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Michigan Enacts the Uniform Commercial Real Estate Receivership Act

by Heather M. Olson*

On February 6, 2018, the Uniform Commercial Real Estate Receivership Act was signed into law in Michigan. The Act, MCL 554.1011 et seq. (2018 PA 16), which took effect on May 7, 2018, codifies the Michigan Court Rules previously established by the Michigan Supreme Court related to receiverships and further expands upon them to bring more clarity, uniformity, and predictability to the receivership process.

I. Background of the Act

Prior to the Act, Michigan courts appointed receivers over commercial real estate pursuant to their general equitable power under MCL 600.2926 and case law involving rent assignments and waste. While the Michigan Supreme Court enacted MCR 2.622 in 2014 to address the uncertainty surrounding court-appointed receiverships, the rules failed to adequately address all aspects of such a receivership,¹ creating intrastate inconsistencies regarding the grounds for appointment and powers of such a receiver. As a result, in 2017 House Bill 4471 (now MCL 554.1011 et seq.) was introduced in order to standardize state law as to receiverships over real and personal property. The Act was drafted and published by the Uniform Law Commission in 2015 (the same organization that drafted the Uniform Commercial Code and numerous other uniform acts) and was designed to provide a standard set

1 See Legislative Analysis of House Bills 4470, available at <http://legislature.mi.gov/doc.aspx?2017-HB-4470>, and 4471, available at <http://legislature.mi.gov/doc.aspx?2017-HB-4471>.

of rules for receivership proceedings specifically dealing with commercial real estate. Michigan is now one of four states that have adopted the Act,² and is one of many other states to enact specific legislation addressing the appointment of a receiver over commercial property.

II. Summary of the Act's Primary Provisions

The Act applies to a receivership of an interest in real property and any personal property related to or used in operating the real property, for any receiver appointed after May 7, 2018.³ While the Act is particularly helpful to a commercial mortgage lender who wishes to have a receiver appointed with the specific authority to sell real property free and clear of redemption rights and junior liens, the Act addresses much more. Specifically, it provides clear guidance and authority on a variety of issues surrounding the grounds and procedure for the appointment of a receiver, obligations of the mortgagor, the legal effect of such an appointment, and a receiver's duties and authority to take certain actions.

A. Grounds for Appointment

Prior to the Act, Michigan law did not permit an

2 As of September 2018, Nevada, Oregon, Tennessee, and Utah have also enacted the Uniform Commercial Real Estate Receivership Act (the "Act"), and Kentucky, Oklahoma, Tennessee, and West Virginia have introduced the Act.

3 MCL 554.1014(1); MCL 554.1040.

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action solely to appoint a receiver, but rather required that such an action be ancillary to some other pending cause of action.⁴ Under the Act, a receiver can now be appointed in connection with a judicial or non-judicial foreclosure action (or other action to enforce a mortgage) and is no longer required to be ancillary to a pending judicial proceeding.⁵ The Act also makes clear that the appointment of a receiver will not constitute an “action on the debt” for purposes of MCL 600.3204(1)(b). This is further affirmed by a complementary amendment to the Foreclosure by Advertisement Statute, MCL 600.3204 (which also took effect on May 7, 2018), to specify that, for purposes of a foreclosure by advertisement, the appointment of a receiver is not an action or proceeding to recover a debt that would prevent a party’s ability to foreclose by advertisement.⁶

The Act specifies the bases upon which a receiver may be appointed, including where the mortgagor has

agreed in writing to the appointment of a receiver upon a default.⁷ This is particularly helpful since many commercial mortgage documents include the mortgagor’s consent to the appointment of a receiver upon its default. (For those mortgage documents that do not include this language, it should certainly be added.) The Act also codifies several other bases that lenders have traditionally relied on in support of a motion to appoint a receiver including: (1) the property held by the mortgagee is not sufficient to satisfy the security obligation, (2) the mortgagor has failed to turn over rents from the property to the lender, and (3) waste or other impairment of the property’s value.⁸

B. Effect of Appointment; Lien Creditor; Stay

Upon appointment, the receiver obtains the status and priority of a lien creditor with respect to the receivership property.⁹ This permits the receiver to establish priority not only against subsequent creditors, but also a prior unperfected party. Moreover, the Act also gives the receiver the status and priority of a lien creditor under Michigan’s recording statute with respect to the receivership property that is real property.¹⁰ In accordance with this, the Act requires a receiver to record a copy of the order appointing receiver in the appropriate real property recording office.¹¹ Entry of an order appointing a receiver operates as a stay against any action to obtain possession of, exercise control over, or enforce a judgment against the receivership property. This injunctive provision, however, does not operate as a stay or injunction with respect to an action to foreclose or otherwise enforce a mortgage by the party seeking appointment of the receiver.¹² Under appropriate circumstances, the appointing court can expand the scope of the stay, grant relief from the stay, and award

4 See *National Lumberman’s Bank v Lake Shore Machinery Co.*, 260 Mich 440; 245 NW 494 (1932); *Michigan Minerals Inc v Williams*, 306 Mich 515, 525; 11 NW2d 224 (1943).

5 MCL 554.1016(2). Historically, Michigan adhered to the legal principle that an action to appoint a receiver must be ancillary to some other pending cause of action. *National Lumberman’s Bank v Lake Shore Machinery Co.*, 260 Mich 440; 245 NW 494 (1932); *Lewis v City of Grand Rapids*, 222 F Supp 349 (WD Mich. 1963); *Massachusetts Mutual Life Ins Co v Ruetter*, 268 Mich 175; 255 NW 754 (1934). In a judicial foreclosure action, this posed no issue as a count to appoint a receiver could be included in the suit. However, where a lender intended to foreclose nonjudicially by advertisement, this posed an issue, often requiring a lender to file a judicial action for enforcement of the assignment of rents or some other claim in order to seek the appointment of a receiver. This is no longer an issue under the Act, as it “permits a mortgagee foreclosing nonjudicially to petition the court directly for the appointment of a receiver, without having to institute an entirely separate action for specific performance of an assignment of rents or some other civil action to which the receivership could serve as an ancillary remedy.” See Section 6, Comment 3 to the Act. A receiver can also be appointed under the Act in connection with a judgment and in certain other contexts. See MCL 554.1016(1).

6 Prior to May 7, 2018, under Michigan’s Foreclosure by Advertisement Statute, MCL 600.3204, a party could not foreclose a mortgage by advertisement if there was an action pending on the debt secured by the mortgage. MCL 600.3204(b). Until this recent amendment to MCL 600.3204(b) clarifying that an action to appoint a receiver is not an “action on the debt,” no statutory authority existed to make such a distinction. The Act also provide that it will not take effect unless House Bill 4470 (2018 PA 15) is also enacted, which it was. See 2018 PA 16, enacting Section 1.

7 This is consistent with the *Restatement (Third) of Property; Mortgages* and the Uniform Assignment of Rents Act, both of which take the view that a mortgagee/assignee of rents is entitled to the appointment of a receiver if the mortgagor has consented to such appointment in the loan documents. *Restatement (Third) of Property, Mortgages* § 4.3(b); UARA § 7.

8 MCL 554.1016(2)(a)-(f).

9 This is consistent with Uniform Commercial Code Article 9, which provides that the term “lien creditor” includes “a receiver in equity from the time of appointment.” MCL 440.9102(1)(yy)(iv). See MCL 554.1019.

10 MCL 554.1019(b).

11 MCL 554.1022(3)(c).

12 The Act sets forth other actions where the order appointing a receiver will not operate as a stay or injunction preventing such action. See MCL 554.1024(4)(a)-(e).

damages for a violation of the stay.¹³ The order appointing the receiver may also serve as an injunction to protect the receivership against interference with the receiver's possession and management of the receivership property and the performance of its duties.

C. Notice and Opportunity for a Hearing

Under the Act, the court may enter an order appointing a receiver only after notice and an opportunity to be heard, unless no interested party timely requests a hearing or the circumstances require the issuance of an order before a hearing can be held.¹⁴ The Act recognizes that receivership is a flexible and equitable remedy and since every receivership is different, specific notice or a hearing may or may not be required prior to the appointment of a receiver. The Act further recognizes the possibility of the appointment of a receiver on an ex parte basis (without prior notice to the mortgagor).¹⁵ The Act permits a court to require a party seeking the ex parte appointment of a receiver to post a bond in an amount specified by the court to protect the mortgagor against any damage suffered if the court later determines that the appointment of a receiver was not warranted.¹⁶

D. Identity and Independence of Receiver

Due to the receiver's role in holding receivership property for the benefit of all interested parties, and in keeping with the concept of a receiver as an independent third party,¹⁷ the Act requires the receiver to provide a sworn statement attesting that it is not disqualified to act as receiver under the Act.¹⁸ The Act sets forth the circumstances under which a receiver is disqualified from serving.¹⁹ While it is common practice for the party seeking

appointment of a receiver to nominate a proposed receiver, under the Act, the court is not bound by the nomination. This is consistent with MCR 2.622, which states that where the parties either stipulate to a chosen receiver or no objection is made by the non-moving party, "the court shall appoint the receiver nominated by the party or parties, unless the court finds that a different receiver should be appointed."²⁰

E. General Powers and Duties of Receiver

The Act provides much needed clarity as to what acts a receiver may (or may not) exercise, either with or without prior approval of the court. Section 12 of the Act, at MCL 554.1022, specifically sets forth what powers the receiver may exercise with and without court approval and what duties of the receiver are mandatory rather than discretionary. The Act makes clear that regardless of whether a receiver's powers are required or optional, the court may expand, modify, or limit powers previously granted to a receiver.²¹

F. Duties of Mortgagor

One of the most beneficial features of the Act is the requirement of the mortgagor to cooperate and preserve and turn over to the receiver all receivership property and property information. The utility of this provision is bolstered by the receiver's ability to seek both actual damages (including reasonable attorneys' fees) and civil contempt sanctions for a mortgagor's failure to do so.²² The Act also gives the receiver the power to subpoena the mortgagor to submit to examination under oath regarding the owner's financial condition, actions with regard to the receivership property, and any other matter relating to the receivership property or receivership.²³ Orders appointing a receiver often contain language requiring a mortgagor to cooperate with the receiver and turn over all receivership property in its possession, custody, and control, including all income from the property. Courts, however, have not been particularly inclined to impose damages or sanctions where a mortgagor fails to comply. This provision provides a much needed enforcement mechanism to allow the receiver to obtain control over the receivership property and perform its duties to operate and manage such property.

13 The stay under the Act is much narrower than an automatic stay arising in bankruptcy court. The Act does not prevent the mortgagor from seeking bankruptcy protection, nor does it prevent creditors from placing the mortgagor in bankruptcy, even if such bankruptcy would interfere with the receivership.

14 MCL 554.1013.

15 MCL 554.1013(2)(a).

16 MCL 554.1016(3).

17 The Receiver is an independent third party who serves as an officer of the court and owes a fiduciary duty to the mortgagor and mortgagee. See 1 *Clark on Receivers* § 34, at 35 (3d ed. 1959).

18 MCL 554.1017(1).

19 MCL 554.1017(2). The Act states that a person is disqualified from serving as a receiver if one or more of the circumstances under MCL 554.1017(2)(a)-(e) apply.

20 MCR 2.622(B)(1).

21 MCL 554.1022(4).

22 MCL 554.1023.

23 MCL 554.1023(1)(d).

G. Engagement and Compensation of Professionals

With court approval, a receiver is explicitly authorized to hire professionals such as attorneys, accountants, appraisers, or brokers to assist the receiver in performing any of its duties or authority under the receivership.²⁴ This allows a receiver to enlist any help that may be needed while including checks and balances on the specifics of such engagements, including compensation and scope of work. The Act clarifies that a person is not disqualified from such an engagement solely because of the person's engagement by, representation of, or other relationship with the receiver, a creditor, or a party.²⁵

H. Use, Sale, Lease, License, or Other Transfer of Receivership Property Other Than in the Ordinary Course

Perhaps the most highly anticipated contribution of the Act is the inclusion of provisions defining the authority of the receiver and the procedure for the sale or transfer of real property free and clear of subordinate liens and redemption rights. Prior to the Act, several Michigan court decisions provided some insight into whether a receiver sale of real property could be made free and clear of redemption rights and liens and encumbrances (where such liens are not in fact extinguished, but rather attach to the proceeds of sale).²⁶ But no published case law or statutory authority existed (outside of the Construction Lien Act). The Act makes clear that:

[w]ith court approval, a receiver may transfer receivership property other than in the ordinary course of business, by sale, lease, license, exchange, or other disposition. Unless the agreement of sale provides otherwise, a sale under this section is free and clear of a lien of the person that obtained appointment of the receiver, any subordinate lien, and any right of redemption but is subject to a senior lien.²⁷

A lien on the property that is extinguished by a receiver's sale of the receivership property "attaches to the

proceeds of the transfer with the same validity, perfection, and priority the lien had on the property immediately before the transfer, even if the proceeds are not sufficient to satisfy all obligations secured by the lien."²⁸ The sale may be a private sale and a creditor holding a valid lien on the property may credit bid at the sale.²⁹ The Act requires court approval of the sale and as a result, a court may not enter an order approving the sale without notice and an opportunity to be heard, including notice of the actual terms of the sale and an opportunity for persons holding an interest in the property to be heard.

I. Executory Contracts and Unexpired Leases

The Act permits a receiver, without court approval, to reject or adopt any executory contract of the owner relating to the receivership property.³⁰ These provisions acknowledge the practicalities involved in a receiver taking over a new property and the time it may need to evaluate the executory contracts in place. As a result, the Act provides the receiver time to adopt or reject these contracts and provides that a receiver's temporary honoring of an existing contract does not prevent the receiver from ultimately rejecting it. The primary limitation on the receiver's power to reject an existing executory contract is that receiver may not reject an unexpired lease of real property under which the owner is the landlord, except under very limited circumstances. It has long been a part of general receivership law that a receiver does not automatically become bound to the owner's existing contracts.³¹ The Act is consistent with this and permits the receiver to decide whether an executory contract is beneficial or burdensome to the receivership property. The Act, however, does not permit a receiver to reject a contract for which one party has made full or substantial performance or a contract for which a party's breach would not excuse the other party's obligation to perform. The Act permits a party to sue for damages as a result of the receiver's rejection of its contract, but there are certain time limitations placed for filing such claims.³²

J. Immunity of Receiver

The Act makes clear that the receiver is generally immune from liability for all actions performed under the

²⁴ MCL 554.1025(1).

²⁵ MCL 554.1025(2).

²⁶ *CSB Bank v Christy*, unpublished opinion of the Michigan Court of Appeals, issued Oct 18, 2012 (Docket No. 305869); *First Fin Bank, NA v Bosgraaf*, unpublished opinion of Ottawa County Circuit Court, issued July 11, 2012 (Docket No. 11-02488-CK).

²⁷ MCL 554.1026(3).

²⁸ MCL 554.1026 (4).

²⁹ MCL 554.1026 (5).

³⁰ MCL 554.1027.

³¹ 2 *Clark on Receivers*, § 423, at 710 (3d ed 1959).

³² MCL 554.1027 (5).

court's order appointing receiver.³³ Under the Act, court approval is required to sue a receiver personally with respect to its duties under the receiver order. The Act provides a 1-year statute of limitations (from the date the receiver is discharged) on any claim against a receiver's bond or alternative security.³⁴

K. Reporting Requirements

The Act sets forth the type of reporting expected from the receiver. A receiver may file interim reports regarding the receivership and receivership property, however such reporting is not required.³⁵ The Act leaves it to the discretion of the court as to the type and timing of such reporting. A receiver, however, is required to file a final report, which includes all of the information required by the Act and permits the court to require additional information.³⁶

L. Creditor Claims

The Act provides a mechanism for creditors of the owner to file claims against the receivership property. The receiver is required to provide notice of its appointment to all creditors of the owner.³⁷ The notice must specify the date by which such a creditor must file a notice of its claim. Failure of a creditor to timely submit its claim disqualifies such creditor from receiving a distribution.³⁸ At any time before entry of an order approving a receiver's final report, the receiver has the power to object to any claim filed by a creditor and the court has the power to determine whether or not to allow the claim.³⁹

M. Termination

The Act provides the court with the power to terminate the receiver for cause.⁴⁰ This includes circumstances where the receiver, dies, resigns, or is removed and where the court determines that the receiver was improvident or the circumstances no longer warrant continuation of the receivership. Upon a court's termination of a receiver, where the court determines that the party seeking the ap-

pointment did so wrongfully or in bad faith, the court may assess damages against such party, including actual fees and expenses of the receivership and actual damages caused by the appointment, including reasonable attorneys' fees.⁴¹

N. Ancillary Receivership; Multi-State Receivership

The Act addresses a common issue where a receivership covers properties located in multiple states and a receiver has already been appointed in another state. Under the Act, the Michigan court may appoint a receiver appointed in another state with respect to property located in Michigan if certain conditions are met. Such receiver is given the same rights, powers, and duties of a receiver appointed under the Act. The court may also issue an order that gives effect to an order entered in another state appointing or directing a receiver.⁴²

O. Receivership in the Context of Mortgage Enforcement

The Act clarifies a common concern among mortgagees seeking an appointment of a receiver by stating explicitly that seeking and obtaining the appointment of a receiver will not constitute an election of remedies by the mortgagee or make the mortgagee a "mortgagee in possession" or "agent" of the mortgagor.⁴³ In addition, as stated above, the Act, together with 2018 PA 15 (the amendment to MCL 600.3204), make clear that an action to appoint a receiver is not an action on the debt that would prevent a foreclosure by advertisement under MCL 600.3204(1)(b).⁴⁴

III. Conclusion

Overall, the Act answers many questions that have surrounded the appointment of a receiver in the past. The Act helps streamline the receivership process, providing clear guidelines for the appointment, authority, and termination of a receiver over real and personal property. The Act provides more certainty as to the validity and finality of a receiver sale of real property and should provide title insurance companies with the assurance they need to insure such sales without hesitation.

33 MCL 554.1028.

34 MCL 554.1018(4).

35 MCL 554.1029.

36 MCL 554.1033.

37 MCL 554.1030.

38 MCL 554.1030(2).

39 MCL 554.1030(5).

40 MCL 554.1032.

41 MCL 554.1032(4)(a), (b).

42 MCL 554.1034.

43 MCL 554.1035.

44 MCL 554.1035(f).