STATE OF MICHIGAN
IN THE 17th CIRCUIT COURT FOR KENT COUNTY

MICHIGAN INCOME AND PRINCIPAL-
PROTECTED GROWTH FUND, L.P.,

Plaintiff,

vs.

AYERS BASEMENT SYSTEMS, LLC,

Defendant.
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Case No. 18-03432-CBB

HON. CHRISTOPHER P. YATES

OPINION AND ORDER DENYING PLAINTIFF'S MOTION *IN LIMINE* TO ENFORCE LIQUIDATED-DAMAGES PROVISION

Capital is the lifeblood of nearly all businesses, but smaller and riskier companies encounter difficulties in obtaining the financing necessary to run their operations. Defendant Ayers Basement Systems, LLC ("Ayers") found itself in that predicament, so it sought out Plaintiff Michigan Income and Principal-Protected Growth Fund, L.P., which is commonly known as "Arctaris," for assistance in lining up $2.5 million in financing. To memorialize their relationship, Arctaris and Ayers signed a term sheet that imposed obligations upon Ayers even if the effort to obtain financing did not bear fruit. Specifically, Ayers agreed to compensate Arctaris for its due diligence and other expenses, to abstain from negotiating with other potential sources of financing for a defined period of time, and to pay Arctaris $250,000 in liquidated damages for a breach of the obligation to stay away from other suitors. According to Arctaris, Ayers breached that corporate prenuptial agreement by flirting with other potential suitors, so Arctaris not only filed this action for breach of contract, but also requested a ruling *in limine* that the liquidated-damages provision is enforceable. Because the Court concludes that that provision prescribes a penalty, the Court shall deny Arctaris's motion *in limine*.

According to the six-page term sheet that governs the relationship between Plaintiff Arctaris and Defendant Ayers,[1] Arctaris was entitled to compensation in at least two forms even if it did not obtain financing for Ayers. First, under the provision entitled "Expenses," Ayers must pay Arctaris its expenses "including legal, accounting due diligence and related expenses, travel, and any broker or finder fees, as these expenses are incurred." Second, under the provision entitled "Exclusivity," Ayers must pay Arctaris the sum of $250,000 to compensate Arctaris for any breach by Ayers of its obligation not to deal with any other potential source of financing during the exclusivity period that is defined in the term sheet. The parties disagree about whether that provision is an impermissible penalty or a valid liquidated-damages provision, so Artcaris has asked the Court to decide *in limine* whether the $250,000 obligation arises from an enforceable liquidated-damages clause.

Under Michigan law, "[a] liquidated damages provision is simply an agreement by the parties fixing the amount of damages in the event of a breach and is enforceable if the amount is reasonable with relation to the possible injury suffered and not unconscionable or excessive."[2] St Clair Medical, PC v Borgiel, 270 Mich App 260, 270-271 (2006). Beyond that, a liquidated-damages "provision

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[1] Plaintiff Arctaris did not attach the term sheet to its complaint, see MCR 2.113(C)(1)(b), and the copy furnished to the Court with the motion papers is heavily redacted, so the Court cannot review all of the provisions contained in the parties' contract.

[2] The reasonableness standard consistently articulated by our Court of Appeals in this context antedates our Supreme Court's decision in Rory v Continental Ins Co, 473 Mich 457 (2005), which quite clearly relegated to the dustbin of history the "reasonableness doctrine" in another context. See id. at 465-470. Indeed, our Supreme Court went so far as to explain that a "mere judicial assessment of 'reasonableness' is an invalid basis upon which to refuse to enforce contractual provisions." Id. at 470. Such sweeping language calls into question the "reasonableness" inquiry with respect to all contractual liquidated-damages provisions, but the Court must presume that our Court of Appeals found a justification for maintaining this standard in spite of the clear command of Rory. See Rosett v Trepeck, No 258531, slip op at 2 n1 (Mich App June 20, 2006); but see id. (Schuette, J, dissenting) (arguing that Rory applies to liquidated-damages provisions). Therefore, the Court must apply the reasonableness standard reaffirmed by our Court of Appeals in the wake of the Rory decision.

is particularly appropriate 'where actual damages are uncertain and difficult to ascertain[.]'" See id. at 271. But a liquidated-damages provision can be "invalid as a penalty" when it allows for a remedy beyond compensation. UAW-GM Human Resource Center v KSL Recreation Corp, 228 Mich App 486, 508 (1998). "The validity of a liquidated damages clause depends on the conditions existing when the contract was signed rather than at the time of the breach[,]" Barclae v Zarb, 300 Mich App 455, 485 (2013), and "[w]hether such a provision is valid and enforceable or invalid as a penalty is a question of law." UAW-GM, 228 Mich App at 508.

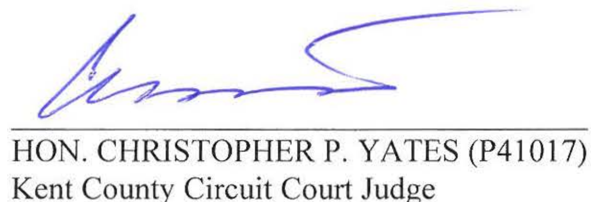
In the Court's view, the validity of the liquidated-damages clause in the term sheet turns upon the applicability of the election-of-remedies doctrine. The Court is satisfied that the defined amount of liquidated damages, *i.e.*, $250,000, "is reasonable with relation to the possible injury suffered [by Plaintiff Arctaris] and not unconscionable or excessive" because the term sheet contemplated a loan in an amount up to $2.5 million at a interest rate of 11 percent.[3] See St Clair Medical, 270 Mich App at 271. The language of the "Exclusivity" section in the term sheet, however, provides more broadly for redress in the forms of "equitable relief (including an injunction and specific performance)" "in addition to all other remedies available at law or otherwise to" Arctaris. Therefore, by its terms, the "Exclusivity" provision affords Arctaris the right to liquidated damages of $250,000, equitable relief, and "all other remedies available at law or otherwise[.]" The conventional remedy at law for breach of a contract is an award of damages "to 'place the nonbreaching party in as good a position as if the contract had been fully performed.'" Allison v AEW Capital Management, LLP, 481 Mich 419, 426 n3 (2008). Such an award of money damages in addition to liquidated damages of $250,000 would

[3] The payment of interest at 11 percent would have been augmented by closing fees and other benefits under the express language of the term sheet, so a loan in the amount of $2.5 million would have provided financial benefits to Plaintiff Arctaris well beyond 11-percent interest on the loan.

almost certainly convert the liquidated damages into an impermissible penalty under the election-of-remedies doctrine, which is not designed "'to prevent recourse to alternate remedies, but to prevent double redress for a single injury.'" See Barclae, 300 Mich App at 486.

Plaintiff Arctaris has anticipated the Court's concern about such "double redress" under the "Exclusivity" provision of the term sheet and offered to accept liquidated damages of $250,000 as its only form of compensation for Defendant Ayers's alleged breach of the "Exclusivity" provision. But the Court must resolve the validity of the liquidated-damages provision based upon the language of the term sheet "as written." Barclae, 300 Mich App at 485. Thus, the Court cannot ignore for the purpose of convenience the breadth of the "Exclusivity" provision, which permits Arctaris to obtain liquidated damages of $250,000 and equitable relief "in addition to all other remedies available at law or otherwise[.]" Although the Court appreciates Arctaris's offer to restrict itself to the remedy at law of $250,000 in liquidated damages because that approach would surely simplify this litigation, the Court cannot accept that offer in order to remove the penal element of the remedies prescribed by the "Exclusivity" provision in the parties' contract. Instead, the Court must prohibit Arctaris from relying upon the liquidated-damages clause as the measure of damages for a breach of the term sheet. Therefore, if Arctaris prevails on its claim for breach of the "Exclusivity" provision, its remedy shall be its actual damages.

IT IS SO ORDERED.



Dated: March 20, 2019

HON. CHRISTOPHER P. YATES (P41017)
Kent County Circuit Court Judge