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STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN FOURTH JUDICIAL DISTRICT

Case Type: Contract/Other

David & Hiba Stemm, LLC,
a Kentucky limited liability company,
and James David Stemm, individually,
and Hiba George-Stemm, individually,

Plaintiffs,

v.

TempWorks Management Services Inc.,

Defendant.

Court File No: **27-CV-14-3571**

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER FOR JUDGMENT

This matter came before the Court for a trial without a jury on December 8, 9 and 10, 2014. Plaintiffs were represented by George E. Antrim, III, Esq., George E. Antrim, III, PLLC. Defendant wwas represented by John H. Reid, Esq., TempWorks Management Services, Inc., and Daniel J. Cragg, Esq., ECKLAND & BLANDO LLP. Based upon all of the evidence admitted and the testimony received, the Court makes the following:

FINDINGS OF FACT

1. Plaintiff David Stemm ("Stemm") has extensive experience in the temporary staffing industry from working with Employment Plus, a staffing agency. Stemm joined Employment Plus as its Risk Manager in January 1998. Stemm's responsibilities were to design, implement and manage Employment Plus's Risk Management program. Part of his responsibility was to negotiate workers compensation insurance.

2. Employment Plus grew rapidly. When Stemm started, Employment Plus was four offices and had about $1 million in sales. By 2000 sales had doubled to $2 million. Sales

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increased to $6 to $10 million by 2004.

3. After 2000 Stemm transitioned into Operations Management with responsibilities for managing all branch functions, hiring personnel, contract negotiations and overall customer service in the event an account was not going favorably. Stemm was eventually placed in charge of Employment Plus's largest profit center – the Onsite Division --which developed techniques for staffing large industrial customers who might use 1200 temporary employees a week.

4. Stemm resigned in 2006 to take on a private venture in Idaho. He returned around March 2010, to start the Healthcare Staffing division for Employment Plus in Indiana. Although Stemm hoped to transition clients from a temporary dental service that Employment Plus's owner Mike Ross had bought, these clients did not stay. Stemm had to get new clients.

5. Around July 2010, Stemm hired Eric Pattison ("Pattison") to work in Fishers, Indiana for Employment Plus Healthcare division. Pattison had contacts in the industry that helped in acquiring customers. While Pattison was employed by the Healthcare division, he was the only operational employee.

6. In 2010, sales for the Healthcare division were between $200,000 - $250,000. Stemm testified that after burden, overhead and the salaries for him and Pattison were accounted for, the business would have been operating at break even. Stemm testified that payroll, which the total is paid to the temporary workers, would have been between $125,000 - $150,000. The court finds that this means that in 2010 there was between $50,000 - $125,000 left to cover burden and salaries to Stemm and Pattison. Stemm provided no information about how much he or Pattison were paid from these revenues. Stemm testified that in 2011, sales and payroll increased 10% and that profits probably increased because of wider margins but supplied no specifics. Again no information was provided as to how much Pattison was paid.

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7. In contrast to Stemm's assertions of increased sales, Michael Testy, the former controller and VP of Finance for Employment Plus, testified that from records he had seen, the Healthcare division in 2011 billed 17,977 hours, nearly 800 fewer hours than the 18,750 hours it had billed in 2010, about a 4% decrease. And the hours billed decreased another 4500 hours in 2012 to 13,473 hours, about a 25% decrease. But he provided no specifics about whether profit increased or decreased between those years. Because billing rates and burdens differed from job to job, billable hours could result in varying degrees of profit. The records themselves were not produced. Testy also relied on incomplete data for 2013 to extrapolate total actual hours billed for 2013. Although Testy testified that if 5 months of actual hours billed for the entire Healthcare division were extrapolated for 12 months, actual hours billed would have been 22,391, showing a significant increase in hours billed for the entire Healthcare division from 2012 to 2013, the court finds this to be too speculative to be reliable. The court finds that there is insufficient evidence to conclude that profits increased at any time in the Healthcare division.

8. Stemm moved to Massachusetts in May 2011, after marrying, but remained the Director of Employment Plus Healthcare.

9. In October 2011, Mr. Stemm left Employment Plus to focus on growing his previously-organized business, David & Hiba Stemm LLC (the "Plaintiff LLC"). It was organized on August 8, 2011 for the purpose of operating as a temporary employment staffing agency. David Stemm is a 49 percent owner of the Plaintiff LLC; his wife, Hiba Stemm, is a 51 percent owner. (Exhibit 2.) The Plaintiff LLC's d/b/a name was "180 Personnel."

10. Stemm contacted Defendant TempWorks Management Services Inc. ("TempWorks" or "TMS") to assist him in starting up his staffing company. TMS was an affordable alternative for a start-up because of its lack of front end investment.

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11. On or about February 1, 2012, 180 Personnel entered into a contract with TempWorks Software, Inc. regarding website design. (Exhibit 3). The cost for the website was $4,100. Because the website is linked to software owned by TMS, it no longer is useful to Stemm or 180 Personnel. He cannot access anyone that might try to contact the website.

12. About a year later Stemm saw an opportunity to start the business. In mid-2013, Pattison became available. He had recently been replaced by a cheaper employee at Employment Plus, Healthcare. Stemm asked Pattison if he would like to work for 180 Personnel.

13. Knowing that clients tended to by loyal to their representative rather than to a company, Stemm perceived a "window of opportunity" in the Indiana market as a result of Pattison's termination. By utilizing the services of TMS, Stemm believed the Indiana-based clients of Employment Plus could immediately transition to 180 Personnel, without need for a ramp-up period or outlay of significant capital because of their close working relationship with Pattison. Because of these relationships, Pattison was considered by Stemm to be the "lynchpin" of the Plaintiff LLC's business plan.

14. Five major clients accounted for a large percentage of Employment Plus Healthcare business. These were Goodman Campbell, Kevin Ward, Otolaryngology Associates, Meridian, and Podiatry Associates. Stemm testified that these five had historical billings with Employment Plus of about $100,000 a year. Stemm testified credibly that the business from these five was steady and reliable. Stemm reasonably believed that these five clients would follow Pattison.

15. Although Pattison was subject to a covenant not to compete with Employment Plus, Stemm testified credibly that Employment Plus assured him that it would not enforce the non-compete if Pattison went to work for Stemm in Indiana and clients wanted to follow him.

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Defendant presented no contrary evidence that Stemm and Pattison should not have reasonably relied on this representation.

16. Pattison accepted Stemm's offer to join 180 Personnel in mid-2013. Stemm testified that Pattison was an independent contractor but Stemm viewed him as an informal partner. No evidence was introduced as to what 180 Personnel would pay Pattison.

17. Having secured Pattison, Stemm put the other pieces in place to start the temporary staffing business. He hoped to work in both Massachusetts and Indiana, but because of Pattison focused his efforts on Indiana. One major obstacle was day to day operations. Casey Kraus ("Kraus") of TempWorks recommended that Stemm consider the entire suite of services afforded by TMS in addition to the website because it would provide all the services the Plaintiff LLC needed under one roof. Kraus had Tempworks employee Bob Pugliano take the lead in working with Stemm.

18. On July 8, 2013, Stemm told Kraus that he would like to utilize "employee of record" services from TMS (Exhibit 9). Stemm provided background information to TMS such as a credit check and return on investment. There were no issues with these background checks. TMS personnel stated that the credit checks were excellent (Exhibit 12).

19. After reviewing the background information TMS decided to enter into a contract with Plaintiff LLC. The parties agree that there is a contract between Plaintiff LLC and TMS for the provision of "employer of record" services (the "Agreement") (Exhibit 14), which was entered into between July and August 2013. Although TMS did not sign the Agreement, it has stipulated to the contract's validity. David and Hibba Stemm also signed as personal guarantors.

20. Under the agreement, 180 Personnel was responsible to find customers that needed staffing and to find the people who would be placed. These people were referred to as

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Staff Consultants. TMS would be the employer of record ("EOR") and provide all the necessary "back office" work needed. TMS would provide workers' compensation insurance, front and back office staffing, software, tax and accounting services, payroll processing services, capital, human resources services, accounts receivable, and other miscellaneous staffing services. Although Stemm could have contracted for all of these services separately it was much quicker to use TMS for everything. And TMS did not require any front end payment.

21. The Plaintiff LLC would collect a "commission" upon payment to TMS of any invoice by a customer/client. The Agreement specified that the commission would be equal to any money remaining from an invoice payment after TMS deducted its "Management Fees". Management Fees included the actual costs of payroll and fees for Staffed Consultants incurred by TMS, plus a 3.99% Administrative Fee. (Exhibit 14 Ex A). Tempworks COO Mari Kautzman ("Kautzman") testified credibly that the 3.99% Administrative Fee did not include the cost of workers compensation insurance. This cost would be added to the cost of payroll.

22. The Agreement required that people could not be placed as employees of TMS unless they had been approved by TMS. (Exhibit 14 para 2.3).

23. The Agreement provided that TMS could terminate the agreement under certain conditions. The following section is particularly important to this case because it is the section that TMS relies on to justify its termination of the contract with Plaintiff LLC.

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SECTION 11.3 – TERMINATION BY TEMPWORKS

TempWorks may, at its option, terminate this Agreement without affording You any opportunity to cure the default, upon the occurrence of a material breach of this Agreement or the occurrence of any of the following Events of Default:

1) The occurrence of any event or condition which, alone or when taken together with all other events or conditions occurring or existing concurrently therewith, TempWorks determines (1) has or may be reasonably expected to have a material adverse effect upon Your business, operations, properties, condition (financial or otherwise); (2) has or may be reasonably expected to have any material adverse effect whatsoever upon the validity or enforceability of this Agreement or any other agreement between You and TempWorks; (3) has or may be reasonably expected to have any material adverse effect upon any security for the Obligations, TempWorks' liens therein or the priority of such liens; or (4) materially impairs the ability of You to perform Your obligations under this Agreement or any other agreement between You and TempWorks, or the ability of TempWorks to enforce and collect the Obligations or realize upon any of the security for the Obligations in accordance with the terms of this Agreement or any other agreement between You and TempWorks or applicable law;

24. Tempworks knew that 180 Personnel wanted to start in the fall of 2013. On July 12, 2013 Stemm emailed Casey Kraus asking specifics about the timeframe to actual operation. He said that "we have a given start date of Sept. 1 and that is our planned date at which we can send a person to work." Stemm asked if the start date was possible or impossible, noting that he would need to do paperwork for applicants a few weeks in advance and secure utilities and office leases. Mr. Kraus assured Stemm the same day that "Assuming that we get all of the paperwork taken care of in a timely fashion, it shouldn't be an[sic] problem to get you up and running in a couple of week.[sic]" (Exhibit 13 TMS03363-64). At no point did anyone at TMS tell Stemm that September 1, was an unrealistic start date.

25. The website was operational in the summer of 2013. It was linked to TMS Enterprise software in September 2013.

26. On August 20, 2013, Ashlee Brace ("Brace"), who would serve as the Project Manager for 180 Personnel, sent Stemm the "Welcome to TempWorks" PDF outlining the information that TempWorks would need for the underwriting process. (Exhibit 15).

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27. Throughout his relationship with TMS, Stemm timely provided all the information that he was requested and that was required. No evidence was raised that Stemm failed to provide adequate information.

28. Due to problems on his end Stemm changed the target date from September 1 to October 1, 2013. Stemm testified credibly that TMS employees Bob Pugliano and Ashlee Brace knew that October 1, 2013 was the targeted start date. The court finds that TMS knew of the October 1 start date, knew that meeting the date was important because of prospective customers that would accept workers on October 1, and never indicated to Stemm that there was any reason he could not rely on being able to start on October 1. Stemm and Plaintiff LLC reasonably relied on representations from TMS that 180 Personnel could begin operations October 1.

29. Stemm took steps for 180 Personnel to be able to do business on October 1. Stemm set up bank accounts in Indianapolis for 180 Personnel and got marketing materials. Stemm spent his own money on these items and expected to pay himself back from the 180 Personnel account after the business was making money. Stemm flew to Indianapolis to meet with the five significant potential customers. They indicated that they were willing to do business with 180 Personnel.

30. On August 23, 2013, Stemm signed a one-year lease for an office in Plymouth, Massachusetts for $340 a month. He intended to use this office as a base for the staffing business as well as for another business venture he had with a Massachusetts drug testing company. That other venture required that he have an office outside of his home to accept shipments. Because he needed this office for the other venture, the court finds that Stemm would have incurred these offices expenses regardless of the TMS contract.

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31. Stemm submitted potential customers/clients to TMS for approval and they were approved for credit on September 18, 2013. (Exhibit 23). The court finds that Plaintiff LLC and TMS in September 2013 were actively going through the approval process for workers to be placed at Otolaryngology Associates, Meridian and Goodman Campbell, and at least two clients were approved.

32. No customer signed a contact with TMS guaranteeing a certain minimum number of requests for employees or a certain amount of business. Such guaranteed contracts are not typical because flexibility is one of the many reasons to use temporary staffing.

33. Stemm submitted two potential Staff Consultants for approval on September 24, 2013, but TMS canceled the contract with Plaintiff LLC before they were approved or disapproved. There was no evidence that either potential employees posed any problems. The court finds that but for the cancellation of the contract, the employees would have been approved, and Plaintiff LLC could have started placing some temporary workers on October 1 if TMS had provided workers' compensation assurances. Although there was at least one other available worker who could have been submitted for approval, the initial placements that were ready for October 1 were less than what Employment Plus had been providing.

34. The court finds that Stemm and Plaintiff LLC had done everything necessary to meet TMS requests and to be ready to start business on October 1. The court finds that the primary remaining obstacle for placing workers on October 1, 2013 was an assurance from TMS that workers' compensation was in place.

35. TMS promised to provide workers' compensation for the Staff Consultants. (The Agreement Para 4.1) This became a critical issue in this case. TMS testified that it was always prepared to provide worker's compensation coverage when needed and could have gotten it at

any time. But the course of events in this case raised a reasonable concern in Stemm's mind as to whether workers' compensation would be available in order to have his Staff Consultants placed on October 1, 2013.

36. On July 8, 2013 Kraus told Stemm in an email that TMS was not bound for insurance in Indiana. (Exhibit 9). TMS intended to provide the workers' compensation that would be needed for the 180 Personnel staffing through a company called Direct HR. The agent at Direct HR that TMS worked with was Mike Sepsey.

37. As the October 1 start date approached, Stemm told Brace that the potential customers needed proof that the workers' compensation was in place. On September 24, Stemm emailed Brace that Otolaryngology needed proof of insurance prior to giving an "official" order. In response, Brace said that she had "just received confirmation that we will be binding coverage on your codes today" and that she would have certificates of insurance by the next day, Wednesday September 25 (Exhibit 34).

38. To finalize the workers' compensation coverage, certain employee information needed to be sent to Direct HR. TMS did not want to send this information itself, and instead on Tuesday, September 24, 2013 at 3:03 p.m., Brace instructed Stemm or Pattison to send the information directly to Mike Sepsey (Exhibit 35). Stemm was not told that he could not call Sepsey.

39. Stemm submitted two employees for approval to Mike Sepsey at Direct HR on September 24 and expected to receive approval within one hour, as TMS had said was the usual approval time. But he heard nothing on September 24.

40. On the morning of Wednesday, September 25, 2013, Stemm called Sepsey to see if Sepsey had all the information that he needed to approve the employees. Although Stemm

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testified that he does not recall saying that the workers were the employees of 180 Personnel, the court finds that Stemm identified 180 Personnel as an employment agency and asked about the status of his temps, or said something else, which created some confusion with Sepsey about who was the employer of record. Sepsey said that Direct HR would not cover the employees and that "it was going to be a problem" for 180 Personnel to do business in Indiana. He refused to answer any of Stemm's questions, stating, "You are not my client. TempWorks is my client," and indicated that he was immediately calling Pugliano or Brace at TempWorks.

41. Sepsey then emailed Brace and Pugliano in the morning of September 25. He said that Direct HR could not cover 180 Personnel employees under workers' compensation because their "carrier did not allow their staffing company to staff for other staffing companies." (Exhibit 36 at 801). Direct HR was willing to supply workers' compensation for TMS employees but not for employees of 180 Personnel.

42. Pugliano assured Stemm that this was a miscommunication that would be resolved quickly. However, during the rest of Wednesday September 25, Stemm was not told that the problem was resolved. He spoke to Pugliano three times during that day and was told each time that everything was fine and Stemm just needed to wait a few more hours.

43. In fact, everything was not fine. Although Brace immediately emailed Sepsey on the morning of September 25 to clarify that TMS was the employer of record, Sepsey told Pugliano that affiliates of TMS should not call Direct HR to approve employees. Pugliano suggested to Brace around noon on September 25 that the problem could be resolved if TMS took the lead with Direct HR on getting employees approved (Exhibit 36).

44. In a series of internal TMS emails addressed to COO Mari Kautzman, Casey Kraus, CEO David Dourgarian, Ashlee Brace and Bob Pugliano on Thursday September 26, it

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became clear that TMS had serious concerns about a resolution that would require more input from TMS employees. Pugliano first explained that even though Direct HR had previously allowed affiliates like 180 Personnel to send in approval information, the process had to change. Direct HR was now requiring that all temp approval documentation be sent by TMS. Casey Kraus responded that this is a "logistical nightmare" and that "it is not worth sinking salary expenses into another person to do the paperwork." Pugliano suggested that clerical time could be minimized if 180 Personnel did the paperwork and send it to TMS to forward on to Direct HR. Kautzman replied that she did not understand the need for a change and that these clerical hours would be "meaningless" and "could be used doing something beneficial to our company and its profitability." At about 2:25 pm on Thursday Pugliano said "If we want to do business with Direct HR moving forward, this is how we have to do it. If not, we don't. I don't make the call. I am informing you of the facts. Make the call." No decision was made that day. Kautzman emailed that she would phone Sepsey and "straighten this out." At 4:03 pm Pugliano asked the higher ups to let him know what they decided, because he was in the process of writing a letter and contract dealing with 180 Personnel for Direct HR to give to its workers' compensation carrier. Pugliano reminded everyone that 180 Personnel expected to place people the following week. (Exhibit 40). No further evidence was provided about what the letter or contract would have said. The court finds that Pugliano was preparing a letter and contract that would have required TMS employees to send approval information to Direct HR, which at that time was the only solution that Pugliano knew Direct HR would accept.

45. The court finds that TMS was unhappy that it might take more clerical time than anticipated to get workers compensation coverage for 180 Personnel. TMS was considering

dropping its relationship with Direct HR but at this point had proposed no alternative for getting 180 Personnel workers' compensation coverage in time to start business on October 1.

46. Pugliano told Stemm on Thursday that he had resolved the issue of getting approval from Direct HR, and was writing a letter and contract to Mike Sepsey that Stemm would be copied on. Despite Pugliano's assurances to Stemm, this issue was not resolved on September 25 because Pugliano had not heard from Kautzman about whether TMS was willing to do the extra clerical work needed to get employee approval from Direct HR.

47. Stemm had not received any letter resolving the situation by the morning of Friday September 27.

48. On the morning of Friday, September 27, 2013 at about 8:30 am CST Stemm called Pugliano. Pugliano said that the COO, Kautzman, had resolved the issue without sending the letter but that he was simply awaiting word from Kautzman within half an hour. This was a false assurance. Shortly after this call at 8:42 am CST Pugliano emailed Mari Kautzman, and copied CEO Dourgarian and Brace, and asked Kautzman to report on her alleged call with Sepsey the previous day, and to advise him on how to proceed with 180 Personnel. (Exhibit 42). Stemm called Pugliano back 29 minutes later at 8:59 a.m. CST. Pugliana gave Stemm an excuse and promised to call in another half hour. The court finds that at this point Pugliano did not know whether or not Kautzman had reached a resolution and had falsely told Stemm there was a resolution.

49. Having heard nothing an hour later about 10:00 am CST, Stemm tried to call Kautzman and was told she was in training. He tried to call Pugliano and was sent to voicemail, which was unusual. The court finds that it was reasonable for Stemm to be concerned that the

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problem with Direct HR approving the employees was not yet completely resolved. Stemm decided to call Sepsey at 10:07 am CST.

50. Sepsey again told Stemm that communications with Direct HR needed to come through TMS. He said he was waiting for paperwork from TMS so that they could do business. Sepsey then emailed Pugliano at 10:15 am CST and asked about when he would get the contract and letter they had discussed on Thursday (Exhibit 45). Sepsey said nothing in the email about having spoken to Kautzman and, contrary to Pugliano's statement earlier that morning to Stemm, Sepsey was still expecting the contract and letter that would require TMS to send in approval information.

51. Kautzman testified that she had a 5 minute conversation with Sepsey and resolved the problem and there was no reason to send a new contract. She testified that Sepsey agreed that Stemm could email information directly to Direct HR without a TMS employee in the middle. But she did not communicate this to Stemm. The court finds Kautzman's testimony was not credible that she had resolved the problem Friday morning, given that Sepsey was still waiting for the contract and letter from TMS.

52. Reasonably believing that the situation was not yet fully resolved, Stemm called TMS at 10:24 a.m. CST, and asked for Kautzman. When told she was unavailable he asked to speak to the CEO, Dourgarian. Dourgarian indicated that he had no knowledge of Stemm's account, even though he had been copied on all the emails about the Direct HR issue two days before, but assured Stemm that he would find out and have someone contact him. Stemm asked that Kautzman call because Stemm had been told that she had solved the problem. Dourgarian told Stemm that Kautzman would call him within 30 minutes. Dourgarian testified that this conversation with Stemm was cordial. Dougarian emailed Kautzman and Pugliano a few minutes

later at 11:08 am CST to "Please figure out what to do with Dave Stemm as he's calling and harassing me." (Exhibit 46 at 3854). He did not provide any direction on how to resolve the problem or tell Kautzman to call Stemm.

53. Kautzman did not call back. At 10:37 am CST Kraus called Stemm and said that "TMS was trying to get you taken care of but you calling Mike Sepsey is not making things easier." Stemm didn't remember Kraus and told Kraus he only wanted to speak to the COO, Kautzman. Kraus testified that he knew nothing about the workers' compensation problem or about Stemm needing to place people the following week, and he did not discuss those issues. He only called because he had been told that Stemm was calling TMS. The court does not find Kraus' testimony that he knew nothing of the workers' compensation problem credible because he had participated in the email chain the day before and complained about the proposed resolution.

54. A few minutes later, around 11:00 am CST on Friday, Stemm insisted that Kautzman be interrupted. Kautzman said "According to what I've been told, TMS was waiting on Mike Sepsey." She did not tell Stemm that she had resolved the problem. Stemm told her that this directly contradicted what he had been told by both Pugliano and Sepsey, and suggested that Sepsey be included in a conference call so they all could understand exactly what was needed to resolve the workers' compensation issue. Kautzman refused, told Stemm that she had people in her office, and hung up the phone. Kautzman then asked to have Stemm's calls sent to her voicemail.

55. Stemm immediately asked to speak to Dourgarian again. Stemm was told that he wasn't answering his phone, and Stemm was connected to Kautzman's voicemail instead. A few minutes later at 11:41 am CST., Stemm called to get Dourgarian's email address.

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56. After speaking with Stemm once on Friday, Dourgarian met with Kraus, Pugliano, Brace and Kautzman to discuss Stemm. Although Dourgarian had told Stemm he would figure out what was going on with the workers' compensation issue, Dourgarian did not discuss how to fix the workers' compensation issue or the status of Stemm's business. He only recalls discussing what he referred to as the crescendo of increasingly unstable interactions with Stemm and whether he fit their risk profile.

57. Dourgarian testified that he made the decision to terminate the contract. He testified that calls from Stemm over the previous few days, especially on the morning of Friday September 27, 2013, led him to believe that Stemm did not meet his risk management profile. He especially noted that Stemm had demanded that Kautzman be pulled out of a meeting, even though Stemm had been told that only Kautzman knew if the situation was resolved. He also noted that Stemm made 9 phone calls to staff within a day or two, even though TMS had not provided the workers' compensation assurances 180 Personnel needed to start working the next week. Dourgarian also testified that he was concerned that Stemm had called Mike Sepsey directly, which he perceived as a failure to follow instructions. Instead of solving the problem with the workers' compensation, Dourgarian declared that Stemm was unstable and TMS was not going to work with him. He directed staff to terminate the contract.

58. Shortly after, on Friday, September 28, 2013 at 1:10 p.m. CST, Stemm received a voicemail from Pugliano stating that at the direction of the CEO and COO, "due to circumstances we are not moving forward with your company at this time." Stemm called Pugliano and asked what those circumstances were, but Pugliano said that he was not made aware of them.

59. Although Kautzman and other witnesses testified that there was no problem getting workers' compensation, the court finds at the time TMS terminated Stemm, TMS had not worked out an arrangement with Mike Sepsey at Direct HR that would not involve TMS incurring increased clerical costs, and had not worked out an alternative. The court finds that getting workers' compensation through some other source was possible but would have cost TMS more than originally anticipated, or at least would have taken an effort to obtain.

60. TMS presented evidence that one reason it cancelled the contract was because a few weeks before, Pattison spoke to Brace in a manner she found rude and bossy. Stemm learned on September 12 that she was offended. He apologized to her and assured her that it would not happen again. No evidence was presented that there was a repeat of this behavior. The court finds that this interaction was not the real factor in TMS decision to terminate the contract, because after this occurred TMS continued with the "on boarding" process approving potential customers and workers.

61. There was no evidence that Stemm was told not to call Direct HR. He was directed to send his information to them. More importantly there is no evidence that his contact with Direct HR damaged any relationship with Tempworks. Indeed, Tempworks testified that everything had been worked out with Direct HR.

62. The court does not find Dourgarian's explanation of why he terminated the contract reasonable or credible. Staff was concerned that getting workers' compensation through Direct HR would entail unanticipated clerical expense. Mr. Stemm's questions to TMS staff were reasonable. Dourgarian admitted that he was too busy for Mr. Stemm. The court finds that Dougarian terminated Stemm because he did not want to have extra expenditures for workers' compensation insurance and did not want to spend time resolving this problem.

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63. Stemm acted reasonably on behalf of Plaintiff LLC and there was no credible evidence that Stemm was mentally unstable or that he or Plaintiff LLC was untrustworthy. TMS failed to produce credible evidence that it was at risk if it performed the contract.

64. Since termination of the Agreement, the Plaintiff LLC has not done business in any capacity. It has no current clients and has not placed a single temporary employee. It has zero dollars of revenue.

65. After TMS terminated the contract, Stemm contacted at least three other vendors to try to obtain employer of record services so he could start the business. He could find no vendor who could provide one stop shopping. Although he could have used multiple vendors to duplicate the TMS services, these were cost prohibitive because he did not have the credit to pay for these services in advance. Stemm was unable to open the business near October 1, 2013.

66. Because Stemm could not start up shortly after October 1, he was not able to retain Pattison.

67. Plaintiffs' claimed reliance damages are for costs that were borne exclusively by David Stemm as an individual; no amounts were paid from bank accounts belonging to the Plaintiff LLC. Additionally, Plaintiffs have itemized costs for dog care and child care while Stemm visited Indiana, which cannot be reasonably viewed as a business expense given that his wife was at home.

68. Stemm testified that he anticipated making a profit of $180,000 a year but presented no details to support that projection.

69. The court finds that although at the time the contract was terminated 180 Personnel had only a few placements lined up for the following week, given the success that Stemm and Pattison had starting up the Employment Plus Healthcare division and given the

relationships with the 5 major customers, 180 Personnel was likely to retain those customers and duplicate the business that had recently been performed. Stemm testified credibly that 180 Personnel would charge these customers the same rates. However, he only specifically mentioned 5 major customers that he and Pattison had spoken to which he credibly testified had agreed to work with 180 Personnel. The court finds that there is insufficient evidence that other customers would also come, particularly in light of the continued competition from the person who had replaced Pattison at Employment Plus.

70. Testy testified on behalf of Plaintiffs' damage claim. Testy testified that from December 31, 2012 until June 2, 2013 Employment Plus billed four of these five major customers 4,024 hours for $98,897 with a total payroll of $58,897. Evidence was not submitted about the billable hours to the fifth customer Meridian. After the Employment Plus burden was subtracted that left a profit of $32,295 over 23 weeks for the four major customers.

71. Testy testified that if the higher burden of 14.9% imposed by TMS contract had been applied that would have resulted in a profit of $31,201 over 23 months. However, Testy did not include the charge for workers' compensation insurance. The court finds that the appropriate additional charge for worker's compensation would have been 0.26%, which Kaufman testified was the typical charge for Assistants. Clerical would have been only 0.2%. The court is using the Assistant figure because there was insufficient evidence how many workers would have been at a clerical rate. There was no evidence that the proposed staffing would have been for physicians or health workers which have a much higher workers' compensation charge. Adding the additional .26% to the 14.9% contractual burden, the total "TMS burden" should be 15.16%. Using this figure the "TMS burden" over 23 months on the 4

customers would have been $8,929 and the profit would been $31,071. This is equivalent to an average profit of about $1,350 per week.

72. The court finds that given the consistent billing history, there is sufficient evidence that 180 Personnel could have maintained these four customers over the next two year life of the contract. If the average profit of $1,350 is extrapolated over 2 years, 104 weeks, the profit over two years at that rate would have been $140,400.

73. Plaintiffs argued that the appropriate way to measure damages was to assume that Plaintiff LLC would have made all the money that the Healthcare division was making adjusted for a slightly higher burden charged by TMS. Even if the court agreed that all the customers would have come to 180 Personnel, which it does not, calculations provided by Testy are too speculative to provide a reliable basis to calculate damages.

74. Testy assumed that 180 Personnel would bill 18,148 hours a year, even though in 2012 the Healthcare division billed only 13,473 hours the year before. He testified that the entire Healthcare division billed 18,750 hours in 2010, 17,977 hours in 2011 and 13,473 hours in 2012. To reach his projection Testy had taken 5 months of data from 2013 and extrapolated from that an expectation of 22,391 hours for 2013 and then averaged that number with the prior three years. But the court finds that too speculative to be of use in considering damages.

75. Testy also used the data from the four major customers to create an average gross profit per hour of $7.75. He used that number multiplied by the 18,148 hours to conclude that 180 Personnel would have made $140,000 a year. But there was no testimony that such a figure would be similar to customers other than the large four or five. And there was testimony that rates and profit margins could vary widely. The court finds that this number is too speculative to extrapolate to other customers.

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CONCLUSIONS OF LAW

1. Plaintiffs allege that Defendant Tempworks Mangement Services, Inc. breached the contract that it entered into with Plaintiff David and Hiba Stemm, LLC, d/b/a 180 Personnel by terminating the agreement on February 28, 2013. Defendant argues that the contract provision at paragraph 11.3 gives TMS complete discretion to decide whether or not it wants to go forward. Defendant argues that it bargained for this escape clause and it had a right to exercise it. However, the court does not agree that paragraph 11.3 gives TMS an unfettered right to simply walk away from a contract. Indeed the provision does not say that. Paragraph 11.3 lays out circumstances that would create an event of default. 1) something happens which "may be reasonably expected to have a material adverse effect on Your [Plaintiff LLC] business operations"; 2) something happens which "may be reasonably expected to have any material adverse effect whatsoever upon the validity or enforceability of this Agreement"; 3) something happens that "may be reasonably expected to have any material adverse impact upon any security for the Obligations"; 4) something happens that "materially impairs the ability of You to perform Your obligations" . . .or the ability of Tempworks to enforce the terms of the agreement. Importantly, the contract does not state that Tempworks can walk away whenever it wants but limits the circumstances that would allow Tempworks to cancel the contract. The language requires that something happens that is both material and reasonably expected to cause harm in the ways set forth in the contract.

2. Tempworks stated that because Stemm made 9 urgent phone calls to inquire about the workers' compensation that Defendant had contractually committed to provide, the CEO allegedly concluded that Stemm was mentally unstable and not a good risk. Even if the court had found this a credible explanation for terminating the contract, which it does not, Defendant

provided insufficient evidence as to how this behavior fell within one of the identified reasons to call an Event of Default under paragraph 11.3. There was no evidence that this conduct would affect 180 Personnel's business operations, or that it would materially affect the validity or enforceability of the Agreement, or of the security, which were the personal guarantees from David and Hiba Stemm. Nor was there any evidence that these actions would impair the ability of 180 Personnel to perform its obligations under the agreement. The testimony from Defendant's witnesses was vague and at best expressed an unease with Mr. Stemm. But unease is insufficient. To rise to the level of an Event of Default, the contract language itself requires that the problem must reasonably be expected to lead to a material adverse result. The court finds Defendant did not have a reasonable basis to call an Event of Default under the contract.

3. Defendant argues that the words "Tempworks determines" in paragraph 11.3 means that Defendant has complete discretion to decide if it wants to go forward with a contract and that this decision cannot be reviewed. The court disagrees. Although Tempworks bargained for the use of discretion, Minnesota law implies a covenant of good faith and fair dealing into every contract.[1] "The term "acceptance" in an enforceable bilateral contract "cannot mean privilege to repudiate solely on whim, but excuse for non-performance to be exercised in good faith and honest judgment." [2] The court in *White Stone Partners* explained that when a bargain is reached there is implicitly an expectation that both sides will act to allow the contract to go forward.

> Without an implied covenant of good faith, an agreement vesting complete discretion to invoke an escape clause in one party may be illusory. As the Eighth Circuit stated in *C.R.I., Inc. v. Watson,* 608 F.2d 1137 (8th Cir.1979):

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[1] Minnwest Bank Cent. v. Flagship Properties LLC, 689 N.W.2d 295, 303 (Minn. Ct. App. 2004)
See White Stone Partners, LP v. Piper Jaffray Companies, Inc., 978 F. Supp. 878, 881 (D. Minn. 1997)
[2] White Stone Partners, LP, 978 F. Supp. at 881 quoting CRI, Inc. v. Watson, 608 F.2d 1137, 1142 (8th Cir. 1979)

> [I]t is reasonable to assume the parties expected [the defendant] had committed himself to "Something." Moreover, a promise to act in good faith and reasonably in bringing the condition about, in accepting or rejecting the ... proposal is necessarily implied. Otherwise, [defendant's] promise would have been conditioned upon the future happening of an event entirely within his control, and therefore illusory.

White Stone Partners, LP, 978 F. Supp. at 881.

4. Good faith and fair dealing at a minimum requires that parties do not act in bad faith with an ulterior motive. Minnesota courts often look to a subjective standard. In other words, courts will not necessarily find that someone violated their duty of good faith if they make an honest mistake, even if negligent. Thus Minnesota courts often require that "to establish a violation of this covenant, a party must establish bad faith by demonstrating that the adverse party has an ulterior motive for its refusal to perform a contractual duty." [3] Defendant argues that Dourgarian honestly believed that Stemm was unstable and posed an undue business risk and that because it was honest, even if unreasonable, that is not a breach of the covenant of good faith. [4]

[3] Minnwest Bank Cent. 689 N.W.2d at 303 citing *Sterling Capital Advisors, Inc. v. Herzog,* 575 N.W.2d 121, 125 (Minn.App.1998).

[4] The case law is divided on whether unreasonableness rather than ulterior motive violates the covenant of good faith. See BP Products N. Am., Inc. v. Twin Cities Stores, Inc., 534 F. Supp. 2d 959, 965 (D. Minn. 2007) ("Unfortunately, on the other question-that is, the question of whether conduct that is merely unreasonable can violate the covenant-Minnesota courts (and federal courts applying Minnesota law) have not been entirely clear or consistent. As is discussed below, though, the substantial weight of authority is that the covenant is breached only by conduct that is dishonest or malicious or otherwise in subjective bad faith.") Although this court is persuaded that basic contract principles require that discretion be exercised in a manner that is not arbitrary or irrational See Tymshare (the phrase "sole discretion" is not the necessarily equivalent of 'for any reason whatsoever, no matter how arbitrary and unreasonable), and would find that Defendant's view that Stemm was mentally unstable was irrational and an abuse of discretion, the court's decision rests on its finding of ulterior motive and bad faith rather than lack of reasonableness.

5. The court does not find Defendant's explanation credible, Instead, the court finds that Tempworks had an ulterior motive for terminating the contract. It did not want to invest the time or money needed to resolve the workers' compensation issue for Plaintiffs. TMS had expressed no concerns about working with 180 Personnel or Stemm in the months proceeding October 1. In the few days leading up to the October 1 start date, Tempworks learned that Direct HR would require that Tempworks personnel send authorizations in. This was a situation that Mr. Kraus referred to as a logistical nightmare. As of Friday morning, no one had found an alternative, and Mr. Dougarian, the CEO, was not interested in working on a solution or providing customer service. Instead he wanted to know why he was being "harassed" by a customer who had contacted him about Tempworks' failure to secure the workers' compensation insurance they had promised to provide. Tempworks' repeated emphasis on the 9 phone calls that Stemm made in two days, and his apparent audacity in asking that COO Kaufman be interrupted once to answer a question, indicated to the court that Timeworks' personnel were very upset at having their routines interrupted. The court finds that Tempworks canceled the contract not because of any risk to the company but because they believed it would be inconvenient and possibly more expensive to perform, and incorrectly believed that it could simply step away from a contract that it no longer liked.

6. The court finds that Defendant anticipatorily breached the contract.[5] On September 28, 2013 Defendant announced that it would no longer move forward with the

[5] Space Ctr., Inc. v. 451 Corp., 298 N.W.2d 443, 450 (Minn. 1980) ("(W)here one party to an executory contract, before the performance is due, expressly renounces the same and gives notice that he will not perform it, his adversary, if he so elects, may treat the renouncement as a breach of the contract and at once bring an action for damages. * * *. (T)he refusal to perform must in effect be an unqualified renunciation or repudiation of the contract. A mere refusal, not of that character, will not obviate the necessity of a tender.")

contract, in other words, Defendant made it clear that it did not intend to perform its end of the contract.[6]

7. Although Plaintiff LLC was a startup company, the court finds that there was evidence that was not too speculative upon which a damage award can be reasonably based. Stemm and Testy testified credibly that sales of the large 5 customers had been steady since 2010, and the court finds it credible that these customers would have followed Pattison. Stemm and Pattison had the knowledge and experience to run a successful company. It is reasonable to assume that they could have brought in the same business from the 5 customers that they had spoken to and secured. Since they would have charged the same rates, the payroll would have been the same. The only difference would have been the burden which was set forth in the Tempworks contract of 14.9% and the additional cost of workers compensation which can be reasonably estimated to be .26%.

8. The court finds that if the contract had continued, Plaintiff LLC could reasonably have expected to make a profit of $140,400 over two years, which was the life of the contract. Any amount above that is too speculative. However, if the business had continued Pattison would have been paid. Given that no information about the agreement with Stemm was provided, the court looks to the Stemm's statement that he viewed Pattison as an informal

[6] Defendant argues that its refusal to perform was not technically an anticipatory breach because it was not "unqualified". Defendant contends that relying on the escape clause in paragraph 11.3 was a qualification that prevents an anticipatory breach. The court disagrees. Qualification does not mean having a reason. An unqualified revocation in one that is unconditional, i.e., there is no circumstance that would allow the contract to proceed. A qualified refusal to proceed is one that could proceed but for an obstacle. See Credit Suisse Lending Trust (USA) 2 v. Phoenix Life Ins. Co., No. 11-CV-054-LM, 2011 WL 3665444, at *6 (D.N.H. Aug. 22, 2011) (Defendant did not say it would never perform but needed permission from the court). Here Defendant made it clear it would not perform under any circumstances; this was an unqualified renunciation. However, even if relying on another's default could be considered a qualification, the court has already found that this reliance was misplaced.

partner, and as such assumes that Pattison would have been paid 50% of the revenue. Since Plaintiff LLC saved that expenditure, its actual damage is $70,200.

9. The court finds that because of the breach Plaintiff LLC also lost the value of the website and should be reimbursed the $4,100 that was paid for that.

10. The court finds that Plaintiff LLC did not fail to mitigate damages.

11. Defendant argues that there could be no damages because it had no obligation to any temporary worker and no workers had been approved. However, the court rejects this argument as well. Rejections would have to be reasonable and there was nothing in the record to suggest that there would have been any reason to reject temporary workers for these 5 ongoing clients.

12. Stemm is entitled to no damages for the money he spent because he personally had no contract and no promise from Defendant. He also does not qualify to recover damages as a promoter, because Plaintiff LLC was in existence at the time Stemm incurred the costs personally. Stemm's reliance on Incompass IT, Inc. v. XO Communications Services, Inc., to find standing for an individual as a promoter is not applicable. In Incompass, the plaintiffs were not individuals but corporations. Defendant had an alleged oral contract with one company Passageway to lease space. That company was succeeded by another HLI.[7] The court rejected the defendant's argument that the successor had no standing because the "promise" was made to the first company and no promise was made to the second. The Court held that there was no fundamental difference between the first "promise" company Passageway and its successor HLI and that the promise was made to individuals who were acting on behalf of both companies.[8] The case is not analogous to Stemm's situation and does not provide support for his contention

[7] There were actually two plaintiffs InCompass and HLI because the successor HLI was related to the other InCompass.
[8] 2012 WL 28267 (D. Minn. Jan. 5, 2012)

that promises made to him while a corporation was in existence should allow for personal standing. InCompass did not allow any individuals to have standing. And the facts are distinctly different. InCompass addresses the relationship between a predecessor and a successor, but that relationship does not exist here. The promise in Stemm's case was made when the corporation existed so there is no "successor" relationship. Stemm's reliance on State v. Indus Tool and Die Works[9] for the premise of promoter standing is also misplaced: in that case, two individuals purchased a business as a partnership and later formed a corporation; the Court found that the individuals in the partnership remained liable for the obligations of the business after forming the corporation. Even if cases allowing promoter liability also allow for promoter standing, the principal does not apply if the rights and obligations were only incurred after the formation of the corporation.[10] In Stemm's situation the corporation was formed before reliance damages were ever incurred, and Stemm does not have standing as a promoter.

13. Plaintiffs claims for promissory estoppel are dismissed. Plaintiff LLC has a contract and has rights under that which bar an additional claim for promissory estoppel. No promises were made to Stemm as an individual, all were made to him in his capacity as representative of the LLC.

[9] 21 N.W.2d 31 (Minn. 1946)
[10] Stemm also cites to Ehlen v. Johnson, 1997 WL 769534*2 (Minn. Ct. App. Dec 16, 1997) for the premise that an individual promoter can have the rights (and obligations) of a corporation. But Ehlen is distinguishable in an important respect: promotor liability for the corporation was only an issue because the corporation was never formed. In this case, as noted, the Plaintiff LLC was formed before any reliance damages were incurred by Stemm.

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ORDER

1. Plaintiff David and Hiba Stemm, LLC is hereby Granted a Judgment against Defendant Tempworks Management Services, Inc. for a total amount of $74,300.
2. Plaintiff James David Stemm's claims for individual reliance damages are Denied.

Let Judgment Be Entered Accordingly.

DATED: _____

BY THE COURT:

Siegesmund, Kristin
2015.02.17 16:42:20 -06'00'

The Honorable Kristin A. Siegesmund
Judge of District Court