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Bad Facts Make Bad Precedent: Supreme Court Rewrites Contract

By Drew Broaddus

On August 23, 2010, the Michigan Supreme Court issued *Shay v Aldridge et al*, __ Mich __ (2010) (Docket No. 138908). The 4-3 decision (Justice Weaver wrote for the majority which also included Chief Justice Kelly, Justice Cavanagh, and Justice Hathaway) has broad implications for cases where contract language is disputed. The Court overruled *Romska v Oppen*, 234 Mich App 512 (1999) “to the extent that [it] precludes the use of parol [or external] evidence when an unnamed party asserts third-party-beneficiary rights based on broad language included in a release from liability and an ambiguity exists with respect to the intended scope of that release.” *Shay*, Slip. Op. at 2.

In *Shay*, plaintiff Thomas Shay sued police officers from Melvindale and Allen Park, claiming gross negligence, as well as assault and battery. A case evaluation panel entered an award in plaintiff’s favor. Specifically, the panel awarded \$25,000 total against two Allen Park officers, and a total of \$1,450,000 against three Melvindale officers. Shay and Allen Park accepted the evaluation as to those two officers’ liability. However, Shay and the Melvindale defendants rejected the \$1,450,000 award as to those defendants. Because his clients had agreed to settle, counsel for Allen Park requested a release and settlement. Shay’s counsel agreed. Shay then executed two releases that released the individual Allen Park officers, their insurance carrier and “all other persons . . . from any and all claims . . . resulting from the incident . . .” Shay also agreed to release his claims to the extent that they could form the basis for an action for indemnity or contribution against “the parties herein released.” Shay further agreed to indemnify and hold harmless the “above named released and discharged parties” and their “heirs, agents, employers, employees and any other related entities.” The Allen Park officers were then dismissed from the case with the consent of Shay’s attorney.

The Melvindale officers then moved for summary disposition, claiming that the releases’ reference to “all other persons” released them as well. The trial court initially denied the motion on procedural grounds. It eventually considered the merits of Melvindale’s position, but rejected Melvindale’s argument. The trial court found that the releases were ambiguous. The ambiguity was resolved against Melvindale based on evidence (including the affidavit of Allen Park’s attorney) that the parties never intended to release the Melvindale defendants.

SECRET WARDLE NOTES:

For decades, it had been established Michigan law that contracts will be interpreted as written. Extrinsic evidence (information not contained in the contract itself) was not considered unless the contract language was ambiguous.

A latent ambiguity exists when the language in the contract itself is clear and suggests a single meaning, but other facts create the need for interpretation. Although the latent ambiguity doctrine has been a part of Michigan law for many years, courts very rarely found latent ambiguities in contracts.

Shay potentially opens the door to a wide range of evidence that would otherwise not be admissible, as parties can now say that a “latent ambiguity” exists even if the contract language itself is clear and unequivocal.

Melvindale appealed to the Court of Appeals which, in an unpublished opinion dated March 5, 2009, reversed the trial court's ruling. The Court of Appeals concluded that the language of the releases was unambiguous, and barred Shay's claims against Melvindale. The Court of Appeals relied on *Romska*: "The releases at issue ... use the same broad language as the release at issue in *Romska*, and they also employ the word 'all.' ... [T]he language is unambiguous and thus must be applied as written. ... The releases indicate that 'all other persons' are discharged 'from any and all claims . . . which I have now or may have . . . ' Accordingly, the releases encompassed the pending litigation and served to bar plaintiff's claims against defendants." (The Court of Appeals also rejected several other arguments raised by Shay. These included; (1) that the releases should be unenforceable against Melvindale due to lack of consideration, and (2) that if the releases were held applicable to Melvindale, the proper remedy should be reformation of the releases).

Shay filed an application for leave to appeal to the Michigan Supreme Court. On October 14, 2009, the Supreme Court considered Shay's Application and scheduled oral argument "on whether to grant the application or take other peremptory action." 485 Mich 911 (2009). The Order specifically instructed the parties to "submit supplemental briefs ... addressing whether *Romska* ... was correctly decided." *Id.*

On August 23, 2010, in lieu of granting the application, the Supreme Court reversed the Court of Appeals. The Court overruled *Romska* "to the extent that it prohibits a court from considering extrinsic evidence of the intended scope of a release" under the circumstances presented in this case. *Shay*, Slip. Op. at 29. Stated another way, the Court held that "courts may consider extrinsic evidence of the intended scope of a release when an unnamed party seeks to enforce third-party-beneficiary rights based on the broad release language but the evidence presented establishes that an ambiguity exists with respect to the intended scope of the release." *Id.* at 11-12. The case was remanded to the trial court for further proceedings consistent with this holding. *Id.* at 30.

In reaching this conclusion, the Court found it particularly important that the Melvindale officers were not involved in the Allen Park officers' settlement negotiations with plaintiff, were not named in the executed releases, and did not sign the releases. The parties negotiating the releases included plaintiff and the Allen Park officers only. In fact, Shay presented an affidavit from Allen Park's attorney, stating that his only intention was to secure the release of his clients. *Shay*, Slip. Op. at 14.

The Melvindale officers conceded that they were not parties to the release, and that the parties to the release did not intend to release them. However, the Melvindale defendants argued that they were third-party beneficiaries of the release, based upon the broad "all other persons" language. In considering this argument, the Court interpreted MCL 600.1405 (which governs the rights of third-party beneficiaries) and as follows: "[I]n order for the Melvindale Officers to qualify as third-party beneficiaries, the language of the releases must have demonstrated an undertaking by plaintiff directly for the benefit of [them] or for a sufficiently designated class that would include the[m]...." *Shay*, Slip. Op. at 15. With these principles in mind, the Court held that "the Melvindale Officers qualify as third-party beneficiaries ... because on its face, the release language unambiguously releases 'all other persons.'" *Id.* at 17.

Being third-party beneficiaries did not, however, automatically entitle Melvindale to the benefit of the release. *Id.* at 18. Although a third-party beneficiary has the right to seek enforcement of a promise, courts must still apply principles of contract interpretation to determine what was actually promised. Applying these principles, the Court found that, although the releases on their face appeared to release Melvindale, this was a "latent ambiguity." A latent ambiguity exists when the language in a contract appears to be clear and intelligible and suggests a single meaning, but other facts create the need for interpretation or a choice among two or more possible meanings. The Court resolved the ambiguity against Melvindale, noting that several important facts were not disputed. For example, the Allen Park and Melvindale defendants were represented by different counsel. Allen Park's counsel explained to plaintiff that the releases were drafted in order to settle plaintiff's claims against his clients. Also, it was expressly agreed that plaintiff would accept the combined \$25,000 case-evaluation awards with respect to Allen Park, but *would not* accept the award as to Melvindale. A stipulation and order dismissing the Allen Park officers *only* was entered. Finally, the Melvindale officers remained parties to plaintiff's lawsuit with a trial date set. *Shay*, Slip. Op. at 25. The Court also found it important that the language of the releases expressly contemplated a situation in which the Allen Park officers might be liable through contribution or indemnity to another party. This implied the existence of a continued lawsuit against other parties. *Id.* at 25.

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Justice Markman authored a dissenting opinion (signed by Justices Corrigan and Young). The dissent was concerned that the Melvindale defendants *were* found to be third-party beneficiaries to the releases, but *were not* entitled to any benefit under those agreements. *Shay*, Slip. Op. (Markman, J., dissenting) at 26-27. The dissent felt that the Melvindale officers were third-party beneficiaries, and that they should be released under the unambiguous “all other persons” language. In the dissent’s view, extrinsic evidence should never be considered when a release is “clear and unambiguous on its face.” *Id.* at 29.

The Supreme Court’s decision in *Shay* could have broad ramifications in contract disputes, as it arguably broadens the scope of individuals who can claim third-party beneficiary status. The decision could also be interpreted to broaden the range of circumstances where extrinsic evidence can be considered, through its reaffirmation of the latent ambiguity doctrine. On the other hand, one could say that the outcome in *Shay* is unique to its facts. The Melvindale defendants acknowledged that the parties had no intention of releasing them. Also, it would have been fundamentally illogical for Shay to waive his claim against Melvindale (that was evaluated at almost \$1.5 million) for no consideration beyond the \$25,000 paid by Allen Park. The Court clearly wanted to avoid this perceived injustice.

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