

COA Opinion: The de facto corporation doctrine is alive in Michigan (and applies to LLCs as well as corporations)

14. April 2010 by Gaëtan Gerville-Réache

On April 13, 2010, the Michigan Court of Appeals issued for publication a per curiam opinion in [Duray Development, LLC v. Perrin, No. 287722](#), holding that, under the de facto corporation doctrine, Outlaw LLC, and not its owner Perrin, was bound by the contract with Duray. It therefore reversed the trial court's judgment against Perrin. The Court also reviewed the trial court's failure to *sua sponte* raise the issue of corporation by estoppel but found no plain error. Finally, the Court reversed the trial court's decision to sanction defendants for not timely filing a witness list by precluding them from offering Perrin as a witness at trial. The trial court should have first considered all relevant factors and other sanction options before exercising its discretion to enter such a heavy sanction.

On October 27, 2004, Duray Development entered into a contract with Outlaw LLC for excavating undeveloped property, called Copper Corners, that Duray had purchased for residential development. The contract was signed on Outlaw's behalf by one of its owners, Carl Perrin, on the same day that Perrin signed Outlaw's articles of incorporation. The contract was intended to supersede an earlier contract of September 30, 2004, entered into by Perrin, Perrin Excavating, and KDM Excavating, none of whom were parties to the second contract. All parties proceeded under the second contract as if Outlaw were the contractor for Copper Corners. Outlaw later failed to timely perform under the second contract, and Duray Development sued for breach of contract. Outlaw counterclaimed for an outstanding payment of \$35,000 under the terms of the contract.

During discovery, Duray learned that Outlaw's articles of incorporation had not obtained a "filed" status at the time the contract was signed and that Outlaw therefore was not at that time a valid LLC under the LLC Act. Then, at the time of trial, the court ruled that because the defendants had failed to timely file a witness list, they would not be allowed to present any witnesses. When defendants attempted to present Perrin as a witness, the trial court prevented them from doing so, in accordance with its earlier ruling.

The trial court ultimately ruled in Duray's favor, finding that Perrin was in breach of contract for \$96,367.68. In a post-trial memorandum, Perrin argued that he was not personally liable for Duray's damages because Outlaw was a de facto corporation at the time he signed the contract. Perrin did not argue corporation by estoppel. The trial court ruled that while the de facto corporation doctrine would most likely have applied if Outlaw were a corporation, it did not apply to Outlaw because Outlaw was an LLC.

First, the Court of Appeals reversed the trial court's ruling that the de facto corporation doctrine does apply to LLCs. The court rejected the plaintiff's argument that the LLC Act displaced the de facto corporation doctrine because it was enacted for the purpose of forming LLCs and specified when an LLC was formed. Despite treatise commentary to the contrary, the Court held that the de facto corporation doctrine continues to exist in Michigan alongside the Business Corporations Act, even though the BCA was enacted for the purpose of forming corporations and specifies exactly when a corporation is incorporated. It saw no reason why the de facto corporation doctrine would continue to exist alongside the LLC Act as well. Since all of the factors for finding a de facto corporation had been satisfied, the court held that the doctrine did apply here and that Outlaw was liable under the second contract, not Perrin individually.

The Court then reviewed the trial court's failure to consider corporation by estoppel for plain error, since the issue had not been raised below. Though the doctrine would likely apply, the Court found no plain error in the court not raising the issue on its own.

Finally, the Court reversed the trial court for failing to consider the relevant factors and options for sanctioning before barring presentation of Perrin as a witness as a sanction for defendants' failure to timely file a witness list. The Court held that, because the matter fell within the trial court's discretion, the trial court's record must reflect that it "gave careful consideration to the factors involved and considered all of its options in determining what sanction was just and proper in the context of the case before it." Here, it could have considered whether the violation was willful or accidental, any earlier refusals to comply with discovery requests, prejudice to the plaintiff, or actual notice to the plaintiff of the witnesses, among others. The Court of Appeals therefore reversed the trial court's denial of the defendants' request to present a witness and remanded for further proceedings consistent with its opinion.