

The Hold-Up Problem: BAD-FAITH MODIFICATION & “ECONOMIC DURESS” UNDER MICHIGAN LAW

The Hold-Up Problem in Long-Term Supply Contracts

Consider a hypothetical long-term supply contract in which the seller threatens to hold up supply unless the buyer agrees to pay higher prices. The seller may have leverage because of substantial costs and/or delay involved in finding an alternate supplier. In some cases, a tight supply chain may leave the buyer with no reasonable alternative to accepting the seller’s demand.

When the buyer seeks payment under the modified agreement, the seller may reasonably feel that the original prices should apply because consent to the higher price was obtained through bad faith and/or under “duress.” What are the buyer’s options under Michigan law?

Modification under the Uniform Commercial Code

Michigan’s enacted version of the Uniform Commercial Code (“UCC”) provides that “[a]n agreement modifying a contract within this article needs no consideration to be binding.” MCL 440.2209. However, the American Law Institute’s commentary on this section provides that “modifications made [under Section 2209] must meet the test of good faith imposed by this Act.” MCLS 440.2209 at Comment 2. The comment goes on to note that, “The effective use of bad faith to escape performance on the original contract terms is barred, and the extortion of a ‘modification’ without legitimate commercial reason is ineffective as a violation of the duty of good faith.” *Id.*

Accordingly, the buyer may assert that the modification is invalid because the seller acted in bad faith by threatening to breach without a “legitimate commercial reason.”

Economic Duress

The seller might also contend that the modification is invalid because the seller’s consent was obtained under duress. Courts have long recognized that a contract is voidable where consent was obtained under duress. However, this doctrine has traditionally been applied only in cases where the duress alleged involved some *unlawful* act (e.g., a threat of violence). To address the particular issue of business tactics that fall short of crime, but nevertheless strike us as objectionable, some courts apply the doctrine of “economic duress.” The question courts face is where to draw the line between legitimate “commercial pressure” and unfair tactics that deprive one side of meaningful choice.

Michigan courts have interpreted this doctrine narrowly, continuing to require proof of a tactic that is unlawful, as opposed to merely wrongful. See, e.g., *Stefanac v Cranbrook Ed Community*, 435 Mich 155, 194 n 40; 458 NW2d 56 (1990) (noting that, “Despite the general enlargement of the doctrine of duress to encompass economic duress, the law in Michigan may have lagged behind. Some fairly recent Michigan cases cite *Hackley v Headley*, 45 Mich 569; 8 NW 511 (1881), for the propositions that a claimant who relies on a theory of economic duress must prove a wrongful or unlawful act, that refusal to pay a debt due on demand is not wrongful, and that fear of financial ruin is not sufficient basis for claiming economic duress”) (citing *Transcontinental Leasing v Michigan Nat’l Bank of Detroit*, 738 F2d 163, 166 (CA 6, 1984) (applying Michigan law), and *Apfelblat v Nat’l Bank*, 158 Mich App 258; 404 NW2d 725 (1987)).

This interpretation of the doctrine of economic duress is narrower than the position taken in the Restatement (Second) of Contracts, which provides that threatening to breach a contract qualifies as a

“wrongful act” sufficient to satisfy the first element of the test for economic duress. Restatement (Second) of Contracts at Section 175 (1981).

There has been some push toward expanding the doctrine to meet the Restatement interpretation. *Kelsey-Hayes Co v Galtaco Redlaw Castings Corp*, 749 F Supp 794, 797 n 5 (ED Mich, 1990) (noting that although “[a] survey of Michigan cases involving duress reveals that there has never been a decision that explicitly adopts the modern formulation of duress[,] . . . the Court is satisfied that if the Michigan Supreme Court looked at the issue today, it would rule that economic duress need not stem from an “illegal” threat. No Michigan decision affirmatively states that Michigan has rejected the modern interpretation of economic duress”).

However, the opinion in *Kelsey-Hayes v Galtaco Redlaaw* has been criticized as failing to apply Michigan law faithfully. See, *Enzymes of Am v Deloitte*, 207 Mich App 28, 35; 523 NW2d 810 (1994), rev’d in part on other grounds, 450 Mich. 889, 539 N.W.2d 513 (1995) (holding, “the established law in Michigan remains unchanged at this time: Illegality is an element of duress”) (citing *Norton v State Hwy Dep’t*, 315 Mich. 313, 320; 24 N.W.2d 132 (1946)); *Whirlpool Corp v Grigoleit Co.*, 2006 U.S. Dist. LEXIS 47588, *9, 2006 WL 1997402 (W.D. Mich. July 13, 2006) (noting that, “Since the Michigan Supreme Court had expressly and repeatedly held that in order to avoid a contractual obligation because of duress, one must allege unlawful coercion, that rule was controlling and the Kelsey court was constitutionally required to abide by it”) (internal citations omitted).

Conclusion

While the doctrine of “economic duress” is interpreted narrowly under Michigan law, the good-faith provisions of the UCC should prevent enforcement of any agreements obtained as a result of supplier’s threats to breach the agreement where such threats are made without a “legitimate commercial purpose.”