

***THE NEW MICHIGAN COMMERCIAL
REAL ESTATE RECEIVERSHIP ACT***

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***Summary Analysis of New Michigan Commercial Real Estate Receivership Act
Michigan Public Act 16 of 2018, MCL 554.1011, et seq.***

- **Signed into law by Governor Snyder on February 6, 2018**
- **Effective on May 7, 2018 and is not retroactive**
- **Based on Uniform Commercial Real Estate Receivership Act that was adopted by the Uniform Laws Commission in 2015**
- **Enacted in five (5) states so far:**
 - **Passed in Utah, Oregon, Nevada, Tennessee and Michigan**
 - **Introduced in West Virginia, Kentucky and Oklahoma**
- **Governs receiverships for commercial real estate**
- **Receiverships utilized for dealing with and liquidating distressed businesses and assets**
- **Act provides clarity and roadmap for appointment of receivers, duties of receivers, treatment of claims and priorities in an area where previously there was little specific law and where custom (as opposed to structure) defined the practice in the real estate lending industry**
- **Act is comprehensive with respect to appointment of receivers, powers of receivers and impact on rights and remedies of borrower subject to a commercial real estate receivership under the Act**

- **Provides greater clarity and predictability for litigants, lenders and others parties involved in receiverships**
- **Generally, courts view appointment of a receiver an “extraordinary remedy” – with such a comprehensive Act, will the courts be more likely or willing to appoint a receiver under the Act?**
- **Act incorporates Michigan Court Rules 2.621 and 2.622, which govern receiverships generally under Michigan law**
- **State Bar worked to amend and develop these two (2) court rules**
- **State Bar also worked with State Court Administrator’s Office (“SCAO”) to develop new forms, consistent with the new court rules**
- **Additional revisions may be needed to address potential inconsistencies between the SCAO forms and the new Act (some inconsistencies limited/dealt with during the adoption process of the Act)**
- **These matters clearly fall within the jurisdiction of the Business Court**
- **The Business Court Judges need to consider and be prepared to address any inconsistencies or omissions that exist between the court rules, the forms and the Act**
- **Primary Provisions of the New Act**
 - **Extensive definitions contained in Section 2 of the Act**
 - **Act applies to receivership over real property and personal property related to the real property and used in its operations**
 - **Receiver can be appointed with on-going judicial foreclosure or foreclosure by advertisement**
 - **Can independently seek receiver and not required to seek in connection with another matter**
 - **Upon appointment, receiver receives status as lien creditor with respect to real and personal property; important and significant provision because there are no subsequent liens that come into play; not given super-lien status**
 - **Borrower/mortgagor required to turn over all property subject to the receivership in its possession, custody or control to the receiver and to cooperate with the receiver**

- **Failure to turn over property or cooperate with receiver can expose borrower/mortgagor to damages and sanctions, including attorney's fees**
- **Grounds for appointment of a receiver expanded under the Act and include:**
 - **Danger of waste, loss, dissipation or impairment**
 - **Property has been or is about to be the subject of a voidable transaction**
 - **Unpaid real estate taxes**
 - **In connection with foreclosure or other enforcement of mortgage:**
 - **Necessary to protect the property from waste, loss, transfer dissipation or impairment**
 - **Written agreement by mortgagor in mortgage securing indebtedness owed to mortgagee or owner upon default by mortgagor of mortgage**
 - **Property securing the mortgage is insufficient in value to satisfy the indebtedness owed to the mortgagee**
 - **Mortgagor fails to turn over rents owed to mortgagee under assignment of rents under the mortgage**
 - **Holder of subordinate lien obtains appointment of a receiver for the property**
 - **Equitable grounds**
 - **During redemption to preserve property sold in execution or foreclosure sale and secure its rents**
 - **After judgment to:**
 - **Carry judgment into effect**
 - **Preserve nonexempt real property or when execution has been returned unsatisfied and owner refuses to apply property to satisfaction of judgment**

- **Selection, appointment, removal and compensation of a receiver under the Act:**
 - **Established by rule of the Supreme Court**
 - **Exclusive jurisdiction with court that appoints receiver**
 - **Appointment :**
 - **Without notice if circumstances require**
 - **After notice and without prior hearing if circumstances require**
 - **After notice and a hearing if no interested party timely requests a hearing**
 - **Court may condition appointment of receiver without prior notice or without a hearing on giving of security by person seeking appointment of receiver; security released upon court concluding appointment justified**
 - **Selection:**
 - **Must be disqualified and submit a statement under penalty of perjury**
 - **Person is “disqualified” if:**
 - **Affiliate of party**
 - **Has interest materially adverse to interest of party**
 - **Has financial interest in outcome of action other than compensation court may allow**
 - **Has a debtor-creditor relationship with a party**
 - **Holds an equity interest in a party other than a controlling interest in a publicly traded company**
 - **Person is not “disqualified if:**
 - **Is owed compensation in an unrelated matter involving a party or was engaged by party in matter unrelated to receivership**

- **Is individual obligated to a party on a debt not in default that was incurred primarily for personal, family or household purposes**
- **Maintains a deposit account with a party**
- **MCR 2.622 requires receiver appointed by court to “have sufficient competence, qualifications and experience to administer the receivership estate”**
- **Under Act, person seeking appointment of a receiver may nominate a person to serve as receiver; court not bound by nomination**
- **Whereas, MCR 2.622 provides that court shall appoint person nominated upon request or stipulated by parties unless within 14 days nonmoving party files objection**
- **MCR 2.622 also requires court to state its rationale for selecting a particular receiver if person selected is different from person nominated after considering: (a) experience in operation and/or liquidation of the type of assets to be administered; (ii) relevant business, legal and receivership knowledge, if any; (iii) ability to obtain the required bonding if more than a nominal bond is required; (iv) any objections to any receiver considered for appointment; (v) whether person is “disqualified; and (vi) any other factor the court deems appropriate**
- **MCR 2.622 also sets forth different requirements for qualifying as a receiver (*i.e.*, within 3 years of date of appointment, did not serve as an investment banker or attorney for investment banker for a security of receivership estate or in connection with offer, sale or issuance of security of receivership estate; or was not within 2 years of appointment, an officer, director or employee of receivership estate; or within 5 years of appointment represented or been employed by the receivership estate or any secured creditor of the receivership estate)**
- **Removal:**
 - **For cause (consistent with MCR 2.622)**
 - **Replaced by court if receiver dies, resigns or is removed**

- **Court may discharge or terminate a receiver if court finds appointment was improvident or circumstances no longer warrant appointment**
 - **If court finds that appointment was sought wrongfully or in bad faith, court may assess fees and expenses, including reasonable attorney's fees and costs and actual damages caused by appointment against person who sought appointment**
- **The Act does not provide to whom the receiver owes fiduciary duties to; whereas, MCR 2.622 specifically limits the fiduciary duties of a receiver to "all persons appearing in the action or the proceeding"**
- **Act requires posting of bond by receiver, as does MCR 2.622**
 - **Act requires bond be conditioned on faithful discharge of receiver's duties, have 1 or more sureties approved by the court, in an amount the court specifies and is effective as of the receiver's appointment**
 - **Act also permits the receiver to post with court alternative security, such as letter of creditor or deposit of funds but may not use receivership estate as alternative security**
 - **Act allows court to authorize a receiver to act before posting a bond or alternative security**
 - **Act provides that a claim against bond or alternative security must be made no later than 1 year after the date the receiver is discharged**
 - **MCR 2.622 sets forth various factors the court may consider in setting a bond:**
 - **Value of receivership estate, if known**
 - **Amount of cash or cash equivalents expected to be received into the receivership estate**
 - **Amount of assets in the receivership estate on deposit with insured financial institutions or invested in U.S. Treasury obligations**
 - **Whether the assets cannot be sold without further order of the court**

- **If receiver is entity, whether has sufficient assets and acceptable errors and omissions insurance to cover any potential losses or liabilities of the receivership estate**
 - **To extent to which any secured creditor is undersecured**
 - **Whether receivership estate is single parcel of real estate involving few trade creditors and**
 - **Whether parties have agreed to nominal bond**
- **Act delineates the powers of a receiver:**
- **Collect, control, manage, conserve and protect receivership property**
 - **Operate a business constituting the receivership property**
 - **May adopt or reject executory contracts relating to receivership property with court approval**
 - **Not by its terms limited to “commercial leases”**
 - **Court may condition adoption on continued performance of contract on terms appropriate under the circumstances**
 - **Contract deemed rejected if receiver does not request adoption or rejection within a reasonable time after appointment – does not define what is “reasonable time”-**
 - **Performance of a receiver of a contract does not mean adoption or preclude rejection**
 - **Contractual provisions that requires or permit forfeiture, modification or termination of contract because of appointment of a receiver is not enforceable (like *ipso facto* clauses under section 365 of the Bankruptcy Code; 11 U.S.C. §365(e))**
 - **Rejection is breach of contract effective immediately before appointment of receiver**
 - **Claim for damages must be submitted at the later of the time set by court or 30 days after court approves rejection**
 - **Receiver has right to assign contract if owner has right to do so**

- **If contract rejected relates to executory contract for sale of receivership property that is real property in possession of purchaser or a real-estate timeshare interest, then purchaser may (i) treat the rejection as a termination of the contract and then have a lien on property to recover purchase price paid, or (ii) retain right to possession of property and then continue to perform obligations under contract**
- **If owner is landlord of unexpired lease, receiver may not reject the contract if:**
 - **Tenant occupies the leased premises as its primary residence**
 - **Receiver was appointed at the request of a person other than a mortgagee, or**
 - **Receiver was appointed by the mortgagee and (i) lease is superior to lien of mortgage, (ii) tenant has enforceable agreement with mortgagee or holder of senior lien that provides its occupancy will not be disturbed as long as it performs obligations under lease, (iii) mortgagee consented to lease (either in signed record or failed to timely object that lease violated mortgage), or (iv) terms of lease commercially reasonable at time lease agreed to and tenant did not know or have reason to know that lease violated mortgage**
- **May in the ordinary course of business sell, lease, license, exchange or dispose of receivership property without court approval; however, need court approval if not in ordinary course of business**
 - **Sale may be by public auction or private sale**
 - **Sales of property under the Act are free and clear of liens (other than certain senior liens)**
 - **Mortgagee permitted to credit bid at sale up to the amount of its debt**
 - **Liens attach to proceeds of sale in the same validity, perfection and priority as existed before the sale**
 - **Sales free of redemption rights**

- **Reversal or modification of sale does not affect validity of sale to person who acquired property in good faith (“honesty in fact and observance of reasonable commercial standards of fair dealing)**
- **May in the ordinary course of business incur unsecured debt and pay expenses incidental to receiver’s preservation, use, sale, license, exchange, collection or disposition of property; however, need court approval if not in ordinary course of business**
- **Assert a claim, cause of action or defense of owner that relates to property**
- **Seek or obtain instructions from court**
- **On subpoena compel a person to submit to examination under oath or produce documents**
- **Engage a professional and pay professional with court approval:**
 - **To retain a professional, must identify and set forth qualifications of professional**
 - **Must delineate scope and nature of proposed engagement**
 - **Must identify any potential conflicts of interest**
 - **Must set forth proposed compensation**
 - **File itemized statement of time spent, work performed, billing rate for each person who performed work and list of itemized expenses must be filed by the professional to be compensated**
- **Apply to court for appointment of ancillary receiver for property in another state**
- **With court approval, recommend allowance/disallowance of a claim**
- **With court approval, make a distribution**
- **Required to prepare and retain appropriate business records and account to court**
- **Powers may be expanded, modified or limited by court**

- **Automatic stay of certain actions related to receivership property to obtain possession, control over or enforce judgment on property; if violate, court may enjoin**
- **Automatic stay does not stay the following:**
 - **Foreclosure or enforcement of mortgage**
 - **Commencement or continuation of criminal proceeding**
 - **Commencement or continuation of action or enforcement of judgement other than money judgment by governmental unit to enforce police or regulatory power**
 - **Establishment of tax liability or appeal of liability by a governmental unit**
- **Court may void act that violates stay/injunction; if knowingly violate, subject to actual damages (including reasonable attorney's fees and costs) and sanction as civil contempt**
- **Rights, powers and obligations similar to a chapter 11 trustee or debtor in possession in bankruptcy**
- **Notice of receivership to all creditors of the borrower/mortgagor unless court determines that the value of the property is not likely to be sufficient to satisfy the claims secured by the property**
- **Act provides mechanism for filing claims and objections to claims by the receiver**
 - **Claim must state name and address of creditor**
 - **Claim must state amount and basis of claim**
 - **Claim must identify any property securing the claim**
 - **Claim must be signed by creditor under penalty of perjury**
 - **Claim must include any record on which claim is based**
 - **Assignee of claim must give timely notice to receiver for assignment to be effective**

- Receiver may object to claims (stating basis for objection) at any time prior to entry of order approving receiver’s final report
 - Unsecured creditors need not submit claims if value of property insufficient to pay their claims
 - Distribution upon notice and payment of claims provided for under the Act in accordance with creditor’s priority under law and as court directs
- Act may impact the rights of a borrower to seek relief under the Bankruptcy Code, 11 U.S.C. §§ 101, *et seq.* after a receivership under the Act has been commenced; bankruptcy court may choose to abstain or dismiss the case
 - Bankruptcy Court may also allow a receiver to stay in place (as opposed to requiring turnover of the property to the chapter 11 debtor in possession) based on a finding of it being in the best interests of creditors (section 543(d)(1) of the Bankruptcy Code) or a finding that it is necessary to prevent fraud or injustice (section 543(d)(2) of the Bankruptcy Code)
 - Section 543(d)(1) is “permissive” by use of word “may”
 - Section 543(d)(2) is “mandatory” by use of word “shall”
 - Presumption in a chapter 11 case is that debtor will remain in place absent cause to remove and appoint a trustee under section 1104 of the Bankruptcy Code
 - Standard for keeping receiver in place is not the same standard that is used to remove a debtor in possession and replace him with a trustee under section 1104(a) of the Bankruptcy Code, which requires a finding of:
 - (i) fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, (section 1104(a)(1) of the Bankruptcy Code), or
 - (ii) it being in the best interests of the creditors (section 1104(a)(2) of the Bankruptcy Code)