

CLIENT ALERT

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COMMERCIAL & BUSINESS LITIGATION

THIRD PARTY DETERMINATIONS IN MICHIGAN

Geoffrey Fields and Christina McDonald

Contracting parties sometimes agree to designate a third-party to make determinations relating to their agreement. The Michigan Court of Appeals recently issued an opinion explaining the rules and consequences of third-party determinations in *Niewiek v Berends Hendricks Stuit Insurance Agency, Inc.*¹

In *Niewiek*, a former shareholder sued an insurance agency disputing valuation of his stock by an appraiser identified in the contract as having a nationally recognized reputation for valuing insurance agencies. The appraiser performed the analysis in a manner similar to previous valuations of the agency, as well as other insurance agencies at the time of the shareholder's departure from the company. Unhappy with the buyout figure, the shareholder engaged a valuation expert and filed a lawsuit in Kent County Business Court to dispute the third-party's findings.

The Court of Appeals affirmed the Trial Court's ruling in favor of the third-party determination, based on this rule: *when contracting parties submit a matter to a third party, the third party decision is binding absent proof of fraud, bad faith, or gross mistake.* The Court of Appeals ruled that proving a gross mistake requires a "mistake that rises to the level of a failure to exercise honest judgment." None of the critiques of the appraisal by the shareholder's valuation expert met this standard.

In its ruling, the Court of Appeals cited and relied on *Moran v. Schmitt*,² which addressed value of work under a construction contract. That prior case underscores the point that a third-party's determination cannot be set aside based only on another expert's differing opinion on subjects requiring a judgment call: "The rule is well settled that an award or estimate, if made, can be impeached for fraud, or such gross mistake as would necessarily imply bad faith, or failure to exercise an honest judgment in the premises."

Besides stock and construction agreement valuations, this rule has been upheld in several other settings in Michigan, including a purchase price adjustment, *Buzzitta v. Larizza Ind., Inc.*,³ an architect's determination of work progress under a building contract, *Strom-Johnson Constr. Co. v. Riverview Furniture Co.*,⁴ and a company suggestion plan program, *Carlini v. U.S. Rubber Co.*⁵

The *Buzzitta* case illustrates the level of proof required to overcome a third-party determination. Proof of bad faith included buyer's failure to use the acquired company's past accounting methods as required by the purchase agreement. Also, buyer's chief financial officer in charge of

the adjustment admitted he lied to the government in an SEC form and to a bank in a confidential memorandum when he described financial information about the company; and, an accountant familiar with the company's past accounting practices testified that such adjustments were not made in good faith.

The recent *Niewiek* case also holds that a third-party valuation is binding even though the agreement does not expressly state the determination is "final" or "binding." The Court of Appeals reasoned that an agreement to abide by a third-party's assessment is final and conclusive even if the agreement does not use such specific language, so long as the plain language of the contract shows the parties' intent to be bound.

¹ 2019 WL 4855941 (Mich.Ct.App. October 1, 2019)

² 109 Mich. 282; 67 N.W. 323 (1896)

³ 32001 WL 624969 (Mich.Ct.App. May 25, 2001), *lv appeal denied*, 465 Mich. 975 (2002)

⁴ 227 Mich. 55; 198 NW 714 (1924)

⁵ 8 Mich.App. 501; 154 N.W.2d 595 (1967)

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FOR MORE INFORMATION CONTACT:



Geoffrey A. Fields is Member in Dickinson Wright's Grand Rapids office. He can be reached at 616.336.1017 or gfields@dickinsonwright.com.



Christina K. McDonald is Member in Dickinson Wright's Grand Rapids office. She can be reached at 616.336.1039 or cmcdonald@dickinsonwright.com.