan, 49107
Robert E. W. Schnoor—6062 Parview Dr. SE, Grand Rapids, 49546
Laurence S. Schultz—2600 W. Big Beaver Rd., Ste. 550, Troy, 48084
Lawrence K. Snider—410 S. Michigan Ave., Ste. 712, Chicago, IL 60605
Douglas L. Toering—1361 E. Big Beaver Rd., Troy, MI 48083
John R. Trentacosta—500 Woodward Ave., Ste. 2700, Detroit, 48226
Jeffrey J. Van Winkle—200 Ottawa Ave. NW, Ste. 500, Grand Rapids, 49503
Robert T. Wilson—41000 Woodward Ave., Bloomfield Hills, 48304

COMMISSIONER LIAISON:

Samantha J. Orvis—10801 S. Saginaw, Bldg. D, Grand Blanc, 48439

2021-2022 Committees and Directorships
Business Law Section

Committees

Business Courts
Chairperson: Douglas L. Toering
Mantese Hongiman, PC
1361 E. Big Beaver Rd.
Troy, MI 48083
Phone: (248) 457-9200
Email: dtoering@manteselaw.com

Commercial Litigation
Chairperson: Douglas L. Toering
Mantese Hongiman, PC
1361 E. Big Beaver Rd.
Troy, MI 48083
Phone: (248) 457-9200
Email: dtoering@manteselaw.com

Corporate Laws
Co-Chair: Justin G. Klimko
Butzel Long
150 W. Jefferson, Ste. 900
Detroit, MI 48226-4430
Phone: (313) 225-7037
Email: klimkojg@butzel.com

Co-Chair: Michael K. Molitor
Thomas Cooley Law School
111 Commerce Ave., SW
Grand Rapids, MI 49503
Phone: (616) 301-6800
Email: molitorm@cooley.edu

Debtor/Creditor Rights
Co-Chair: Judith Greenstone Miller
Jaffe Raitt Heuer & Weiss, PC
27777 Franklin Rd., Ste. 2500
Southfield, MI 48034-8214
Phone (248) 727-1429
Email: jmiller@jaffelaw.com

Co-Chair: Marc Swanson
Miller Canfield
150 W. Jefferson Ave., Ste. 2500
Detroit, MI 48226-4415
Phone (313) 496-7591
Email: swansonm@millercanfield.com

Co-Vice Chair: Paul Hage
Jaffe Raitt Heuer & Weiss, PC
27777 Franklin Rd., Ste. 2500
Southfield, MI 48034-8214
Phone: (248) 351-3000
Email: phage@jaffelaw.com

Co-Vice Chair: Shanna M. Kaminski
Varnum LLP
160 W. Fort St., 5th Fl.
Detroit, MI 48226
Phone: (313) 481-7332
Email: smkaminski@varnumlaw.com

Financial Institutions
Co-Chair: David W. Barton
Bodman PLC
229 Court St.
Cheboygan, MI 49721
Phone: (231) 627-8007
Email: dbarton@bodmanlaw.com

Co-Chair: Thomas M. Schehr
Dykema
400 Renaissance Center
Detroit, MI 48243
Phone: (313) 568-6659
Email: tschehr@dykema.com

In-House Counsel
Chairperson: Jordan Segal
Maddin Hauser Roth & Heller, PC
28400 Northwestern Hwy, Ste. 200
Southfield, MI 48034
Phone: (248) 359-7539
Email: jsegal@maddinhauser.com

Law Schools
Chairperson: Mark E. Kellogg
Fraser Trebilcock Davis & Dunlap PC
124 W. Allegan St., Ste. 1000
Lansing, MI 48933
Phone: (517) 482-5800
Email: mkellogg@fraserlaw.com

LLC & Partnership
Co-Chair: Donald A. DeLong
Marshall & Melhorn PLLC
300 Galleria Officentre, Ste. 318
Southfield, MI 48034
Phone: (248) 357-3400
Email: delong@marshall-melhorn.com

Co-Chair: Loukas P. Kalliantasis
Clark Hill PLC
151 S. Old Woodward Ave., Ste. 200
Birmingham, MI 48009
Phone: (248) 988-5859
Email: lkalliantasis@clarkhill.com

Nonprofit Corporations
Co-Chair: Celeste E. Arduino
Bodman PLC
1901 St. Antoine St., Fl. 6
Detroit, MI 48226
Phone: (313) 393-7593
Email: carduino@bodmanlaw.com

Co-Chair: Jennifer M. Oertel
Bodman PLC
201 S. Division St., Ste. 400
Ann Arbor, MI 48104
Phone: (734) 930-6898
Email: joertel@jaffelaw.com

Regulation of Securities
Chairperson: Patrick J. Haddad
Kerr, Russell and Weber, PLC
500 Woodward Ave., Ste. 2500
Detroit, MI 48226
Phone: (313) 961-0200
Email: phaddad@kerr-russell.com

Small Business Forum
Co-Chair: Sharan Lee Levine
Levine & Levine
136 E. Michigan Ave., Ste. 1400
Kalamazoo, MI 49007-3920
Phone: (269) 382-0464
Email: slevine@levine-levine.com

Co-Chair: Mark C. Rossman
Rossman Saxe, PC
2145 Crooks Rd., Ste. 220
Troy, MI 48084
Phone: (248) 385-5481
Email: mark@rossmansaxe.com

Uniform Commercial Code
Chairperson: Michael S. Khoury
FisherBroyles, LLP
31350 Telegraph Rd., Ste. 201
Bingham Farms, MI 48025
Phone: (248) 590-2910
Email: michael.khoury@fisherbroyles.com

Communication and Development
Kevin T. Block
Kerr, Russell and Weber, PLC
500 Woodward Ave., Ste. 2500
Detroit, MI 48226
(313) 961-0200
ktb@krwlaw.com

Jennifer E. Consiglio
Butzel Long PC
41000 Woodward Ave.,
Stoneridge West
Bloomfield Hills, MI 48304
(248) 593-3023
consiglio@butzel.com

Julia A. Dale
LARA Corporations, Securities &
Commercial Licensing Bureau
PO Box 30054
Lansing, MI 48909
(517) 241-6463
dalej@michigan.gov

Mark R. High
Dickinson Wright, PLLC
500 Woodward Ave., Ste. 4000
Detroit, MI 48226-5403
(313) 223-3500
mhigh@dickinsonwright.com

Michael S. Khoury
FisherBroyles LLP
31350 Telegraph Rd., Ste. 201
Bingham Farms, MI 48025
(248) 590-2910
michael.khoury@fisherbroyles.com

John T. Schuring
Dickinson Wright, PLLC
200 Ottawa Ave. NW, Ste. 1000
Grand Rapids, MI 49503
(616) 336-1023
jschuring@dickinsonwright.com

Diversity & Inclusion
Amber D. Beebe
City of Grand Rapids Department
of Law
200 Monroe Ave. NW
Grand Rapids, MI 49503-2206
(616) 456-3496
abeebe@grand-rapids.mi.us

Mark W. Peters
Bodman PLC
201 W. Big Beaver Rd., Ste. 500
Troy, MI 48084
(248) 743-6043
mpeters@bodmanlaw.com

Legislative Review
Eric I. Lark
Kerr, Russell and Weber, PLC
500 Woodward Ave., Ste. 2500
Detroit, MI 48226-5499
(313) 961-0200
eil@krwlaw.com

Nominating
Tania E. (Dee Dee) Fuller
Fuller Law & Counseling, PC
751 Kenmoor, SE, Ste. C
Grand Rapids, MI 49546
(616) 454-0022
fullerd@fullerlaw.biz

Programs
Catherine Ferguson
Wayne State University Law School
471 W. Palmer Ave.
Detroit, MI 48202

Tania E. (Dee Dee) Fuller
Fuller Law & Counseling, PC
751 Kenmoor, SE, Ste. C
Grand Rapids, MI 49546
(616) 454-0022
fullerd@fullerlaw.biz

Eric I. Lark
Kerr, Russell and Weber, PLC
500 Woodward Ave., Ste. 2500
Detroit, MI 48226-5499
(313) 961-0200
eil@krwlaw.com

Daniel H. Minkus
Clark Hill, PLC
151 S. Old Woodward, Ste. 200
Birmingham, MI 48009
(248) 988-5849
dminkus@clarkhill.com

Mark W. Peters
Bodman PLC
201 W. Big Beaver Rd., Ste. 500
Troy, MI 48084
(248) 743-6043
mpeters@bodmanlaw.com

John T. Schuring
Dickinson Wright, PLLC
200 Ottawa Ave. NW, Ste. 1000
Grand Rapids, MI 49503
(616) 336-1023
jschuring@dickinsonwright.com

Sarah Williams
Bodman PLC
201 S Division St., Ste. 400
Ann Arbor, MI 48104
(734) 930-2485
swilliams@bodmanlaw.com

Publications
Brendan J. Cahill
Dykema
39577 Woodward Ave., Ste. 300
Bloomfield Hills, MI 48304
(248) 203-0721
bcahill@dykema.com

Liaisons

ICLE Liaison
Marguerite M. Donahue
Jaffe Raitt Heuer & Weiss, PC
27777 Franklin Rd., Ste. 2500
Southfield, MI 48034
(248) 727-1432
mdonahue@jaffelaw.com

Probate & Estate Planning Section Liaison
John R. Dresser
Dresser Law PLLC
67621 Crooked Creek Rd.
White Pigeon, MI 49099-8754
john.dresser57@gmail.com

Young Lawyers Section Liaison
James R. Waggoner
Clark Hill PLC
151 S. Old Woodward Ave., Ste. 200
Birmingham, MI 48009
jwaggoner@clarkhill.com

 By Alexis Lupo

Business Entity Formation Volumes

New business entity formation in Michigan is the highest it has been in the past two decades.[1] During the last fiscal year, from October 1, 2020 through September 30, 2021, the Corporations Division filed the formation and incorporation documents to form 158,229 new business entities.[2] An additional 6882 foreign entities were qualified to transact business in Michigan during that same period.[3] During the prior fiscal year spanning October 1, 2019 through September 30, 2020, 123,281 new business entities were formed and 5254 foreign entities qualified to transact business in Michigan.[4] This is a 28.5% increase between the last two fiscal years. Compared to before the coronavirus (COVID-19) pandemic, the increase in new domestic business entity formation and foreign qualification over the five fiscal years prior to the pandemic was an average of 7.4%. The peak, stand-out months were August 2020 and March 2021 with approximately 18,000 new entities formed or qualified each month.[5]

The percentage increase was most striking in foreign qualifications as the five-year average before the most recent fiscal year was merely 1.88%, and then the increase between the last two fiscal years jumped 31%. The same data for domestic, Michigan business entities was quite substantial with the five-year average before the most recent fiscal year being 10.6%, and then the increase between the last two fiscal years rose to 28.3%.

Unsurprisingly, the preferred type of Michigan business entity is a limited liability company. More than eighteen times as many limited liability companies were formed than profit corporations during the last fiscal year. Profit corporation formation has been experiencing a steady decline each year that averages out to -3.7% over the past five fiscal years.

The trend in Michigan is above the rest of the nation based on the data from the U.S. Census Bureau.[6] In fact, Michigan is among the states with the largest increase in business formations from 2019 to 2020.[7] There are only six other states that had the same or higher percentage increase—which are alphabetically: Alabama, Georgia, Illinois, Louisiana, Mississippi, and South Carolina.[8] The U.S. Census Bureau bases its data on employer identification number (EIN) applications received by the Internal Revenue Service (IRS Form SS-4) and the first instance of payroll tax liabilities for those corresponding applications.[9] The U.S. Census Bureau offers a series of data, graphs, and charts regarding business formation statistics that "can help businesses, policymakers, regional planners, and researchers assess the current state of early entrepreneurship at the national and state levels."[10]

Headlines are touting the uptick in business entity formation as a "start-up boom."[11] Economists are mixed on what this actually means. It could be that new businesses are replacing the businesses that closed and dissolved during the pandemic, or it could be a "rocket ship to a better economy."[12] University of Maryland economist John Haltiwanger thinks that the current boom in business formation is a positive net result. "'I have been struck over the last six months at how much of a sustained increase this surge in new business applications has been,' he says. 'Here's the thing: when we've seen sustained increases like this in the past, it has boded well for job creation, innovation, and productivity growth in the United States.'"[13] However, it is too soon to know whether entrepreneurship is trending upward.[14] The U.S. Census Bureau's data from the pandemic time period demonstrates initial start-up activity, but it will take several years before it is known whether these entities operated and created jobs.[15] Overall, if Michigan business lawyers are feeling like they are being spread thin as clients are seeking to form more entities than usual, the data certainly supports that feeling.

NOTES

1. New Business Entities, Michigan Department of Licensing and Regulatory Affairs, https://www.michigan.gov/lara/0,4601,7-154-89334_61343_35413-114905--,00.html.
2. *Id.*
3. *Id.*
4. *Id.*
5. New Corporation and Limited Liability Company Monthly Totals, Michigan Department of Licensing and Regulatory Affairs, https://www.michigan.gov/lara/0,4601,7-154-89334_61343_35413_60200_47880-114906--,00.html.
6. Business Formation Statistics, U.S. Census Bureau, https://www.census.gov/econ/bfs/index.html.
7. Annual Business Applications by State and County, Business Formation Statistics, U.S. Census Bureau, https://www.census.gov/econ/bfs/index.html.
8. *Id.*
9. Methodology, Business Formation Statistics, U.S. Census Bureau, https://www.census.gov/econ/bfs/methodology.html.
10. About the Data, Business Formation Statistics, U.S. Census Bureau, https://www.census.gov/econ/bfs/about_the_data.html.
11. Ben Casselman, "Start-Up Boom in the Pandemic Is Growing Stronger," The New York Times, Aug. 19, 2021, https://www.nytimes.com/2021/08/19/business/startup-business-creation-pandemic.html and Greg Rosalsky, "What America's Startup Boom Could Mean For The Economy," NPR, June 29, 2021, https://www.npr.org/sections/money/2021/06/29/1010229557/what-americas-startup-boom-could-mean-for-the-economy.
12. Greg Rosalsky, "What America's Startup Boom Could Mean For The Economy," NPR, June 29, 2021, https://www.npr.org/sections/money/2021/06/29/1010229557/what-americas-startup-boom-could-mean-for-the-economy.
13. *Id.*
14. Ben Casselman, "Start-Up Boom in the Pandemic Is Growing Stronger," The New York Times, Aug. 19, 2021, https://www.nytimes.com/2021/08/19/business/startup-business-creation-pandemic.html.
15. *Id.*

Alexis Lupo is the Corporations Division Director in the State of Michigan's Corporations, Securities & Commercial Licensing Bureau. She serves as Treasurer for the International Association of Commercial Administrators. Ms. Lupo is a member of the Business Law Section and an appointed member of the State Bar of Michigan's Standing Committee on Character and Fitness.

 By Eric M. Nemeth

Tax Legislative Uncertainty Continues as Tax Enforcement Presses Forward

For even a casual observer of the federal tax and legislative process, it has been difficult to not be drawn into the fray. If for no other reason, clients have "heard" that various "things" are going to happen and how do we plan. As lawyers, we know that it can be hard to get clients to properly plan when we know what the law actually is at the time; but when we don't know what the law is going to be, or if it is going to change at all, the task is well…functionally impossible.

Continued, the various proposals that could be part of new tax legislation are for various tax rate increases, a surtax and significant changes to the estate and gift tax laws that would potentially expose more larger estates to those tax regimes. At present, continued vigilance to the legislative front is the best counsel in this developing area of the law.

International Tax Enforcement and "Dodging?" Continue to Draw Scrutiny

In 2016, the so-called Panama Papers made international headlines after 11.5 million documents were leaked after the Panamanian law firm Mossack Fonseca had its records breached. The original whistleblower remains unknown. The documents were a virtual treasure trove of personal information and business dealings of over 200,000 entities and thousands of individuals worldwide. Heads of state, international businesspeople, athletes, and celebrities were all named. Not everyone was engaged in illegal activity, but a light was shone on the potential for international tax evasion and avoidance that mobilized a global push for tax enforcement. A particularly stern eye was cast upon tax havens. Many arrests and other actions followed and are ongoing.

In October 2021, the "Pandora Papers" were released—11.9 million documents exposing secret offshore accounts of the wealthy and powerful. A key point that is not widely discussed is that many of the tax, business, and wealth planning strategies may be entirely legal. Individuals and entities with a global presence made nearly seamless by ecommerce or digital commerce have been able to take advantage of often opaque and contradictory rules to keep assets from taxation and, in some cases, even basic reporting. Other times, various structures are used to keep the identity of the ultimate owner of an asset, such as an office building or lavish estate, secret.

President Biden has referenced the Pandora Papers. His administration highlighted their contents at a press conference in October following-up on his promise to further crackdown on tax havens. He might not have to look far. Specifically, the states of Nevada and South Dakota were cited by the head of the Financial Accountability and Corporate Transparency Coalition for their laws that promote, or at least condone, unknown entity ownership. One immediate fallout in the United States has been calls to accelerate the new anti-money laundering rules. The proposed rules are specifically intended to require various entities to provide information about their beneficial owners.

One approach to target global tax avoidance and evasion is to establish an international global minimum tax rate and rules that would track large multinational businesses. This past October, a deal was reached with over 135 jurisdictions to establish a 15 percent minimum tax starting in 2023. The rules are targeted at the largest multi-national companies and has a proposed "grace period." What is clear though, is that the largest developed economies have become unified in their desire to seek tax revenue for global players and challenge business structures and operations that seem little more than paper trails to divert profits from one jurisdiction to another almost solely because the receiving jurisdiction with little or no real operations offers a special tax deal.

Attorney-Client Privilege v. IRS Summons

As lawyers, we all know that the attorney-client privilege is one of the bedrocks of our profession. However, the extent and limitations of the privilege are often misunderstood; particularly, in tax practice where, for example, tax return preparation is not privileged even if performed by an attorney. Also, issues of waiver surface frequently. For instance, there is the recent U.S. Supreme Court decision to reject a request by the law firm Taylor Lohmeyer Law Firm, PLLC to hear their appeal of an 9-8 Fifth Circuit decision upholding an IRS summons seeking the identity of law firm clients that may have sought certain tax advice.

The use by the IRS of "John Doe" summonses has been the topic of many tax columns. An extremely powerful investigative enforcement tool the IRS can utilize when, for example, they know what they are looking for, but they don't know the specific taxpayer. Cryptocurrency has been a recent area in the use of a John Doe summons.

By leaving the Fifth Circuit ruling undisturbed, the IRS can proceed with summons enforcement even if the information is provided by the law firm. I would expect that the authority to issue a John Doe summons to law firms in the future will be tightly regulated by the IRS and will not be at the field level. Nevertheless, careful thought about the nature of privilege may be in order when addressing tax planning matters.

Clients utilizing "common" tax avoidance strategies from mass producers should not be surprised if the service provider is the investigative target. Finding the tax-centric service providers is no harder than searching the Internet in many cases. Where do you think the IRS' "Dirty Dozen" content arises?

IRS FAQs on Reasonable Cause

On October 15, 2021, the IRS announced that it is updating its process for certain FAQs concerning newly enacted legislation. If the FAQs are significant in connection to new legislation, they will be posted on IRS.gov in a separate Fact Sheet. Since the Fact Sheet will be dated, taxpayers will be able to cite to a specific version of the FAQ. If the taxpayer can later establish good faith reliance, the taxpayer will establish a good faith defense. For further details see the *General Overview of Taxpayer Reliance on Guidelines Published in the Internal Revenue Bulletin and FAQs*.[1]

Eric M. Nemeth of Varnum LLP in Novi, Michigan practices in the areas of civil and criminal tax controversies, litigating matters in the various federal courts and administratively. Before joining Varnum, he served as a senior trial attorney for the Office of Chief Counsel of the Internal Revenue Service and as a special assistant U.S. attorney for the U.S. Department of Justice, as well as a judge advocate general for the U.S. Army Reserve.

NOTES

1. https://www.irs.gov/newsroom/general-overview-of-taxpayer-reliance-on-guidance-published-in-the-internal-revenue-bulletin-and-faqs.

 By Michael S. Khoury and Scott Nathan

The New Meaning of Three Little Words: Van Buren v United States *and "Exceeds Authorized Access"*

The U.S. Computer Fraud and Abuse Act ("CFAA")[1] was originally designed to protect information on federal computers by criminalizing the act of gaining access to those computers without authority. It was expanded to prohibit accessing information on any computer when such access exceeded the user's authority. Thereafter companies and other organizations would use the CFAA to prevent employees from taking company information and discourage competitors from attempting to use confidential information improperly acquired, among other things. Much litigation and disagreement ensued about what it means to "exceed authorized access." In *Van Buren v United States*,[2] the U.S. Supreme Court settled this dispute though perhaps not as some might have expected.

The CFAA: A Brief History

In an unusually prescient step, Congress in 1984 passed the Comprehensive Crime Control Act, which included criminal penalties for improperly accessing information on federal computers. In 1986, Congress amended part of this statute by passing the CFAA. In its early incarnation, the CFAA prohibited accessing "federal interest" computers with an intent to defraud, accessing a computer without authorization and altering or damaging or destroying information, and trafficking in computer passwords. In 1994, Congress broadened the CFAA by giving private parties the right to sue for such things as taking property from a computer as part of a scheme to defraud, suing insiders who damage computers, and third parties that gain unauthorized access. Later amendments expanded the scope of protection from "federal interest" computers to "protected computers," essentially defined as any computer connected to the internet, whether those computers are within or outside of the United States.

Litigation and the CFAA

Many issues have been litigated in criminal and civil cases regarding the CFAA. Courts have ruled on the meaning of "intent to defraud," "protected computers," accessing computers "without authorization," "exceeding authorized access," and what constitutes "damage" for purposes of triggering the minimum dollar threshold for bringing a CFAA claim. In *EF Cultural Travel BV v Explorica, Inc and Zefer Corp*,[3] several executive officers of EF Cultural, a global leader in the student tours industry, left to start a competing company, Explorica. The former employees hired a technology company, Zefer Corp., to build its website and gather competitive information from the Internet. Using search criteria provided by Explorica, Zefer used an automated web search tool to find and "scrape" specific information from EF Cultural's website. EF Cultural sued its former executives and Explorica for, among other things, violating the former employees' noncompetition agreements with EF Cultural, and sued Explorica and Zefer for violating the CFAA by acquiring what EF Cultural argued was sensitive pricing and other information from EF Cultural's website. The U.S. Court of Appeals for the First Circuit ruled that the former executives were aware that accessing EF Cultural's pricing information for their own use violated their noncompetition agreements and could be the basis for a claim of "exceeding authorized access" under the CFAA. However, the CFAA claim against Zefer, which knew nothing of the noncompetition agreements and only accessed what was publicly available on the Internet, was less likely to succeed in part because EF Cultural did not provide any warnings, notices, or disclaimers on its website about the limits of authorized access to the information there.

The Sixth Circuit also weighed in on the topic in favor of the more restrictive approach in the case of *Royal Truck & Trailer Sales and Serv, Inc v Kraft*,[4] holding that a former employer could not bring CFAA claims against former employees because they had permission to access the information at the time.

Van Buren v United States and "Exceeds Authorized Access"

In the thirty years after the CFAA was signed into law, federal courts around the country issued opinions in sometimes stark contrast with one another about the definition of various terms in the statute and the application of the CFAA. In *Van Buren v United States*, Justice Amy Cohen Barrett settled at least one issue: the meaning of "exceeds authorized access."

Nathan Van Buren was a police sergeant in Georgia. He asked to borrow money from someone named Albo, whose local legal troubles were apparently well known. Albo reported this to the police and the FBI, alleging that the loan request was a shakedown. Authorities set up a sting operation in which Albo offered Van Buren $5000 in exchange for information in the police database. Van Buren, who had authority to access the database in his capacity as a police officer, searched for and delivered the requested information. Van Buren was arrested, charged, and convicted of, among other things, violating the "exceeds authorized access" provision of the CFAA.

In what some may characterize as a results-oriented opinion, the *Van Buren* Court held that because Van Buren was authorized to access the requested information on the law enforcement database, and the CFAA is silent about what someone does with information they are permitted to access, Van Buren's conviction for violating the CFAA must be overturned. The Court's opinion starts with the statutory definition of "exceeds authorized access," which is "to access a computer with authorization and to use such access to obtain … information in the computer that the accesser *is not entitled so to obtain*."[5] From this platform, the Court engages in a lengthy discussion of the word "so" and its placement in this section of the law, ultimately rejecting government claims that the law necessarily contemplated the uses to which such information would be put.

Conclusions

In reality, most of the impact of the *Van Buren* decision will be experienced by those whose activities are of interest to federal law enforcement. Nevertheless, there are some implications for the commercial world, too. For example, if someone in the IT department who has general access to the network decides that they want to create trouble for their employer, it is no longer a violation of subsection (a)(6) to take information to which they have been given access and use it for ulterior purposes. The employer can, of course, address such issues by making sure that each employee signs a nondisclosure agreement that prohibits the improper use of company information to which they are given access and, perhaps, to include a specific reference to the CFAA. In addition, placing public notices on websites and internal notices for those who access sensitive information that the use of such information is limited to specific purposes should help the next time someone uses their access for purposes they might know are not permitted but nonetheless need to be told.

An important lesson for businesses involves information governance. Businesses must understand the data and information that it collects and maintains, how that data and information is used, and, most importantly for the topic of this article, who in the business has access rights to this data and information. Limiting access is not only important for various compliance requirements, such as privacy, but also will help to limit the ability of those with some access to improperly use information of the business.

NOTES

1. 18 USC 1030.
2. ___ US ___, 141 S Ct 1648 (2021).
3. 274 F3d 577(1st Cir 2001).
4. 974 F3d 756 (6th Cir 2020).
5. 18 USC 1030(a)(6) (emphasis added).

Michael S. Khoury is a partner in the Detroit office of FisherBroyles, LLP, and specializes in business, technology transactions, privacy and data security and international law. He is a past Chair of the State Bar of Michigan Business and Information Technology Law Sections.

Scott Nathan is a partner at FisherBroyles LLP whose practice principally focuses in the areas of ESG (environment, social and governance), assisting new and mid-sized companies with business and financing needs, and data privacy matters. As a litigator, Scott was co-counsel for Zefer Corporation in EF Cultural Travel v Explorica, Inc and Zefer Corp, discussed in the article.

 By Douglas L. Toering and Fatima M. Bolyea

An Insight at the State Level

In this column, we focus on what is being done for the Michigan business courts at the state level. Specifically, we look at the involvement of the Michigan Supreme Court and the Michigan State Court Administrative Office as they relate to the business courts. We start with Justice Brian K. Zahra, who is the Michigan Supreme Court Justice liaison for the business courts. We then proceed to discuss the work the State Court Administrative Office ("SCAO") does with the business courts. For that, we turn to State Court Administrator Emeritus Milton L. Mack. We will also take a peek at the work of the new Michigan Judicial Council. Lastly, the statewide business court website has been redesigned.

Justice Brian Zahra

Michigan Supreme Court Justice Brian Zahra is the liaison between the Michigan Supreme Court and the business courts. He has held this role for approximately 2½ years. Essentially, most important matters that arise with the business courts ultimately make their way to Justice Zahra.

In this position, Justice Zahra works with SCAO to facilitate training programs for the business court judges. The business judges meet twice each year to discuss important trends in Michigan and nationwide. At these meetings, the business court judges discuss possible rules changes and best practices. One issue that is sometimes discussed is the need to ensure uniformity in the jurisdiction of business courts. In other words, what constitutes a business court case? Most or all the business judges are members of the American College of Business Court Judges, which provides them access to important educational materials. (Hon. Christopher P. Yates—a business court judge for Kent County and the Treasurer of the Business Law Section—is the Vice President, Educational Director, 2020-2021 of the organization.)

Selecting Business Judges—the Application Process and Desired Characteristics

The selection process for a business court judge typically begins with a current business court judge informing his or her SCAO regional administrator that he or she will be retiring from the position or will not be running for the position again. State Court Administrator Thomas P. Boyd then informs Justice Zahra that there will be a vacancy in a business court, and that SCAO will be accepting applications.

The application for the business court judge position is a formal document from the State Court Administrative Office. The application explains the purpose of the business court docket as facilitating more timely, effective, and predictable resolution of complex business cases. The application next provides a list of essential skills and competencies that every business court judge must possess:

1) **Judicial Temperament**: According to the American Bar Association, judicial temperament means that a judge exhibits "compassion, decisiveness, open-mindedness, sensitivity, courtesy, patience, freedom from bias and commitment to equal justice."
2) **Character and Ethics**: There should be no doubt about an applicant's personal or professional ethics. *** A candidate should have demonstrated a personal standard of ethical conduct that stands out among both the general citizenry and the applicant's fellow practitioners.
3) **Experience and Education**: The candidate has education and experience that will assist him or her in presiding over complex disputes on the business court docket.
4) **Suitability to Workload**: Business courts are intended to provide a case management structure that facilitates more timely, effective, and predictable resolution of complex business cases. Consequently, a candidate for the business court appointment should be able to balance his or her workload with administrative duties.
5) **Ability and Willingness to use Technology in the Resolution of Disputes**: A purpose of the business court is to "… allow business or commercial disputes to be resolved with the expertise, technology, and efficiency required by the information age economy." MCL 600.8033(3)(b).
6) **Ability to Communicate**: The business court should "Enhance the accuracy, consistency, and predictability of decisions in business and commercial cases.["] MCL 600.8033(3)(c). Therefore, the candidate should be able to communicate effectively both orally and in writing.

The application also asks why the candidate wishes to serve as a business court judge. The applicant's experience with complex business litigation, both as an attorney and as a jurist, is also considered. This includes any training or education relevant to business and commercial litigation.

The judge's trial experience is also important. As such, the application requests case names and docket numbers of the last three jury trials and last two bench trials over which the applicant presided that were taken to verdict and the attorneys that tried the cases. For the bench trials, the applicant must include any written findings of fact and conclusions of law. The application also requests information regarding docket management, experience with specialized dockets, and dispute resolution practices. Lastly, the applicant is asked to attach three copies of his or her most recent written opinions.

In reviewing an applicant, the Michigan Supreme Court considers factors in addition to those discussed above. This includes disposition on the bench, input from SCAO regional administrators (who have a good pulse on the court in question), input from attorneys and the state bar, and the quality of written opinions.

Once an individual decides to apply, private practice attorneys may voluntarily submit letters of recommendation in support of that judge. However, the application makes clear that applicants are not to solicit letters of recommendation for the position.

The application process is continually refined over the years, as SCAO and Justice Zahra receive input from the business court judges and business attorneys. Over the years, the procedure for appointment to the business court has become more refined and rigorous. By honing the application, potential appointees realize that the Court takes the business courts very seriously. Taking on a business court position is a commitment; the judge must be willing to work diligently, dedicate significant time, and have a grasp and understanding of business processes and procedures so as to best resolve business disputes. This ongoing improvement will continue to result in the selection of dedicated and higher-quality appointments.

Interim Reviews of Judges and Submitting Concerns to SCAO

Recently, the Michigan Supreme Court has decided to conduct interim reviews of the business court judges. In doing so, SCAO and the Court consider: feedback from attorneys and the bar; input from SCAO regional administrators; the judges' record on appeal; judicial temperament on the bench; whether judges are posting their opinions online; and the quality of such opinions.

As for this last factor, selected business court opinions posted online are reviewed for quality of analysis, reasoning, and whether such opinions were rightly or wrongly decided. This review allows the Court to consider the judges' performance regardless of whether the case/opinion ever reaches the Court on appeal.

The Court gives significant weight to feedback from the SCAO regional administrators, which is often based on comments received from members of the bar. If a member of the bar has a comment, compliment, complaint, or concern about the business courts or a particular judge, that individual may put their comment in writing and send it to their SCAO regional administrator. The author may also copy Justice Zahra. Justice Zahra may review the concerns with the SCAO regional administrator (and possibly State Court Administrator Thomas P. Boyd).[1]

Future of Zoom/Virtual Proceedings

Justice Zahra shared that, in general, the members of the Court believe that in-person proceedings are preferable when possible. However, the pandemic has demonstrated that virtual proceedings can be used with some success. This is particularly true in the Court of Appeals and the Michigan Supreme Court. In the trial courts, according to Justice Zahra, some litigants have not had the same respect for the court as they might have if they were physically present in the courtroom, with the judge on the bench and the bailiff calling the cases.

Justice Zahra stated that some form of virtual proceedings is here to stay. Certainly, virtual proceedings have helped make the court process more efficient. The question is: how often and in what circumstances should virtual proceedings be used?

Advice for Arguing in the Michigan Supreme Court

When appearing for oral argument in front of the Court, Justice Zahra recommends attorneys start their presentation by stating the three or four reasons why the Court should rule in their favor. The remainder of the attorney's argument should track with those listed points. After stating these points, he recommends that the attorney then waive the "free-fire zone" and be open to questions from the bench.

Attorneys should not take questions from the Court as criticism or attempts to embarrass them. Many times, a Justice asks a question to further develop a point, or to assist a colleague that is torn on an issue, or simply because the issue is confusing. The best oral argument is one that is conversational, not adversarial.

Assessment of Business Courts—Now and Future

The business courts are doing well, and—as with all good things in life—those involved are striving to consistently improve them. When the business courts were first created, the only guidance provided to SCAO, the Court, and the business judges was the business court statute itself. The business courts have come a long way since then, and are very good. With continued education for the judges, ongoing improvements to the application process, and sustained involvement from the bar in providing feedback and comments, Justice Zahra is confident that the business courts will continue on their path to excellence: "The business courts are already very good; the business court judges and the Michigan Supreme Court are together striving to make them *excellent*."

Judge Milton L. Mack

Judge Milton L. Mack served as SCAO Administrator from July 15, 2015 until March 23, 2020, when he became SCAO Administrator Emeritus. Prior to joining SCAO, Judge Mack served as a Wayne County Probate Court Judge for 25 years, with the last 18 years as Chief Judge of that court. Judge Mack turned over the reins of SCAO to current SCAO Administrator Judge Thomas P. Boyd on March 23, 2020. Judge Boyd began his term at the height of the pandemic when much of the state including the courts was closing.

One of Judge Mack's passions is his ongoing effort with the National Conference of Chief Justices and the

Conference of State Court Administrators to identify how the legal system fails individuals that suffer from mental health issues, and to determine ways to correct this. As part of this multi-year effort (which began in 2004 when he served on Michigan's Mental Health Commission), Judge Mack authored a paper for the Conference of State Court Administrators. This 2016-2017 policy paper was titled, "Decriminalization of Mental Illness: Fixing a Broken System."[2] As Judge Mack observed, "left untreated, mental health affects all aspects of life."

As Administrator Emeritus, his work on this issue continues to this day and has the strong support of Chief Justice Bridget M. McCormack. Judge Mack now serves in various capacities on the National Judicial Task Force to Examine State Courts' Response to Mental Illness. The Task Force "assists state courts in their efforts to more effectively respond to the needs of court-involved individuals with serious mental illness."[3]

During his tenure as SCAO Administrator, Judge Mack worked with regional court administrators to develop an application form for business court judges. This process has evolved over time and requires candidates to submit examples of their past opinions. Judge Mack was involved in reviewing applications for business court judges, looking for process improvements, improving the selection process for business court judges, and making sure that the Michigan Supreme Court has the information needed to make informed decisions about applicants for the business court. The Michigan Supreme Court understands how important this process is, and takes it very seriously.

Have the business courts met their objectives? In a word, "yes." Having a specialized and experienced group of judges to handle business disputes "has been very helpful."

Overall, according to Judge Mack, "business courts are here to stay; they're not going away." If business attorneys have concerns about the business court, they are encouraged to come forward and share those ideas or concerns.

Asked for advice to business lawyers, Judge Mack responded that business lawyers are "in a unique position to recommend process improvements" for the business courts. Lawyers may send those recommendations to SCAO. Business lawyers can also recommend what they believe are characteristics that business court judges should possess. Again, these should be sent to SCAO. Business lawyers are "consumers for the business courts, so their recommendations are important." As appropriate, SCAO will transmit these recommendations to the Michigan Supreme Court. The Supreme Court "really listens" and will "pay attention."

Zoom is also here to stay: It's "not going away."[4] Before Judge Mack transitioned to Administrator Emeritus, and a year before the start of the COVID-19 pandemic, SCAO arranged to purchase Polycom equipment and Zoom licenses for all Michigan judges. Who would have known at that time what the future would hold beginning in 2020 and how virtual court proceedings would be critical to the functioning of the courts in Michigan during the pandemic?

Indeed, the possibilities for using technology in the administration of justice are "endless." To that point, Judge Mack mentioned that a least one state is experimenting with jury selection done remotely—prospective jurors don't have to leave their homes during *voir dire*. And England has moved heavily (almost completely) to virtual proceedings.

Serving as a visiting probate court judge in Macomb County in 2020, Judge Mack asked how the parties liked probate court proceedings done virtually. The response? "All smiles." He noted that the parties could either drive to court and wait, or spend 15 minutes on Zoom. Judge Mack commented that attendance in court proceedings increased when parties could participate by Zoom. Judge Mack emphasized that technology such as Zoom is an important tool in furthering access to justice in Michigan.

The Judicial Council

Speaking of improvements in the judicial system, Judge Mack serves as the Project Director for the Michigan Judicial Council's efforts to develop a strategic plan for the judiciary. He is supported by Ryan Gamby, Management Analyst for the Michigan Supreme Court and SCAO. Judge Boyd also provides leadership and guidance and serves as the liaison with Chief Justice McCormack and other Justices. This effort is funded through a grant from the State Justice Institute in Reston, Virginia.[5] The Chief Justice chairs the Michigan Judicial Council.

The stated purpose of the Judicial Council is as follows:

> The state of Michigan has 83 counties and nearly 10 million residents. The Michigan Constitution vests Michigan's judicial power in "One Court of Justice;" however, we operate as a non-unified trial court system with varying and complicated funding structures, a multitude of case management systems, and many local court rules across the state. Resources available to support the delivery of justice in Michigan varies greatly from jurisdiction to jurisdiction. While many judicial reform initiatives are under way, ranging from access to justice to implementing technology, our branch of government needs a *statewide strategic planning effort* that will establish *statewide goals and strategies* for making *system-wide improvements*.[6]

To that end, "[d]eveloping and implementing a statewide judicial strategic plan is a high priority for the Michigan Supreme Court and State Court Administrative Office. The process will help create a unified vision for the future, build agreement around priorities, develop innovative and comprehensive strategies for making system-wide improvements, and coordinate many innovations resulting from recent reforms."[7] The goal is to present a proposed strategic plan to the Michigan Supreme Court by year-end or early 2022.

Part of the work of the Judicial Council will be to evaluate what judges believe is important and what external users (lawyers, litigants, the public) think is important.

Although the Judicial Council is not focused on the business courts as such, its work will likely affect the business courts. For more information about the Michigan Judicial Council including its diverse membership and Administrative Orders, go to: https://www.courts.michigan.gov/JudicialCouncil/. Stay tuned!

New Website

One final note. Check out the redesigned business court website. This continues to include the business court opinions, local administrative orders, categories for business court opinions, and more. https://www.courts.michigan.gov/administration/trial-court/trial-court-operations/business-court/.

NOTES

1. The SCAO regional administrators are as follows: Region 1 (Detroit): Paul Paruk; Region 2 (Lansing): Julia Norton; Region 3 (Mt. Pleasant): Bruce Kilmer; Region 4 (Gaylord): Jerry Kole; Region 5 (Lansing): Jill Booth; and Region 6 (Detroit): Jennifer Phillips.

2. Steve Canterbury, West Virginia State Court Administrator (ret.), and Judge Laura R. Mack contributed to the paper. https://cosca.ncsc.org/__data/assets/pdf_file/0018/23643/2016-2017-decriminalization-of-mental-illness-fixing-a-broken-system.pdf.

3. https://www.ncsc.org/behavioralhealth.

4. This column is not a commentary on, or an endorsement of, any particular virtual platform.

5. https://www.courts.michigan.gov/49868b/siteassets/committees,-boards-special-initiatves/michigan-judicial-council/submitted-sji-grant-application.pdf.

6. Emphasis added. https://www.courts.michigan.gov/JudicialCouncil/.

7. https://www.courts.michigan.gov/JudicialCouncil/.

Douglas L. Toering of Mantese Honigman, PC, is a past chair of the SBM's Business Law Section, for which he chairs the Commercial Litigation Committee and Business Courts Committee. His practice includes commercial litigation including shareholder litigation and insurance litigation, business transactional matters, healthcare law, and business mediation.

Fatima M. Bolyea is a partner at Mantese Honigman, PC. Her practice includes complex commercial litigation, shareholder and partnership disputes, business transactions, and healthcare law.

Introduction to the Theme Issue on the Uniform Commercial Code

By Michael S. Khoury

The theme for this issue of the *Michigan Business Law Journal* is the Uniform Commercial Code. Regular readers will know that each issue tries to focus on a single topic that is usually coordinated by one of the committees of the Business Law Section. As with all committees in our section, every member is invited and encouraged to participate. As the current chair of the UCC Committee, I want to extend that personal invitation to you.

It probably says a lot about the state of the UCC in Michigan that there is relatively little new legislation. Portions of the UCC have undergone substantial revision such as the adoptions across the country of the revised version of Article 9 (Secured Transactions) more than 20 years ago. The more recent changes are more technical. We hope that the topics covered in this issue will interest you.

Several articles address the impact of more current developments on the UCC and commercial law in general, especially the strategies for dealing with the pandemic's effect on supply chain and the very recent focus by governments and businesses on the principles and initiatives around environmental, social and governance issues in business ("ESG"). There is an interesting article involving website terms and contract formation, and a fascinating review of the work of the UCC Permanent Editorial Board regarding Article 9. We hope that these articles provide you with interesting and thought-provoking reading.

Michael S. Khoury is a partner in the Detroit office of FisherBroyles, LLP, and specializes in business, technology transactions, privacy and data security and international law. He is a past Chair of the State Bar of Michigan Business and Information Technology Law Sections.

Constant Commentary: Things Are Brewing at the PEB

By Darrell W. Pierce

The Uniform Commercial Code ("UCC") was created, and is sponsored, by the Uniform Law Commission and the American Law Institute. The sponsors created the UCC and, for more than fifty years, have kept it updated through their drafting committee process. The process involves significant effort. Drafting committees typically meet multiple times over a period of years, and they intentionally seek input from legal experts, nonlegal experts, representatives of businesses that "use" the UCC, and other interested parties. Multiple drafts are circulated for comment, and once a final draft is approved by a drafting committee, it needs to be approved by the UCC's sponsors (this usually takes a year or two) and then enacted into law in each UCC jurisdiction. So, the UCC as a statute evolves, but the process takes a while.

The sponsors also created the Permanent Editorial Board for the Uniform Commercial Code (the "PEB") to monitor and address UCC developments on an ongoing basis. Since 1987, the PEB has issued "Commentaries" to resolve ambiguities in the UCC (including questions of the scope of the UCC), to state a "preferred resolution" of a UCC issue (e.g., when bad caselaw arises), to apply the UCC to new or changed circumstances, to clarify the interaction of the UCC with other law (including principles of equity), or to otherwise improve the operation of the UCC.[1] As of August, 2021, the PEB has issued 23 Commentaries, with two issued in the last twelve months. However, the PEB also has seven Commentaries in draft form out for comments. If those are also issued, it seems notable that nine of the resulting 30 Commentaries will have been issued in a relatively short period of time.

Perhaps the pandemic's disruption freed up time for PEB members to discuss issues and draft Commentaries, and I know there is lot of talent and energy on the PEB. But Commentaries don't get drafted in the absence of something serious to address. This article will review the recent and proposed Commentaries, as a means of highlighting the issues that caused the PEB to act.

PEB Commentary 22, *Status of a Disposition Under Section 9-610 of the Uniform Commercial Code if the Transferee Does Not Act in Good Faith*, was issued in final form on August 24, 2020. It addresses the important issue of what happens when a foreclosure sale buyer does not act in good faith, and it was issued in response to a case that, if not wrongly decided under its facts, set a bad precedent in an overbroad articulation of the law. When a debtor defaults, a secured party has the right under the UCC, among its other rights, to repossess and sell collateral, after notice and in a commercially reasonable manner, in a public or private sale.[2] In addition to notice and commercial reasonableness requirements, the secured party must act in good faith, which requires not only honesty in fact, but "the observance of reasonable commercial standards of fair dealing."[3] These requirements afford significant protections for debtors and other parties with interests in the collateral being foreclosed, and the foreclosing secured party is liable for failure to meet them, even after the collateral has been sold.

In addition, to facilitate foreclosure sales and support collateral values, Article 9 affords significant protection for foreclosure sale buyers. As long as a foreclosure sale buyer gives value and acts in good faith, the foreclosure sale transfers to the buyer as a matter of law all of the debtor's rights in the collateral, and it discharges the security interest being foreclosed as well as junior security interests and liens, even if the foreclosing secured party fails to meet Article 9 requirements and remains liable for damages.[4]

On the other hand, a foreclosure sale buyer who does not act in good faith takes subject to the debtor's rights, the security interest being foreclosed, and other security interests and liens.[5] The foreclosure sale is, in effect, subject to being "unwound." As the Commentary explains, the debtor's rights include its right under Article 9 to redeem collateral prior to its sale.[6] It may well be the case that the debtor is unable to redeem because it lacks the means to perform the relevant secured obligations, but the right is obviously important to a debtor who is able to redeem after a sale to a buyer who did not act in good faith—perhaps in collusion with the foreclosing secured party.

The Commentary is the result of an arguable ambiguity in the UCC between the rule under UCC Section 9-617 regarding rights of non-good-faith foreclosure sale buyers, and language in UCC Section 9-623 expressing the customary rule that a foreclosure sale cuts off a debtor's right of redemption. An argument might be made that, because a foreclosure sale cuts off redemption rights, the debtor has no meaningful rights to exercise under UCC Section 9-617; in other words, unless there is a third party who can enforce rights in the collateral, all foreclosure sales would be "final" notwithstanding a purchaser's bad faith. This would appear to conflict with the language of UCC Section 9-617(c) and the intended protection for debtors' rights of redemption.

Unfortunately, a court accepted that argument in *Atlas MF Mezzanine Borrower, LLC v Macquarie Texas Loan Holder, LLC*, 174 AD3d 150 (2019). The court refused to permit the debtor to set aside the foreclosure sale and limited the debtor to seeking damages, based on a policy that foreclosure sales should be final. The PEB disagreed, stating "[a] bad faith transferee may not rely on the "takes free" rule. Any policy based on commercial certainty is subordinate to the policy of not rewarding those who do not act in good faith." To help prevent *Atlas* from being followed, the PEB also approved an amendment to Official Comment 4 to UCC Section 9-617, clarifying how the UCC should be interpreted and citing the Commentary.

PEB Commentary 23, *Protected Series Under the Uniform Protected Series Act (2017)*, was issued February 24, 2021. Unlike PEB Commentary 22, which was issued to correct an arguable ambiguity in the UCC and to state a "preferred resolution" of an issue, this Commentary addresses the application of the UCC to a new development, series limited liability companies ("series LLCs"), which were not envisioned when the current UCC was drafted.[7] A full discussion of the origins, nature and legal status of series LLCs is beyond the scope of this article, a series LLC is a limited liability company that has "series" within it. Whether or not a series is a "person," it is not a subsidiary. Yet, under statutes authorizing series LLCs, a "protected" series is allowed to have its own assets and incur its own obligations without having rights in the assets or liability for the obligations of other protected series, even though all of the series remain part of the series LLC.

As series conduct business for their own account and otherwise need to be identified, they have names, and this begs the question of what name is the proper debtor name to use on an Article 9 financing statement. Under Article 9, debtor names on financing statements need to be precise and accurate or the financing statement is not legally effective to perfect a security interest.[8] If a lender seeks collateral from a protected series, should it use the name of the relevant series, the name of the series LLC, or both? The Commentary concludes that a protected series is a "person" as defined in Article 1 of the UCC ("person" includes "any other legal or commercial entity"[9]), a protected series that grants a security interest is the "debtor" under Article 9 of the UCC ("a debtor is a person…"[10]), a protected series that sells accounts, chattel paper, payment intangibles or promissory notes[11] is also a "debtor" under Article 9, as is a protected series that is the consignee in an Article 9 consignment, and a protected series is a "registered organization" for purposes of determining where, and the proper debtor name under which, to file a financing statement.[12]

The Commentary makes it clear that a secured party should treat a protected series as a debtor separate from its series LLC if it wants assets allocated to the protected series as collateral. Accordingly, such a secured party should file a financing statement under the name of the protected series in the state where the series LLC is organized. The Commentary concludes with amendments to the Official Comments to UCC Section 1-201 (a protected series is a person), UCC Section 9-102 (a protected series can be a debtor under Article 9), and UCC Section 9-307 (a protected series is a registered organization).

But treating a protected series as a debtor and filing under only its name may not be adequate protection for a secured party depending on applicable circumstances, including the secured party's appetite for risk. The secured party will probably want to have some protection against a reallocation of assets and liabilities among the protected series within the series LLC. The secured party may want to add the series LLC, or other protected series within the series LLC, as debtors or guarantors, or it may want security interests

Drafting committees typically meet multiple times over a period of years, and they intentionally seek input from legal experts, nonlegal experts, representatives of businesses that "use" the UCC, and other interested parties.

In addition to the recent Commentaries, the PEB has issued seven draft Commentaries for public comment in 2021.

from them to secure nonmonetary obligations such as reporting covenants and negative covenants regarding debt, other liens and reallocations. In any event, given the vagaries surrounding series LLCs, it is not uncommon for secured parties to file financing statements under the name of each protected series that is a debtor and under the name of the series LLC itself.

In addition to the recent Commentaries, the PEB has issued seven draft Commentaries for public comment in 2021. The first four were issued March 4.

The first, which states a "preferred outcome" in response to a Sixth Circuit decision, addresses UCC Section 1-305. Many practitioners are familiar with the rule found in subsection (a)—that UCC remedies should be "liberally administered" in favor of aggrieved parties. Subsection (b) adds that "[a]ny right or obligation declared by the Uniform Commercial Code is enforceable by action unless the provision declaring it specifies and limited effect." In most cases, one need not rely on UCC Section 1-305(b) as other provisions of the UCC, notably in Articles 2 and 9, provide express and adequate remedies. But Article 8 is an exception.

Among other things, Article 8 governs the relationship between a "securities intermediary" (e.g., a broker) and its customer, and it establishes important rights for customers with respect to investments in "securities entitlements" made by the customer. In essence, the intermediary must follow the customer's instructions to buy, sell, distribute and transfer. In particular, the customer has the right to have a securities entitlement credited to the customer's account liquidated and converted into a certificated security to be delivered to the customer to hold. The customer has this right under relevant securities laws as well as under the UCC. While there is no private right of action under federal law (i.e., SEC Rule 15c3-3), the customer should have a cause of action pursuant to UCC Section 1-305(b), even if the relevant provisions of Article 8 do not themselves expressly provide for one.

In *Harris v TD Ameritrade, Inc*, 805 F3d 664 (6th Cir 2015), under facts that invoked the customer's right to convert and hold in certificated form,[13] the Sixth Circuit found that no cause of action existed under the UCC for a violation of UCC Section 8-508. The court reasoned that no cause of action was expressly stated in UCC Section 9-508, and there was no authority under applicable state law to imply one. Of course, as observed by the PEB, the court failed to account for UCC Section 1-305(b) and, in light of UCC Section 1-305(a)'s admonishment to "liberally administer" the UCC, a proper application of the UCC would have been to allow a cause of action to proceed. The draft ends with proposed amendments to the Official Comments to clarify the interpretation of UCC Section 1-305(b) and to call attention to that section in Article 8.

The second March 4 draft Commentary addresses how to apply UCC choice of law rules to the question of how certain transactions might be characterized. Most commercial transactions are what they say they are, both in form and substance, and their nature is not at all controversial. But there are some notable exceptions, such as whether a transaction is a "true" sale (or a "true" lease), or merely creates a security interest. A lessor with merely a security interest will have to abide by Article 9 foreclosure rules if there is a default under the lease, where a "true" lessor retains ownership of the leased assets with typical lessors' remedies. A buyer who holds merely a security interest to secure a debt will similarly have to follow Article 9 rules in the event of a default and, unlike a true sale, the seller will retain rights in its collateral. A seller in a true sale does not retain an interest in the sold assets, even if they are accounts, chattel paper, payment intangibles or promissory notes, as long as the sale is perfected as required by Article 9.[14] A recharacterization of a transaction can be significant to a party that expected a different result.

But characterization not only affects the rights and remedies of the parties to a transaction, it also is important to others who are not party to the transaction, including competing creditors, potential buyers, and others who would normally expect to be able to identify the proper jurisdiction in which to perfect by filing, and search for, UCC security interests.

The choice of law issue addressed by the draft Commentary arises when a transaction that would be characterized one way under the parties' chosen law would be characterized in a different way under the relevant Article 9 jurisdiction, and it arises because the UCC has different choice of law rules; one found in Article 1 and those set forth in other provisions of the UCC, including Part 3 of Article 9. UCC Section 1-301(a) states the familiar general rule that the parties to a transaction are free to choose the law governing the transaction, as long as the chosen law is of a jurisdiction that has a reasonable relationship to the transaction. That rule is subject to exceptions, including the choice of law rules found in Part 3 of Article 9.[15]

Part 3 establishes nonwaivable choice of law rules for perfection, effect of perfection or non-perfection, and priority for security interests. Article 9 also provides that, subject to certain exceptions, it applies to every transaction within its scope, which of course includes any transaction that creates a security interest.[16] In transactions subject to Article 9, buyers and lessors will want to perfect their interests by filing UCC financing statements, and third parties will want to know where to search for effective UCC financing statements. Everyone needs to know where to file and search, so transaction parties cannot alter these uniformly enacted choice of law rules.

The draft Commentary clarifies the application of the potentially conflicting choice of law rules, explaining when the Article 9 rules on creation, perfection, effect of perfection or nonperfection, and priority of security interests apply instead of the parties' chosen law. Article 9 does not directly address this issue in the statute. It never has, even though it has always had mandatory choice of law rules for perfection, effect of perfection and priority. The drafters of the 2001 version of Article 9 did not see a need to change this because prior caselaw, left untouched by the 2001 version, had successfully navigated the application of the seemingly inconsistent rules.

The pre-2001 cases[17] held that while the parties' chosen law would be applied to determine their relative rights, applicable Article 9 would be applied to determine if a security interest existed and where it needed to be perfected to have priority. In two of the cases, under the parties' chosen law, the leases were properly characterized as "true" leases and would be enforced as such. But insofar as perfection and priority were at issue, applicable Article 9 law would apply. In both cases, the lessors failed to protect themselves by filing a precautionary financing statement. As a result, one was treated as unperfected with the resulting loss of priority, and the other, while saved by a finding that the lease was indeed not subject to Article 9, had to go to the expense of litigation that would have been avoided by a precautionary filing. A third case found that an attempt to retain title, which would have been effective under German law, would be treated as the mere retention of a security interest under applicable Article 9, which was left unperfected.

Parties to transactions that might be Article 9 transactions should always consider the law of the potentially relevant Article 9 jurisdictions, even if under the law chosen by the parties, the transactions would not be subject to Article 9. While the general rule of freedom to choose applicable law will be applied as between the parties, it will not apply to the extent that under applicable Article 9 would require perfection in order to maintain rights as against third parties. Characterization of a transaction is generally determined under the parties' chosen law, but for determining Article 9 applicability, the law of the relevant Article 9 jurisdiction where one would perfect (most importantly the one where one would file and search for financing statements) is applied.

The third of the March 4 draft Commentaries clarifies the application of UCC rules that appear to be at odds with each other. It discusses the relative priorities of a secured party and a buyer of rights to payment where the secured party files an authorized financing statement in anticipation of lending to a debtor, the buyer buys the right to payment from the debtor for value and promptly files to perfect its interest, and later the secured party closes, getting a security agreement granting a security interest in the right to payment from the debtor and lends. Who has priority in the right to payment?

As discussed in the draft, the buyer will argue that by the time the security interest would have attached, when the security agreement was signed and then only if the debtor had rights in the collateral, the debtor had sold the right to payment and no longer had any rights in it. Accordingly, the buyer should take free and clear of a security interest that never attached. The secured party, on the other hand, will point out that the primary Article 9 rule is "first to file or perfect,"[18] which was designed to enable lenders to file, search, and then lend only when they are assured of priority. The secured party was first-to-file, and so it should have priority even though perfection did not occur until attachment.

Article 9 applies not only to consensual security interests to secure debts, but also to sales of certain rights to payment.[19] As a

> The choice of law issue addressed by the draft Commentary arises when a transaction that would be characterized one way under the parties' chosen law would be characterized in a different way under the relevant Article 9 jurisdiction[.]

The PEB also observed that Article 9 was intended to address the "blurred distinction" between sales of and consensual security interests in rights to payment.

result, both transactions types of transactions create security interests[20] that need to be perfected in order to be effective against third parties. There is no doubt that the secured party would prevail if it closed before the buyer consummated its sale and filed its financing statement to perfect the sale. Even if the sale were a true sale, the buyer would take subject to the secured party's already attached and perfected security interest.[21]

But in the scenario discussed in the draft Commentary, the buyer's security interest has attached and been perfected before the secured party's security interest attaches and is effective (even though perfection occurs immediately upon attachment because the secured party has filed its financing statement). If a true sale, the debtor no longer has any legal or equitable interest in the right to payment at the time the secured party's security interest would have attached.[22] This would appear to create a conflict between UCC Section 9-203(b)(2), which requires the debtor to have rights in collateral (or the power to transfer it[23]) for a security interest to attach, and the "first-to-file-or-perfect" priority rule found in UCC Section 9-322.

As the PEB observes in the draft, the general principle that one cannot sell what one does not own is not always followed. Indeed, Article 9 provides that a newly perfected security interest has priority over a previously existing unperfected security interest, even if the perfected secured party has knowledge of the unperfected security interest at the time it perfects. This is to protect Article 9's filing system, to avoid litigation over knowledge, and to allow lenders to file, search and confirm priority under the first-to-file rule prior to lending. Another example noted by the PEB is UCC Section 9-330(d), which provides that a buyer of a promissory note whose interest is automatically perfected upon attachment under UCC Section 9-309(4) loses priority to a subsequent pledgee of the note who perfects by taking possession without knowledge of the buyer's interest.

The PEB also observed that Article 9 was intended to address the "blurred distinction" between sales of and consensual security interests in rights to payment. One objective was to cause buyers to perfect their interests, which affords notice to others, rather than have buyers argue that their unperfected interests prevailed. This avoids litigation over the characterization issue, which would otherwise be determinative in many cases, by bringing both buyers and lenders within Article 9's priority system where outcomes are much easier to determine. Bringing sales of rights to payment into Article 9 also allows the first-to-file priority rule to work (as applicable[24]) as intended for lenders.

The PEB proposes to amend the Official Comments to address this priority question and its conclusion that, based on Article 9's overall scheme, the debtor retained the power to sell, and the first-to-file secured party prevails over the buyer, even though the buyer was first to attach and perfect, and even though by the time the secured party's security interest attached and became perfected, the debtor no longer owned the right to payment.

The final draft Commentary issued on March 4 also addresses a priority question. Does the priority of a buyer of a promissory note or payment intangible, who is automatically perfected upon attachment,[25] but who had properly filed an effective financing statement covering promissory notes and payment intangibles before attachment, get the benefit of the "first-to-file" priority rule?

In its discussion, the PEB hypothesized that there is a lender to the seller/debtor ("SP2") who gets and perfects by filing a security interest in the promissory note or payment intangible after the buyer filed its financing statement but before the buyer's security interest attaches.

The PEB notes that Article 9 has other instances where perfection might be accomplished by filing as well as some other means (e.g., perfection by possession), nothing in Article 9 prevents filing when perfection is already accomplished by some other means, and it would be "anomalous" to not give effect to the filing given the Article 9 filing system. SP2 has notice of the buyer and its potential priority. Like any other searcher, SP2 needs to make further inquiry to determine the extent of buyer's interest ("true" buyer or not; what obligations are secured, if any). SP2 should know that if buyer is really a lender, it would clearly have priority, and the PEB observes if the same result is not achieved if buyer is a "true" buyer, parties would need to litigate the true sale issue to determine priority. As discussed above, Article 9 was intended to eliminate the need to such litigation to the extent possible. Accordingly, the PEB proposes to conclude that the buyer prevails under the first-to-file rule, stating that a contrary result would "needlessly disregard the good sense and practical functioning of Article 9's filing system." Official Comments would be added to the UCC's Official Text to reflect the PEB's conclusion.

On June 16, 2021, the PEB issued a draft Commentary addressing the application of Article 9 provisions that override certain restrictions on transfer, particularly those that might prevent attachment of a security interest securing an obligation, where the collateral is an ownership interest in an unincorporated business organization like a limited liability company or a partnership.

The 2001 version of Article 9 added provisions[26] to address the relative rights of secured parties and certain third parties. The idea behind the provisions was, notwithstanding the fact that transfer restrictions imposed by contract or otherwise might be otherwise enforceable, they should not prevent the attachment of a security interest. This should be the case even if the transfer restrictions would inhibit or prevent a foreclosure sale. After all, in a bankruptcy and under some other insolvency laws, the transfer restrictions could ultimately be ignored, and the relevant asset sold to satisfy creditors. In such a scenario, why shouldn't a perfected secured party have priority? The provisions attempted to strike the appropriate balance between facilitating security interests and protecting beneficiaries of transfer restrictions.

Unfortunately, issues arose with respect to ownership interests in unincorporated business organizations because of tensions with the "pick your partner" rule where, under relevant law and organic documents, partners and limited liability company members cannot be forced to accept another person as a partner or member unless they agree or the organic documents otherwise provide. In some states, notably Delaware, proponents of the pick your partner rule were successful in sponsoring nonuniform amendments to the UCC that made the Article 9 overrides inapplicable. As a result, the Official Text of Article 9 was amended in 2018 to provide uniform language to delete the overrides that apply to ownership interests in unincorporated organizations. If a State has enacted those amendments,[27] the draft Commentary would not apply at all.

The PEB's discussion of the relevant issues is thorough and need not be fully summarized here, but a few points should be noted. One is that any conflict can be completely avoided if the relevant issuer of the ownership interests opts in to UCC Article 8 and converts its ownership interests into certificated or uncertificated securities. This will have an impact but does not prevent continued implementation of restrictions that have the same practical effect as the pick your partner rule.

The PEB observes that, in any event, Article 9 and its transfer restriction overrides never apply to the outright sale or gift of a partnership or membership interest, or to most transfers by operation of law. Outright sales of general intangibles are governed by other law. Moreover, the overrides are complex and nuanced in an attempt to balance competing rights and interests.

The June 16 draft Commentary expresses the PEB's view that the Article 9 transfer restriction overrides are pretty good, well-balanced and do not need to be removed from Article 9 to protect the pick your partner rule. The author agrees. It has always been important to review ownership interest transfer restrictions when taking ownership interests in unincorporated organizations as collateral. Even if transfer restriction overrides apply, one likes to prepare for, and facilitate in advance to the extent possible, a possible foreclosure sale. But from the secured party perspective, it's nice to have the overrides as a backstop.

Also on June 16, the PEB issued a draft Commentary to address a case[28] where the Sixth Circuit may have achieved a correct result, but it did not properly apply Article 9's rules regarding proceeds of collateral.

Article 9 protects secured parties by causing security interests automatically to attach to identifiable proceeds of their collateral, which are automatically perfected for 20 days, and which are afforded the benefits of continuous perfection (relation back) priority as applicable if perfected by other means within the 20-day period.[29] Article 9 defines "proceeds" by reference to their origin: they include whatever is received on a sale, lease or license of collateral, distributions on collateral, and other items, like warranty claims, that arise in respect of collateral. It does not define proceeds by reference to any of the collateral "types"—like "accounts"—identified and defined in the UCC[30] that are commonly used to describe collateral in security agreements and financing statements, because proceeds could be anything.

The PEB observes that, in any event, Article 9 and its transfer restriction overrides never apply to the outright sale or gift of a partnership or membership interest, or to most transfers by operation of law.

The case involved a debtor that granted a security interest to SP1 in its accounts, and in its equipment (trucks and trailers) and proceeds, but SP1 failed to indicate accounts were collateral on its financing statement, so only perfected in the equipment and proceeds. Later SP2 takes and perfects a security interest in the debtor's accounts. Subsequently, SP1 and SP2 dispute priority in accounts. The Court sides with SP2, but in doing so, it misconstrues the relationship between proceeds and accounts, finding they are mutually exclusive terms. Although the accounts may well have not included equipment proceeds, the PEB points out that the accounts (as a collateral type) could have included some that arose out of a transaction (like a lease of equipment) or other situation that caused them to be proceeds for SP1 as well. If so, for accounts that are proceeds of SP1 equipment collateral, SP1 would have priority.

The PEB does not address whether or not the accounts in question were proceeds of the equipment. But the draft Commentary sets forth Article 9's protections for rights in proceeds (need not be stated on financing statement, automatic attachment, automatic temporary perfection, etc.), suggesting that the court should have undertaken to identify if any of the accounts were SP1 protected proceeds rather than erroneously concluding they could not be proceeds as a matter of statutory construction. The PEB proposes an addition to the Official Comments to call attention to the issue.

Finally, the latest draft Commentary was issued on August 5 to address the emerging issues created by "intangible money." The advent of blockchain technology and cryptocurrencies has created questions regarding the application of the UCC. The UCC defines "money" as "a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries."[31]

The PEB suggests that the drafters of the definition did not contemplate that money would be intangible except in specific limited situations addressed by the second sentence. But the definition does not require money to be tangible, and recent governmental actions to authorize, at least to a limited extent, the use of cryptocurrencies calls into question whether cryptocurrencies might now be treated as "money" under the UCC.[32]

The PEB does not address all the relevant issues (it takes no position on the effect of recent governmental actions, for example), but focuses instead on the potential application of certain provisions of Article 9 to intangible money. The UCC Sections are 9-312(b)(3), 9-313(a), 9-301(2), and 9-3013c)(C). The first two sections require a security interest in money to be perfected by possession, and one cannot possess an intangible. The second two sections specify choice of law rules that are based on money's location, and the location of intangible money is problematic.

The PEB, seeking here to apply the UCC to the new and changed circumstances of intangible money, concludes that the cited UCC Sections should apply only to tangible money, and the perfection, priority and choice of law rules applicable to intangible money should be the same as those applicable to general intangibles. One would then perfect a security interest in intangible money by filing a financing statement in the debtor's location state.

A secured party considering intangible money as collateral should carefully consider the risks posed by the current legal uncertainty. They might consider acting as the custodian for the debtor where they would have the power to sell collateral if need be, or they might consider causing the debtor to hold its intangible money as a "financial asset" in a securities account, in which case it becomes amenable to perfection by filing or by control.[33] The choice of law rules will be easier to apply to either of these options.

The sponsors of the UCC have a drafting committee working to address emerging technology issues, so we await further developments regarding intangible money.

It will also be interesting to see if the draft Commentaries will change in response to comments. Some may not be adopted—the PEB reserves the right to withdraw a Commentary at any time. But they highlight issues important enough to catch the PEB's attention. The discussions are informative and help clarify, if not resolve, some difficult analyses. Even in draft form, PEB Commentaries help practitioners and UCC "users" make better choices in structuring and documenting UCC transactions. We will all, as they say, "stay tuned"… .

NOTES

1. *See*, www.uniformlaws.org and www.ali.org.

2. *See*, Part 6 of Article 9 of the UCC. The PEB refers to the "Current UCC" in its Commentaries, which is the most recent promulgated official text. This article does as well, noting just this once that Michigan has its non-uniform system for statutory subsections and clauses. Michigan also has some non-uniform provisions in its version of the UCC, but none are relevant to the issues addressed in the recent Commentaries.

3. UCC Sections 1-304 and 1-201(b)(20).

4. UCC Section 9-617(b).

5. UCC Section 9-617(c).

6. UCC Section 9-623.

7. Note that the ULC also tried to bring some uniformity to series LLC law by promulgating the Uniform Protected Series Act.

8. *See*, UCC Sections 9-503 and 9-506.

9. UCC Section 1-201(b)(27). The Commentary's discussion of this issue is detailed and thorough for those interested in the history and conception of personhood.

10. UCC Section 9-102(a)(28).

11. Such sales also create security interests by definition. UCC Section 1-201(b)(35).

12. A "registered organization" is an organization that is created by the filing of a "public organic record" with a State. UCC Sections 9-102(a)(71) and 9-102(a)(68). Corporations, limited liability companies, and limited partnerships are also registered organizations.

13. The PEB set forth a simple illustration that allowed for an easy application of the UCC and noted the case "involved facts paralleling the illustration at a high level of generality… ." The PEB, of course, was most concerned with the court's ruling that no cause of action existed under the UCC, not the particular outcome.

14. UCC Section 9-318.

15. UCC Sections 9-301 through 9-307.

16. UCC Section 9-109(a).

17. *In re Eagle Enters, Inc.*, 237 BR 269 (ED Pa 1999), "true" lease under chosen German law, but the lessor did not file in Pennsylvania where, under Article 9, the lease created merely a security interest, *Carlson v Tandy Comput Leasing*, 803 F2d 391 (8th Cir 1986), which presents essentially the same facts except the chosen law was Texas where a statute controlled characterization of lease but the lessor failed to consider Missouri's Article 9, and *Hong Kong and Shanghai Banking Corp, Ltd v HFH USA Corp*, 805 F Supp 133 (WDNY 1992), where a German contract that purported to retain title to goods sold on credit, which is permitted in Germany, was treated as a conditional sale agreement under New York law.

18. UCC Section 9-322.

19. UCC Section 9-109. Article 9 also applies to certain consignments and certain security interests created under other Articles of the UCC.

20. UCC Section 1-201(b)(35).

21. A security interest needs to attach in order to perfected. UCC Section 9-308(a).

22. UCC Section 9-318(a). However, UCC Section 9-318(b) provides that a seller of an account or chattel paper still has the power to grant a security interest in the sold account or chattel paper as long as the buyer is unperfected. The PEB disagreed with the argument that the seller's power to so grant would be cut off when the buyer perfects because, among other reasons, UCC Section 9-203(b)(2) allows a security interest to attach to collateral a debtor has the power to transfer, and Article 9 includes sales of rights to payment within its scope to minimize litigation over characterization of transactions.

23. For example, goods entrusted to a merchant and consigned inventory.

24. Article 9 also has variety of priority rules, such as those that protect priority for holders of promissory notes and certain chattel paper purchasers, which are beyond the scope of this article.

25. UCC Section 9-309(3) and (4).

26. Part 4 of Article 9.

27. Michigan has not.

28. *1st Source Bank v Wilson Bank & Trust*, 735 F3d 500 (6th Cir 2013).

29. UCC Section 9-315.

30. Most are defined in Article 9, and most are listed in the definition of general intangibles as they are, by definition, personal property other than that included in one of the listed collateral types.

31. UCC Section 1-201(b)(24).

32. For example, El Salvador will recognize Bitcoin as a medium of exchange September 7, 2021.

33. *See*, UCC Article 8 regarding securities accounts generally, UCC Section 8-102(a)(9) for the definition of financial asset (the author takes no position on this issue), UCC Section 9-312 on perfection by filing and UCC Section 9-106 regarding control.

Darrell W. Pierce is Senior Counsel at Dykema Gossett PLLC. He is an ALI member. Any opinions are his own and do not reflect the views of Dykema, the ALI or any client.

ESG and Corporate Reporting: Advancing Regulatory Requirements

By Maureen Stroud

With the advancement of Environmental, Social, Governance (ESG) reporting requirements, momentum is building towards regulations requiring ESG reporting in specific aspects considered material risk to publicly traded businesses. The topics considered material can be specific to the industry. However, there appears to be consensus on climate risk and social impacts in the supply chain being the most common areas of interest in existing regulations and impending regulations globally. The European Union and member states are advancing in this area with the most breadth, with other regions following quickly. According to the Principles of Responsible Investment (PRI), "government and policy maker interest in sustainable finance and investment has grown dramatically since the start of the century."[1] Of the policies that they are tracking, "95% have been developed since the year 2000."[2]

The European Union started down the path of regulations on climate and corporate ESG disclosures in 2016 and again in 2019 with the Amendment to Regulation (EU) 2016/1011 (Benchmark Regulation), which introduced a regulatory framework laying down the "minimum requirements for EU Climate Transition and EU Paris-aligned Benchmarks at [the European] Union level."[3,4] Additional regulations are in development to define the "principal adverse impacts" for "sustainability-related financial disclosures (SFDR)."[5,6] These regulations on sustainability-related financial disclosures define the requirements for entity-level disclosures and product-level disclosures. The entity-level disclosures include "climate and environment; and social and employee matters, respect for human rights, anti-corruption and anti-bribery aspects."[7]

In addition to the advancement of disclosure regulations in the European Union, these regulations are continuing to advance around the world, with Australia, South Africa, the United States of America, and South America following the European Union and European Member States.[8]

Corporate Reporting on ESG in the United States

In 2010, the U.S. Security and Exchange Commission ("The SEC") released guidance on "Disclosure Related to Climate Change."[9] This disclosure requirement did not make waves amongst publicly traded companies, as there was no enforcement or monitoring to ensure consistent and comprehensive disclosures.

Comprehensive Environmental, Social, and Governance reporting would include climate change but would also include other environmental topics like biodiversity, materials, water, energy, and waste.[10] Social topics include, but are not limited to employment, labor and management relations, occupational health and safety, diversity and equal opportunity, human rights, rights of indigenous peoples, and supplier social assessments.[11]

In the United States, there have not been specific regulations mandating reporting of environmental social governance metrics. The Sustainability Accounting and Standards Board (SASB) has developed standards for reporting on specific aspects of environmental, social, and governance metrics for each industry. They started this process to develop standard reporting frameworks and have been lobbying for the inclusion of these ESG metrics in the non-financial reporting sections of publicly traded companies' 10-K annual reports. However, they have not been successful in establishing a mandate for consistent and measurable data that can be compared from company to company.

For more than a decade, both private and publicly traded companies have been reporting on environmental, social, and governance impacts. However, the level of quantitative measurements and data varies widely from company to company and from industry to industry. Because there is no requirement to produce a sustainability report or minimum reporting requirements for those reports, corporations produce reports that can range in scope and breadth. The reports use different reporting formats and frameworks.[12] Some corporations are reporting comprehensive metrics using the Global Reporting Index (GRI) frameworks with publicly stated goals and climate goals approved by the Science-based Target Initiative (SBTI) and reported to the Climate Disclosure Project (CDP) for ratings and rankings. Others are reporting on a hodgepodge of initiatives without clear descriptions of their governance structure or metrics for social and environmental impacts.

The inconsistency amongst publicly traded companies reporting has created much confusion amongst corporations, ESG and sustainability practitioners, investors, financial advisors, and consumers.

To "enhance its focus on climate-related disclosure in public company filings," Acting Chair of the SEC, Allison Herren Lee made an announcement that the SEC would be reviewing 2010 guidance on climate change matters.[13] In her February 2021 statement, Lee stated that "ensuring compliance with the rules on the books and updating existing guidance are immediate steps the agency can take on the path to developing a more comprehensive framework that produces consistent, comparable, and reliable climate-related disclosures."[14]

On March 4, 2021, the SEC announced the creation of a "Climate and ESG Task Force in the Division of Enforcement."[15] Their initial focus will be to "identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules."[16] In addition, the Climate and ESG Task Force will be analyzing disclosures "and compliance issues relating to investment advisors' and funds' ESG strategies."[17]

At the time of publication, the SEC is soliciting comments[18] as the initial stage of public comment period begins. The timing of rulemaking is unclear at this point, as the comment period is still open.

Challenges for ESG Investments

ESG ratings services take publicly available information and apply their own proprietary algorithms to rank and rate corporations based on their reported environmental, social, and governance metrics.

Starting with FTSE and Dow Jones Sustainability Index, they have since expanded to hundreds of funds to manage portfolios for more sustainable investments. The metrics are not consistent, and the funds are not consistent from one fund manager to the next. It is not clear how a company can be rated high on one rating system but low on another. The attributes of the funds vary widely as well, without a clear definition of how investors should judge companies on their ESG initiatives.

The ratings systems define winners and losers in the investment requirements. The problem is that without the clarity of the definitions for how different ESG factors should be weighed and measured, there is much confusion on the part of investors and companies looking to report. It is unclear how much information is needed, which factors are more influential to investors, and which information may put the company at risk to their competitors and by the weighting of the ratings.

The SEC requires a third-party audit of a publicly traded company's financial statements, but there is no similar requirement for ESG, also discussed as "non-financial reporting."[19] Without the requirements for oversight and governance of the reporting mechanisms, it presents a risk to companies that are reporting their data publicly, as some companies may provide only partial data or none at all. Some may provide comprehensive, audited ESG data and get scored poorly and get penalized by the rating systems, while others can provide partial, unaudited ESG metrics and obtain good ESG ratings, out ranking their competitors based on weighting, thus "gaming the system" to obtain favorable ratings for investment.

Because of the perceived public relations risk of being too transparent, being penalized in the market by being rated unfavorably, and providing poor quality data, some companies are choosing not to share their metrics at all. This can be another problem, as they miss the opportunity to showcase their programs, initiatives, and improvements in ESG programs, as the ratings methodologies are unclear, inconsistent, and unregulated. In addition, it is challenging to determine the format and the location of the ESG metrics. There are no requirements for standardized formats or degree of validation like there is for financial reporting that is already currently in place.

In the United States, there have not been specific regulations mandating reporting of environmental social governance metrics.

The inconsistency amongst publicly traded companies reporting has created much confusion amongst corporations, ESG and sustainability practitioners, investors, financial advisors, and consumers.

SEC Action to set ESG Rules

In their findings, Congress determined that the "Securities and Exchange Commission (SEC) has broad authority to require disclosure of information if such information is in the interest of, or is material to investors."[20] Therefore, Congress has found that the SEC has the authority to manage the requirements for investor disclosures of ESG metrics, as they have for financial data. The investor community has "reported that voluntary disclosures of ESG metrics are inadequate" for assessing the risk and opportunities associated with ESG topics in corporate disclosures.[21] As such, a "rule requiring reporting and standardization of ESG disclosures is in the interest of investors."[22]

Due to varying levels of transparency and accuracy in the ESG data that is reported by corporations, the House of Representatives passed a new Act on June 17, 2021 to address the issues with ESG reporting for use by investors in the United States. The ESG Disclosure Simplification Act of 2021[23,24] will "require each issuer, in any filing of the issuer described in such part that requires audited financial statements, to disclose environmental, social, and governance metrics…"[25] and grants the Securities and Exchange Commission to "define ESG metrics."[26]

In June 2021, Commissioner Elad L. Roisman gave a speech at the National Investor Relations Institute's 2021 Virtual Conference to discuss the "important role Investor Relations ("IR") teams play in our capital markets, serving as a primary channel for communication between companies' leaders and groups such as analysts, as well as asset managers and investors who hold ownership positions in those companies."[27]

The Security Exchange Commission has included a proposed rule to establish requirements "for investment companies and investment advisors related to environmental, social, and governance (ESG) factors, including ESG claims and related disclosures."[28]

In May 2021, "Bloomberg reported that John Coates, the SEC's Acting Director of the Division of Corporation Finance, indicated that new disclosure requirements would focus on three areas: diversity, equity and inclusion; climate change; and human capital management."[29]

Conclusion

I recommend that corporations focus on strategically aligning their ESG disclosures based upon a Materiality Assessment with a strong focus on climate-related risk disclosures for their own operations and those of their upstream and downstream suppliers;[30] diversity, equity and inclusion; and human capital management within their own operations and through their supply chain. Corporations that score higher on ESG ratings publish their environmental, social, governance goals and supporting metrics on their websites and in their sustainability reports. The most advanced corporations are evaluating their climate-related risks and working with their suppliers to support the climate-related goals, targets, and risk reduction strategies. If you are consulting on a global basis or working for a large multinational corporation, there may be different disclosure requirements from country to country and from industry to industry depending on the specific reporting requirements. The Global Reporting Initiative (GRI) index is an internationally recognized framework for reporting on ESG metrics.

Any views expressed in this article belong to the author alone and do not represent or reflect the views of Shinka Sustainability Consultants, LLC or of any other people, institutions or organizations that the authors or Shinka Sustainability Consultants, LLC may or may not be associated with or represent. Any views or opinions expressed herein are not intended to malign any individual, company, organization, or group.

NOTES

1. Principles for Responsible Investment (PRI), a partner of the United Nations Environment Programme Finance Initiative and the UN Global Compact, developed a database of global sustainable finance policy in 2016 and have been updating and sharing publicly at https://www.unpri.org/policy/regulation-database.

2. Principles for Responsible Investment (PRI), https://www.unpri.org/policy/regulation-database.

3. Principles for Responsible Investment (PRI), https://www.unpri.org/policy/regulation-database.

4. Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (Text with EEA relevance) https://www.legislation.gov.uk/eur/2016/1011/contents.

5. Principles for Responsible Investment (PRI), https://www.unpri.org/policy/regulation-database.

6. Regulatory Technical Standards for the EU Sustainable Finance Disclosures regulation (RTS for the SFDR) (2020), https://www.esma.europa.eu/press-

news/esma-news/three-european-supervisory-authorities-publish-final-report-and-draft-rts.

7. Regulatory Technical Standards for the EU Sustainable Finance Disclosures regulation (RTS for the SFDR) (2020), https://www.esma.europa.eu/press-news/esma-news/three-european-supervisory-authorities-publish-final-report-and-draft-rts.

8. Principles for Responsible Investment (PRI), https://www.unpri.org/policy/regulation-database.

9. U.S. Security and Exchange Commission. "Interpretation: Commission Guidance Regarding Disclosure Related to Climate Change." 17 CFR PARTS 211, 231 and 241 [Release Nos. 33-9106; 34-61469; FR-82], February 8, 2010, https://www.sec.gov/rules/interp/2010/33-9106.pdf.

10. Global Reporting Index (GRI). "Consolidated Set of GRI Sustainability Reporting Standards 2020" (October 5, 2021)

11. Global Reporting Index (GRI). "Consolidated Set of GRI Sustainability Reporting Standards 2020," (October 5, 2021)

12. ESG Disclosure Act. H. R. 1187, Section 102(2).

13. U.S Security and Exchange Commission (SEC). "Statement on the Review of Climate-Related Disclosure," February 24, 2021. https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure.

14. U.S Security and Exchange Commission (SEC). "Statement on the Review of Climate-Related Disclosure," February 24, 2021. https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure.

15. U.S Security and Exchange Commission (SEC). "SEC Announces Enforcement Task Force Focused on Climate and ESG Issues," March 4, 2021. https://www.sec.gov/news/press-release/2021-42.

16. U.S Security and Exchange Commission (SEC). "SEC Announces Enforcement Task Force Focused on Climate and ESG Issues," March 4, 2021. https://www.sec.gov/news/press-release/2021-42.

17. U.S Security and Exchange Commission (SEC). "SEC Announces Enforcement Task Force Focused on Climate and ESG Issues," March 4, 2021. https://www.sec.gov/news/press-release/2021-42.

18. The questions that have been posed for comments can be found at U.S Security and Exchange Commission (SEC). "Public Input Welcomed on Climate Change Disclosures," March 15, 2021. https://www.sec.gov/news/public-statement/lee-climate-change-disclosures#_ftn2. Comments on Climate Disclosure can be submitted to the https://www.sec.gov/cgi-bin/ruling-comments page.

19. Elad L. Roisman, "Can the SEC Make ESG Rules that are Sustainable?" Washington D.C., June 22, 2021, https://www.sec.gov/news/speech/can-the-sec-make-esg-rules-that-are-sustainable.

20. ESG Disclosure Act. H. R. 1187, Section 102(1).

21. ESG Disclosure Act. H. R. 1187, Section 102(3).

22. ESG Disclosure Act. H. R. 1187, Section 102(3).

23. ESG Disclosure Act. H. R. 1187.

24. The ESG Disclosure Act of 2021 was amended by adding Subpart (k) "ESG Disclosures" in Section 14 of the Securities Exchange Act of 1934 (15 USC 78n).

25. ESG Disclosure Act. H. R. 1187, Section 103(b)(1)(A.

26. ESG Disclosure Act. H. R. 1187, Section 103(b)(1)(B).

27. Elad L. Roisman, "Can the SCE Make ESG Rules that are Sustainable?," June 22, 2021.

28. Security Exchange Commission. "Rules Related to Investment Companies and Investment Advisors to Address Matters Relating to Environmental, Social and Governance Factors," Proposed Rule (RIN: 3235-AM96), Spring 2021.

29. David A. Katz & Laura A. McIntosh, Wachtell, Lipton, Rosen & Katz, " SEC Regulation of ESG Disclosures," posted in Harvard Law School Forum on Corporate Governance, Friday, May 28, 2021, https://corpgov.law.harvard.edu/2021/05/28/sec-regulation-of-esg-disclosures.

30. The carbon impacts of upstream and downstream supply chain are outlined in the Scope 3 guidelines from The GHG Protocol's The Corporate Value Chain (Scope 3) Accounting and Reporting Standard.

Maureen Stroud is Founder and Managing Director of Shinka Sustainability Consultants, LLC. Maureen specializes in sustainability and ESG strategy development, circular economy business model innovation, and climate change, carbon footprinting and carbon markets policy and advisory services. Maureen has advised large commercial clients, manufacturing clients, high tech companies, and small and middle market companies.

ESG and Human Rights in Modern Supply Chains: The Limits of Transparency

By Ahpaly Coradin and Amy Epstein Gluck

Recent private sector activism, particularly in the financial sector, and the United States' rejoining of the Paris Agreement[1] in 2021 have fostered federal initiatives around environmental, social, and governance issues in business ("ESG"). U.S. initiatives have anchored in transparency of corporate disclosure (a governance or "G" issue) and corporate diversity and inclusion (a social or "S" issue) as a means for investors to evaluate companies' adherence to ESG principles. In the specific context of supply chains, ESG concerns often revolve around "S" issues, particularly human rights and labor rights. However, because modern supply chains involve commodities, processes, services, and supplies from global sources, all aspects of ESG may be implicated and, at times, conflict with one another. Two recent ongoing human rights crises provide distinct case studies as to the unintended and perhaps undesired consequences of the application of ESG principles to supply chain risk management with voluntary, transparency-based frameworks.

Supply Chain Transparency Laws in the United States

U.S. laws requiring transparency in supply chains are relatively limited in number. The Trafficking Victims Protection Reauthorization Act ("TVPRA") directs the Labor Department to "monitor and combat forced labor and child labor in foreign countries" and targets "goods that are produced with inputs that are produced with forced labor or child labor."[2] The Dodd-Frank Act and its regulations relate to supply chain transparency in the important yet relatively narrow issue of conflict minerals from the Democratic Republic of Congo (DRC).[3] Congress has failed to pass additional federal supply chain transparency laws.[4]

The California Transparency in Supply Chains Act of 2010 requires retailers with annual global receipts over $100 Million and doing business in California to provide public information regarding their efforts to eradicate slavery and human trafficking from their supply chains.[5] However, that state law does not require companies to *make* efforts but only to disclose what efforts, if any, they are making. Furthermore, the law does not require periodic updates and imposes no penalties for violations other than an action for injunctive relief that may be brought by the state attorney general.[6] It is a toothless tiger.

Metrics, KPIs, and Benchmarks in Supply Chain ESG Compliance

A constructive application of ESG principles involves establishing clear and credible ESG metrics, KPIs, and benchmarks,[7] without which neither a company nor its stakeholders have the means of assessing if and to what extent a company is adopting said principles. Companies should consider how best to track the effectiveness of their ESG programs in their supply chains, using "appropriate qualitative and quantitative indicators" and "feedback from internal and external sources."[8] As the United States appears to be moving towards mandatory disclosures and possibly common metrics in public company reporting, the discussion has centered on cost and risk allocation—i.e. how to achieve transparency while limiting the burdens and potential legal exposure of providing said disclosure, the presumption being that increased transparency will be more burdensome and ultimately less profitable. Yet, increased transparency alone has not shown it can effectuate the fundamental changes needed, particularly in the race to "Net Zero" greenhouse gas emissions.[9]

Absent a regulatory regime that imposes accountability as well as transparency requirements, companies whose supply chains do not conform to ESG principles may be exposed to increased cost of capital and reputational risk, which can result in shareholder activism, stock price fluctuation, board upheaval, and even boycotts. The lack of uniform metrics could lead not only to inaccurate disclosure but inefficiency and waste in otherwise good faith attempts at adopting ESG principles. Until appropriate regulatory frameworks are enacted, the establishment of ESG metrics and KPIs by companies throughout their supply chains is sound risk management and a potential differentiator when benchmarking within an industry.

Child Slavery in U.S. Chocolate Supply Chain

According to a 2020 NORC study funded by the U.S. Department of Labor, in the 2018-2019 season, 1.56 million children worked in cocoa production in Côte d'Ivoire and Ghana. Of these, 1.48 million children were exposed to "at least one component of hazardous child labor in cocoa production."[10]

On June 17, 2021, the Supreme Court of the United States (SCOTUS) handed down a jurisdictional ruling on the Alien Tort Statute ("ATS")[11] that all but forecloses its application to claims against U.S. companies arising outside of the United States. As a result, U.S. companies with international supply chains may not be held liable under the ATS for torts committed abroad through their supply chains, even if the U.S. company exercises control over a foreign company in that supply chain. In other words, there is a dearth of accountability.

In *Nestlé USA, Inc v Doe*,[12] SCOTUS barred several Malian nationals from suing Nestlé USA, Inc. and Cargill, Inc. under the ATS. The plaintiffs alleged that they were trafficked into Côte d'Ivoire as child slaves to produce cocoa. Nestlé and Cargill provided technical and financial resources to the farms where the plaintiffs worked. In return, Nestlé and Cargill had exclusive rights to buy cocoa from the farms. According to plaintiffs, this arrangement aided and abetted child slavery, as Nestlé and Cargill knew or should have known that the farms were exploiting children and failed to exercise their economic leverage over the farms to stop the child slavery.[13] SCOTUS ruled 8-1 that (i) the ATS does not expressly apply extraterritorially and (ii) plaintiffs failed to show in its pleadings that the conduct applicable under the ATS —i.e. the conduct that directly caused the injury[14]—occurred in the United States, even if other conduct occurred abroad. The Court reversed the Ninth Circuit Court of Appeals' finding that plaintiffs had pleaded sufficient domestic conduct on the part of the defendants because "every major operational decision by both companies is made in or approved in the U. S."[15] Justice Clarence Thomas, writing for the Court, held that "allegations of general corporate activity—like decisionmaking[sic]—cannot alone establish domestic application of the ATS."[16] However, the Court declined to hold that all U.S. corporations are exempt from suit under the ATS.

Additionally, a majority of the Court chose not to follow Justice Thomas' limitation of extraterritoriality to only three historical torts dating back to the ATS's enactment in the 18th century.[17] Justice Thomas reasoned that courts must not create causes of action for violations of international law out of deference to the "political branches [who] have the responsibility and institutional capacity to weigh foreign-policy concerns."[18] He alluded to the Harkin-Engel Protocol, a voluntary agreement between U.S. food companies, the U.S. Department of Labor, and the governments of Côte d'Ivoire and Ghana to eliminate child labor in the production of cocoa, which he implied could be threatened by plaintiffs' claims: "[C]ompanies or individuals may be less likely to engage in intergovernmental efforts if they fear those activities will subject them to private suits."[19]

U.S. laws requiring transparency in supply chains are relatively limited in number.

Justice Sonia Sotomayor, joined by Justices Elena Kagan and Stephen Breyer, voted with the majority but rejected the idea that courts lack the capacity to consider all factors relevant to recognizing actionable torts under the ATS.[20] Justice Sotomayor pointed to the TVPRA as an alternative law under which plaintiffs' claims could be brought, which if anything supports judicial capacity for allowing victims of slavery to sue perpetrators under the ATS, assuming a domestic cause of action were brought.[21]

Despite its jurisdictional narrowing of the ATS to domestic claims, the *Nestlé USA* decision appears to leave open the door for claims against U.S. companies that indirectly use or benefit from slavery through their supply chains, whether through the limited application of the ATS for domestic torts or through the TVPRA. In one such case, *Coubaly v Cargill, Inc*,[22] another group of Malians have sued Nestlé USA, Cargill, and Hershey Company among others under the TVPRA describing similar circumstances as in *Nestlé USA*. The class action complaint alleges that the defendant U.S. companies "have knowingly profited from the forced labor of children…

The lack of uniform metrics could lead not only to inaccurate disclosure but inefficiency and waste in otherwise good faith attempts at adopting ESG principles.

harvesting Defendants' cocoa" and "have engaged in various schemes to mislead the public by explicitly promising to 'phase out' their use of forced child labor…"[23] Given that the TVPRA expressly provides for the extraterritorial jurisdiction of federal courts over human trafficking claims,[24] *Coubaly* merits close watching as it makes its way through the federal courts.[25]

Nestle USA and *Coubaly* raise serious questions about the efficacy of voluntary agreements, such as the Harkin-Engel Protocol, to curb child labor. The cases suggest that major food companies are well aware of the continued practice of child slavery in their supply chains and have not taken the steps necessary to eradicate it. This is not surprising given that the Harkin-Engel Protocol's objective does not explicitly eliminate all child labor.[26] The protocol establishes nonbinding agreements for chocolate manufacturers to voluntarily self-regulate but lacks any framework for accountability should they not do so. The thrust of the protocol is largely information sharing and general cooperation between the industry and the African governments, which lessens the prospects for more robust industry accountability and action given the general economic dependence of African governments on commodity exports. From an ESG perspective, increased transparency and information sharing has yet to yield the desired result, which is an end to child labor in the chocolate supply chain.

Forced Labor in Cotton and Solar Panel Supply Chains

Since 2017, the Chinese government has reportedly engaged in a harsh campaign to forcibly assimilate the Uyghurs, a Muslim ethnic minority in Xinjiang, China, through use of "vocational education and training centers," likened to concentration camps.[27]Allegations include a plethora of human rights abuses, including government-sponsored killings and disappearances, torture, arbitrary detention, rape, forced sterilization and coerced abortions, human trafficking, forced labor, and child labor.[28] Though it admits the camps exist, the Chinese government has denounced the charges.[29] The U.S. Department of State has labeled China's campaign a "genocide."[30]

The Xinjiang Uyghur Autonomous Region (Xinjiang) produces approximately 20 percent of the world's cotton and 84 percent of China's, but the industry is tainted by reports of over half a million Uyghurs forced to pick cotton.[31] In response, on June 17, 2020, the United States enacted the Uyghur Human Rights Policy Act (UHRPA), which consists mostly of Congressional calls for sanctions against China, funding for Radio Free Asia's Uyghur language service, and U.S. advocacy on behalf of the Uyghurs.[32] On July 1, 2020, the United States issued a Supply Chain Business Advisory that "[b]usinesses with potential exposure in their supply chain to [Xinjiang]… should be aware of the reputational, economic, and legal risks of involvement with entities that engage in human rights abuses, including but not limited to forced labor in the manufacture of goods intended for domestic and international distribution… [and] should apply industry human rights due diligence policies and procedures to address risks."[33] A ban on cotton products originating from the Xinjiang Production and Construction Corps., a major producer,[34] soon followed, and on January 13, 2021, the U.S. banned all Xinjiang cotton and tomato products.[35]

In October 2020, the Better Cotton Initiative (BCI), a global nonprofit cotton sustainability program that includes Nike, H&M, Adidas, Zara, Burberry, Gap and other major brands as members, issued a statement on its website that it had suspended licensing Xinjiang cotton production and ceased field-level activities.[36] In March, 2021, Chinese social media initiated a boycott against these western brands, and major Chinese online retailers removed the brands from their platforms.[37] China also issued a warning on children's clothing imports by H&M, Nike, Zara, and Gap alleging that the apparels may "contain 'dyes or harmful substances' which may be absorbed by the body and endanger a child's health."[38]

Xinjiang's strategic importance to the energy sector is arguably even more pronounced than in cotton, as it contains 25 percent of China's hydrocarbon reserves and 38 percent of its coal.[39] It is estimated that 50 percent of the global supply of polysilicon, a key raw material for solar panels, is produced in Xinjiang, and production has quadrupled since 2018.[40] On June 24, 2021, the United States banned the import of solar panels and other polysilicon goods produced by a Chinese manufacturer alleged to use forced labor in Xinjiang.[41] On July 13, 2021, six U.S. federal departments issued an unprecedented Xinjiang Supply Chain Business

Advisory that explicitly warns of the "significant reputational, economic, and legal risks of involvement with entities or individuals in or linked to Xinjiang that engage in human rights abuses…."[42] The advisory details the types of risk perceived and due diligence recommended.[43]

Not surprisingly, the complexity of the Xinjiang situation and its effect on supply chains has received varying reactions from western industrial associations. BCI has come under significant pressure, as its China branch publicly split with its Swiss headquarters, declaring that it had found no signs of forced labor in Xinjiang. In April 2021, BCI deleted its October 2020 statement about Xinjiang from its website and has not commented since, suggesting internal discord as to how to respond to Chinese pressure.[44] U.S. apparel associations have called for an end to the oppression of the Uyghurs and for broad dialogue among all stakeholders to resolve the crisis.[45] With regard to the U.S. polysilicon ban, the Solar Energy Industry Association (SEIA) has denounced the human rights situation in Xinjiang and obtained a Forced Labor Prevention Pledge from 175 members that the solar supply chain be free of forced labor.[46]

The effect of the Xinjiang crisis on the solar panel supply chain creates acute tension among all three pillars of ESG. Solar power is a key component of the transition from fossil fuels, which will be necessary if the world is to achieve Net Zero. Yet, half of the global solar power supply chain goes through Xinjiang. By virtue of the Uyghur human rights crisis, which already presents difficult social and governance issues to companies in the solar energy supply chain, the sustainability of solar power—i.e. its cost/benefit in the context of ESG—must be reevaluated, if the Uyghur situation remains unresolved. For major non-energy U.S. companies that currently use, or seek to use, solar power as a means to reduce their Scope 1, 2, and 3 emissions,[47] investor relations could become complicated if ESG investors press these companies to exert economic pressure on China in exchange for relief for the Uyghurs, and the companies fail to do so. In Europe, companies will likely have to navigate the new European Climate Law that imposes binding Net Zero targets, including a 55 percent reduction in GHG emissions from 1990 levels by 2030[48]—presumably requiring increased renewable energy generation including solar power—with existing anti-slavery legislation and a proposed EU law imposing liability on companies that violate human rights, the environment, or good governance principles, or contribute to such violations inside or outside Europe.[49] Additional mandatory reductions in GHG emissions may be imposed following this month's COP26 in Glasgow.

Conclusion

We recommend supply chain due diligence to assess and manage risk, including a review of regulatory and contract obligations, audits, foreign country risk assessments, establishment of internal metrics, KPIs and benchmarks, and, where warranted by heightened risk factors, forensic accounting of suppliers. Best practices for companies include mapping their supply chains to the commodity or raw material level and prioritizing engagement with suppliers and subsuppliers based on risk, whether at the country level, commodity level, supplier-category level, or a combination thereof.[50]

Any views expressed in this article belong to the authors alone and do not represent or reflect the views of FisherBroyles, LLP or of any other people, institutions, or organizations that the authors or FisherBroyles, LLP may or may not be associated with or represent. Any views or opinions expressed herein are not intended to malign any individual, company, organization, or group.

> Until appropriate regulatory frameworks are enacted, the establishment of ESG metrics and KPIs by companies throughout their supply chains is sound risk management and a potential differentiator when benchmarking within an industry.

NOTES

1. The Paris Agreement was adopted by 197 countries on December 12, 2015 at the 21st Conference of Parties (COP21) in Paris, France. Article 4 of the Paris Agreement calls for signatory countries to submit every five years "successive nationally determined contributions" (NDC) to cutting GHG emissions, which must represent "a progression beyond the Party's then current nationally determined contribution and reflect its highest possible ambition…."

2. Laws and Regulations | U.S. Department of Labor (dol.gov) *See also Coubaly* case *infra*.

3. Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act mandates corporate public disclosure of "conflict minerals" originating from the DRC or surrounding areas, and Rule 13p-1 of the Securities Exchange Act of 1934 requires disclosure by SEC-reporting companies using "minerals that are 'necessary to the functionality or production' of a product manufactured by the company or contracted by the company to be manufactured." Disclosure of Payments By Resource Extraction Issuers: A Compliance Guide for Small Entities and Others (sec.gov).

4. *See e.g.* "The Business Supply Chain Transparency on Trafficking and Slavery Act of 2018" (H.R. 7089)

and "The Business Supply Chain Transparency on Trafficking and Slavery Act of 2015" (H.R. 3226).

5. SB 657 Home Page/State of California/Department of Justice/Office of the Attorney General.

6. Frequently Asked Questions (FAQs) - SB 657 | State of California/Department of Justice/Office of the Attorney General.

7. Generally speaking, *metrics* refer to measurements and quantifiable data points that can be demonstrated with relative clarity and objectivity. *Key Performance Indicators* (KPIs) are metrics used to gauge performance in relation to a specific business goal or target. *Benchmarks* are standards against which a company compares itself. *Benchmarking* also refers to a company's self-evaluation in comparison to other companies in its industry.

8. United Nations Guiding Principles on Business and Human Rights (UNGP), Principle 20.

9. Net Zero is the cutting of greenhouse gas ("GHG") emissions required in order to limit global warming to 1.5 C (2.7 F) above pre-industrial levels, which would avoid intensifying natural disasters. See Global Warming of 1.5 ºC — (ipcc.ch) The IPCC is the leading world body on the science of climate change.

10. Assessing Progress in Reducing Child Labor in Cocoa Production in Cocoa Growing Areas of Côte d'Ivoire and Ghana (norc.org) at 10.

11. Also known as the Alien Tort Claims Act, the Alien Tort Statute is an 18th century law that grants jurisdiction to federal courts "of all causes where an alien sues for a tort only in violation of the law of nations or of a treaty of the United States." 28 USC 1350.

12. 593 US ___, 141 S Ct 1931 (2021).

13. *Id.* at 2.

14. *Id.* at 4.

15. *Id.* at 5 (*citing* Doe v Nestlé, SA, 906 F3d 1120 (2018) and 929 F3d 623 (2019)).

16. *Id.*

17. These are "violation of safe conducts, infringement of the rights of ambassadors, and piracy." *Id.* at 5-6 (*citing Sosa v Alvarez-Machain*, 542 US 692, 724 (2004)).

18. *Id.* at 9 (citing *Jesner v Arab Bank, PLC*, ___ US ___, 138 S Ct 1386 (slip op. at 18-19)(2018)).

19. *Id.*

20. *Supra* n. 12, Opinion of Sotomayor, J. at 9.

21. *Id.* at 11, remarking that "nothing in the [TVPRA] will preclude trafficking victims from availing themselves of applicable State, local or other Federal laws in seeking compensatory or other damages and relief in any civil proceeding." (citing H.R. Conf. Rep. No. 106-939, p. 93 (2000)).

22. District of Columbia District Court, Case No. 1:21-cv-00386 (filed Feb. 12, 2021).

23. STAMPED COMPLAINT.pdf (iradvocates.org) at 1-2.

24. 18 USC 1596(a).

25. On July 30, 2021, the defendants filed a joint motion to dismiss, arguing *inter alia* that the TVPRA does not apply extraterritorially. *See* http://www.iradvocates.org/sites/iradvocates.org/files/7.30.21%20Defs%20Memo.%20in%20Support%20of%20Motion%20to%20Dismiss.pdf.

26. Africa: Child Labor in Cocoa Fields/Harkin-Engel Protocol (ilo.org).

27. Eva Dou, "Who Are the Uighurs? China's Xinjiang Crackdown Explained," (washingtonpost.com).

28. *Id.*

29. Remi Castets, "What's Really Happening to Uighurs in Xinjiang?"(thenation.com).

30. *See* China (Includes Hong Kong, Macau, and Tibet), United States Department of State (March 30, 2021).

31. Helen Davidson, "Xinjiang: More Than Half a Million Forced to Pick Cotton," (theguardian.com).

32. PUBL145.PS (congress.gov).

33. Xinjiang Supply Chain Business Advisory (state.gov) The advisory is explicitly informational only and does not have the force of law. The advisory was updated on July 13, 2021. *See* https://www.state.gov/xinjiang-supply-chain-business-advisory/.

34. CBP Issues Detention Order on Cotton Products Made by Xinjiang Production and Construction Corps Using Prison Labor | U.S. Customs and Border Protection.

35. CBP Issues Region-Wide Withhold Release Order on Products Made by Slave Labor in Xinjiang/U.S. Customs and Border Protection (January 13, 2021).

36. Brenton Johns, "Better Cotton Initiative Statement on Xinjiang Disappears from Website" (businessoffashion.com).

37. Siladitya Ray, "China Accuses Nike, H&M and Others of Selling Goods that Could Be 'Harmful To Children' Months After Xinjiang Cotton Backlash" (forbes.com).

38. *Id.*

39. *Supra* n. 30.

40. Supply Chain Ethics & Sustainability/SEIA.

41. FACT SHEET: New U.S. Government Actions on Forced Labor in Xinjiang/The White House.

42. Xinjiang-Business-Advisory-13July2021-1.pdf (state.gov).

43. *Id.*

44. *See* Joint Association Statement on Supply Chains and Xinjiang (aafaglobal.org) and Industry Statement in Support of Global Approach to Protect Citizens in Xinjiang (aafaglobal.org).

45. *See* https://www.reuters.com/business/levi-strauss-sustainability-chief-leaves-better-cotton-initiative-board-2021-08-06/

46. Solar Industry Forced Labor Prevention Pledge Signatories.pdf (seia.org).

47. Scope 1 emissions are direct greenhouse (GHG) emissions that occur from sources that are controlled or owned by an organization (e.g., emissions associated with fuel combustion in boilers, furnaces, vehicles). Scope 2 emissions are indirect GHG emissions associated with the purchase of electricity, steam, heat, or cooling. Scope 1 and Scope 2 Inventory Guidance | EPA Center for Corporate Climate Leadership | US EPA Scope 3 emissions are the result of activities from assets not owned or controlled by the reporting organization, but that the organization indirectly impacts in its value chain. Scope 3 Inventory Guidance | EPA Center for Corporate Climate Leadership | US EPA.

48. European Climate Law/Climate Action (europa.eu).

49. Corporate due diligence and corporate accountability, *Journal Général de l'Europe* (journalgeneraldeleurope.org).

50. *See generally* BSR (Business for Sustainable Responsibility) HRWG 2019 Spring Meeting Summary.docx (bsr.org).

Ahpaly Coradin is Partner and the ESG Advisory Group Co-Lead with FisherBroyles, LLP. Ahpaly specializes in international transactions, inbound foreign investment, and cross-border business. Ahpaly has advised large institutional clients, foreign government agencies, small and middle market companies, and high net-worth individuals—particularly from Europe, Latin America, Asia, and Africa. Ahpaly is also a dispute resolution neutral in arbitration and mediation, with particular experience in bi-lingual and cross-border mediation.

Amy Epstein Gluck is a Partner with FisherBroyles, LLP and is the Employment Counsel for the firm. Amy focuses her practice on employment law counseling, serving as a trusted legal advisor to business owners, in-house counsel, and Human Resources, and works to prevent organizational problems (not just react to them). Amy defends employers against employee claims and lawsuits involving discrimination, harassment, retaliation, wage and hour violations, and COVID-19 claims. She counsels and provides training to organizations about preventing harassment, discrimination, and retaliation; gender transition plans and policies; employee management techniques; providing reasonable accommodations for disability compliance (under the ADA) and recognizing requests for accommodations; worker classification; and inclusivity and diversity initiatives. Amy also drafts, negotiates, and analyzes employment and separation agreements, restrictive covenants, and employee handbooks.

Incorporating Unilaterally Updateable Website Terms into Contracts

By Christopher J. Falkowski

Introduction

Michigan attorneys are well versed in addressing complex contractual matters. "Battle of the forms" under UCC 2-207 are common occurrences in the manufacturing industries of the Midwest for decades. In certain respects, incorporating website terms is a natural online extension to the more traditional paper-version of a purchase order. So long as the contractual promises are not entirely illusory, a binding contract will likely be found because "a promise that is 'partly' illusory is by definition not illusory."[1]

Some instances of incorporated website terms do merit extra attention. Attorneys will increasingly encounter a contractual provision that reads something like this *Example #1*:

> <u>Additional Terms</u>. The Agreement between the Parties incorporates by reference the terms and conditions ("Terms") set forth at http://www.GoliathCorp.com/terms.

At first glance, such a provision may seem noncontroversial as the ability to incorporate documents by reference into a binding integrated contract has long been established under Michigan law.[2] The fact that an electronic record is used in lieu of a paper document is similarly noncontroversial, as the use of electronic records to form binding contracts was statutorily recognized under Michigan law in 2000 with the enactment of the Uniform Electronic Transactions Act ("UETA").[3]

What makes the incorporation of website terms at least somewhat problematic is that websites can be unilaterally changed over time. *Example #1* above does not include the time limitation that is inherent with an attached paper copy of a purchase order or in the language of *Example #2* below:

> <u>Additional Terms</u>. The Agreement between the Parties incorporates by reference the terms and conditions ("Terms") set forth at http://www.GoliathCorp.com/terms *as those Terms existed on the Effective Date.*

From an operational standpoint, nothing in *Example #1* stops "Goliath Corp" from updating their website the day after executing the agreement. In theory, Goliath Corp could unilaterally rewrite the agreement by rewriting the terms on their website. Prudence recommends against relying exclusively on courts to fully address opportunistic abuses, and practical realities may not enable the deletion or even substantial modification of such a provision. This leaves the option of "fixing" the problem by restricting unilateral changes in terms of timing, notifications, requiring that such changes be applicable to a broad base of customers, and options to terminate.[4]

The incorporation of terms and conditions via an updateable website introduces fundamental questions as to whether a binding contract has been formed, the effective terms of such an agreement, and the limits that such terms can be subsequently modified while still being enforceable.

Trends Favors Validation

The recent history of courts and legislatures in response to innovative contracting practices is to avoid the categorical invalidation of new contractual frameworks. Changes in information technology, innovative business practices, and creative lawyering have presented many questions of what can and cannot form the basis of a binding contract. The general trend validating new contractual frameworks is quite strong. Courts and legislatures are reluctant to undermine large channels of commerce, and contractual innovations are typically introduced with creative lawyers well versed in established principles of contract law.

Prior contractual innovations such as Open source licensing,[5] "browsewrap" agreements,[6] and "shrinkwrap" agreements[7] involve acceptance communicated exclusively and implicitly through behavior without affirmative expressions of consent. These contractual innovations were controversial when first introduced but are well-established now. "Browsewrap" agreements share the same kind of capacity for abuse as the provision in *Example #1* above in that website terms of use are often changed without meaningful notice. Users of online services such as Facebook and Google will find that the terms of use for those services have changed many times over the years.

Contractual innovations have also been validated and reinforced through legislation. The ability of parties to form binding contractual agreements using electronic records has been validated under state law through UETA[8] and in federal law through the Electronic Signatures in Global and National Commerce Act ("E-Sign").[9]

The Trend Towards SaaS and Subscription Agreements

In the years that followed UETA and E-Sign, much on the online economy has transitioned away from the "software as a product" model where the licensee downloads the entirety of the software being used to their own machines and moved towards providing "software as a service" ("SaaS") where the licensee accesses the software from servers controlled by the licensor. Long established software vendors such as Microsoft and Adobe now favor providing access to their applications exclusively through monthly subscription agreements rather than one-time license fees.

The business trend towards subscription agreements is necessarily impacting the expectations that parties have with respect to online contract terms and the flexibility of vendors to change those terms without an affirmative expression of consent by their customers. One prominent example of how business and technical innovations are shaping contractual expectations is Amazon Web Services ("AWS"). AWS is the industry leader in cloud computing,[10] a market that is expected to grow from $371.4 billion in 2020 to $832.1 billion by 2025.[11] The AWS Customer Agreement expressly reserves the right to make unilateral changes in the future:

> 12. Modifications to the Agreement.
>
> We may modify this Agreement (including any Policies) *at any time by posting* a revised version on the AWS Site or by otherwise notifying you in accordance with Section 13.10; provided, however, that we will provide at least 90 days' advance notice in accordance with Section 13.10 for adverse changes to any Service Level Agreement. Subject to the 90 day advance notice requirement with respect to adverse changes to Service Level Agreements, *the modified terms will become effective upon posting* or, if we notify you by email, as stated in the email message. By continuing to use the Service Offerings after the effective date of any modifications to this Agreement, you agree to be bound by the modified terms. *It is your responsibility to check the AWS Site regularly for modifications* to this Agreement. We last modified this Agreement on the date listed at the end of this Agreement (emphasis added).

Given the substantial and growing importance of cloud infrastructure services provided by companies such as Amazon and Microsoft to the large enterprises who have outsourced much of what once were internal IT operations, the categorical rejection of unilateral contract modifications is unlikely to occur in the future. This is particularly true in a business-to-business context.[12]

In certain respects, incorporating website terms is a natural online extension to the more traditional paper-version of a purchase order.

UCC 2-205: Firm Offers

The incorporation of website terms by reference into an agreement was recently validated by the Michigan Court of Appeals in *Cadillac Rubber & Plastics, Inc v Tubular Metal Sys, LLC,* which addressed the issue in the context of UCC 2-205 and UCC 2-306.[13]

Section 2-205 of the UCC provides the requirement of "firm offers" as a prerequisite for the formation of a contract.

> An offer by a *merchant* to buy or sell goods in a *signed writing* which by its terms gives assurance that it will be held open is *not revocable, for lack of consideration*, during the time stated or if no time is stated for a *reasonable time*, but in no event may such period of irrevocability exceed 3 months; but any such term of assurance on a form supplied by the offeree must be *separately signed by the offeror*.[14]

UCC 2-205 is relevant to the incorporation of online terms into an agreement to the extent that the terms are typically not in a "signed writing" much less "separately signed by the offeror." Moreover, UCC 2-205 addresses situations where it is unknown whether or not an actual exchange of contractual consideration will eventually take place, resulting in what could be a potentially "illusory" arrangement. Few published decisions by Michigan courts cite UCC 2-205.[15]

UCC 2-306: Output, Requirements, and Exclusive Dealings

UCC 2-306 relates to contracts where the quantity of goods is not known at the time of contracting:

> (1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur *in good faith*, except that no quantity *unreasonably disproportionate* to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.
>
> (2) A lawful agreement by either the seller or the buyer for *exclusive dealing* in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use *best efforts* to supply the goods and by the buyer to use *best efforts* to promote their sale.[16]

Changes in information technology, innovative business practices, and creative lawyering have presented many questions of what can and cannot form the basis of a binding contract.

Subsection (1) of UCC 2-306 places certain constraints of "good faith" and not being "unreasonably disproportionate" to any stated estimate in the context of a requirements contract. Section (2) of UCC 2-306 places the requirement of "best efforts" on a seller or buyer benefiting from an exclusive relationship.

Cadillac Rubber & Plastics, Inc. v. Tubular Metal Systems, LLC

In *Cadillac Rubber & Plastics, Inc v Tubular Metal Sys, LLC*[17] the Michigan Court of Appeals upheld the enforceability of a contract in which online terms were incorporated by reference. The dispute involved Avon, the plaintiff/appellant, a supplier of automotive hoses to Tubular, the defendant/appellee, who used the hoses in producing parts for General Motors.[18]

The court summarized the key facts as follows:

> Tubular issued two blanket purchase orders to Avon, one in 2012 and the other in 2016. Both purchase orders provided that Tubular would release material requirements each week. *The orders further incorporated by reference Tubular's terms and conditions of purchase, which were posted online.* Paragraph 4(b) of those terms and conditions is particularly relevant to this case, stating:
>
> If the face of the Order … specifies the quantities as … "blanket order," … then, in *consideration for ten US dollars (US$10.00)*, the payment of which shall be made by Buyer upon the termination or non-renewal of this Order, Seller grants to Buyer an irrevocable option during the term of this Order to purchase Supplies in such quantities as determined by Buyer and identified as firm orders in material authorization releases, manifests, broadcasts or similar releases ("Material Authorization Releases") that are transmitted to Seller during the term of this Order … provided that Buyer shall purchase no less than one piece or unit of each of the Supplies and no more than one hundred percent (100%) of Buyer's requirements for the Supplies. All references herein to "this Order" shall include any Material Authorization Releases (emphasis added).[19]

Section 2 of the terms and conditions defined the term of the contract as "for the life of the program initiated by Buyer's Customer [General Motors]."[20] "Beginning with the 2012 purchase order, Tubular issued weekly material authorization releases to Avon, listing the quantity of parts needed and a reasonable forecast of future requirements. Avon fulfilled those releases with the required parts."[21]

In 2018, Avon filed a complaint:

> seeking declaratory judgment and damages for breach of contract. Under the purchase orders and Tubular's terms and conditions, Tubular is only obligated to purchase the quantity of parts set forth in its material authorization releases. According to Avon, "[t]his 'per releases' quantity term creates a series of spot-buy (also called fixed-quantity) contracts, *not a requirements contract.*" Therefore, Avon asserted that it had the right to accept or reject each material authorization release issued by Tubular. Avon further claimed that the "irrevocable option" allegedly created by ¶ 4(b) of Tubular's terms and conditions "is invalid and/or not binding on Avon because it is on Tubular's form and *Avon did not separately sign the portion of the form that contains the alleged firm offer*. MCL 440.2205." Avon

> requested a judgment declaring that the blanket purchase orders are not requirements contracts, the alleged "irrevocable option" in Tubular's terms is invalid or unenforceable, and Avon has the right to reject any material authorization release that Avon has not yet accepted. Avon also asserted that Tubular had breached the parties' contracts by requiring Avon to supply Tubular's requirements of the parts (emphasis added).[22]

In response, "Tubular argued that an enforceable requirements contract existed between the parties in light of the blanket purchase orders, Tubular's terms and conditions, the material authorization releases, and the parties' ongoing relationship since 2012. Tubular further argued that an enforceable option contract existed."[23]

The trial court granted Tubular's motion for summary disposition pursuant to MCR 2.116(I)(2).[24] The Michigan Court of Appeals decision expressed its agreement with the trial court that the "separate-signature requirement [of UCC 2-205] only applies when no consideration is given for the firm offer."[25] In this case, the firm offer was supported by consideration, specifically $10. Therefore, this [separately signed by the offeror] provision does not apply."[26] The court then quoted comment 3 to UCC 2-205, which specifically states that "[t]his section deals only with the offer which is not supported by consideration."[27]

Avon argued that "even if there was an enforceable firm offer, this agreement did not create a requirements contract"[28] but rather a series of "spot buy" contracts with individual quantities instead of a single requirements contract.[29] Avon argued that the nonexclusivity of the purchases and the fact that each order acted as a single transaction with separate quantities meant that this agreement was not a single requirements contract.[30] The Court of Appeals affirmed the trial court in rejecting Avon's argument, explaining that Tubular's two purchase orders incorporated Tubular's terms and conditions from its website and that the purchase orders also provided for a weekly "material requirement."[31] This combination was sufficient to create a requirements contract under UCC 2-306. A requirement contracts did not need to be exclusive to be a requirements contract, as exclusivity was only referenced in UCC 2-306(2) and not UCC-2-306(1).[32]

Examples of Failed Attempts to Incorporate Website Terms

There are some cases outside of Michigan where the attempt to incorporate online terms failed. In *Affinity Internet, Inc v Consolidated Credit Counseling Servs, Inc,*[33] the Florida Court of Appeals refused to enforce an arbitration clause in online terms and conditions because the written contract used the words "subject to" instead of the words "incorporate by reference."

In *Feldman v United Parcel Serv, Inc,*[34] a Federal District Court rejected the attempt to incorporate website terms into the agreement because UPS did not make it easy for the customer to access that information:

> Just above the "Print" button, which a customer must click to print the shipping label, the screen reads as follows: "Review everything carefully and then click *Print* to print your shipping request … Below the "Print" button are two hyperlinks, one entitled "Terms of Service" and the other entitled "Privacy Policy."… If a customer clicks on the "Terms of Service" button, a pop-up window is displayed on the computer screen that states that all shipments are subject to restrictions set forth in the UPS Tariff…The pop-up screen further states that the UPS Tariff is available on the UPS website or upon request from the counter associate, and it provides the web address of the general UPS website. (*Id.*) *The pop-up screen, however, does not provide a hyperlink to the UPS website or the terms of the tariff* (emphasis added).

In *Fu Da Int'l v Kohl's Dep't Stores, Inc,*[35] a federal district court rejected the alleged incorporation by reference of online terms because they were not shown to have existed until after the initial contract was signed:

> However, Kohl's, the party seeking to enforce the clauses, has not shown that the forum selection clause in the Terms and Conditions was reasonably communicated to Fu Da, or that the parties were subject to it. Although Fu Da was bound to the "terms and conditions on www.connection.kohls.com," as incorporated into the Vendor Purchase Agreement, it was only subject to such terms that existed on Kohl's' website at the time of its entry into the Vendor Purchase Agreement on April 5, 2006. Fu Da argues that because the date on

In *Cadillac Rubber & Plastics, Inc v Tubular Metal Sys, LLC* the Michigan Court of Appeals upheld the enforceability of a contract in which online terms were incorporated by reference.

> the Terms and Conditions submitted by Kohl's is April 2008, Kohl's has not shown that the Terms and Conditions existed, or existed in the same form, in April 2006.
>
> Kohl's concedes that a forum selection clause is deemed a "material alteration" of a contract where it is added "after the fact and unilaterally by one party to the agreement, without the consent of the other side." … If Kohl's added the forum selection clause to its website after Fu Da signed the Vendor Purchase Agreement, it would be unenforceable without evidence of Fu Da's clear and unequivocal agreement to such a clause because it would be an improper material alteration to the Vendor Purchase Agreement.

Section 304(a) of UCITA provides that the terms of the agreement "do not have to be repeatedly displayed or otherwise brought to the attention of a party with respect to each successive performance, unless the terms are modified."

These cases show that the party seeking to incorporate website terms cannot be seen to hide the intention or implications of incorporated website terms and conditions into an integrated agreement. It is an interesting thought experiment to envision how the court in *Fu Da* would have analyzed the AWS Customer Agreement quoted earlier in this article.

Uniform Computer Information Transactions Act ("UCITA")

The Uniform Computer Information Transactions Act ("UCITA")[36] was developed by the National Conference of Commissioners on Uniform State Laws ("NCCUSL").[37] Since its approval by the NCCUSL in 1999, it has been enacted by only Maryland[38] and Virginia.[39] UCITA has not been enacted by a Michigan court. Nor has it ever been referenced or cited by a Michigan court.[40] UCITA has nonetheless been referenced when courts are faced with difficult questions and are looking for guidance. When Supreme Court Justice Sotomayor sat on the U.S. Court of Appeals for the Second Circuit, her opinion in *Specht v Netscape Commc'ns Corp*, 306 F3d 17 (2nd Cir 2002) provided the following analysis within the footnotes that mentioned UCITA 17 times:[41]

> We hasten to point out that UCITA, which has been enacted into law only in Maryland and Virginia, does not govern the parties' transactions in the present case, but we nevertheless find that UCITA's provisions offer insight into the evolving online "circumstances" that defendants argue placed plaintiffs on inquiry notice of the existence of the SmartDownload license terms.

Section 304(b) of UCITA, which describes the procedure for changing terms as to future performances, does directly address the issue of unilateral changes to a contract:

> (b) If a contract provides that terms may be changed as to future performances by compliance with a described procedure, a change proposed in good faith pursuant to that procedure becomes part of the contract if the procedure:
>
> (1) Reasonably notifies the other party of the change; and
>
> (2) In a mass-market transaction, permits the other party to terminate the contract as to future performance if the change alters a material term and the party in good faith determines that the modification is unacceptable.

The key requirements for a binding and enforceable unilateral change through a change in website terms are: (1) the contract must provide for that ability to amend the terms in the future; (2) there must be reasonable notice, but not necessarily advance notice; and (3) an ability to terminate in response to the change if the transaction is a mass-market transaction. The term "mass-market transaction" is defined in Section 102(a)(45) and categorically covers consumer transactions as well as other transactions were the customers are subject to substantially identical terms. An example of a mass-market transaction would be the AWS Customer License referenced above. Section 7.2(a) of the AWS Customer License Agreement allows termination for convenience upon 30-days advance notice, but section 12 of that agreement allows for unilateral modifications without providing advance notice (except for changes to the Service Level Agreement for which 90 days advance notice is required).

Section 304(a) of UCITA provides that the terms of the agreement "do not have to be repeatedly displayed or otherwise brought to the attention of a party with respect to each successive performance, unless the terms are modified." Section 304(c) of UCITA provides that "the parties by agreement may determine the standards for reasonable notice unless the agreed standards are manifestly unreasonable in light of the commercial circumstances."

Cases Citing UCITA

In *MA Mortenson Co v Timerline Software Corp*,[42] the Washington Supreme Court cited UCITA in support of a "layered contracting" approach:

> UCITA embraces the theory of "layered contracting," which acknowledges while "some contracts are formed and their terms fully defined at a single point in time, many transactions involve a rolling or layered process. An agreement exists, but terms are clarified or created over time. UCITA § 208 cmt. 3 (Approved Official Draft).

The decision addressed "whether a limitation on consequential damages enclosed in a 'shrinkwrap license' accompanying computer software is enforceable."[43] The plaintiff used defendant's software "to prepare a construction bid and discovered the bid was $1.95 million less than it should have been."[44]

The dispute involved a purchase order[45] and a license agreement[46] "set forth on the outside of each diskette pouch" that was not seen by the licensee until after delivery of the software. The license agreement included the following provision:

> CAREFULLY READ THE FOLLOWING TERMS AND CONDITIONS BEFORE USING THE PROGRAMS. USE OF THE PROGRAMS INDICATES YOUR ACKNOWLEDGEMENT THAT YOU HAVE READ THIS LICENSE, UNDERSTAND IT, AND AGREE TO BE BOUND BY ITS TERMS AND CONDITIONS. IF YOU DO NOT AGREE TO THESE TERMS AND CONDITIONS, PROMPTLY RETURN THE PROGRAMS AND USER MANUALS TO THE PLACE OF PURCHASE AND YOUR PURCHASE PRICE WILL BE REFUNDED. YOU AGREE THAT YOUR USE OF THE PROGRAM ACKNOWLEDGES THAT YOU HAVE READ THIS LICENSE, UNDERSTAND IT, AND AGREE TO BE BOUND BY ITS TERMS AND CONDITIONS.[47]

The license agreement also included a limitation of remedies and liability section that excluded consequential damages.[48] The president of defendant personally delivered the software to one of plaintiff's offices and was asked to return at a later date for installation.[49] The parties dispute what happened on the day that the software was installed, but the defendant argued that plaintiff's president opened and installed the software and that as a result, the defendant "never saw any of the licensing information."[50] A "bug" was subsequently discovered in the software, and litigation commenced "alleging breach of express and implied warranties."[51] Despite's defendants contention that the contract "consisted of the purchase order and that it never saw or agreed to the provisions in the license agreement," summary judgment was granted by the trial court.[52] The Court of Appeals affirmed, finding that "(1) the purchase order was not an integrated contract; (2) the license terms were part of the contract; and (3) the limitation of remedies clause was not unconscionable, and therefore enforceable."[53]

The parties to the dispute agreed that Article 2 of the UCC applied to the licensing of software, and the Washington Supreme Court was persuaded by the defendant's argument that "the parties did not intend the purchase order to be an exclusive recitation of the contract terms, and points to the absence from the purchase order of several key details of the agreement."[54]

Conclusion

So long as the incorporated terms from a website do not render the contract between the parties as purely illusory, such agreements are likely to be upheld by future courts. While a comprehensive rewriting of the contract by an overly opportunistic party is unlikely to be enforced, a contract in which one party reserves the rights to make unilateral changes to the agreement will be upheld in many contexts. The prospects for validation are increased with more active attempts to notify the other party and the ability of the other party to terminate in response to undesirable changes.

So long as the incorporated terms from a website do not render the contract between the parties as purely illusory, such agreements are likely to be upheld by future courts.

NOTES

1. *M&G Polymers USA, LLC v Tackett*, 574 US 427, 441 (2015) ("a promise that is 'partly' illusory' is by definition not illusory").
2. *See Hittlesey v Herbrand Co*, 217 Mich 625, 628, 627, 187 NW 279 (1922) ("'a contract must be construed as a whole, effect must be given to writings incorporated in the contract by reference'").
3. *See* MCL 450.831-.849. *See also* 15 USC 7001-7006.
4. *See* Uniform Computer Information Transactions Act ("UCITA") Section 304(b).
5. *Jacobsen v Katzer*, 535 F3d 1373, 1382 (Fed Cir 2008).
6. *Hearing Consultants, Inc v J2 Global Commc'ns, Inc*, No 2014-003540-CK (Mich Cir Sept 11, 2014); *Zaltz v. JDATE,* 952 F Supp 2d 439 (EDNY 2013).

7. *ProCD, Inc v Zeidenberg*, 86 F3d 1447 (7th Cir 1995).

8. *See* MCL 450.831-.849.

9. *See* 15 USC 7001-7006.

10. www.Statisa.com as published on July 5, 2021. https://www.statista.com/chart/18819/worldwide-market-share-of-leading-cloud-infrastructure-service-providers/.

11. https://www.globenewswire.com/news-release/2020/08/21/2081841/0/en/Cloud-Computing-Industry-to-Grow-from-371-4-Billion-in-2020-to-832-1-Billion-by-2025-at-a-CAGR-of-17-5.html.

12. *See Cadillac Rubber & Plastics, Inc v Tubular Metal Sys, LLC,* 331 Mich App 416, 419, 952 NW2d 576 (2020) (defendant argued that the terms set forth on the website were not binding because those terms were not signed); *Briede v Valspar Corp*, No 12-CV-13406 at *15 (ED Mich 2013) ("Plaintiff argues that the Service Contract is an illusory contract because it 'gives the promisor the unlimited right to determine the nature or extent of his performance'"). *MA Mortenson Co v Timberline Software Corp,* 140 Wash2d 568, 598 (2000) (defendant software licensee alleges not to have seen the terms prior to the installing of the software).

13. *Cadillac Rubber & Plastics, Inc v Tubular Metal Sys, LLC*, 331 Mich App 416, 419, 952 NW2d 576 (2020).

14. MCL 440.2205 (emphasis added).

15. In a nationwide Lexis search performed on August 7, 2021, only three cases could be found citing MCL 440.2205. *See Cadillac Rubber & Plastics, Inc v Tubular Metal Sys, LLC*, 331 Mich App 416, 952 NW2d 576 (2020) (the case that is the primary focus of this article); *H&H Wholesale Servs, Inc v Kamstra Int'l, BV*, 373 F Supp 3d 826, 835 (ED Mich 2019) (tangential reference to MCL 440.2205 as a "price gap filler"); and *People v. Evans*, 434 Mich. 314, 329 n13, 454 N.W.2d 105 (tangential reference to UCC 2-205 in a footnote in criminal case on the issue of a forfeited surety bond).

16. MCL 440.2306 (emphasis added).

17. *Cadillac Rubber & Plastics, Inc v Tubular Metal Sys, LLC,* 331 Mich App 416, 952 NW2d 576 (2020).

18. *Id.* at 419.

19. *Id.* at 419-420.

20. *Id.* at 420.

21. *Id.* at 420.

22. *Id.* at 420-421.

23. *Id.* at 421.

24. *Id.* at 422.

25. *Id.* at 423.

26. *Id.* at 423.

27. *Id.* at 424.

28. *Id.* at 425.

29. *Id.* at 426.

30. *Id.* at 426.

31. *Id.* at 426-428.

32. *Id.*

33. *Affinity Internet, Inc. v Consolidated Credit Counseling Svcs., Inc.*, 920 So2d 1286, 1288 (Fla Ct App 2006).

34. *Feldman v United Parcel Serv, Inc*, No 06 Civ 2490(MHO) (SDNY Mar 24, 2008).

35. *Fu Da Int'l v Kohl's Dep't Stores, Inc,* No 08 Civ 5164(HB) (SDNY Jan 21, 2009).

36. https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=3cdfd26f-995c-7d32-bc3e-6acfbcec67d5&forceDialog=0.

37. https://www.uniformlaws.org/home.

38. Md Com Law Code Ann. 22-101 et al.

39. Va Code Ann 59.1-501,2 et al.

40. A Lexis search performed on August 8, 2021 failed to reveal even one Michigan court decision that included the text "UCITA."

41. *Specht v Netscape Commc'ns Corp*, 306 F3d 17, 39 n17 (2nd Cir 2002).

42. *See MA Mortenson Co v Timberline Software Corp,* 140 Wash2d 568, 998 P2d 305 n10 (2000) ("UCITA embraces the theory of 'layered contracting,' which acknowledges while 'some contracts are formed and their terms fully defined at a single point in time, many transactions involve a rolling or layered process" where an "agreement exists, but terms are clarified or created over time.").

43. *Id.* at 423.

44. *Id. at 423.*

45. *Id.* at 573.

46. *Id.* at 574.

47. *Id.*

48. *Id.* at 575.

49. *Id.*

50. *Id.*

51. *Id.* at 576.

52. *Id.* at 577.

53. *Id.*

54. *Id.* at 577-578.

Christopher J. Falkowsk is a former computer programmer who started his solo law practice at Falkowski PLLC in 2005. Mr. Falkowski works primarily with tech-based startup enterprises, helping them to navigate intellectual property, information technology, and general business issues. He is a two-time former Chairperson for the IT Law Section for the State Bar of Michigan. Mr. Falkowski represents clients on patent and trademark matters before the USPTO. He is also licensed to practice before the U.S. Supreme Court as well as the U.S. Court of Appeals for the Federal Circuit.

A Manufacturer's Pandemic Survival Guide: Supply Chain Contracting Strategies and Considerations for Mitigating Future Risk

By Nicholas J. Ellis and Leah R. Imbrogno

Introduction

Now in its second year, the full effects of the pandemic on manufacturers and the supply chain are just starting to come into focus. As companies continue to dig out from under the crush of supply shortages and delivery issues, we are able to look back on the issues they faced as a result of the pandemic and consider lessons learned. This article addresses some of the most critical supply chain contract provisions that became vital as a result of the pandemic, as well as strategies to mitigate risk, with the goal of helping companies continue to navigate through the pandemic and prepare for inevitable future shocks to the supply chain.

The Pandemic's Impact on Manufacturers

For manufacturers, the pandemic revealed inherent weaknesses in the supply chain. The pandemic changed almost everything about the way that business was conducted, with shipping and transportation of goods in particular grinding to a near halt. All of a sudden, suppliers were dealing with a lack of materials, employee shortages, and the inability to meet their contractually agreed-upon deadlines. The stress on the supply chain hit just-in-time (JIT) manufacturers and their customers particularly hard.

To promote efficiency and reduce costs, JIT manufacturers intentionally work on tight production schedules, limit sub-suppliers, and keep little-to-no inventory on hand. The success of JIT manufacturing is dependent on each link in the supply chain running smoothly and without delay. The pandemic—and resultant delays due to, among other things, employee shortages or government restrictions—started a chain reaction that left JIT suppliers unable to conduct business as usual. With plants shut down or working on reduced capacity, and few contingency plans in place, delivery deadlines came and went.

Buyers cried breach, while suppliers and buyers alike scrambled to their contracts to review force majeure provisions and other rights and obligations. Some were able to rely on well-crafted contractual provisions as a protection against liability for delay, while others learned (often for the first time) that their contracts provided little protection in the event of catastrophe. For better or worse, the pandemic has provided all parties to the supply chain with an excuse to take time to review their contracts, including their standard terms and conditions of purchase or sale, and revise them to ensure they contain necessary provisions to protect the company's rights in the event of an unexpected crisis.

Contracting Key Terms and Strategies

The foundation of any supply relationship is the parties' contract. The contract sets forth their respective rights and responsibilities and, in some cases, the circumstances in which those responsibilities may be excused. Under the Uniform Commercial Code (UCC), contracts can take many forms, from an extensively negotiated long-term supply agreement, all the way down to a simple handwritten order form or even the conduct and emails of the parties.[1] The pandemic, and related government restrictions, highlighted the importance of many contractual provisions and how they affect the parties' rights, and ultimately the costs and liabilities they have incurred as a result of the pandemic.

Force Majeure

Arguably, the pandemic has not impacted any area of supply chain contract practice

The foundation of any supply relationship is the parties' contract.

more so than the humble force majeure provision. While such terms vary widely depending on the contract,[2] generally speaking, a force majeure provision excuses a party from liability due to a delay or failure to perform an obligation under the contract if performance has been made impossible or impracticable due to an unforeseeable event that is outside of the non-performing party's control.[3] In this regard, force majeure provisions are similar (although not identical) to the default protections provided under section 2-615 of the UCC in circumstances when performance is rendered impracticable due to the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract was made.

While many parties, and most courts that have addressed the issue,[4] have acknowledged that the pandemic and/or related government restrictions likely qualify as a force majeure event under most force majeure provisions, the primary area of dispute often involves the degree to which these events have actually prevented performance. Absent specific contractual language providing otherwise, most courts generally require that, in order to invoke force majeure, performance must have been rendered effectively impossible, not just more expensive or difficult.[5]

The pandemic has elevated the force majeure provision from a term that, in many cases, was little more than an afterthought, to one of the most critical contractual risk mitigation provisions. Buyers and suppliers should carefully consider the force majeure provisions in their contracts, both with respect to their scope and the clarity of the parties' rights and obligations. In cases where they may not already be expressly covered, parties should consider adding pandemics and government action to any list of enumerated force majeure events.

Both sides also may want to consider language clarifying or conditioning their obligations with respect to increased cost—although their interests and goals will usually be opposed. For example, a buyer may wish to include express language obligating the supplier to pay for expedited freight, overtime, or other costly measures that can be used to overcome or mitigate issues posed by a force majeure event. Although arguably required in many cases under the existing law, express language imposing such requirements can help avoid disputes and the risk that comes with uncertainty. Conversely, suppliers may wish to qualify or limit their obligations to incur additional costs and avoid the sometimes harsh default rules applied by many courts. This can be achieved to some degree by adding either "reasonableness" language to qualify the obligations, or, if the supplier has significant leverage, more concrete limits on the measures/expenses that the supplier is required to undertake.

Quantity

Under the UCC, the only term that must appear in a contract for the sale of goods is quantity.[6] Absent a written quantity term, any contract for the sale of goods (over $1000) is unenforceable under the statute of frauds provisions of the UCC.[7] A written quantity term need not be expressly set forth as a number. It is sufficient that there is a writing, signed by the parties, from which a quantity can be determined, even if doing so requires reference to evidence outside of the contract. For example, many manufacturing contracts are "requirements contracts," under which the quantity term is not fixed but instead is defined by the requirements of the buyer.

Throughout the course of the pandemic, particularly as costs of production began to rise due to higher commodity costs, higher labor costs, costs of compliance with COVID-19 safety measures, and other factors, many suppliers sought to increase their prices. Some even looked to exit certain lines of business altogether. In cases where the parties' contract does not include a proper written quantity term, suppliers have found a legal "out" that might not otherwise exist. Where the contract lacks an enforceable quantity that the supplier is obligated to provide, the supplier has no further obligation and can set new terms, including higher prices, as a condition to accepting additional orders.

Duration and Rights of Termination

Critical to any supply contract is the duration for which the parties are bound. Under the UCC, absent an agreed duration, a contract may be terminated by either party upon "reasonable notice."[8] Some contracts also provide one or both parties with the right to terminate the agreement earlier than the agreed-upon duration, often upon some period of written notice. Similarly, some contracts are structured to include a series of shorter terms that renew automatically, with the ability of one or both parties to decline a renewal by providing notice within a specified time of the expiration date.

As with the issues noted above regarding quantity, contracts without a specified duration, or that otherwise allow for a non-renewal or early termination, provide parties with the ability to exit a difficult or unprofitable contract when faced with higher prices and rising costs. Contractual notice periods that may have allowed sufficient time to identify an alternative provider during normal times often proved inadequate in the midst of the pandemic, with limited ability to conduct onsite visits and with market costs for any replacement increasing.

As many sectors of the economy continue to struggle with their supply chains and limited capacity, companies should carefully consider the balance of risks between a long-term commitment versus a contract that allows for an early exit. To the extent that a contract allows for early exit or non-renewal, buyers should consider carefully how much time is needed to complete a re-sourcing. If the supplier is unwilling to sign up for a longer term commitment or notice period, including an obligation on the supplier to cover transition services following a termination, this may present a reasonable compromise position.

Limitations of Liability

The UCC permits contracting parties to limit their liability and the remedies available for breach.[9] There are a number of ways that parties may try to limit liability in their supply contracts, including consequential damages disclaimers and damages caps. A limitation of remedy is a tool, most often used by suppliers, to reduce the remedies that a buyer may be entitled to in the event of a breach—e.g., limiting the buyer to "repair or replacement" of a defective product.[10] In contrast, a limitation on damages expressly excludes certain kinds of damages—such as incidental and consequential damages—or capping the total damages that the other side can recover.

For many suppliers and buyers, the power of these risk-shifting provisions, and particularly limitations on damages, was highlighted during the pandemic. For example, a supplier may have been fully in breach of its contractual obligations. However, if the buyer had previously accepted a contract that disclaimed incidental/consequential damages, or otherwise significantly limited the supplier's liability, the buyer could be left without a claim for meaningful damages. This not only limits the buyer's recourse in any litigation, it also significantly alters the bargaining power between the parties during any discussions as the buyer seeks to obtain compliance.

Both buyers and suppliers should continue to pay close attention to any limitation on damages or remedies in their contracts and consider carefully the impact that such provisions may have in light of the ongoing disruptions resulting from the pandemic. The ability of parties to negotiate such provisions often depends almost entirely on their respective leverage in negotiating the contract. When forced to accept provisions that they might otherwise have preferred to avoid, parties should, to the extent possible, focus on limitations or exclusions that address the most egregious or worst case scenarios. A buyer that has no choice but to accept certain limitations on liability may be able to seek carve-outs that allow full liability in the case of an intentional or bad-faith breach of the agreement. Conversely, suppliers that are unable to obtain a general limitation on liability may have better luck negotiating for more narrow exceptions, such as capping liability for expedited freight costs in any given month.

Choice of Law/Forum

Last, but certainly not least, parties should consider the choice of law and choice of forum provisions in their contracts and the practical effect that those provisions may have on their available remedies. A choice of law provision selects the law that will govern the contract, and a choice of forum governs the jurisdiction where such claims must (if exclusive) or may (if non-exclusive) be brought. While these provisions can have a significant practical impact on a dispute, many parties do not give proper consideration to their impact. A buyer may have an otherwise ironclad argument that a supplier is obligated to deliver a product according to the contract. However, if the forum selection provision requires the buyer to bring any dispute in a foreign jurisdiction, the buyer may find that it is not possible, or at least not practical, to be able to enforce its rights in time to avoid significant disruption in supply. On the other hand, a supplier facing non-payment for goods previously delivered may find it not financially viable to have to

Under the UCC, the only term that must appear in a contract for the sale of goods is quantity.

bring a suit in a foreign country to collect on outstanding payments.

Both buyers and suppliers should carefully consider the practical impact of any choice of law or forum selection provision on the exercise of their remedies. In cases where the other side may not be willing to litigate in a company's home jurisdiction, consider whether there may be other "neutral" jurisdictions in which both parties have operations or otherwise are comfortable litigating. In some cases, particularly those involving international transactions, arbitration may provide a viable compromise, although arbitrations can bring their own costs and potential challenges.

Both buyers and suppliers should continue to pay close attention to any limitation on damages or remedies in their contracts and consider carefully the impact that such provisions may have in light of the ongoing disruptions resulting from the pandemic.

Practical Considerations to Mitigate Future Risk

The first and best line of defense in mitigating risk is to ensure that the contractual provisions discussed above are reviewed in detail and renegotiated if necessary to protect a company's rights. However, there also are several practical considerations and strategies that should be considered to help manufacturing companies in particular continue to navigate through the pandemic and prepare for the next worldwide crisis. Although these items may result in certain cost increases in the company's supply chain, the investment may well prevent damages down the road.

Develop a Supplier Contingency Plan

Consider qualifying multiple suppliers to prepare in the event of shortages, and options to dual-source certain products and raw materials. If the supplier is a sole-source, directed-buy, manufacturing companies should consider whether they are in a position to ask the buyer for more than one directed supplier. Companies should closely examine the entire length of their supply chain and develop back-up plans for sourcing any materials or processes that are essential to manufacturing their products. Companies that take this approach also may want to consider imposing the same obligations on their sub-suppliers.

Coordinate Data Sharing and Communication with Sub-suppliers

Incorporating business-to-business communications between suppliers helps to ensure that companies are not caught by surprise in the event of a shortage or stoppage of work. Parties to the supply chain have the common goal of maintaining continuity of supply. As such, each link in the supply chain should work together to ensure that they have open communications regarding potential disruptions to supply.

Consider Warehousing of Inventory

Consider whether stocking parts is feasible for your business or whether there is an option to require your supplier to maintain a bank of parts or inventory in a different, nearby location. Also consider whether in-housing certain manufacturing operations or parts is an option for your business. While this strategy is not a foolproof way to ensure continuity of supply, it does provide manufacturers with options to maintain production in the face of materials shortages.

Conclusion

It is not *if* another global crisis occurs, but *when*. Manufacturers should invest in developing contingency plans now to ensure they are adequately prepared for future risks to the supply chain. Those companies that can demonstrate resiliency in the face of uncertainty and challenges will be best positioned for long-term success. The issues discussed above represent just a few examples of the ways in which the pandemic has altered many companies' approach to contracting and business. Going forward, manufacturers must consider the changed landscape of the supply chain and how best to protect their interests.

NOTES

1. MCL 440.2204.
2. *Melford Olsen Honey, Inc v Adee*, 452 F3d 956, 963 (8th Cir 2006) (The scope and effect of a *force majeure* clause depends on the specific contract language).
3. *Black's Law Dictionary* 674 (8th ed 2004).
4. *See, e.g.*, *JN Contemporary Art LLC v Phillips Auctioneers LLC*, 507 F Supp 3d 490 (SDNY 2020); *In re Hitz Rest Grp*, 616 BR 374 (Bankr ND Ill 2020).
5. *Phillips Puerto Rico Core, Inc v Tradax Petroleum Ltd*, 782 F2d 314 (2d Cir 1985); *Erickson v Dart Oil & Gas Corp*, 189 Mich App 679, 474 NW2d 150 (1991).
6. *Trost v Trost*, 525 Fed Appx 335, 345 (6th Cir 2013).
7. MCL 440.2201(1).
8. MCL 440.2309(2); John R. Trentacosta & Irina Kashcheyeva, *Risks and Strategies with Contracts of Indefinite Duration*, 32 MI Bus LJ 13 (Fall 2012).
9. MCL 440.2718; MCL 440.2719; *WXON-TV, Inc v AC Nielsen Co*, 740 F Supp 1261 (ED Mich 1990).
10. MCL 440.2719(1)(a).

Nicholas J. Ellis is a senior counsel and litigator in the Detroit office of Foley & Lardner LLP. He is a supply chain attorney whose practice focuses on the Uniform Commercial Code (UCC), supply chain disputes, warranty claims, contract law and business tort law. He has significant experience with supply chain disputes, including breach of contract, breach of warranty, pricing, and "stop shipment" disputes in the state and federal courts for Michigan and other jurisdictions, as well as various arbitral tribunals, including the American Arbitration Association (AAA) and International Center for Dispute Resolution (ICDR). He is a member of Foley & Lardner LLP's Business Litigation & Dispute Resolution Practice and Automotive Industry Team.

Leah R. Imbrogno is a senior counsel, commercial litigator and trial lawyer with Foley & Lardner LLP. She assists corporate clients, specifically manufacturing and automotive companies, throughout all phases of complex commercial litigation, mediation, arbitration, and international arbitration. Leah has successfully litigated and tried cases in state and federal courts, the American Arbitration Association (AAA) and the Singapore International Arbitration Centre (SIAC). She is a member of Foley's Business Litigation & Dispute Resolution Practice and Automotive and Manufacturing Industry Teams.

Section 2-201 Isn't Optional: Option Provisions, Requirements Contracts, and Cadillac Rubber

By Jason D. Killips*

Introduction

Is an option provision in a contract for the sale of goods—one in which the buyer has the option to buy as many parts from the seller as it chooses so long as it buys at least one—enforceable under the Uniform Commercial Code? According to the Michigan Court of Appeals, it is because an option provision creates a requirements contract under § 2-306 of the UCC.[1] This article argues that not only did the court rule incorrectly in the context of the case (which was decided on summary disposition), but that contracts for the sale of goods with such option provisions should be enforced only one release at a time.

The Michigan Court of Appeals Enforces an Option Provision as a Requirements Contract

In *Cadillac Rubber*, the seller manufactured hoses that it delivered to the buyer, which used the hoses to assemble larger components for General Motors.[2] The buyer's terms and conditions, incorporated into the parties' contract, contained an options provision:

> in consideration for ten US dollars (US$10.00), the payment of which shall be made by Buyer upon the termination or non-renewal of this Order, Seller grants to Buyer an irrevocable option during the term of this Order to purchase Supplies in such quantities as determined by Buyer and identified as firm orders in material authorization releases, manifests, broadcasts or similar releases ("Material Authorization Releases") that are transmitted to Seller during the term of this Order … provided that Buyer shall purchase no less than one piece or unit of each of the Supplies and no more than one hundred percent (100%) of Buyer's requirements for the Supplies.[3]

The buyer issued releases to the seller each week, specifying firm quantities and a forecast of future quantities; the seller then delivered parts to fill those releases.[4] But the parties did not live happily ever after.

For reasons undisclosed in the appellate opinion, the seller sued the buyer, seeking a declaratory judgment clarifying the nature of the parties' contracts, and immediately moved for summary disposition.[5] It argued that the option provision didn't create a requirements contract, so the parties were bound only one release at a time—essentially, they agreed to a series of fixed-quantity contracts.[6] This structure would give the seller the freedom to accept or reject each release because each is a separate contract.[7] The buyer argued in response that the option provision created an enforceable requirements contract.[8] The trial court granted summary disposition in favor of the buyer, holding that the parties had a requirements contract.[9] A divided panel of the Michigan Court of Appeals affirmed.[10]

This article first argues that the *Cadillac Rubber* court's holding is wrong—an option provision should not be read to create a requirements contract in all situations. (This is Judge Douglas Shapiro's conclusion in his excellent dissent from the relevant part of the majority opinion.)[11] This article then goes further and argues that option provisions like that at issue in *Cadillac Rubber* should be interpreted to never create a requirements contract because they don't measure the buyer's obligation to buy and the seller's obligation to deliver by the requirements of the buyer. Instead, option provisions measure the quantity by only the buyer's whim. Under UCC § 2-201,[12] contracts like that aren't enforceable. Contracts with option provisions should thus be enforced only to the extent of each firm release that the buyer issues and the seller accepts.

This article focuses on the sorts of contracts common in the automotive supply chain, which often feature a general document (like a purchase order incorporating terms) and regular releases communicating specific quantities and delivery dates. This

*The author would like to thank his colleagues Dan Sharkey, Mike Turco, Jonathan Jorissen, and Chris Struble for their help editing this article.

means that it also focuses on requirements contracts under § 2-306.[13] But the principles described here should apply to contracts used in other industries and to output contracts (also covered in § 2-306).

The UCC Limits the Enforcement of Contracts to Stated Quantities

Evaluating the *Cadillac Rubber* opinion requires an understanding of the UCC's statute of frauds and provisions governing quantity. The statute of frauds, § 2-201, requires contracts for the sale of goods to include a quantity term—even an indefinite one—because this is enough to give a court confidence that an agreement was made.[14] But § 2-201 doesn't stop there; it also limits enforcement to the written quantity: "the contract is not enforceable under this subsection beyond the quantity of goods shown in the writing."[15] Because of this, "[t]he only term which must appear in the agreement is the quantity term."[16] This is to prevent one party from claiming an oral contract for 100 units while the other claims it was for 500.[17] To enforce a contract for the sale of goods, the court must be able to determine with certainty how many parts the buyer committed to buy and the seller committed to deliver.

In the automotive supply chain, courts typically see three broad categories of quantity terms. The first is the most straightforward—integers. These fixed-quantity contracts, sometimes called spot-buys, are unambiguous, and nothing more need be said about them.

The second type is the clear requirements contract under § 2-306(1).[18] Such a contract "measures the quantity by the … requirements of the buyer."[19] The clearest of these contracts state that "this is a 100% requirements contract" or the like, and such a quantity term is sufficiently specific to be enforced under § 2-201.[20] These contracts are not too indefinite to enforce because, once the buyer's requirements become known, so too does its obligation to buy and the seller's obligation to deliver.

But not every contract with a quantity term that becomes definite only in the future is a requirements contract. For § 2-306 to apply, "the buyer must agree to purchase a portion of its requirements from the seller."[21] A classic case of a blanket contract with regular releases that is *not* a requirements contract is *Advanced Plastic Corp v White Consol Indus, Inc*.[22] There, the buyer's terms referred to the buyer's "requirements . . . to the extent of and in accordance with" the buyer's releases.[23] The trial court found that the quantity term was measured by the buyer's "wishe[s]," not its requirements,[24] and the Sixth Circuit agreed: "The language of this document clearly demonstrates that the parties intended for [the buyer] to purchase quantities of parts only according to its releases, and not according to its requirements."[25] In other words, if the buyer can order whatever quantity it wants, the contract is not one for requirements under § 2-306.

This distinction leads to the third type of contract, where the interesting disputes arise. These contracts might say that they are "blanket" contracts, or list "as rel." in the quantity column. They might also include contracts with option provisions like that in *Cadillac Rubber*. Courts presented with these sorts of contracts must decide whether these are requirements contracts under § 2-306, or whether they are something else.

> Evaluating the *Cadillac Rubber* opinion requires an understanding of the UCC's statute of frauds and provisions governing quantity.

That "something else," at least in the context of release-based contract structures, is usually a release-by-release contract. This is because the UCC contemplates quantity terms stated as integers or measured by the buyer's requirements (or seller's output).[26] So if the contract structure is not a requirements contract, then it is only enforceable once a firm quantity is stated, and only to that extent.[27] In these contract structures, that happens only when a release is issued. A typical release lists firm quantities for only a few weeks of deliveries, followed by a nonbinding forecast. This means that each release, if accepted, forms a fixed-quantity contract that will expire in a few weeks. Buyers often send new releases every week or so, but nothing obligates the buyer to send a new release or the seller to accept it. Such a release-by-release contract gives both parties the freedom to allow their contractual obligations to expire in short order by either not issuing or not accepting a new release. This is precisely what happened in *Advanced Plastics*, discussed above.[28]

An Option Provision Doesn't Unambiguously Measure the Quantity by the Buyer's Requirements

Between the easy cases of a contract for "100 parts" and one for "100% of buyer's requirements for parts," where does an option provision like that in *Cadillac Rubber* fall? The

Cadillac Rubber majority, because it resolved the case in the summary-disposition context, essentially held that an option provision amounts to "100% of buyer's requirements for parts." That holding is wrong.

Any contract for the sale of goods that contains an option provision like that in *Cadillac Rubber* doesn't look at all like a requirements contract. An option provision gives the buyer "an irrevocable option … to purchase [parts] in such quantities as determined by Buyer and identified" on releases, so long as the buyer purchases at least one part and no more than 100% of buyer's requirements.[29] By its plain language, such a provision requires the buyer to purchase only a single part; after that, it can order as few or as many as it chooses. Nothing in the provision ties the buyer's choice to its requirements. Instead, the buyer has unfettered discretion to purchase or not. An obligation that is mere whim is no obligation at all. Contrast that with the seller's unbounded obligation to deliver—whatever quantity the buyer orders, the seller must supply.

This imbalance between the buyer's obligation to buy and the seller's obligation to deliver isn't present in either fixed-quantity or requirements contract structures. If a contract is for "100 parts," then the buyer must buy 100 parts, and the seller must deliver 100 parts. And if the contract is for "100% of buyer's requirements for parts"—or "13% of buyer's requirements for parts," for that matter—the obligations are balanced because once the buyer knows how many parts it needs, simple math turns that "100%" or "13%" into an integer. And that integer applies equally to the buyer's obligation to buy and the seller's obligation to deliver.

Remember that the UCC contemplates only two types of quantity terms—integers and requirements (or output).[30] A party seeking to enforce an option provision as a long-term, ongoing obligation must thus argue that it creates a requirements contract. This is why the question at issue in *Cadillac Products* was not whether the option provision was enforceable under the UCC as an option, but whether it created a requirements contract—only as a requirements contract could it be enforced on more than a release-by-release basis. But as explained above, an option provision doesn't look like a requirements contract because it doesn't link the buyer's obligation to buy to its requirements for the parts. Nor does it balance the parties' obligations like requirements contract (or a fixed-quantity contract, for that matter) does. So an option provision shouldn't be interpreted to create a requirements contract.

A party seeking to enforce an option provision as a long-term, ongoing obligation must thus argue that it creates a requirements contract.

The *Cadillac Rubber* majority relied on three main arguments when it decided that the option provision was "indisputably" a requirements contract.[31] None of them align with the UCC principles just discussed.

First, the majority noted that the purchase orders stated that the "material requirement will be released weekly," and that the buyer's terms provided that the buyer "was obligated to purchase from [the seller] a quantity between one part and 100% of [the buyer's] requirements."[32] But nothing in that language links the quantity the buyer had to order to the buyer's requirements. Even if the reference to "material requirement" could be interpreted as obligating the buyer to buy all the parts it needs from the seller—and that's quite the stretch—that interpretation contradicts the plain language that allows the buyer to choose to buy no more than one part.

Second, the majority relied on the Eastern District of Michigan's decision in *Johnson Controls, Inc v TRW Vehicle Safety Sys*.[33] That case featured an option term nearly identical to that in *Cadillac Rubber*.[34] The *Johnson Controls* court didn't hold that it created a requirements contract, though. Instead, it held that the option provision satisfied the statute of frauds but was "ambiguous."[35] The court held that summary judgment for the seller was inappropriate because "[v]iewing the evidence in the light most favorable to [the buyer], questions of fact remain as to whether the parties intended a requirements contract."[36] So *Johnson Controls* doesn't support the *Cadillac Rubber* majority's conclusion that this option provision clearly creates a requirements contract. (This was one of Judge Shapiro's main points in dissent.)[37]

Finally, the *Cadillac Rubber* majority relied on the parties' course of performance.[38] The majority agreed with the trial court's findings that "[the buyer] has regularly issued material authorization releases setting forth the quantity of parts needed as well as a reasonable forecast of future requirements, and [the seller] has fulfilled those releases by providing the required parts."[39] It held that this course of performance helped "establish[] the existence of a requirements contract as a matter of law."[40] But the course of performance described here, while consistent with a requirements contract, is just as consistent with a series of release-by-release contracts. So this evidence is ambiguous at best.

Because of these flaws, the *Cadillac Rubber* majority shouldn't have held that the option provision establishes a requirements contract as a matter of law. At a minimum, it should have followed *Johnson Controls*, held that the option provision could be a requirements contract but that a fact question remained, and remanded to the trial court. This is what Judge Shapiro would have done.[41]

A Better Rule Is that Option Provisions Don't Create Requirements Contracts

The *Cadillac Rubber* court should have gone even further and held, contrary to *Johnson Controls*, that a contract with an option provision is not a requirements contract.

This conclusion rests on the fundamental rules of contract interpretation. "The primary goal" of that process "is to honor the intent of the parties."[42] The best evidence of the parties' intent is the language of the contract they agreed to.[43] If the language is clear and unambiguous, courts enforce the contract as written.[44] Courts can't make a different agreement for the parties than they made, and can't "look to extrinsic testimony to determine their intent when the words used by them are clear and unambiguous and have a definite meaning."[45] So a "prior course of performance cannot alter the clear and unambiguous language of the contract."[46]

Contracts with option provisions like that in *Cadillac Rubber* are clear and unambiguous. They give the buyer the discretion to order as many parts as it chooses so long as it orders at least one. Nothing in the provision requires the buyer to order any share of its requirements from the seller. So the buyer wouldn't breach the contract if it needed parts and chose to order them from a different supplier so long as it ordered one part from the seller with which it has the option contract.

The releases are just as clear. These are typically simple documents that state firm quantities and delivery dates for a few weeks, followed by nonbinding estimates. There is nothing ambiguous about "1,500 parts on July 31."

Taken together, the option provision and the releases allow the buyer to order as many parts from the seller as it chooses to, and require the seller to deliver as many parts as the buyer orders. This contract is neither unclear nor ambiguous, but it says nothing linking the buyer's obligation to buy or the seller's obligation to deliver to the buyer's requirements.[47] Instead, the only quantities that appear are the integers in the releases.

A consequence of this contract structure, though, is that because nothing ties the quantity to the buyer's requirements and firm quantities appear in the release, the contract is enforceable under the UCC only release by release.[48] And as explained in *Advanced Plastics*, the buyer may stop issuing releases and the seller may stop accepting them at any time.[49] If that happens, the parties' obligations expire once they've delivered and paid for the firm quantities on the last accepted release.[50]

A consequence of this contract structure, though, is that because nothing ties the quantity to the buyer's requirements and firm quantities appear in the release, the contract is enforceable under the UCC only release by release.

Because this structure is created by the unambiguous language of the contract, a reviewing court should construe it as it is, not look to extrinsic evidence to change it into a requirements contract.[51] This is where the *Johnson Controls* court went wrong. That court focused on the policies underlying the UCC, including its goal "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties … ."[52] The court recognized that the contract (nearly identical to the *Cadillac Rubber* contract) listed specific quantities on the buyer's periodically issued releases, and held that this was a sufficient quantity term to satisfy § 2-201's statute of frauds.[53] But then the court opened the door to parol evidence to convert a contract that doesn't even suggest that the quantity may be measured by the buyer's requirements into a requirements contract: "That this may have been a requirements contract seems reasonable in light of the practice among automotive suppliers to enter into long-term, just-in-time production arrangements that rely on a fixed price and a variable quantity, and provide flexibility to adjust to changing commercial conditions."[54]

While the *Johnson Controls* court was right that it would have been reasonable for an automotive supplier to agree to a requirements contract, it was wrong to suggest that it would consider parol evidence to convert this option contract with fixed-quantity releases into one for the buyer's requirements. And the *Cadillac Rubber* court was even more wrong to hold that such contract language *must* be a requirements contract. This holding elevates parol evidence over the plain language of the contract.

This holding also lacks support in cases from other jurisdictions. As Judge Shapiro noted in dissent, the *Cadillac Rubber* majority "does not cite any case holding that a promise to buy between 1 unit and 100% of requirements is sufficient to create a requirements contract."[55] This article's author couldn't find support elsewhere, either. Instead, tbe few other courts to have considered the question[56] have followed Seventh Circuit Judge Richard Posner's analysis in the classic case *Empire Gas Corp v American Bakeries Co*, which held that "a requirements contract was more than a buyer's option."[57] "[A] requirements contract is not just an option to buy."[58] So Michigan appears to now stand alone in holding that an option to buy *is* a requirements contract.

If the parties in these cases had intended to form requirements contracts, it would have been simple enough for them to say so. Take the contract provision in *Cadillac Rubber*, which begins

> If the face of the Order … specifies the quantities as … "blanket order", … then, in consideration for ten US dollars (US$10.00), the payment of which shall be made by Buyer upon the termination or non-renewal of this Order, Seller grants to Buyer an irrevocable option during the term of this Order to purchase Supplies in such quantities as determined by Buyer and identified as firm orders in material authorization releases, manifests, broadcasts or similar releases … ."[59]

If the parties wanted to form a requirements contract, they could have replaced this with "If the face of the Order … specifies the quantities as … 'blanket order', … then it is a 100% requirements contract." Listing "100% req." or something similar in the quantity field on the purchase order would have accomplished the same goal.

Why might the parties have chosen a structure other than a requirements contract? While such contracts offer some advantages, there are downsides, too. A requirements-contract buyer doesn't have the flexibility to allocate orders among different sellers. (Even if the buyer has a 60% requirements contract with one seller and a 40% requirements contract with another, that specific allocation will be rigidly enforced.) And a requirements-contract seller is often obligated to deliver parts for years while having no guarantee of how the volumes or market prices will fluctuate. So it is reasonable that, even in the automotive supply chain, parties may choose a structure other a requirements contract.

There are also good reasons why the parties may have chosen an option structure that binds them one release at a time. In this structure, the buyer has unfettered discretion to order from this seller or others, and it can even stop ordering from this seller altogether, so long as it buys one part. And the seller has the freedom to exit the business in short order and can use that freedom to renegotiate terms if volumes or markets change. Both parties give up the security that comes with requirements contracts in exchange for more flexibility. So if parties choose this structure, courts shouldn't change it into something else.

Courts Should Enforce the Parties' Intent, and that Means Not Enforcing as Requirements Contracts Agreements that the Parties Structured in a Different Way

The approach suggested here is hardly revolutionary—it is based on enforcing the parties' intent as expressed through the plain language of their contracts. It also reflects that, however broadly the UCC was intended to apply to contracts for the sale of goods, § 2-201 is clear that contracts aren't enforceable beyond their explicitly stated quantities.[60] This is not a secret to contracting parties, so when they choose a contract structure enforceable only one release at a time, courts should honor that structure and resist efforts to impose a requirements contract that the parties never agreed to.

NOTES

1. *Cadillac Rubber & Plastics, Inc v Tubular Metal Sys, LLC*, 331 Mich App 416, 952 NW2d 576 (2020).
2. 331 Mich App at 419.
3. *Id.* at 419–20.
4. *Id.* at 420–421.
5. *Id.* at 420.
6. *Id.*
7. *Id.*
8. *Id.* at 421.
9. *Id.*
10. *Id.*
11. *Id.* at 431 (Shapiro, J., concurring in part and dissenting in part).
12. MCL 440.2201.

13. MCL 440.2306.
14. MCL 440.2201; *In re Frost Estate*, 130 Mich App 556, 561, 344 NW2d 331 (1983).
15. MCL 440.2201(1).
16. *In re Frost Estate*, 130 Mich App at 559; *see also Lorenz Supply Co v American Standard, Inc*, 419 Mich 610, 614 n 4, 358 NW2d 845 (1984).
17. *H&H Wholesale Servs, Inc v Kamstra Int'l, BV*, 373 F Supp 3d 826, 836 (ED Mich 2019) (citing 1 White, Summers, & Hillman, Uniform Commercial Code § 3:11 (6th ed)).
18. MCL 440.2306(1).
19. *Id.*
20. *Lorenz Supply*, 419 Mich at 615.
21. *Advanced Plastics Corp v White Consol Indus, Inc*, No 92-76375, 1995 WL 19379, at *3 (6th Cir 1995) (unpublished per curiam opinion).
22. 828 F Supp 484 (ED Mich 1993), aff'd 1995 WL 19379 (6th Cir 1995) (unpublished per curiam opinion).
23. *Advanced Plastics*, 828 F Supp at 486.
24. *Id.*
25. *Advanced Plastics*, 1995 WL 19379 at *2.
26. MCL 440.2201; MCL 440.2306.
27. MCL 440.2201.
28. *Advanced Plastics*, 828 F Supp at 487–88; *Advanced Plastics*, 1995 WL 19379 at *2–3.
29. *Id.* at 419–20.
30. MCL 440.2201; MCL 440.2306.
31. *Id.* at 429.
32. *Id.* at 430 (text is all-caps in original).
33. *Id.* at 427, citing *Johnson Controls, Inc v TRW Vehicle Safety Sys, Inc*, 491 F Supp 2d 707 (ED Mich 2007).
34. *Johnson Controls*, 491 F Supp 2d at 710.
35. *Id.* at 718.
36. *Id.* at 719.
37. *Cadillac Rubber*, 331 Mich App at 432–33.
38. *Id.* at 430–31.
39. *Id.*
40. *Id.* at 431.
41. *Id.*
42. *Rasheed v Chrysler Corp*, 445 Mich 109, 127 n 28, 517 NW2d 19 (1994).
43. *Klapp v United Ins Grp Agency, Inc*, 468 Mich 459, 468, 473, 663 NW2d 447 (2003).
44. *Quality Prods and Concepts Co v Nagel Precision, Inc*, 469 Mich 362, 375, 666 NW2d 251 (2003).
45. *UAW-GM Human Res Ctr v KSL Recreation Corp*, 228 Mich App 486, 491, 579 NW2d 411 (1998) (quotations and citations omitted).
46. *Ditzik v Schaffer Lumber Co*, 139 Mich App 81, 89, 360 NW2d 876 (1984).
47. MCL 440.2306(1).
48. *See, generally, Advanced Plastics*, 828 F Supp at 488; *Advanced Plastics*, 1995 WL 19379 at *2.
49. *Advanced Plastics*, 828 F Supp at 488.
50. *Id.*
51. *UAW-GM Human Res Ctr*, 228 Mich App at 491.
52. *Johnson Controls*, 491 F Supp 2d at 716–17 (quoting the pre-2013 version of MCL 440.1102).
53. *Johnson Controls*, 491 F Supp 2d at 717.
54. *Id.* at 718.
55. *Cadillac Rubber*, 311 Mich App at 434.
56. *See, e.g.*, *Merritt-Campbell, Inc v RxP Prods, Inc*, 164 F3d 957, 963–64 (5th Cir 1999); *Technical Assistance Int'l, Inc v United States*, 150 F3d 1369, 1372 (Fed Cir 1998); *BRC Rubber & Plastics, Inc v Continental Carbon Co*, 876 F Supp 2d 1042, 1051 (ND Ind 2012).
57. 840 F2d 1333, 1339 (7th Cir 1988).
58. *Agfa-Gevaert, AG v AB Dick Co*, 879 F2d 1518, 1522–23 (7th Cir 1989).
59. *Cadillac Rubber*, 311 Mich App at 419.
60. MCL 440.2201.

Jason D. Killips is a member of Brooks Wilkins Sharkey & Turco PLLC in Birmingham. His practice focuses on supply-chain consulting, commercial litigation, and appeals, often in the automotive industry. He spends too much time thinking about requirements contracts.

Case Digest

MSSC, Inc v Airboss Flexible Prods Co, No 354533, ___ Mich App ___, ___ NW2d ___ (July 29, 2021)

In July 2013, the parties entered into an automotive parts supply agreement whereby defendant would supply and assemble various component parts that plaintiff needed for its contract with the OEM. The agreement was memorialized in an unsigned "blanket" purchase order (PO) that specified certain parts to be supplied by defendant and a unit price for those parts and that plaintiff's terms and conditions applied. The PO did not specify a quantity of parts to be supplied, instead stating that the "[a]nnual volume [required] is an estimate based on" the forecast of the OEM. The PO was periodically amended to reflect agreed-upon changes to various terms including pricing and delivery. Defendant requested a price increase and refused to release further product until parties could come to a mutual agreement on revised pricing. Plaintiff did not agree with the price increase and asked defendant to meet its contractual obligations. Defendant terminated the parties' agreement.

Plaintiff filed suit and both parties moved for summary disposition. Defendant argued that the PO was unenforceable under Michigan's Uniform Commercial Code's (UCC), MCL 440.1101 *et seq.*, statute of frauds because it failed to include a written quantity term and was not signed by defendant. The court affirmed the grant of plaintiff's MCR 2.116(I)(2) summary disposition agreeing with the trial court finding that the use of the term "blanket order" coupled with the express terms and conditions created a requirements contract or an imprecise quantity term that satisfied the statute of frauds. In addition, defendant did not establish lack of mutuality of obligation because there was no evidence that plaintiff acted in bad faith or in violation of commercial standards of fair dealing. Lastly, plaintiff's written confirmation of the contract and defendant's failure to object within ten days of its receipt satisfied the exception under MCL 440.2201(2) to the signed writing requirement for a sale of goods contract.

Joseph & Anita Russell Tr v Russell, No 354511, ___ Mich App ___, ___ NW2d ___ (July 22, 2021)

Defendants executed a promissory note and entered in to an oral loan agreement with the settlor/trustees of the Joseph and Anita Russell Trust. Both the note and the oral agreement provided the total amount due under the agreement, the interest rate, and that installment payments in the amount of $500 or more were due each and every month. The promissory note also contained a default provision that allowed for the trustees to declare the entire balance due and owing if a payment was unpaid for 60 days. Defendants made regular payments under both agreements, but the record showed that there were occasional months where payment was not made and the trustees did not declare a default. One of the trustees granted power of attorney to plaintiff, and defendants began making payments directly to her. Seven months after plaintiff started accepting payments from defendants on the two loans, plaintiff's attorney sent a demand letter to defendants, asserting that the promissory note and the oral loan agreement were payable on demand and insisting defendants pay the entire balance due by the next month. When defendants did not pay, plaintiff filed the lawsuit seeking full payment of both loans.

The trial court agreed with defendants' argument that the loans were not payable on demand, and it granted summary disposition in their favor. Plaintiff filed the instant appeal contending that the promissory note does not state any time of payment, and it does not indicate on its face a specific date when final payment is due, therefore it is payable on demand under MCL 440.3108(1)(b). The court disagreed, stating that the plaintiff ignores the plain and unambiguous language of the statute and the promissory note, which clearly states that payment is due "each and every month commencing 30 days from the date hereof[.]" Additionally, the 60-day default clause confirms that the promissory note is not payable on demand. Plaintiff's other arguments "add language" to the statute that do not exist as there is no requirement that the note specify a date when final payment is due, and there is no requirement that an amortization schedule be attached. The promissory note is payable at a definite time because the monthly payments make it payable at a time that is "readily ascertainable" under MCL 440.3108(2). The oral loan agreement's $500 monthly installments made its final payment date easy to ascertain, and there was no indication from the transaction history that the loan agreement was payable on demand. The court affirmed the grant of summary disposition in favor of defendants.

Index of Articles

(vol 30 and succeeding issues)*

*For cumulative index from volume 16, go to http://connect.michbar.org/businesslaw/newsletter.

ICLE Resources for Business Lawyers

Books

Michigan Security Interests in Personal Property

By Hon. Scott W. Dales, Hon. John T. Gregg, Patrick E. Mears, and Paul R. Hage

This book helps you correctly determine which security interest has priority, know the rights of secured parties on default and consequences for noncompliance with UCC Article 9's enforcement requirements, and spot and understand non-UCC statutory liens.

Print Book: $149.00 **Online Book/0-4 Lawyers:** $189.00
Online Book/5-29 Lawyers: $299.00 ***Product #: 2010551105***

Michigan Contract Law, Second Edition

Edited by John R. Trentacosta

This book allows you to respond confidently to client questions about negotiations or disputes, respond to nonperformance with an effective demand letter, weigh all the options for recovery in disputes, and quickly retrieve black letter statements of Michgan contract law with citations.

Print Book: $149.00 **Online Book/0-4 Lawyers:** $189.00
Online Book/5-29 Lawyers: $299.00 ***Product #: 2013551152***

Seminars

Business Law Update: Compliance and Contracts

Presented by Matthew W. Bower, Joseph R. Morrison, Jr., and Max H. Matthies

Cosponsored by the Business Law Section of the State Bar of Michigan. Advise your clients on the issues involving management of a remote workforce and be aware of regional, state, and local taxing authorities. Stay in compliance with securities laws.

On-Demand Seminar **Now Available!**
General fee: $95 ***Seminar #: 2021CT1123***
Section Members: $85
ICLE Partners: $0 **New Lawyers:** $45

Trade Secrets Update

Presented by Bernard J. Fuhs, Paul M. Mersino, and Rebekah Page-Gourley

Cosponsored by the Business Law Section of the State Bar of Michigan. Businesses must be vigilant in protecting their trade secrets in the midst of employee resignations, a remote workforce brought on by COVID-19, and potential regulatory changes. Stay ahead of the trends and provide solutions for your clients.

On-Demand Seminar **Now Available!**
General fee: $95 ***Seminar #: 2021CT1133***
Section Members: $85
ICLE Partners: $0 **New Lawyers:** $45

cosponsored by

The State Bar of Michigan

The University of Michigan Law School

Wayne State University Law School

Western Michigan University Cooley Law School

University of Detroit Mercy School of Law

Michigan State University College of Law

ICLE

The education provider of the State Bar of Michigan

1020 Greene Street
Ann Arbor, MI
48109-1444

Phone
Toll-Free (877) 229-4350
or (734) 764-0533

Fax
Toll-Free (877) 229-4351
or (734) 763-2412

www.icle.org
(877) 229-4350

Notes

Notes

Notes

SUBSCRIPTION INFORMATION

Any member of the State Bar of Michigan may become a member of the Section and receive the *Michigan Business Law Journal* by sending a membership request and annual dues of $30 to the Business Law Section, State Bar of Michigan, 306 Townsend Street, Lansing, Michigan 48933-2012.

Any person who is not eligible to become a member of the State Bar of Michigan, and any institution, may obtain an annual subscription to the *Michigan Business Law Journal* by sending a request and a $30 annual fee to the Business Law Section, State Bar of Michigan, 306 Townsend Street, Lansing, Michigan 48933-2012.

CHANGING YOUR ADDRESS?

Changes in address may be sent to:

Membership Services Department
State Bar of Michigan
306 Townsend Street
Lansing, Michigan 48933-2012

The State Bar maintains the mailing list for the *Michigan Business Law Journal*, all Section newsletters, as well as the *Michigan Bar Journal*. As soon as you inform the State Bar of your new address, Bar personnel will amend the mailing list, and you will continue to receive your copies of the *Michigan Business Law Journal* and all other State Bar publications and announcements without interruption.

CITATION FORM

The *Michigan Business Law Journal* should be cited as MI Bus LJ.

DISCLAIMER

The opinions expressed herein are those of the authors and do not necessarily reflect those of the Business Law Section.

CUMULATIVE INDEX

The cumulative index for volumes 16 to volume 36 No 1 may be found online at the Business Law Section's website (http://connect.michbar.org/businesslaw/newsletter). The index in this issue is cumulative from volume 30 No 1 (Spring 2010).

SBM
STATE BAR OF MICHIGAN

PRSRT STD
U.S. POSTAGE
PAID
SAGINAW, MI
PERMIT NO. 269

BUSINESS LAW SECTION
State Bar of Michigan
306 Townsend Street
Lansing, Michigan 48933-2012

BRENDAN J. CAHILL
Publications Director

Published in cooperation with
THE INSTITUTE OF CONTINUING
LEGAL EDUCATION
MAXIMILLIAN H. MATTHIES
Staff Attorneys
CHRISTINE MATHEWS
Copy and Production Editor

SECTION CALENDAR

Annual Meeting and Council Meeting

DATE	TIME	LOCATION
December 3, 2021	10:00 a.m.	Zoom