STATE OF MICHIGAN

IN THE CIRCUIT COURT FOR THE COUNTY OF OAKLAND

STEPHEN SCHMALTZ,

Plaintiff,

Case No. 2019-176295-CB

v.

Hon. Martha D. Anderson

FLOTRONICS, INC., ET AL.,

Defendants.

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OPINION AND ORDER RE: DEFENDANTS' MOTION FOR PARTIAL SUMMARY DISPOSITION OF COUNTS III AND IV OF PLAINTIFF'S AMENDED COMPLAINT

This matter is before the Court on Defendants' Motion for Partial Summary Disposition of Counts III and IV of Plaintiff's Amended Complaint pursuant to MCR 2.116(C)(8). The Court dispenses with oral argument in accordance with MCR 2.119(E)(3).

By way of background, Defendant Flotronics, Inc. ("Flotronics") is a corporation that is owned by Defendant Lloyd Schmaltz and his two sons, Plaintiff Stephen Schmaltz and Defendant Michael Schmaltz. In 2017, Flotronics, Inc. was reorganized as a holding and management company and it transferred certain operations to its subsidiary companies, namely Minitec Automation, LCC and Flotronics Automation, LLC. The intent of the reorganization was to give Stephen Schmaltz and Michael Schmaltz each his own business due to continued family conflict. The Flotronics, Inc. Voting Trust was also established in 2017.

On September 3, 2019, Stephen Schmaltz initiated litigation against Defendants on allegations that the separation of operations into the subsidiaries has been unsuccessful. Plaintiff asserts that the corporation is unable to function in the best interests of its creditors and shareholders. As such, Plaintiff is seeking the judicial dissolution of the corporation. Plaintiff has also raised claims of shareholder oppression, breach of fiduciary duty by the Board of Directors as a derivative action, and breach of fiduciary duty by the Trustees of the Voting Trust.

In their motion for partial summary disposition, Defendants are seeking the dismissal of Count III, Breach of Fiduciary Duty by Board of Directors (Derivative Action), and Count IV, Breach of Fiduciary Duty by Trustees of Voting Trust, of Plaintiff's Amended Complaint pursuant to MCR 2.116(C)(8). A motion under MCR 2.116(C)(8) tests the legal sufficiency of the complaint. *Maiden v Rozwood*, 461 Mich 109, 120; 597 NW2d 817 (1999). When analyzing such a motion, all well-pled factual allegations are accepted as true and construed in a light most favorable to the nonmovant. *Wade v Dept of Corrections*, 439 Mich 158, 162-163; 483 NW2d 26 (1992). A (C)(8) motion may be granted only where the claims alleged are "so clearly unenforceable as a matter of law that no factual development could possibly justify recovery." *Id.* And, when deciding such a motion, the Court considers only the pleadings. MCR 2.116(G)(5).

It is Defendants' position that Counts III and IV of Plaintiff's Amended Complaint are both derivative actions. Defendants argue that Plaintiff has failed to state a claim upon which relief can be granted in Counts III and IV since Plaintiff has not complied with the pre-suit demand requirements of the Michigan Business Corporations Act ("MBCA") concerning a derivative proceeding.

Regarding the required ninety-day time frame under MCL 450.1493a, Defendants assert that Plaintiff's August 16, 2019 emails were sent only thirteen days prior to the initiation of this action. In addition, Defendants argue that Plaintiff's August 16th proposal[1] did not make any demand upon anyone or any entity. Rather, the August 16th proposal simply communicated Plaintiff's interest in being placed on the Board of Directors as well as his opinion that the company should be consolidated. Defendants also point to a second email,[2] authored by Plaintiff on August 16, 2019, that concerned a change in accounting. As such, Defendants maintain that neither email constitutes a demand under the MBCA.

Defendants next address Plaintiff's emails from January 5, 2018[3] and March 26, 2018.[4] In his January email, Plaintiff expressed his opposition to the 2017 reorganization and he indicated that he would like the Board of Directors to reconsider their decision. Defendants characterize Plaintiff's January email as an expression of Plaintiff's disagreement with the reorganization and a request for further consideration as opposed to an actual demand. Regarding the March 26, 2018 email, Plaintiff proposed an equitable split of Flotronics to his father, however, Defendants do not believe that this proposal was a demand to satisfy the requirements of MCL 450.1493a. Defendants argue that none of the emails contain a demand by Plaintiff for Flotronics to take certain actions. Therefore, Defendants assert that Plaintiff has failed to state a claim upon which relief can be granted and Counts III and IV should be dismissed.

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[1] See the August 16, 2019 (2:16 PM) email; Exhibit 6 of the Amended Complaint. Pursuant to MCR 2.113(C)(1), "[i]f a claim or defense is based on a written instrument, a copy of the instrument or its pertinent parts must be attached to the pleading." Under MCR 2.113(C)(2), an attachment is a part of the pleadings for all purposes.
[2] See the August 16, 2019 (1:40 PM) email; Exhibit 6 of the Amended Complaint.
[3] See the January 5, 2018 email; Exhibit 5 of the Amended Complaint.
[4] See the March 26, 2018 email; Exhibit 3 of the Amended Complaint.

In response, Plaintiff argues that his derivative claim under MCL 450.1493a should be allowed to proceed in light of his January 5, 2018 email, which was sent approximately twenty months prior to the filing of the Complaint. In that email, Plaintiff contends that he communicated his opposition to the reorganization of Flotronics to the Board of Directors. Specifically, Plaintiff wrote: "[i]t is my belief that the [reorganization plan] will reduce the overall value of the company. I want to go on record to inform the BOD that I am opposed to this change, and would like them to reconsider their decision now that the company has new owners who are not supportive." According to Plaintiff, the substance of the January 5, 2018 email was to compel Flotronics management to stop pursuing a damaging course of action. Plaintiff maintains that the Board of Directors should have taken appropriate action regarding this demand or request, however, they failed to do so.

Plaintiff contends that there were continued communications on August 16, 2019 concerning the reorganization. Plaintiff argues that he wanted to reverse the separation of Flotronics and seek new leadership. With the understanding that Lloyd Schmaltz dismissed members of the Board of Directors, Plaintiff asserts that he took the only steps available to protect the interests of the shareholders and that was to file this lawsuit.

In reply, Defendants again argue that Plaintiff has failed to make a timely, written demand as required by MCL 450.1493a for derivative actions. While Plaintiff relies on his January 5, 2018 email for his derivative claim, Defendants point out that the email was not sent to all Flotronics' board members because Plaintiff omitted his father and Board Chairman, Lloyd Schmaltz. Secondly, Defendants contend that Plaintiff's statements in the email are vague and even incomprehensible as he provides no detail or explanation for his statements. Third, Plaintiff does not make any demands upon the Board in the January 5, 2018 email.

Whereas Plaintiff wrote that he "would like them [Board of Directors] to reconsider their decision," Defendants maintain that this desire is not a demand within the meaning of the MBCA.

Upon review of Count III in Plaintiff's Amended Complaint, the Court observes that Plaintiff is pursuing a derivative action against Defendants for Breach of Fiduciary Duty by Board of Directors. Under MCL 450.1491a(a), a "derivative proceeding means a civil suit in the right of a domestic corporation or a foreign corporation that is authorized to or does transact business in this state."

Pursuant to MCL 450.1493a of the MBCA:

> A shareholder may not commence a derivative proceeding until all of the following have occurred:
> (a) A written demand has been made upon the corporation to take suitable action.
> (b) Ninety days have expired from the date the demand was made unless the shareholder has earlier been notified that the demand has been rejected by the corporation or unless irreparable injury to the corporation would result by waiting for the expiration of the 90-day period.

In Paragraph 79 of the Amended Complaint, Plaintiff alleges that "[t]he August 16 proposal should be regarded as a written demand under Section 493a of the MBCA and Lloyd's response should be regarded as the rejection of that demand." The Court observes, however, that the August 16, 2019 emails were sent approximately eighteen days prior to the initiation of this lawsuit on September 3, 2019. As such, Plaintiff has not met the ninety-day requirement as set forth in MCL 450.1493a(b). Therefore, Plaintiff is precluded from commencing a derivative proceeding based upon the untimely August 16, 2019 emails.

Next, Plaintiff alleges in the Amended Complaint that "[i]n addition or in the alternative, the company's inaction regarding the January 5, 2018 and March 26, 2018 [emails]

should be regarded as the rejection of written demands under Section 493a of the MBCA." See Paragraph 80 of the Amended Complaint. In relation to the January 5, 2018 email, the Court agrees with Defendants that the email was not addressed to the entire Board of Directors. In particular, the leader[5] or chairman of the Board of Directors, Lloyd Schmaltz, was omitted from the email. The email roughly outlined Plaintiff's "concerns and comments to the new program." In addition, Plaintiff wrote: "I want to go on the record to inform the BOD that I am opposed to this change, and would like them to reconsider their decision now that the company has new owners who are not supportive. As an owner and employee of Flotronics, Inc. I cannot support this plan as it stands." The Court agrees with Defendants that while Plaintiff communicated his concerns as well as his desire that the Board reconsider its decision, he did not make a demand within the meaning of MCL 450.1493a.

"Demand" as defined by Black's Law Dictionary is: "[t]he assertion of a legal or procedural right" or "[t]o claim as one's due; to require; to seek relief." *Black's Law Dictionary* (11th ed. 2019). Further, MCL 450.1493a(a) provides that the written demand must be made upon the corporation to take suitable action. Here, Plaintiff never asserted a right or made a formal demand upon the entire Board of Directors to take suitable action, e.g., to reverse or dismantle the reorganization.

What is more, Plaintiff sent an email to Lloyd Schmaltz, Mark Aiello, and Judy Schmaltz on March 26, 2018[6] that stated "[t]he company has a much higher value as a whole, but if you think we can spilt [sic] equitably – let's do it today. Let's do it now and sell of [sic] one of the ½'s" This email is in response to an earlier email from Lloyd Schmaltz in which he writes

[5] See the reference to Lloyd Schmaltz as BOD leader by Plaintiff in the August 16, 2019 email; Exhibit 6 of the Amended Complaint.
[6] See Exhibit 3 of the Amended Complaint.

"[t]here is no secret that my belief is that the company should eventually be equability [sic] split so that each Mike and Steve could enjoy the benefit and pride – of owning and growing a company. We could not do that prior to the January transfer of shares but the LLC project set the groundwork for that." These emails evidence ongoing discussions by Plaintiff, Lloyd Schmaltz, and others concerning the reorganization and alternatives for the future of the company, including the equitable split of Flotronics.

In his August 16, 2019 email, Plaintiff wrote: "I am no longer interested in splitting the companies – It will never work long term for me, and Mike will never afford it. I think we should consolidate into one. We just need new leadership to make that happen." As evidenced by this email, Plaintiff had supported the reorganization at one point in time. Considering the email conversations in their entirety, which again demonstrate ongoing discussions and considerations of Flotronics' future, the Court finds that neither the January 5, 2018 email nor the March 26, 2018 email constitute written demands within the meaning of MCL 450.1493a.[7]

Based on the foregoing analysis and accepting all well-pled allegations as true and construing them in a light most favorable to Plaintiff, the Court finds that Plaintiff has failed to meet the requirements of MCL 450.1493a and is consequently precluded from bringing his derivative action, or Count III, against Defendants.

Regarding Count IV of the Amended Complaint, Defendants maintain that Plaintiff has styled his claim as a derivative action since he does not assert any individual damage. That is,

[7] "[A] demand is not required where it would be futile." *Campau v McMath*, 185 Mich App 724, 729; 185 NW2d 724 (1990), citing to *Kimball v Bangs,* 321 Mich 394, 418, 32 NW2d 831 (1948). The futility exception to a written demand requirement is considered when defendants plead that a demand would be futile. *Huron City Co. v Parcells*, unpublished per curiam opinion of the Court of Appeals, issued February 8, 2018 (Docket No. 335978). In this matter, however, Plaintiff has not pled that a written demand would be futile to fall within the futility exception.

Plaintiff only alleges that termination of the Voting Trust would be in the shareholders' best interests. See Paragraph 85 of the Amended Complaint. Defendants also point out that the Court dismissed the Trustees of the Flotronics, Inc. Voting Trust Agreement as a party on December 11, 2019. Therefore, Defendants argue that Count IV must be dismissed. Defendants also seek the dismissal of former Trustee Jodi Schmaltz.[8]

In opposition, Plaintiff argues that the breach of the Trustees' duty under the Flotronics Voting Trust is not a derivative claim since he is a direct beneficiary of the Trust. Plaintiff contends that the Trust is not fulfilling its purpose and has allowed Lloyd Schmaltz to remain in absolute control without any accountability.

With respect to Count IV, the Court must first determine whether Plaintiff's Breach of Fiduciary Duty by Trustees of Voting Trust is a direct claim or a derivative action. "In general, a suit to enforce corporate rights or to redress or prevent injury to the corporation, whether arising out of contract or tort, must be brought in the name of the corporation and not that of a stockholder, officer or employee. The general rule is inapplicable where the individual shows a violation of a duty owed directly to him. This exception does not arise, however, merely because the acts complained of resulted in damage both to the corporation and to the individual, but is limited to cases where the wrong done amounts to a breach of duty owed to the individual personally. Thus, where the alleged injury to the individual results only from the injury to the corporation, the injury is merely derivative and the individual does not have

[8] In their Reply Brief, Defendants request the dismissal of Jodi Schmaltz as a defendant. "Reply briefs may contain only rebuttal argument . . ." *Blazer Foods, Inc v Restaurant Properties, Inc*, 259 Mich App 241, 252, 673 NW2d 805 (2003). Since the request to dismiss Jodi Schmaltz was not raised in Defendants' motion and principal brief so that Plaintiff had an opportunity to respond, the Court will not address Defendants' request herein.

a right of action against the third party." *Michigan Nat. Bank v Mudgett*, 178 Mich App 677, 679–80; 444 NW2d 534 (1989).

Stated otherwise, "[a] stockholder may individually sue corporate directors, officers, or other persons when he has sustained a loss separate and distinct from that of other stockholders generally." See 19 Am Jur 2d, Corporations, § 2245, p 147; C*hristner v Anderson, Nietzke & Co., P.C.*, 433 Mich 1, 9; 444 NW2d 779 (1989).

In this matter, the Court must determine who suffered the alleged injury – the shareholder directly or the corporation. In Paragraph 85 of the Amended Complaint, Plaintiff alleges that "[t]ermination of the Voting Trust would be in the best interests of the shareholders of the corporation." Thereafter, Plaintiff asserts that "[a]s a result of the illegal actions by Lloyd and the other Trustees, the Plaintiff has suffered damages in excess of $25,000.00." See Paragraph 86 of the Amended Complaint.

As Defendants argue, Plaintiff's allegations focus on the termination of the Voting Trust being in the best interests of the shareholders on account of the Trustees' alleged failure to appoint directors to the Board and a third Trustee to the Voting Trust. While Plaintiff alleges that it has suffered damages, Plaintiff has not pled sufficient allegations to demonstrate that this harm is separate and distinct from that of the other shareholders. Since the harm has not been alleged as personal only to Plaintiff, the Court concludes that the alleged injury to Plaintiff results from the injury to the corporation and so the claim is derivative in nature.

Based on the foregoing analysis and accepting all well-pled allegations as true and construing them in a light most favorable to Plaintiff, the Court finds that Plaintiff has not adequately pled its Breach of Fiduciary Duty by Trustees of Voting Trust as a derivative action

because Plaintiff has failed to comply with the pre-suit demand requirements set forth in MCL 450.1493a. Therefore, Count IV fails as a matter of law.

Accordingly, the Court finds that Plaintiff's Counts III and IV are "so clearly unenforceable as a matter of law that no factual development could possibly justify recovery." *Wade, supra*.

It is hereby ordered that Defendants' Motion for Partial Summary Disposition of Counts III and IV of Plaintiff's Amended Complaint is GRANTED under MCR 2.116(C)(8).

It is further ordered that Counts III and IV of Plaintiff's Amended Complaint are DISMISSED with prejudice.

IT IS SO ORDERED.

This Opinion and Order does not resolve the last pending matter and does not close the case.

/s/ Martha Anderson
HON. MARTHA D. ANDERSON
Business Court Judge

Dated: 5/5/2020.