



# The Michigan Business Law

## JOURNAL

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The editorial staff of the *Michigan Business Law Journal* welcomes suggested business law topics of general interest to the Section members, which may be the subject of future articles. Proposed business law topics may be submitted through the Publications Director, D. Richard McDonald, *The Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, Michigan 48304, (248) 203-0859, drmcDonald@dykema.com, or through Daniel D. Kopka, ICLE, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, (734) 936-3432, dan@icle.org. General guidelines for the preparation of articles for the Michigan Business Law Journal can be found on the Section's website at <http://michbar.org/business/bizlawjournal.cfm>.

Each issue of the *Michigan Business Law Journal* has a different primary, legal theme focused on articles related to one of the standing committees of the Business Law Section, although we welcome articles concerning any business law related topic for any issue. The primary theme of upcoming issues of the *Michigan Business Law Journal* and the related deadlines for submitting articles are as follows:

<b>Issue</b>	<b>Primary Theme/Committee</b>	<b>Article Deadline</b>
Fall 2015	Uniform Commercial Code Committee	July 31, 2015
Spring 2016	Commercial Litigation Committee	November 30, 2015
Summer 2016	LLC & Partnership Committee	March 31, 2016
Fall 2016	Financial Institutions Committee	July 31, 2016

## **ADVERTISING**

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## **MISSION STATEMENT**

*The mission of the Business Law Section is to foster the highest quality of professionalism and practice in business law and enhance the legislative and regulatory environment for conducting business in Michigan.*

*To fulfill this mission, the Section shall: (1) expand the resources of business lawyers by providing educational, networking, and mentoring opportunities; (2) review and promote improvements to Michigan's business legislation and regulations; and (3) provide a forum to facilitate service and commitment and to promote ethical conduct and collegiality within the practice.*

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# From the Desk of the Chairperson

By James L. Carey



## Change

In the February 1936 issue of *Esquire* magazine, Novelist F. Scott Fitzgerald made the following observation: “the test of a first-rate intelligence is the ability to hold two opposed ideas in the mind at the same time, and still retain the ability to function. One

should, for example, be able to see that things are hopeless and yet be determined to make them otherwise. This philosophy fitted on to my early adult life, when I saw the improbable, the implausible, often the ‘impossible,’ come true. Life was something you dominated if you were any good. Life yielded easily to intelligence and effort, or to what proportion could be mustered of both.”

I hope that as business lawyers, we see the wisdom, and the hard-work, that can bring the “impossible” to our clients. And that through our client’s success, we can find a measure of success for ourselves and our families.

But the two opposing ideas that seem to present themselves quite often were summed up well by the nineteenth century French critic, journalist, and novelist Jean-Baptiste Alphonse Karr. He said “*plus ça change, plus c’est la même chose*” which is most often translated as “the more things change, the more they stay the same.” More recent philosophers (okay, musicians—but aren’t they the closest things we have to philosophers these days?) came at the issue like this:

Tattered jeans are back in fashion  
Instead of records, now it’s MP3s  
I tell you one more time with feeling  
Even though this world is reeling  
You’re still you and I’m still me  
I didn’t mean to cause a scene  
But I guess it’s time to roll up our sleeves

The more things change the more they stay the same  
The same sunrise, it’s just another day  
If you hang in long enough they say you’re coming back  
Just take a look, we’re living proof and baby that’s a fact  
You know the more things change the more they stay the same  
The more things change the more they stay the same

You’re either running round in circles or you’re running out of time  
Everybody somewhere either 12, 3, 6 or 9  
The times they are a-changing  
We’re here to turn the page  
It’s the same old story but it’s told a different way

Those words were penned by Jon Bon Jovi and Richie Sambora and sung in “The More Things Change,” one of four new songs released on the 2010 album *Greatest Hits Bon Jovi*. So this song about change was released on a greatest hit album, even though it was not, and would not be, a hit. Even singing about change is sometimes as unheralded as it is hard.

And if you would be so kind as to indulge one more quote (I promise, I am coming to a point here), President John F. Kennedy addressed the Assembly Hall at the Paulskirche in Frankfurt, Germany in June of 1963. As part of his address to the assembled civic leaders of Germany, President Kennedy said:

For time and the world do not stand still. Change is the law of life. And those who look only to the past or the present are certain to miss the future.

And so here you are, reading the *Michigan Business Law Journal*, to learn something about receiverships that you didn’t know before, to understand new court rules, to gain some insight into the Corporations Division of the state of Michigan, to better appreciate the technology that could help your practice, to delve the intricacies of tax matters, or to just see if there is anything else new or different that you need to know. The work put into each issue of your *Michigan Business Law Journal* is, to say the least, substantial. I am certain it will provide you with some valuable insight if you take the time to use it.

Which is also what I will tell you about your Business Law Section. Our just completed Business Boot Camp was a huge success. Well over 250 business lawyers attended in one of two locations (Grand Rapids or Plymouth) and spent two days learning about business law. A whole host of new Michigan securities law regulations are being worked on in Lansing and by our Section’s committee, so those changes are coming. A new non-profit act has been put in place by the legislature and signed by the governor. Our 27<sup>th</sup> Annual Business Law Institute will be held in Grand Rapids this September, at the same time as the Grand Rapids Art Prize—a great opportunity to delve the intricacies of business law and relax with the splendor of great new art (now there’s a tough combination to beat). Your Business Law Section has no shortage of important topics to cover and changes to help you explore.

So enjoy and profit from these articles, visit our Business Law Section website, come out to some events, and change, change, change—you certainly don’t want to miss out on the future!

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## Draft Securities Rules

In November, the Corporations, Securities and Commercial Licensing Bureau (CSCL) completed the draft of proposed rules under the Uniform Securities Act (2002). CSCL sent the draft rules to the Business Law Section (BLS) for input. CSCL staff met with representatives of the BLS Securities Regulation Committee at the end of January to discuss comments and concerns regarding the draft rules. There are several steps in the rulemaking process, and time must be allowed to complete each step.

After a proposed draft is finalized, the next step is for the CSCL to prepare and submit a Request for Rulemaking (RFR) to the Office of Regulatory Reinvention (ORR) and submit the draft rules to ORR for review. CSCL's goal is to submit the RFR and draft rules before May 2015. After ORR approves the draft it notifies the Joint Committee on Administrative Rules and sends the draft to the Legislative Service Bureau for editing for format and style. When the Legislative Service Bureau returns the edited draft to ORR, ORR will return the draft to CSCL to add the formatting edits.

The next step is for CSCL to prepare a Regulatory Impact Statement & Cost-Benefit Analysis and send it to ORR for approval at least 28 days prior to the public hearing. CSCL prepares a public hearing notice, including the deadline for written comment, and sends the notice to ORR along with the edited draft rules. The Notice of Hearing is published in three newspapers, including one in the Upper Peninsula, at least ten days but not more than sixty days prior to the public hearing. The public hearing notice and draft rules are also published in the *Michigan Register* by ORR. Members of the public may present information and views on the proposed rules at the public hearing.

After the public hearing, CSCL will review the written and public comments and prepare a final draft of the rules and Joint Committee on Administrative Rules Report (JCAR Report) for submission to ORR. ORR

will send the final draft to Legislative Service Bureau to review for form, classification, and arrangement. The JCAR Report and final draft of the rules are then sent to the Joint Committee on Administrative Rules by ORR. The rules must be before the Committee for fifteen session days. Rules can be filed by ORR with the Office of Great Seal after the fifteen session days at JCAR expire. The rules may become effective immediately upon filing, or at a later date specified in the rules.

## Perpetual Existence for Corporations

The published decision of the Michigan Court of Appeals in *Hogg v Four Lakes Ass'n*<sup>1</sup> addresses a perpetual existence for a corporation formed under the Summer Resort Owners Act.<sup>2</sup> Consistent with the 1908 Michigan Constitution, section 2 of Act 137 of 1929 limited the term of existence of a summer resort owners corporation to 30 years. The 1963 Michigan Constitution contains no limitation on terms of corporate existence. In addition, Act 26 of 1963 (2<sup>nd</sup> Ex Sess), effective January 1, 1964, provides in section 1 that "Notwithstanding any other provision of law, the term of existence of every domestic corporation heretofore incorporated or hereafter incorporating under any law of this state may be perpetual..."<sup>3</sup>

Articles of incorporation for Four Lakes Association, Inc. filed on May 8, 1968, provide for perpetual term. Plaintiff alleged Four Lakes Association, Inc. was no longer a valid organization and should cease operations because MCL 455. 202 limits a summer resort owners association to a term of 30 years.

The trial court denied plaintiff's motion for summary disposition and granted summary disposition to defendants. The plaintiff appealed and the Michigan Court of Appeals affirmed the trial court. The Court of Appeals concluded MCL 450.371 permits all corporations incorporated under Michigan law to choose perpetual existence or to exist for a limited period of time.<sup>4</sup> This is the first pub-

lished decision of the Michigan Court of Appeals addressing perpetual existence for a corporation formed under a statute containing a limitation on corporate term of existence. It held that Four Lakes Association, Inc. "is therefore in existence and may carry out the functions specified in its articles."

## When is a Corporation a Summer Resort Corporation?

In *Roy v Island & Fonda Lakes Ass'n*,<sup>5</sup> the Michigan Court of Appeals refers to Island & Fonda Lakes Association (IFLA) as a "summer resort corporation"<sup>6</sup> created in 1942.

The opinion discusses the applicability of the Business Corporation Act to a summer resort corporation and concludes an action for shareholder oppression under MCL 450.1489(1) would be available to Roy.

Both the trial court and the Michigan Court of Appeals addressed various concerns raised by the parties and applied the summer resort owners act and the Business Corporation Act to the facts and arguments presented. The court concluded that "summer resort corporations are effectively municipalities with police powers over roadways within their boundaries and the power to maintain those roads and compel the payment of dues for purpose of maintaining those roads."

The records of the CSCL indicate articles of incorporation for the Island, Briggs and Fonda Lake Improvement Association filed June 17, 1943, created a nonprofit, nonstock corporation and state the purpose of the corporation is, "For the upkeep of sanitation and improvement of roads, collecting of garbage." The Certificate of Amendment filed on September 23, 1993, changed the corporate name to Island & Fonda Lakes Association and states the purpose to be "for organized maintenance and improvement of common roads and parks and to promote changes which affect the health and welfare of all property owners and residents of the area."<sup>7</sup>

The court applied law applicable to a corporation formed under 1929 PA 137 to the actions of Roy and of IFLA and concluded that IFLA's lien was valid and its counterclaim to foreclose the lien should not have been dismissed. The case raises an interesting question of whether a corporation that is not formed under any incorporation statute applicable to summer resort and park associations<sup>8</sup> should be permitted to rely on the provisions in any of those statutes. If the answer is "yes," what are the criteria which the corporation must meet for the provisions in statutes in chapter 455 to be applicable to the corporation and its members and shareholders? If the answer is "no," what information needs to be provided to homeowners, property owners, and associations to clarify that an association must be organized under a statute in chapter 455 to be a summer resort association?

2014 PA 557 amends section 251(1) to permit formation of a corporation solely under the Nonprofit Corporation Act for a purpose for which a corporation could be formed under another statute of the state, unless that statute prohibits such formation. The amendment to section 251(1) further provides, "A corporation that is formed under this act for a purpose for which a corporation may be formed under another statute of this state does not have any powers or privileges conferred by that other statute that are not conferred under this act." It is unclear what impact, if any, the amendment of section 251 of the Nonprofit Corporation Act would have on a case such as *Roy v Island & Fonda Lakes Association*.

## Omnicare Securities Litigation

In *In Re Omnicare, Inc Sec Litig*,<sup>9</sup> KBC Asset Management N.V. (KBC) brought action on behalf of Paul Ansfield and other similarly situated shareholders against Omnicare, Inc. and several of its current and former officers. Plaintiffs alleged defendants made material misrepresentations and omissions in violation of section

10(b) of the Securities Exchange Act of 1934<sup>10</sup> and rule 10b-5<sup>11</sup> regarding Omnicare's compliance with Medicare and Medicaid regulations. KBC alleged that internal audits conducted by Omnicare of Medicare and Medicaid claims revealed irregularities in billing that included false reimbursement claims and lack of proper documentation. The complaint alleged that although Omnicare and the individual defendants knew about the allegations of fraud or noncompliance, they stated in public and in Form 10-Ks from 2007 to 2010 that its billing practices "materially comply with applicable state and federal requirements" and that Omnicare believed it was in "compliance in all material respects with federal, state and local laws."

The district court granted defendants motion to dismiss and KBC appealed. The Court of Appeals for the Sixth Circuit applied the requirements of the Private Securities Litigation Reform Act of 1995<sup>12</sup> and applied the heightened pleading standards, which it characterized "as not easily satisfied," to KBC's complaint. The decision discusses the six elements of a securities fraud suit under section 10(b) of the 1934 Act and SEC rule 10b-5 and whether KBC's complaint was sufficient to state a valid claim. The court concluded that plaintiff's complaint did not meet the requirements and affirmed the district court's dismissal of KBC's complaint.

12. 15 USC 78n-4.

*G. Ann Baker was Deputy Director of the Corporations, Securities and Commercial Licensing Bureau, Department of Licensing and Regulatory Affairs. Ms. Baker routinely works with the department, legislature, and State Bar of Michigan's Business Law Section to review legislation. She is a past chair of the Business Law Section and is the 2008 recipient of the Stephen H. Schulman Outstanding Business Lawyer Award. Ms. Baker retired from state service on January 30, 2015.*

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## NOTES

1. No 316989, 2014 Mich App LEXIS 1994 (Oct 23, 2014).
2. 1929 PA 137, MCL 455.201-455.220.
3. MCL 450.371.
4. MCL 450.371 is incorrectly referred to as part of the General Corporation Act, which is MCL 450.1-450.192.
5. No 315124, 2014 Mich App LEXIS 2128 (Nov 4, 2014)(unpublished).
6. 1929 PA 137.
7. Filed documents are available online at [www.michigan.gov/entitysearch](http://www.michigan.gov/entitysearch).
8. MCL Chapter 455.
9. 769 F3d 455 (2014).
10. 15 USC 78j(b) and 78t(a).
11. 17 CFR 240.10b-5.



## IRS Budget Cuts – Practical Impact for Practitioners and Our Clients

In well-publicized news, Congress approved a \$10.9 billion budget for the IRS for FY 2015.<sup>1</sup> This is a cut of \$346 million and well below the \$13.6 billion budget request by the IRS Oversight Board and below the President's \$12.5 billion request.<sup>2</sup> By comparison, the funding amount for the IRS in FY 2009 was \$11.9 billion.<sup>3</sup> IRS Commissioner John Koskinen has already predicted the loss of 1,800 employees through attrition, a reduction in the number of examinations, and possibly at least two furlough days for all IRS employees.

The purpose of this column is not to debate the wisdom or merit of the budget but, rather, to explore the practical impact for practitioners (not just tax) and our clients. The overall impact may surprise some people.

First, everybody, and I mean everybody, whether individual or entity, for profit, non-profit, corporation, partnership, or something else *must* deal with the IRS. Why? That is the law. If your clients ever earn any income or expect to collect social security, use Medicare, sell assets, or have a savings account, they will have some contact with the IRS. So what can we expect?

### Tax Filing

Regarding the impact of budget cuts on the annual filing of the income tax return and information return (FBAR), Commissioner Koskinen predicts that tax refunds will be delayed. For individual and communities relying on refunds from earned income tax credits or just refunds to pay for vacations, tuition, or just everyday expenses, this will have a meaningful impact. The first year of the Affordable Care Act ("ACA") and resultant informational reporting requirements are sure to add to the strain.

### Telephone Calls to the IRS

Have a question about your tax return or maybe correspondence from the IRS? Expect to wait and wait and wait—if you get through at all. This

situation has very practical adverse consequences. The lack of response by the IRS to taxpayer questions will undoubtedly lead to more incorrect taxpayers filings requiring more effort and expense to rectify for both taxpayers and the government. Some taxpayers may simply give up and pay more in taxes, interest, and penalties than they are legally obligated. Others may leave important benefits unclaimed.

Did someone steal your identity? I discussed this growing and devastating problem in the Fall 2014 Tax Matters column. The stress of dealing with identity theft will be compounded by endless holds and perhaps delays in getting help. Documentation with the IRS will become even more important, do not assume anything.

### Private Letter Ruling Request

Practitioners can, and should, plan for delays and possibly further consolidation in such requests. This will lead to possible uncertainty in tax planning and consequences.

### Enforcement

The continued trend in the reduction of examinations and investigations may sound like good news to some people. However, the IRS receives thousands upon thousands of whistleblower claims from irate taxpayers and business competitors about perceived tax fraud or unfair competitive advantages from unscrupulous individuals. The lack of enforcement portends the real possibility of undermining the "self-assessment" underpinnings of our tax system.

### IRS Computer "Errors"

A particular area of concern should be a further reliance by the IRS on computer processing. What I mean by this is the Automated Collection System or "ACS." Computer generated notices can, and do, lead to the rapid filing of tax liens and levies. Millions of tax liens are filed annually. Couple this with the above-referenced inability to

deal with a human being can, and likely will, result in rote action that will have a lasting impact upon our clients' credit scores, credit ratings, and possibly banking relationships.

### Appeals and Refund Claims

Administrative appeals of adverse examination and collection actions such as Protests and Collection Due Process ("CDP") requests could see delays in necessary consideration of over six months but possibly a year or more. Personal experience has confirmed the delays. Given that some appeals from actions such as lien filings are "post" action appeals, the delays can have serious collateral consequences. In addition, uncertainty of tax liabilities or tax positions have a generally negative impact on taxpayers.

### Other Branches of Government

Simultaneous with the IRS cuts, enforcement budgets at some other law enforcement organizations have increased. The Department of Justice Tax Division will be generally fully-funded with a small increase for FY 2015 and a staff of 377 attorneys.<sup>4</sup> A possible result of the Tax Division budget is greater initiation in tax enforcement from the legal side. While there may be fewer litigation referrals to the Department of Justice from the IRS, those cases will certainly receive great attention and focus. It is also likely that other law enforcement agencies such as the Federal Bureau of Investigation (FBI) and the Secret Service will increase their scrutiny of financially related crimes in areas where jurisdiction has overlap. These organizations have different review and processing procedures that could leave clients with fewer administrative remedies. Caution remains the watchword.

## NOTES

1. Consolidated And Further Continuing Appropriations Act 2015, 113 Pub L No 235, 128 Stat 2130 (2014).

2. IRS Oversight Board FY 2015 *IRS Budget Recommendation Special Report*, May 2014

3. IRS Oversight Board FY 2014 *Budget Recommendation Special Report*, May 2013

4. Department of Justice FY 2015 *Budget and Performance Summary*.



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## *Cybersecurity – Evolution or Turmoil?*

“What should I do about cybersecurity and privacy?” This question is being asked in C-Suites, boardrooms, and among the owners of small and medium-sized businesses all over this country. If Chase Bank,<sup>1</sup> Anthem Health,<sup>2</sup> Home Depot, and Target<sup>3</sup> are susceptible, how can a business of any size protect itself?

### **What Data?**

Take a step back and look at your situation. While everyone has network capabilities that subject their organizations to risk, an assessment of the level and types of risks is the important first step. What information are you collecting and storing? Are you collecting financial and personal health information subject to federal regulation? Assessing what information is confidential, whether regulated or basic information that is related to your business, is a necessary first step.

### **Physical Security**

Often overlooked in the data privacy and security assessments are the policies and procedures within your organization. If confidential information is maintained at the organization’s offices, are those offices secured? Is access controlled? If someone enters the premises without authority, how much information can that person access? Are passwords left posted to the monitors or underneath the keyboard? Does a person with access to confidential information leave a computer logged into the network and otherwise unprotected? These are the simple assessments you need to make.

### **Organizational Awareness**

The highest level of risk in any organization is not from a hacker or criminal element, but from the people within your organization. Whether through lack of awareness or intent to damage, an employee in your organization can compromise data and security. An analysis should be done to identify what kind of infor-

mation is available to employees. Is it highly sensitive information only available on a need-to-know basis? For example, in a medical environment, personal health information generally should not be available to anyone not involved in the delivery of health services.

A next step is to review policies and procedures utilized to protect information. Is the information segregated in your systems environment? Is it protected within the network? If confidential information is being transmitted electronically, is the transmission encrypted? If information is being taken out of the secure environment, for example on physical media or a flash drive, is it encrypted so that it is protected if lost or stolen and recovered by someone outside the organization?

These are some of the preliminary items that an organization should assess internally. Then you need to understand the applicable regulatory environment. The rest of this column looks at some developments on the horizon.

Recent federal initiatives in the areas of data privacy and cybersecurity are running into conflict with state laws and the initiatives of businesses to address the privacy of data and the security of information. 2015 promises to be a year in which many of these initiatives will collide.

### **Data Breach**

Approximately 48 states have enacted laws addressing the responsibility of parties regarding the inadvertent disclosure of private information, whether through a security breach or simply a loss of media that contains personal information. Michigan is among those states that have a set of laws requiring notification to affected parties under certain circumstances, as well as safe harbor provisions if the organization adopts appropriate practices for protecting and maintaining data. Up until now, the initiatives in Congress have sought to weaken the data breach protection laws of the

states by enacting preemptive legislation that would substantially reduce a holder’s responsibility in the event of data disclosure.

The cybersecurity proposal made by the federal government in January 2015 would enact federal legislation whereby holders of data will be accountable if their systems are compromised.<sup>4</sup> We may see effective legislative proposals that would harmonize the rules for data breach notification instead of 48 separate statutes dealing with data breach investigations. Of course, everything is in the details.

One issue that has always been a concern is the extent to which any federal legislation will preempt the state rules. As of the date of this writing, the federal rules propose to preempt the state rules, but states have, in the past, sought to impose more restrictive obligations to protect their citizens.

### **Critical Infrastructure**

The proposals made by the federal government to protect critical infrastructure in the cybersecurity environment were disappointing. Instead of seeking to establish firm rules, the proposals suggest voluntary standards. As telecommunications, power, industrial operations, and many other aspects of our lives become interconnected, the threat of a hack or breach and risk to the population can become significant.

### **The Internet of Things**

This fairly new internet is almost causing fatigue because of its overuse. The convenience resulting from access and interconnection of our home heating, cooling, security, and other systems, as well as refrigerators, stereos, and other individual components, can also cause risks. If everything in our homes is accessible through the Internet, there is great convenience for us, but also risk that must be addressed.

In Michigan, much has been discussed about autonomous and in-

terconnected vehicles. As our population ages, vehicles that can sense potential accidents, have automated braking or crash avoidance systems, or can drive themselves may result in tremendous benefits to our population. However, the hacker community is already working on ways in which it can compromise these systems. Imagine driving down the freeway and all of a sudden your airbag deploys because a vehicle nearby sends a signal to your systems. The automotive industry is certainly cognizant of these concerns, but nothing will be foolproof. There will certainly be a balancing of benefits and risks, and the evolution of these technologies may be fast and furious.

## Guidance for Financial Institutions

Guidance given to financial institutions has generally lagged behind the practical obligations of our banks to protect the integrity and security of their systems. One organization involved in this area is the Federal Financial Institutions Examination Council (FFIEC), which has responsibility related to audits and compliance.<sup>5</sup> It has provided some general guidance to institutions in the past. The newly released guidance that is part of the FFIEC IT examination handbook counsels institutions to focus on managing and monitoring third-party vendors and addressing internal “cyber resilience” related to their systems and third-party services.

This focus on the susceptibility of organizations based on third parties to whom some operations have been sourced has been a substantial weakness in the security environment. Some initial discussions are now taking place regarding cloud providers, but businesses, including financial institutions, tend to assume that third-party technology providers are sufficiently protective of the systems. That may not be a good assumption.

## The U.S.-European Union Safe Harbor Agreement

The safe harbor rules provide a mechanism by which U.S. businesses are allowed to exchange data between the U.S. and the EU. The general EU rules, which are now being strengthened, require that EU data can never be sent to a region that does not have adequate data security. The view in the EU has been that the U.S. does not have adequate controls, but companies that adopt and implement the safe harbor rules will be protected.

The revelations of mass surveillance by the National Security Agency, disclosed by the whistleblower Edward Snowden, exposed the extent to which the U.S. and other governments have been intercepting, storing, and reviewing private data and communications. As a result of the Snowden disclosures, many technology companies have faced significant issues with users around the world. In some cases, European companies have refused to do business with some of these U.S. companies, causing a direct negative impact on them. In response, many of the companies, especially those that store data and provide communication services (think e-mail, Google, Facebook) have been encrypting data transmission to prevent snooping. The encryption of data will prevent the exact kind of surveillance that the intelligence agencies believe they need to monitor threats. This puts technology providers in direct conflict with the intelligence community.

Another big issue affecting businesses is that a number of EU decision makers now wish to scrap the safe harbor rules because the U.S. has shown that it *cannot* adequately protect the privacy of information. At the writing of this article, those issues are still in flux.

## Final Thoughts

The topics discussed above show that these developing issues will not just be local or national in scope. They will impact international business, our critical infrastructures, industrial innovation, and perhaps even our

way of life. These certainly will be interesting times.

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## NOTES

1. “The Real JPMorgan Data Breach Danger Is Still on Its Way,” Oct 12, 2014. <http://abcnews.go.com/Business/real-jpmorgan-data-breach-danger/story?id=26077161>.
2. “Anthem Hack: Lessons for IT Leaders,” *Information Week*, Feb. 12, 2015. <http://www.informationweek.com/strategic-cio/anthem-hack-lessons-for-it-leaders/a/d-id/1319073>
3. “Home Depot’s Suspected Breach Looks Just Like the Target Hack,” *Bloomberg Business*, September 2, 2015. <http://www.bloomberg.com/bw/articles/2014-09-02/home-depots-credit-card-breach-looks-just-like-the-target-hack>.
4. “SECURING CYBERSPACE - President Obama Announces New Cybersecurity Legislative Proposal and Other Cybersecurity Efforts,” White House Press Release, January 13, 2015. <http://www.whitehouse.gov/the-press-office/2015/01/13/securing-cyberspace-president-obama-announces-new-cybersecurity-legislat>
5. FFIEC IT Examination Handbook InfoBase - Business Continuity Planning. <http://ithandbook.ffiec.gov/it-booklets/business-continuity-planning.aspx>



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## *Being an Attorney in a Small Legal Department Is a Big Job*

Did you know that approximately 33 percent of legal departments are small, comprised of one to five attorneys? Although I have worked for several companies during my career, I have not had a chance to work in a small legal department, but I have met many interesting people that have chosen that path. I recently asked Dawn Reamer to share her experiences with me so that I could share them with you. She provided some interesting insights into the life of an attorney in a small legal department. I hope that it will help you to better understand the role and to network with each other.

Dawn Reamer is currently the sole attorney for Aisin Holdings of America, Inc. (AHA), which is the North American headquarters of Aisin Seiki Co., Ltd. The global headquarters are located in Japan. Aisin is a \$31 billion company and the world's fifth largest supplier of automotive components and systems.

As the only in-house counsel for AHA, Reamer is responsible for managing all legal issues for AHA and its 13 North American subsidiaries, which consists of approximately 6,000 employees in nine states, Mexico, and Canada. She is also focused on building the North American Legal and Compliance functions within the organization. In the short time that she has worked for AHA, she has implemented a Code of Conduct, a comprehensive investigation process, proactive training for managers, and the systems and processes for managing various legal issues. She has also worked to successfully resolve a significant lawsuit against one of the AHA's subsidiaries—an issue which began prior to her start at AHA. Reamer's day-to-day functions also include contract review, litigation management, managing AHA's compliance program, legal risk avoidance, mergers and acquisitions, and counseling employees on various legal matters.

Previously, Reamer served as in-house counsel for another Detroit-

area Japanese Tier One supplier, Yazaki North America, a leading manufacturer of automotive wiring harnesses. Reamer began as an intern, eventually becoming a full-time staff attorney after passing the bar the same year. She worked for Yazaki for 11 years, progressing to Corporate Counsel, becoming only the second in-house attorney hired by the company.

At Yazaki, being part of a small department comprised of four staff attorneys gave Reamer the chance to participate in a variety of legal activities. "The uncertainty in the automotive industry presented many opportunities to learn," according to Reamer. During the downturn in 2008, Reamer supported the company's efforts to manage risk associated with financially distressed customers and suppliers, and she was successful in implementing financial recovery strategies that ultimately helped Yazaki avoid preference claims and which were successful in helping Yazaki recover several million dollars. "It is not often that the Legal Department has the ability to contribute to the bottom line of the organization. I was pleased to be able to show that the Legal Department was more than a cost center and was flattered when I was nominated for Yazaki's Excellence Award for this activity," Reamer stated.

Reamer also worked with the Purchasing Department to implement contingency plans and exit strategies designed to reduce organizational risks in the event of a supplier's financial collapse. "It was an intense time and we wondered if we'd be able to get product from some suppliers," said Reamer. "Fortunately, with a lot of hard work, planning, and many late nights we were able to ensure that the customer was not impacted." This activity protected the company from incurring shut down costs that could easily have reached millions of dollars.

In addition, Reamer took the lead role in counseling the Human Re-

sources group and the Compliance Department. She assisted with the implementation of the Code of Conduct and a complaint investigation process. These activities occurred while Reamer was also responsible for contract review and client counseling regarding the day-to-day tasks of the organization.

Reamer attributes her success to hard work and excellent mentors (both inside and out). "There is an opportunity to learn from everyone that you come into contact with," she said. "I have been fortunate to have worked with many excellent attorneys and business people." Reamer said she has also worked hard to develop relationships with other attorneys, including those in the Business Law Section, a move that has helped develop a network vital to her personal and professional growth.

One of the most surprising things to me was that in addition to her big role in a small department, Reamer still finds time to be involved in various organizations and was appointed by Governor Rick Snyder to the Board of the Michigan Statewide Independent Living Council. The Council provides leadership, research, planning, and education required to support independent living services in the state. She is also on the Board of Governors for the Legal Issues Council of the Original Equipment Suppliers Association and is a member of the Board of the Michigan Chapter of the Association of Corporate Counsel, the in-house bar association for those who practice in legal departments globally.

When it comes to dispensing advice of the non-legal variety, Reamer freely tells other attorneys, simply, that relationships are critical. "Within a corporation, the client needs to know that in-house counsel is there to assist them in meeting their objectives," she said. "Asking questions can help the client think in a different way and can help develop a common solution. This requires a great deal of flexibility and patience. Hav-

ing the right relationship determines whether the attorney is brought in early rather than after there is already a problem." To learn more about how a lawyer's critical thinking skills can benefit a company, see Janet Toronski's article, "Transform Your Career: From the Legal Office to the Business Office," in the Fall 2014 *In-House Insights* article.

Finally, Reamer believes trust is also a key element to the job of an in-house counsel, especially as it applies to legal services sought by the client. "We need to be able to trust that outside counsel will partner with us, will take time to understand the needs of the client, and take time to understand the culture of the organization in order to ensure the best possible outcome. These relationships can have a huge impact on the services that an organization receives."

Initially, I thought that the world of an attorney in a small legal department might differ dramatically from others. The more I spoke to Dawn Reamer, however, the more I realized we had a lot in common and could learn from each other. Taking time to connect with each other like this is something that I think benefits the over 4000 in-house counsels in Michigan, and why I started this column. This column is the fourth in the *In-House Insight* series. We are interested in hearing what you think of the series so far and how the Business Law Section can better support you. Feel free to contact us at [businesslaw@mi.rr.com](mailto:businesslaw@mi.rr.com). We look forward to connecting with you at our next event and online.

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*In-House*

*Kim Yapchai is Senior Director, Global Ethics and Compliance at Whirlpool Corporation in Benton Harbor. She is past chair of the Counsel Committee.*

# Receiverships Overview

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By Judy B. Calton\*

The Debtor/Creditor Rights Committee of the Business Law Section is pleased to present a series of articles for this issue of the *Michigan Business Law Journal* on Michigan receivership law, especially in light of the recent changes to MCR 2.622.

The Committee recognized in 2012 that Michigan did not have a court rule addressing the appointment of receivers and the conduct of receiverships outside the context of proceedings supplementary to a judgment. In addition, concerns were raised that trial courts, when appointing receivers, were ignoring the parties' recommended selection of a receiver and appointing unqualified receivers.

Accordingly, the Receivership Rule Committee was formed to draft amended rules with input from persons experienced in the various aspects of receivership law – the bench, the mortgagee, the borrower, and receivers. The Committee consists of C. David Bargamian of Barris Sott Denn & Driker PLLC; Judy B. Calton of Honigman Miller Schwartz and Cohn LLP; Robert J. Diehl, Jr. of Bodman PLC; J. Benjamin Dolan of Dickinson Wright PLLC; David M. Findling of Findling Law Firm PLC; Honorable Kirsten Frank Kelly of the Michigan Court of Appeals; Kay Standridge Kress of Pepper Hamilton LLP; Robert D. Mollhagen of Varnum LLP; and Aaron M. Silver, then of Honigman Miller Schwartz and Cohn LLP, now of General Motors LLC Legal Staff.

The Committee researched the law, statutes, and rules on receiverships in Michigan and other jurisdictions. Based on that work, the Committee debated and drafted proposed amendments to MCR 2.621 and a comprehensive rule to replace MCR 2.622. The Business Law Council approved submitting the proposed rules to the Michigan Supreme Court.

The provision in the proposed rule that the appointing court should defer to the parties' choice of receiver drew significant negative comment, particularly from the bench (the judges worried that it would deprive the trial courts of their judicial discretion). Based on these concerns, the Michigan Supreme

Court revised the proposed rule somewhat before sending it out for public comment again. As revised, MCR 2.622(B)(1) contains a provision that "the court shall appoint the receiver nominated by the party or parties, unless the court finds that a different receiver should be appointed." If, however, the court determines that the nominated receiver should not be appointed, the court is required to state its rationale. MCR 2.622(B)(5). The Business Law Council again supported the proposed rule.

We present the revised rules, five articles, the transcript of a judges' panel with valuable insights on the new rule and receiverships in general, and a set of forms recommended for use in receivership cases.



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\*The author gratefully acknowledges the assistance of Seth A. Drucker, Foster Swift Collins & Smith P.C.

## **MCR 2.621 Proceedings Supplementary to Judgment**

**(A) Relief Under These Rules.** When a party to a civil action obtains a money judgment, that party may, by motion in that action or by a separate civil action:

- (1) obtain the relief formerly obtainable by a creditor's bill;
- (2) obtain relief supplementary to judgment under MCL 600.6101–600.6143; and
- (3) obtain other relief in aid of execution authorized by statute or court rule.

### **(B) Pleading.**

(1) If the motion or complaint seeks to reach an equitable interest of a debtor, it must be verified, and

(a) state the amount due the creditor on the judgment, over and above all just claims of the debtor by way of setoff or otherwise, and

(b) show that the debtor has equitable interests exceeding \$100 in value.

(2) The judgment creditor may obtain relief under MCL 600.6110, and discovery under subchapter 2.300 of these rules.

**(C) Subpoenas and Orders.** A subpoena or order to enjoin the transfer of assets pursuant to MCL 600.6119 must be served under MCR 2.105. The subpoena must specify the amount claimed by the judgment creditor. The court shall endorse its approval of the issuance of the subpoena on the original subpoena, which must be filed in the action. The subrule does not apply to subpoenas for ordinary witnesses.

### **(D) Order Directing Delivery of Property or Money.**

(1) When a court orders the payment of money or delivery of personal property to an officer who has possession of the writ of execution, the order may be entered on notice the court deems just, or without notice.

(2) If a receiver has been appointed, or a receivership has been extended to the supplementary proceeding, the order may direct the payment of money or delivery of property to the receiver.

**(E) Receivers.** When necessary to protect the rights of a judgment creditor, the court may, under MCR 2.622, appoint a receiver in a proceeding under subrule (A)(2), pending the determination of the proceeding.

**(F) Violation of Injunction.** The court may punish for contempt a person who violates the restraining provision of an order or subpoena or, if the person is not the judgment debtor, may enter judgment against the person in the amount of the unpaid portion of the judgment and costs allowed by law or these rules or in the amount of the value of the property transferred, whichever is less.

**(G) New Proceeding.** If there has been a prior supplementary proceeding with respect to the same judgment against the party, whether the judgment debtor or another person, further proceedings may be commenced against that party only by leave of court. Leave may be granted on ex parte motion of the judgment creditor, but only on a finding by the court, based on affidavit of the judgment creditor or another person having personal knowledge of the facts, other than the attorney of the judgment creditor. The affidavit must state that



- (1) there is reason to believe that the party against whom the proceeding is sought to be commenced has property or income the creditor is entitled to reach, or, if a third party, is indebted to the judgment debtor;
- (2) the existence of the property, income, or indebtedness was not known to the judgment creditor during the pendency of a prior supplementary proceeding; and
- (3) the additional supplementary proceeding is sought in good faith to discover assets and not to harass the judgment debtor or third party.

**(H) Appeal; Procedure; Bonds.** A final order entered in a supplementary proceeding may be appealed in the usual manner. The appeal is governed by the provisions of chapter 7 of these rules except as modified by this subrule.

- (1) The appellant must give a bond to the effect that he or she will pay all costs and damages that may be awarded against him or her on the appeal. If the appeal is by the judgment creditor, the amount of the bond may not exceed \$200, and subrules (H)(2)-(4) do not apply. If the appeal is by a party other than the judgment creditor, subrules (H)(2)-(4) apply.
- (2) If the order appealed from is for the payment of money or the delivery of property, the bond of the appellant must be in an amount at least double the amount of the money or property ordered to be paid or delivered. The bond must be on the condition that if the order appealed from is affirmed in whole or in part the appellant will
  - (a) pay the amount directed to be paid or deliver the property in as good condition as it is at the time of the appeal, and
  - (b) pay all damages and costs that may be awarded against the appellant.
- (3) If the order appealed from directs the assignment or delivery of papers or documents by the appellant, the papers must be delivered to the clerk of the court in which the proceeding is pending or placed in the hands of an officer or receiver, as the judge who entered the order directs, to await the appeal, subject to the order of the appellate courts.
- (4) If the order appealed from directs the sale of real estate of the appellant or delivery of possession by the appellant, the appeal bond must also provide that during the possession of the property by the appellant, or any person holding under the appellant, he or she will not commit or suffer any waste of the property, and that if the order is affirmed he or she will pay the value of the use of the property from the time of appeal until the delivery of possession.

## **MCR 2.622 Receivers**

**(A) Appointment of Receiver.** Upon the motion of a party or on its own initiative, and for good cause shown, the court may appoint a receiver as provided by law. A receiver appointed under this section is a fiduciary for the benefit of all persons appearing in the action or proceeding. For purposes of this rule, "receivership estate" means the entity, person, or property subject to the receivership.

**(B) Selection of Receiver.** If the court determines there is good cause to appoint a receiver, the court shall select the receiver in accordance with this subrule. Every receiver selected by the court must have sufficient competence, qualifications, and experience to administer the receivership estate.

(1) *Stipulated Receiver or No Objection Raised.* The moving party may request, or the parties may stipulate to, the selection of a receiver. The moving party shall describe how the nominated receiver meets the requirement in subsection (B) that a receiver selected by the court have sufficient competence, qualifications, and experience to administer the receivership estate, considering the factors listed in subsection (B)(5). If the nonmoving party does not file an objection to the moving party's nominated receiver within 14 days after the petition or motion is served, or if the parties stipulate to the selection of a receiver, the court shall appoint the receiver nominated by the party or parties, unless the court finds that a different receiver should be appointed.

(2) *Receiver Appointed Sua Sponte.* If the court appoints a receiver on its own initiative, any party may file objection to the selected receiver and submit an alternative nominee for appointment as receiver within 14 days after the order appointing the receiver is served. The objecting party shall describe how the alternative nominee meets the requirement in subsection (B) that a receiver selected by the court have sufficient competence, qualifications, and experience to administer the receivership estate, considering the factors listed in subsection (B)(5).

(3) *Reduction in Time to Object.* The court, for good cause shown, may in its discretion, with or without motion or notice, order the period for objection to the selected receiver reduced.

(4) *Objections.* The party filing an objection must serve it on all parties as required by MCR 2.107, together with a notice of hearing.

(5) If a party objects under subsection (B)(2) or the court makes an initial determination that a different receiver should be appointed than the receiver nominated by a party under subsection (B)(1), the court shall state its rationale for selecting a particular receiver after considering the following factors:

- (a) experience in the operation and/or liquidation of the type of assets to be administered;
- (b) relevant business, legal and receivership knowledge, if any;
- (c) ability to obtain the required bonding if more than a nominal bond is required;
- (d) any objections to any receiver considered for appointment;
- (e) whether the receiver considered for appointment is disqualified under subrule (B)(6); and
- (f) any other factor the court deems appropriate.

(6) Except as otherwise provided by law or by subrule (B)(7), a person or entity may not serve as a receiver or in any other professional capacity representing or assisting the receiver, if such person or entity:

- (a) is a creditor or a holder of an equity security of the receivership estate;
- (b) is or was an investment banker for any outstanding security of the receivership estate;
- (c) has been, within three years before the date of the appointment of a receiver, an investment banker for a security of the receivership estate, or an attorney for such an investment banker, in connection with the offer, sale, or issuance of a security of the receivership estate;
- (d) is or was, within two years before the date of the appointment of a receiver, a director, an officer, or an employee of the receivership estate or of an investment banker specified in subrule (b) or (c) of this section, unless the court finds the appointment is in the best interest of the receivership estate and that there is no actual conflict of interest by reason of the employment;
- (e) has an interest materially adverse to the interest of any class of creditors or equity security holders by reason of any direct or indirect relationship to, connection with, or interest in the receivership estate or an investment banker specified in subrule (b) or (c) of this section, or for any other reason;
- (f) has or represents an interest adverse to the receivership estate or stands in any relation to the subject of the action or proceeding that would tend to interfere with the impartial discharge of duties as an officer of the court;

- (g) has, at any time within five years before the date of the appointment of a receiver, represented or been employed by the receivership estate or any secured creditor of the receivership estate as an attorney, accountant, appraiser, or in any other professional capacity and the court finds an actual conflict of interest by reason of the representation or employment;
- (h) is an "insider" as defined by MCL 566.31(g);
- (i) represents or is employed by a creditor of the receivership estate and, on objection of an interested party, the court finds an actual conflict of interest by reason of the representation or employment; or
- (j) has a relationship to the action or proceeding that will interfere with the impartial discharge of the receiver's duties.

(7) Any person who has represented or has been employed by the receivership estate is eligible to serve for a specified limited purpose, if the court determines such employment or appointment is in the best interest of the receivership estate and if such professional does not represent or hold an interest materially adverse to the receivership estate.

**(C) Order of Appointment.** The order of appointment shall include provisions related to the following:

- (1) bonding amounts and requirements as provided in subrule (G);
- (2) identification of real and personal property of the receivership estate;
- (3) procedures and standards related to the reasonable compensation of the receiver as provided in subrule (F);
- (4) reports required to be produced and filed by the receiver, including the final report and accounting;
- (5) a description of the duties, authority and powers of the receiver;
- (6) a listing of property to be surrendered to the receiver; and
- (7) any other provision the court deems appropriate.

**(D) Duties.**

- (1) Within 7 days after entry of the order of appointment, the receiver shall file an acceptance of receivership with the court. The acceptance shall be served on all parties to the action.
- (2) Unless otherwise ordered, within 28 days after the filing of the acceptance of appointment, the receiver shall provide notice of entry of the order of appointment to any person or entity having a recorded interest in all or any part of the receivership estate.
- (3) The receiver shall file with the court an inventory of the property of the receivership estate within 35 days after entry of the order of appointment, unless an inventory has already been filed.
- (4) The receiver shall account for all receipts, disbursements and distributions of money and property of the receivership estate
- (5) If there are sufficient funds to make a distribution to a class of creditors, the receiver may request that each creditor in the class of all creditors file a written proof of claim with the court. The receiver may contest the allowance of any claim.
- (6) The receiver shall furnish information concerning the receivership estate and its administration as reasonably requested by any party to the action or proceeding.
- (7) The receiver shall file with the court a final written report and final accounting of the administration of the receivership estate.

**(E) Powers.**

- (1) Except as otherwise provided by law or by the order of appointment, a receiver has general power to sue for and collect all debts, demands, and rents of the receivership estate, and to compromise or settle claims.
- (2) A receiver may liquidate the personal property of the receivership estate into money. By separate order of the court, a receiver may sell real property of the receivership estate.
- (3) A receiver may pay the ordinary expenses of the receivership but may not distribute the funds in the receivership estate to a party to the action without an order of the court.

(4) A receiver may only be discharged on order of the court.

**(F) Compensation and Expenses of Receiver.**

(1) A receiver shall be entitled to reasonable compensation for services rendered to the receivership estate.

(2) The order appointing a receiver shall specify:

(a) the source and method of compensation of the receiver;

(b) that interim compensation may be paid to the receiver after notice to all parties to the action or proceeding and opportunity to object as provided in subsection (5);

(c) that all compensation of the receiver is subject to final review and approval of the court.

(3) All approved fees and expenses incurred by a receiver, including fees and expenses for persons or entities retained by the receiver, shall be paid or reimbursed as provided in the order appointing the receiver.

(4) The receiver shall file with the court an application for payment of fees and the original notice of the request. The notice shall provide that fees and expenses will be deemed approved if no written objection is filed with the court within 7 days after service of the notice. The receiver shall serve the notice and a copy of the application on all parties to the action or proceedings, and file a proof of service with the court.

(5) The application by a receiver, for interim or final payment of fees and expenses, shall include:

(a) A description in reasonable detail of the services rendered, time expended, and expenses incurred;

(b) The amount of compensation and expenses requested;

(c) The amount of any compensation and expenses previously paid to the receiver;

(d) The amount of any compensation and expenses received by the receiver from or to be paid by any source other than the receivership estate;

(e) A description in reasonable detail of any agreement or understanding for a division or sharing of compensation between the person rendering the services and any other person except as permitted in subpart (6).

If written objections are filed or if, in the court's determination, the application for compensation requires a hearing, the court shall schedule a hearing and notify all parties of the scheduled hearing.

(6) A receiver or person performing services for a receiver shall not, in any form or manner, share or agree to share compensation for services rendered to the receivership estate with any person other than a firm member, partner, employer, or regular associate of the person rendering the services except as authorized by order of the court.

**(G) Bond.** In setting an appropriate bond for the receiver, the court may consider factors including but not limited to:

(1) The value of the receivership estate, if known;

(2) The amount of cash or cash equivalents expected to be received into the receivership estate;

(3) The amount of assets in the receivership estate on deposit in insured financial institutions or invested in U.S. Treasury obligations;

(4) Whether the assets in the receivership estate cannot be sold without further order of the court;

(5) If the receiver is an entity, whether the receiver has sufficient assets or acceptable errors and omissions insurance to cover any potential losses or liabilities of the receivership estate;

(6) The extent to which any secured creditor is undersecured;

(7) Whether the receivership estate is a single parcel of real estate involving few trade creditors; and

(8) Whether the parties have agreed to a nominal bond.

**(H) Intervention.** An interested person or entity may move to intervene. Any motion to intervene shall comply with MCR 2.209.

**(I) Removal of Receiver.** After notice and hearing, the court may remove any receiver for good cause shown.

# *When Appointment of a Receiver Is Appropriate*

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By Gregory J. DeMars, Robert J. Diehl, Jr., and Maryam H. Karnib

## **Introduction**

A receiver is a person that a court appoints to protect the interests of others. The receiver has the administrative power to affect the rights and interests of all parties involved. Lenders and other stakeholders routinely seek a receiver when a borrower experiences financial distress. This article focuses on the legal basis for a receivership, the risks and benefits a party should think about when it comes to an appointment of a receiver, and what Michigan courts take into consideration when determining whether to grant a receivership. The article highlights both the courts' broad authority and the limiting principles courts implement when it comes to such appointments. Finally, the article explains the requirements that must be satisfied before a court appoints a receiver.

## **The Legal Basis of Receiverships**

Michigan courts have broad authority to appoint a receiver as an equitable remedy.<sup>1</sup> This common law authority has been recognized by statute: "Circuit court judges in the exercise of their equitable powers may appoint receivers in all cases pending where appointment is allowed by law."<sup>2</sup> Courts have recognized that the language "allowed by law" does not create an independent grant of authority.<sup>3</sup> Instead, the language highlights that the court has the power to appoint a receiver (1) where a statute specifically allows a court to appoint a receiver, and (2) "where the facts and circumstances render the appointment of a receiver an appropriate exercise of the circuit court's equitable jurisdiction."<sup>4</sup>

Because the courts have broad authority to appoint a receiver, equity has developed restraints to avoid abuses. Courts have recognized that an appointment of a receiver is a drastic remedy, which should be utilized only as a last resort.<sup>5</sup> A court will not appoint a receiver if there are "less intrusive means" available to achieve the requested relief.<sup>6</sup> A plaintiff may be required to show it attempted to accomplish relief through other means prior to seeking a receivership.<sup>7</sup> Receiver-

ships must be ancillary to a legal action or a foreclosure by advertisement.<sup>8</sup> This means that a party cannot just file a complaint for a receivership, but, rather, it must plead a cognizable cause of action.<sup>9</sup>

## **The Reasons for a Receivership**

While lenders often desire the appointment of receivers, borrowers are generally opposed to the appointment. Lenders generally seek to appoint a receiver because the appointment can occur quickly and serve to preserve the mortgaged property and other collateral while other remedies are also pursued. Depending on the circumstances, a court can appoint a receiver immediately when the lender files a lawsuit, giving the receiver immediate possession and control of the property. A lender's typical remedies for the non-payment of a loan, such as foreclosures, work-outs, deeds in lieu of foreclosure, and suits on the debt or guarantee, often take a long time to play out. The appointment of a receiver also assures the lender that no waste occurs on the property. Unlike borrowers, who may lack the liquidity and resources to make repairs and management decisions that the property requires, receivers typically have the lenders' support to provide the resources to ensure that the property is preserved. Lenders also favor appointment of a receiver because the receiver can reverse previous poor management decisions and prevent future deterioration of the property.

Borrowers tend to resist the appointment of receivers because a receivership decreases the borrower's control of the property while increasing the risk of foreclosure. After a court appoints a receiver, the borrower is no longer in control of the property's cash flow. This cuts off the borrower's income from the property in the form of management and other fees. Historically, the receivership order may attempt to give the receiver the power to sell the property and waive redemption rights.<sup>10</sup> Furthermore, the receiver's compensation and expenses are often added to

the borrower's mortgage debt, which makes repayment more difficult and increases the risk of a deficiency. "The general rule is that fees and expenses will be a charge on the receivership property and be paid out of such property."<sup>11</sup> A receivership can also adversely affect the borrower's credit rating and result in adverse tax consequences.

### Receivership for Waste

There are many justifications sufficient to merit appointment of a receiver. One traditional justification is waste of the property.<sup>12</sup> Waste is any action, or failure to act, that wrongfully diminishes the property's value.<sup>13</sup> Courts have historically deemed physical damage or neglect of the property as waste. Even threatened diminution to the value of the property can be considered waste.<sup>14</sup> Although the spectrum of what constitutes non-statutory waste is broad, a court may require the moving party to present an expert to support the conclusion that waste exists, which makes it more difficult to prove.

Michigan statutory law also allows the parties to define what constitutes waste in their mortgage documents including, for example, the non-payment of taxes and insurance.<sup>15</sup> Although the statute gives parties the flexibility to define waste, courts are not required to appoint a receiver on such grounds. Courts will typically balance many factors in deciding whether an appointment of a receiver is appropriate on the basis of waste, including (1) the amount of unpaid taxes or insurance, (2) the length of the past due period, (3) the value of the mortgaged property, (4) the likelihood of deficiency following the sale, (5) whether the deficiency would be collectable, (6) the presence of misconduct or mismanagement, and (7) whether the documents allow appointment of receiver. The waste statute also provides the court with the authority to grant the receiver broad powers by providing that "[s]ubject to the order of the court, the receiver may collect the rents and income from such property and shall exercise such control over such property as to such court may seem proper."<sup>16</sup>

### Receivership to Collect Rents

Another justification for appointment of a receiver is an assignment of rents. As previously stated, the waste statute gives the court authority to grant a receiver broad powers, including the power to collect rents. Even in the absence of statutory waste, MCL 554.231 allows parties to enter into an assignment

of rents agreement to secure a loan.<sup>17</sup> The assignment of rents is not a mortgage of rents and, thus, does not require foreclosure to exercise remedies on default. Rather, the assignment becomes effective immediately on the debtor's default, and the lender can begin collecting rent payments without providing notice to the debtor.<sup>18</sup> While the lender can collect rents immediately on default, the assignment does not become effective against tenants of the property until the lender meets certain statutory requirements. Specifically, the lender must record a notice of default with the register of deeds and serve the tenants with a copy of the notice and the assignment.<sup>19</sup> While the statute only provides the parties with the authority to enter into an assignment of rents agreement, courts have found that an appointment of a receiver is appropriate when a party invokes such agreement.<sup>20</sup>

Though a lender has the right to collect rent under an assignment of rents after default, the lender should first examine certain risks that it may face by invoking the assignment. For example, if the lender demands payment of rent from tenants without a receivership, the tenants may withhold rent payments, which can lead to a reduced cash flow.

### Construction Lien Receivership

Receivership appointments are not limited to the lender and debtor context. For example, MCL 570.1122, under the Construction Lien Act, provides that if "the improvement to the real property is not completed as of the date of commencement of an action in which enforcement of a construction lien through foreclosure is sought...any lien claimant or mortgagee may petition the court for the appointment of a receiver."<sup>21</sup>

### Michigan Business Corporation Act Receivership

Another setting in which a court may appoint a receiver is under the Michigan Business Corporation Act. It provides courts the authority to appoint a temporary receiver when the corporation is undertaking a plan of reorganization.<sup>22</sup> The court has the broad authority to grant any such power as it deems necessary.<sup>23</sup> Further, the court may appoint a receiver to supervise the liquidation of a corporation if after dissolution, the corporation, a creditor, or a shareholder applies for circuit court supervision of the process.<sup>24</sup>

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Courts have recognized that the language "allowed by law" does not create an independent grant of authority.

## Proceedings Supplementary to a Judgment

The Michigan Court Rules also grant courts the authority to appoint a receiver when it is necessary to protect the rights of a judgment creditor.<sup>25</sup> The appointment is supplementary relief to the judgment.<sup>26</sup> If the court appoints a receiver, third parties who claim an interest adverse to the judgment debtor may intervene in the action.<sup>27</sup> However, the receiver can only bring an action at the request of a judgment creditor.<sup>28</sup> The receiver can protect itself by requiring reasonable security against all costs before bringing the action.<sup>29</sup> Additionally, the judgment creditor may be responsible for all costs if the action fails.

## How to Get a Receiver Appointed

In Michigan, a receiver can be appointed by motion of the parties or by the court's own initiative.<sup>30</sup> As discussed earlier, an appointment of receiver is an ancillary remedy to other relief sought.<sup>31</sup> Before granting the receivership, a court must find that there is good cause to appoint a receiver and that the receiver has "sufficient competence, qualifications, and experience to administer the receivership estate."<sup>32</sup> The moving party has the burden to show good cause.<sup>33</sup> To meet this burden, the moving party must demonstrate that its interest cannot be protected by other means. For example, the moving party can show the lack of other efficient or effective means to protect the property. The creditor can also highlight any fact that shows the debtor's lack of resources to preserve the property and the debtor's prior lack of performance. Depending on the facts of the case, a court may require an evidentiary hearing before appointing a receiver.<sup>34</sup> However, if the non-moving party does not refute or contradict the facts presented, then the court generally will not require a hearing.<sup>35</sup>

While a court may select a receiver at the request of the moving party, by stipulation, or sua sponte<sup>36</sup> the court must find that the selected receiver has "sufficient competence, qualifications, and experience to administer the receivership estate."<sup>37</sup> In making this determination, the court must take the following factors into consideration:

- (1) Experience in the operation and/or liquidation of the type of assets administered;
- (2) Relevant business, legal and receivership knowledge, if any;

- (3) Ability to obtain the required bonding if more than a nominal bond is required;
- (4) Any objections to any receiver considered for appointment;
- (5) Whether the receiver considered for appointment is disqualified [under the court rules]; and
- (6) Any other factor the court deems appropriate.<sup>38</sup>

If the moving party requests appointment of a designated receiver, it must show that the designee has met the specified requirements using the above factors. The non-moving party may object to the nominated receiver by filing an objection within fourteen days after being served the motion.<sup>39</sup> Although the parties can stipulate to the appointment of a receiver, the court does not have to appoint the selected receiver if it "finds that a different receiver should be appointed."<sup>40</sup> The parties also have an opportunity to object if the court appoints a receiver sua sponte.<sup>41</sup> Either party may object to the court's selected receiver and "submit an alternative nominee" within fourteen days after "the court order appointing the receiver is served."<sup>42</sup> After a court appoints a receiver, its decision will only be overturned if there is an abuse of discretion.<sup>43</sup> A party seeking reversal of a receivership appointment must submit an appeal to the appellate court,<sup>44</sup> the party cannot challenge such appointment through a writ of mandamus.<sup>45</sup>

Michigan statutory law requires courts to obtain a bond from an appointed receiver.<sup>46</sup> MCL 600.2926 provides that "[i]n all cases in which a receiver is appointed the court shall provide for a bond and shall define the receiver's power and duties where they are not otherwise spelled out by law."<sup>47</sup> Yet the failure of the court to require the receiver to give a bond is not "fatal."<sup>48</sup> In other words, an appellate court will not void an order appointing a receiver just because the order failed to require the receiver to give a bond.<sup>49</sup> Instead, to remedy the mistake, the appellate court will enter an order nunc pro tunc that sets a bond.<sup>50</sup> MCR 2.622(G) provides a non-exhaustive list of factors that a court can consider in setting an appropriate bond for the receiver. These factors include:

- (1) The value of the receivership estate, if known;
- (2) The amount of cash or cash equivalents expected to be received into the receivership estate;

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In Michigan, a receiver can be appointed by motion of the parties or by the court's own initiative.

- (3) The amount of assets in the receivership estate on deposit in insured financial institutions or invested in U.S. Treasury obligations;
- (4) Whether the assets in the receivership estate cannot be sold without further order of the court;
- (5) If the receiver is an entity, whether the receiver has sufficient assets or acceptable errors and omissions insurance to cover any potential losses or liabilities of the receivership estate;
- (6) The extent to which any secured creditor is unsecured;
- (7) Whether the receivership estate is a single parcel of real estate involving few trade creditors; and
- (8) Whether the parties have agreed to a nominal bond.<sup>51</sup>

Once the court sets the receiver's bond and issues an order appointing the receiver, the receiver must file "an acceptance of receivership" and serve a copy on all parties to the action. Then the receiver may begin to exercise its powers.<sup>52</sup>

## Conclusion

A party must evaluate its own interests when deciding to seek or resist the appointment of a receiver. Although the appointment of a receiver generally provides certain advantages that other actions do not, an analysis of the risks involved in each action is crucial. Even if a party desires the appointment of a receiver, courts have the ultimate decision-making power. A court will only appoint a receiver if the court finds that it is equitable to do so. The court takes into account many factors in deciding whether it is equitable to appoint a receiver. A party seeking such appointment should gather as much evidence as possible to show that the debtor or opposing party does not have the resources to protect the property or the moving party's interest.

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## NOTES

1. *Michigan Minerals, Inc v Williams*, 306 Mich 515, 525-27, 11 NW2d 224 (1943); *Petitpren v Taylor Sch Dist*, 104 Mich App 283, 293-94, 304 NW2d 224 (1981).
2. MCL 600.2926.
3. *Petitpren*, *supra* note 1, 104 Mich App at 294.
4. *Id.*
5. *Korash v Livonia*, 388 Mich 737, 202 NW2d 803 (1972); *Michigan Minerals*, *supra* note 1, 306 Mich at 525; *Jenks v Horton*, 96 Mich 13, 16, 55 NW 372 1893; *Hosner v Brown*, 40 Mich App 515, 536, 199 NW2d 295 (1972).

6. *People v Israelite House of David*, 246 Mich 606, 225 NW 638 (1929) (upholding an injunction as opposed to appointing a receiver because the injunction was sufficient to address the plaintiff's concerns).

7. *Petitpren*, *supra* note 1, 104 Mich App at 283 (illustrating this principle by reversing the lower court's order of receivership; the court held that the lower court had not reviewed other less drastic methods before granting the receivership in favor of the plaintiffs).

8. *National Lumberman's Bank v Lake Shore Mach Co*, 260 Mich 440, 443, 245 NW 494 (1932).

9. *Id.*

10. See Hon. Mark A. Goldsmith and Gregory J. DeMars, *Receiverships in the Real Estate Setting*, MI Bus LJ 36 (Summer 2008), available at <http://www.michbar.org/business/BU/Summer2008/goldsmith-demars.pdf>. The receivership order may have provided for a power of sale with a waiver of redemption rights. However, a court needs to look at the creation of such rights, pursuant to a receivership order, carefully in light of the requirements of the foreclosure by advertisement statute, MCL 600.3201, and the judicial foreclosure statute, MCL 600.3101. MCR 2.622(E)(2) now requires that the receiver's power to sell the real property be given in a separate order from the order appointing the receiver.

11. *Id.* at 39.

12. *Nusbaum v Shapero*, 249 Mich 252, 263, 228 NW 785 (1930).

13. *Id.*

14. *Union St Ry Co v Saginaw*, 115 Mich 300, 73 NW 243 (1897) (railroad company refused to comply with a city order for track improvements, which could have reduced the value of the mortgaged land.). See also Goldsmith and DeMars, *supra* note 10, MI Bus LJ at 37 (providing an overview on how the law has evolved in this area).

15. MCL 600.2927(1); *Union Guardian Trust Co v Rau*, 255 Mich 324, 238 NW 166 (1931).

16. MCL 600.2927(2).

17. *Smith v Mutual Benefit Life Ins Co*, 362 Mich 114, 124, 106 NW2d 515 (1960).

18. MCL 554.231.

19. *In re PMG Props*, 55 BR 864, 869-70 (Bankr ED Mich 1985).

20. *Mutual Benefit Life Ins Co*, *supra* note 17, 362 Mich 114.

21. MCL 570.1122 (note that this statute is not applicable to residential structures nor any apartment building with four or less units).

22. MCL 450.1204-1205.

23. *Id.*

24. MCL 450.1851.

25. MCR 2.621(E).

26. *Id.*

27. MCR 2.622(A).

28. MCR 2.622(C).

29. *Id.*

30. MCR 2.622(A).

31. *Petitpren*, *supra* note 1, 104 Mich App at 296.

32. MCR 2.622(A)-(B).

33. MCR 2.622(A).

34. *Hofmeister v Randall*, 124 Mich App 443, 447, 335 NW2d 65 (1983).

35. *Band v Livonia Assocs*, 176 Mich App 95, 106, 439 NW2d 285 (1989).

36. MCR 2.622(B)(1)-(2).

37. MCR 2.622(8).

38. MCR 2.622(8)(5).

39. MCR 2.622(8)(1).

40. *Id.*

41. MCR 2.622(8)(2).



42. *Id.*

43. *Reed v Reed*, 265 Mich App 131, 161, 693 NW2d 825 (2005).

44. *Scott v Speed*, 58 Mich 311, 312, 25 NW 200 (1885).

45. *Id.*

46. MCL 600.2926; *see also Ypsilanti Fire Marshal v Kircher*, 273 Mich App 496, 529, 730 NW2d 481(2007).

47. *Id.*

48. *Livonia Assocs*, *supra* note 36, 176 Mich App at 107.

49. *Id.*

50. *Id.* “A *nunc pro tunc* order is the proper procedure to enter an order ‘which should have been made as a matter of course, and as a legal duty.’”

51. MCR 2.622(G).

52. 2.622(0).



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# Payment of a Receiver

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By Judy B. Calton\*

## The Source of Payment

It is well established that a receiver is entitled to reasonable compensation and reimbursement of necessary expenses, as determined by the appointing court.<sup>1</sup> Before the 2014 amendments to MCR 2.622, however, there was no established rule as to how the compensation should be determined or the source of payment of the compensation. Revised MCR 2.622 confirms the principle that a receiver should be paid.<sup>2</sup> It also mandates that the order of appointment of the receiver specify the source and method of payment.<sup>3</sup>

Generally, the receiver's compensation will be a charge to be paid out of the receivership property.<sup>4</sup> Unfortunately, receivership property often fails to generate sufficient cash flow to cover all of the receiver's compensation, operating expenses, and scheduled payments to a secured creditor. Thus, the order of appointment should provide for payment of the receiver and designate a source of payment if cash flow is insufficient.

A mortgagee that did not move for the appointment of the receiver but consents to the appointment and benefits therefrom can have its collateral charged for the receiver's fees and costs.<sup>5</sup> A mortgagee who did not move for the appointment of the receiver and did not consent cannot be charged in derogation of its statutory priority, even if the mortgagee benefited from the receivership.<sup>6</sup> Mere acquiescence is not consent.<sup>7</sup>

The only way to avoid a fight over whether a secured creditor consented or benefited from the creation of a receivership estate is to reach an agreement with the secured creditor at the time of appointment and reference or include the agreement in the order of appointment.

Mortgage documents typically provide that a receiver appointed at the request of the mortgagee will be paid by the cash flow of the receivership property, if sufficient. If insufficient, the receivership costs will be borne by the borrower and added to the mortgage debt.<sup>8</sup> Such a provision addresses the lender's rights against the property and borrower, but it does not directly address

the receiver's right to receive payment from the lender. If the lender will directly advance payments to the receiver (perhaps subject to an agreed budget), then that arrangement should be expressly contained in the order of appointment. If the receiver is to be paid from the proceeds of the sale of the receivership property, the receiver's fees should have a first priority lien against the property, senior to the secured creditor's interest, pursuant to a subordination agreement. The order of appointment needs to make clear the receiver's right to fees will be senior in priority to the lender's liens.

## Procedures For Allowance and Payment of Fees

MCR 2.622(F) lays out the procedure to be followed for the allowance and payment of a receiver's fees:

- 1 An application must be filed for payment.
- 2 The application package must include:
  - (a) the application;
  - (b) a notice to the effect that, if no written objection to the application is filed within 7 days of service of the notice, the application will be deemed approved;<sup>9</sup> and
  - (c) a proof of service.

The application package must be served on all parties to the action or proceeding.

If a timely objection is filed, or if the court determines a hearing is required, the court will schedule a hearing on the application. All parties to the case or proceeding must be given notice of the hearing on the application.<sup>10</sup>

The same fee application procedure applies to both interim fee applications and the final fee application.

A receiver or person performing services for a receiver cannot share or agree to share compensation for services with others not in the same firm, except as authorized by the court.<sup>11</sup>

This is an anti-kickback or bribery provision.<sup>12</sup> If the receiver or the receiver's firm wants to engage an independent contractor,

*\*The author gratefully acknowledges the assistance of Joseph Lucas, Rhoades McKee, and Seth A. Drucker, Foster Swift Collins & Smith, P.C.*

that arrangement should be approved by the court to avoid this prohibition.

### Contents of the Application

The application is required, at a minimum, to contain the following:

1. A description in reasonable detail of the services rendered, time expended, and expenses incurred;
2. The amount of compensation and expenses requested;
3. The amount of compensation and expenses previously paid;
4. The amount of any compensation and expenses received or to be received by the receiver from any source other than the receivership estate (i.e. from the secured lender, asset purchaser, etc.); and
5. A description of any agreement or understanding for a division or sharing of compensation between the person rendering the services and any other person (other than agreements to share within a firm).<sup>13</sup>

Because the rule permits the court to approve an application without a hearing, it is in the receiver's interest to include more information than the minimum required, enabling the court to find the application is warranted without the necessity of a hearing. Thus, although not mandatory, it is recommended that the application include a detailed time summary comparable to a detailed invoice describing the services provided by each professional with the date of the service and the time for that service. If the receiver is not already keeping time records in such a manner, it should immediately begin to do so. The application should also include a narrative that describes the necessity and benefit of the services provided. The fee applications filed by professionals in bankruptcy court can serve as useful precedents.

It is also recommended that the application include an attestation that the receiver has complied with the prohibition in MCR 2.622(F)(6) against sharing or agreeing to share compensation by including an affidavit stating similar to the following:

No agreement or understanding exists between the Receiver and any other person or firm for the division of any compensation requested in this matter other than agreements or understandings relating to the com-

pensation among the parties of the Receiver's firm.

To reduce the odds of an objection to the application being filed and increase the odds of court approval without a hearing before filing the application, the receiver should seek consent to the application of secured party or other party who moved for the appointment of the receiver or is at least partially responsible for payment of the receiver's compensation. The receiver can then state in the application that such party either consented or does not object to the application.

Finally, to assist the court in granting the application without a hearing, include a proposed order granting the application and awarding the requested fees and reimbursement.<sup>14</sup>

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### NOTES

1. *Fisk v Fisk*, 333 Mich 513, 516-517, 53 NW2d 356 (1952).

2. MCR 2.622(F)(1) provides "[a] receiver should be entitled to reasonable compensation for services rendered to the receivership estate."

3. MCR 2.622(F)(2)(a).

4. *Fisk*, 333 Mich at 516-517.

5. *Bailey v Bailey*, 262 Mich 215, 247 NW 160 (1933).

6. *Price v Kosmalski (In re Receivership of 11910 S Francis Rd)*, 492 Mich 208, 225-230, 821 NW2d 503 (2012).

7. *Id.*

8. Hon. Mark A. Goldsmith and Gregory J. DeMars, *Receiverships in the Real Estate Setting*, 28 MI Bus LJ 36, 39 (Summer 2008).

9. A proposed form of Notice of Request For Fees and Expenses By Receiver Under MCR 2.622(F)(4) is an exhibit to the article *Receivership Forms* in this edition of the *Michigan Business Law Journal*.

10. MCR 2.622(F)(2)(b).

11. MCR 2.622(F)(6).

12. MCR 2.622(F)(6) is derived from the bankruptcy provision, 11 USC 504.

13. MCR 2.622(F)(5).

14. See MCR 2.621 and MCR 2.622: The New Playing Field For State Court Receiverships: The *View From The Bench*, included as an article on page 37 in this edition of the *Michigan Business Law Journal*.

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The same fee application procedure applies to both interim fee applications and the final fee application.



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# Receiver Qualifications Under MCR 2.622

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By Michael S. Leib\*

## Introduction

The receivership court rule, MCR 2.622, contains the requirements for qualification of a receiver. Specifically, MCR 2.622(b) governs the selection of a receiver and requires that the “receiver selected by the court must have sufficient competence, qualifications, and experience to administer the receivership estate.” This article discusses the specific factors identified by the rule in MCR 2.622(b) (5) and (6) to support such qualification and practical considerations for qualifying the receiver.<sup>1</sup>

## What is New

MCR 2.622 identifies factors to be considered in determining the qualification of a proposed receiver, but the list is not exclusive. The court may consider “any other factor.” There is nothing new about considering the qualifications of a proposed receiver. However, there was no previous guidance by rule or statute. It is certainly prudent to have a “qualified” receiver – it makes good business sense.

What is new in MCR 2.622 is a specific requirement that the proposed receiver be qualified, regardless of who selects the receiver.<sup>2</sup> The rule now requires the party moving to appoint the receiver to “justify” the appointment by describing the qualifications of the proposed receiver. The court may decline to appoint the proposed receiver, even if no other party objects, if the court does not agree with the moving party’s choice. While there is no inherent change in the ability of the court to choose the receiver, the record must now support qualification of such person.

What are the factors to support or affect qualification? They are set forth in MCR 2.622(B)(5) and are summarized below:

1. Experience.
2. Relevant business, legal, and receivership knowledge.
3. Ability to be bonded.
4. Objections to appointment.
5. Whether there is disqualification by

actual conflict or otherwise as identified in 2.622(B)(6).

6. Any other reason the court deems appropriate.

The court rule also identifies a variety of factors that disqualify the receiver or any professional representing or assisting the receiver. Loosely based on the “disinterestedness” requirements in the United States Bankruptcy Code, they are set forth in MCR 2.622(B)(6) and summarized below. A receiver or its professional will be disqualified if such person or entity:

1. Is a creditor or equity holder of the receivership estate;
2. Is or was an investment banker for an outstanding security of the estate;
3. Within three years before the appointment, was an investment banker, or an attorney, or an investment banker for a security of the receivership estate in connection with the offer, sale, or issuance of such security;
4. Within two years before the appointment, is or was a director, officer, or employee of the receivership estate, unless the court finds no actual conflict and that the appointment is in the best interest of the estate;
5. Has a material adverse interest to any class of creditors or equity holders;
6. Has or represents an interest adverse to the estate or stands in any relation to the subject of the action that would tend to interfere with the impartial discharge of duties as an officer of the court;
7. Within five years before the appointment of a receiver was employed or engaged by the receivership estate of a secured creditor of the estate in any professional capacity such as attorney, accountant, or appraiser, and the court finds an actual conflict of interest;
8. Is an “insider” as defined in MCL 566.31(g);

*\*The author gratefully acknowledges the assistance of Laura J. Eisele of Laura J. Eisele, PLC d/b/a LJE Law Firm.*

9. Represents or is employed by a creditor, and the court finds an actual conflict after objection by an interested party;
10. Has a relationship in the action that will interfere with the impartial discharge of the receiver's duties.

Note that MCR 2.622(B)(7) provides that a receiver may be appointed for a "specified limited purpose, if the court determines that such employment or appointment is in the best interest of the receivership estates and if such professional does not represent or hold an interest materially adverse to the receivership estate."

### Best Practices for Demonstrating Qualifications

There should be a section in the motion seeking appointment of the receiver specifically addressing qualifications. The movant should strongly consider support by an affidavit of the proposed receiver describing his or her experience and specifically stating that the proposed receiver can be bonded and is not disqualified for any of the reasons set forth in 2.622(B)(6).

The moving party should attach marketing materials of the proposed receiver. The materials should be tailored to the proposed assignment to make sure the proposed receiver's experience is demonstrably relevant to the assignment. The moving party should identify the experience of the proposed receiver in handling any problems unique to the receivership property.

A moving party should know the requirements of the relevant judge and call chambers in advance of the hearing and find out what the judge expects to happen at the hearing on the motion to appoint the receiver. Does he or she want the proposed receiver present? Will the judge want testimony on qualifications? It is good practice where and when possible to have the proposed receiver present at the hearing on the motion to appoint the receiver. Make sure the receiver has kept his or her eye on fees and costs so that the receiver and counsel know whether the receiver is in line with local charges for receivers in similar cases.

It is my belief that the order appointing receiver should contain language specifically finding that the proposed receiver is qualified and does not have any of the conflicts identified in MCR 2.622(B)(6), even though MCR 2.622(C) does not require its inclusion.

### Disqualification

What will disqualify a prospective receiver? A receiver is "a fiduciary for the benefit of all persons appearing in the action or proceeding."<sup>3</sup> While MCR 2.622(B)(7) sets forth certain disqualifying factors, in general, a current or past relationship inconsistent with the receiver's role as a fiduciary for all persons appearing in the action may disqualify the receiver. However, compare this requirement to MCR 2.621(E), where a receiver may be appointed to protect the rights of a judgment creditor.

Some sections of MCR 2.622(B)(6) are absolute bars to appointment — others require a finding of lack of actual conflict to allow appointment. Consider disclosing any potential issues in the motion and on the record. The order appointing the receiver should address any finding necessary to disclose and resolve potential conflict issues even though not required under MCR 2.622(C).

Possible past relationships in real estate cases might create a problem. For example, the following relationships may preclude qualification: creditors of the borrower or those proposed receivers with a past work history with the borrower or lender, such as service as a property manager for the lender, borrower, appraiser, or another receiver.

### Conclusion

While the practical requirement that the appointed receiver be "qualified" has not changed, MCR 2.622 outlines factors to consider for qualification. The rule also outlines relationships and factors that disqualify a receiver for appointment. The best practices for motions to appoint a receiver addressing qualification issues include (i) providing the court with an affidavit of the receiver outlining qualifications and lack of conflicts, and (ii) including findings in the order that the receiver is qualified and is not conflicted.

### NOTES

1. The procedure for appointment of a receiver, as well as the practice and timeline, is discussed in more detail in other articles in this issue of the *Michigan Business Law Journal*.

2. MCR 2.622(B)(1), (B)(2).

3. MCR 2.622(A).

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What is new in MCR 2.622 is a specific requirement that the proposed receiver be qualified, regardless of who selects the receiver.



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# *Statutory and Court Rule Requirements for an Order Appointing a Receiver*

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By Kay Standridge Kress

The order appointing a receiver may be the most critical document in a receivership case. Among other things, it identifies the person or entity that will act as the receiver, describes the duties, authority, and power of the receiver, provides the amount of the bond to be posted by the receiver, identifies the real and personal property of the receivership estate, provides the standards for professional compensation, and sets forth the information to be included in reports that the receiver must file. A proposed order is usually attached to the motion requesting the appointment of the receiver. This article will discuss the statutory and court rule requirements of such an order.

Without a doubt, it is critical that the receiver order include a description of the duties, authority, and power of the receiver.<sup>1</sup> There are both mandatory provisions as well as optional provisions of a receiver order. The mandatory provisions include:

1. Providing to any person or entity having a recorded interest in all or any part of the receivership estate a notice of entry of the receivership order;<sup>2</sup>
2. The receiver's power to sue and collect all debts, demands, and rents of the receivership estate and to compromise or settle claims;<sup>3</sup>
3. The personal property that may be liquidated by the receiver without further order of the court;<sup>4</sup> and
4. The ability of the receiver to pay ordinary expenses of the receivership.<sup>5</sup>

The parties or the court may also insert any other provisions that are applicable, including, for example:

1. The amount of insurance required to be maintained by the receiver;
2. Details of entities or persons to be retained by the receiver (for example, employees, attorneys, accountants, brokers, or management companies);

3. The allowed expenditures of the receiver (the type and proposed amount), particularly those outside the course of business (for example, capital expenditures), without further order of the court;
4. The bank accounts to be maintained by the receiver;
5. The licenses and permits for the receiver to maintain or use, if applicable;
6. The ability of the receiver to borrow money and details concerning such borrowing and whether receivership certificates may be issued; and
7. Whether the receiver order will include an injunction against the collection of pre-receivership receivables or pre-receivership actions.

Next, the order will also identify all of the personal and real property over which the receiver has authority. This real and personal property is generally known as the receivership estate. If real property is involved, it is best to attach the legal description of such property to the proposed order. Similarly, it is best to provide as much detail as possible as to any personal property included in the receivership estate. The order must also detail the receivership property that must be surrendered to the receiver by third-parties.<sup>6</sup>

In all cases in which a receiver is appointed, the court shall provide for a bond,<sup>7</sup> and the court will consider the following factors in setting the amount of the bond for the receiver:<sup>8</sup>

1. The value of the receivership property, if known;
2. The amount of cash or cash equivalents expected to be received into the receivership estate;
3. The amount of assets in the receivership estate on deposit in an insured financial institutions or invested in U.S. Treasury obligations;
4. Whether the assets in the receivership estate can be sold without fur-



ther order of the court,

5. The extent to which any secured creditor is undersecured,
6. Whether the receivership estate is a single parcel of real estate involving few trade creditors, and
7. Whether the parties have agreed to a nominal amount.

An order appointing a receiver will also specify (a) the source and method of compensation of the receiver,<sup>9</sup> (b) that interim compensation may be paid to the receiver after notice to all parties to the action or proceeding,<sup>10</sup> and (c) that all compensation of the receiver is subject to a final review and approval by the court. The fees and expenses of persons or entities retained by the receiver will also be paid pursuant to the terms provided in the order.

Finally, the receiver is required to produce and file certain reports with the court. The order will provide the information to be addressed in the operative reports, including:

1. The receiver's acceptance of appointment;<sup>11</sup>
2. An inventory of the receivership estate property;<sup>12</sup>
3. An accounting of all receipts, disbursements and distributions of money that flows through the receivership estate;<sup>13</sup>
4. Information concerning the receivership estate and its administration.<sup>14</sup> For example, in the case of a rental property, the report should contain cash flow statements, profit and loss statements, rent ledgers and occupancy rates, a balance sheet and/or proformas or budgets; and
5. A final written report and a final account of the administration of the receivership estate.<sup>15</sup>

7. MCL 600.2926.
8. MCR 2.622(G).
9. MCR 2.622(F)(2)(3).
10. MCR 2.622(F)(5).
11. MCR 2.622(D)(l).
12. MCR 2.622(D)(3).
13. MCR 2.622 (D)(4).
14. MCR 2.622(D)(5).
15. MCR 2.622(D)(7).



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## NOTES

1. MCL 600.2926.
2. MCR 2.622(D)(2).
3. MCR 2.622(E)(1).
4. MCR 2.622(E)(2). Note that MCR 2.622(E)(2) provides that a receiver cannot sell real property of the receivership estate without a separate order of the court.
5. MCR 2.622(E)(3).
6. MCR 2.622(C).

# *If You Want Certainty, File for Bankruptcy – If You Want Flexibility, Ask for the Appointment of a Receiver*

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By David M. Findling<sup>1</sup>

## **Introduction**

Before adoption of MCR 2.622 in 2014, the court rule governing receiverships had not been updated for over 50 years and provided no chronological deadlines, and little guidance for the appointment of the receiver or the administration of a receivership.

In the vacuum of required deadlines and clearly defined responsibilities, knowledgeable attorneys and receivers adopted best practices for receiverships. In an effort to codify these best practices, the Receivership Committee (the “Committee”) was formed in 2012, “...because of a need identified by the Debtor/Creditor Rights Committee of the Business Law Section of the State Bar of Michigan to expand and update the rules regarding receivership proceedings.”<sup>2</sup>

## **Limitations of the Former MCR 2.622**

The common law<sup>3</sup> and Michigan statutes<sup>4</sup> have long recognized the circuit court’s broad authority to appoint receivers. While numerous Michigan statutes authorize the appointment of a receiver,<sup>5</sup> the former MCR 2.622 was the only court rule governing receiverships, and by its terms was limited to a receiver appointed pursuant to MCL 600.6104(4) to enforce a money judgment.<sup>6</sup> Moreover, MCR 2.622 did not address numerous issues relative to the appointment of a receiver and the governance of a receivership estate, including standards for selecting a receiver, the receiver’s responsibilities, the receiver’s compensation, notices to parties in interest, and procedures for distributions from the receivership estate.

## **Drafting Of MCR 2.622, As Adopted By The Michigan Supreme Court**

The Committee focused its efforts on:

1. Applicability of the amended rule to all types of receiverships;

2. Providing direction to bench and bar as to the operation of a receivership;
3. Consideration of issues related to qualifications, selection, and appointment;<sup>7</sup> and
4. Requirements for acceptance, reporting, and accounting by receivers.

A receivership is one of the most powerful judicial appointments and frequently the least understood. Before MCR 2.622 was revised, it was necessary to look to an amalgam of common law, the order appointing the receiver, and a two paragraph general appointment statute to discern the authority of the receiver.<sup>8</sup>

The legislature’s recognition of a circuit court judge’s equitable jurisdiction to appoint a receiver is codified in MCL 600.2926, which provides in part: “Circuit court judges in the exercise of their equitable powers, may appoint receivers in all cases pending where appointment is allowed by law.” The Michigan Court of Appeals has analyzed the phrase “allowed by law:”<sup>9</sup>

This statute [MCL 600.2926] does not independently grant a circuit court with the authority to appoint receivers but rather confirms that appointment of a receiver is a remedy available to the court in situations where “allowed by law.” Although there are several statutes which specifically allow appointment of a receiver, the phrase “allowed by law” is not limited to these statutes, since the Supreme Court has recognized that there are cases where the trial court may appoint a receiver in the absence of a statute pursuant to its inherent equitable authority. It thus becomes apparent that, as used in the statute, the phrase “allowed by law” refers to (1) those cases where appointment of a receiver is provided for by

statute and (2) those cases where the facts and circumstances render the appointment of a receiver an appropriate exercise of the circuit court's equitable jurisdiction. Accordingly, the fact that no specific statute calls for appointment of a receiver in the instant case did not deprive the trial court of the authority to make such an appointment.<sup>10</sup>

Therefore, the phrase allowed by law is not constrained by statutory authorization. Rather, it includes circumstances where it is "an appropriate exercise of the circuit court's equitable jurisdiction."<sup>11</sup>

### Who Chooses the Receiver

The choice of receiver is important to the court, counsel, and the litigants. As the former Chief Judge of the New York Court of Appeals once stated, "[P]ublic confidence in the courts is put at risk when judicial appointments are based on considerations other than merit. Simply put, the public must have faith that the courts operate free of favoritism and partiality."

As a court officer,<sup>12</sup> the receiver's charge is to administer the receivership estate and seek compliance with the court's orders. As a fiduciary, it is important that the receiver treat all of the parties fairly, without the appearance of impropriety. Efforts, in varying forms, have been made across the country to require receivers to be chosen based solely on their qualifications and ability to administer the receivership.

In 1973, Professor Frank Kennedy, Executive Director of the Commission on the Bankruptcy Laws of the United States (the "Commission"), submitted its Report of the Bankruptcy Commission to Congress (the "Report"). In its Report, the Commission discussed the problems which existed by allowing the bankruptcy referees to choose the [bankruptcy] receiver:

The Commission believed that there are defects in the system. In the first place, referees are engaged in incompatible duties since they both supervise administration of estates in the bankruptcy courts and perform the judicial functions of deciding disputes between litigants, including the trustee whom they appoint and supervise. The referee's involvement in administration compromises his judicial independence or at least the appearance of

such independence.<sup>13</sup>

Following the issuance of the Report, Congress enacted The Bankruptcy Reform Act of 1978<sup>14</sup> (the "Act") regulating bankruptcies, establishing the United States Bankruptcy Courts and implementing the United States Trustee Program. To preserve its independence, the office of the United States Trustee was placed under the direction of the Department of Justice and 11 USC 105(b) provided that bankruptcy courts "...may not appoint a receiver in a case under this title."

### Appointment of Receivers in Michigan<sup>16</sup>

Few areas of practice create more tension between the judge, the creditor's attorney, and the debtor's attorney than the nomination of a receiver. As an officer of the court,<sup>15</sup> judges expect receivers to be independent and not be the "bank's guy." Conversely, attorneys, especially those representing secured creditors, believe that they are in the best position to nominate a receiver capable of properly administering the creditor's collateral.

MCR 2.622(B)(1) and (2) now provide guidance for both the bench and attorneys as to how a receiver may be nominated and appointed by a court.

(B) Selection of Receiver. If the court determines there is good cause to appoint a receiver, the court shall select the receiver in accordance with this subrule. Every receiver selected by the court must have sufficient competence, qualifications, and experience to administer the receivership estate.

(1) Stipulated Receiver or No Objection Raised. The moving party may request, or the parties may stipulate to, the selection of a receiver. The moving party shall describe how the nominated receiver meets the requirement in subsection (B) that a receiver selected by the court have sufficient competence, qualifications, and experience to administer the receivership estate, considering the factors listed in subsection (B)(5). If the nonmoving party does not file an objection to the moving party's nominated receiver within 14 days after the petition or motion is served, or if the parties stipulate to the selection of a receiver, the court shall appoint the receiver nominated by the party or parties, unless the court finds

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A receivership is one of the most powerful judicial appointments and frequently the least understood.

that a different receiver should be appointed.

(2) Receiver Appointed Sua Sponte. If the court appoints a receiver on its own initiative, any party may file objection to the selected receiver and submit an alternative nominee for appointment as receiver within 14 days after the order appointing the receiver is served. The objecting party shall describe how the alternative nominee meets the requirement in subsection (B) that a receiver selected by the court have sufficient competence, qualifications, and experience to administer the receivership estate, considering the factors listed in subsection (B)(5).

A compromise was reached in the adoption of MCR 2.622(B). Although the rule mandates the appointment of the nominated receiver, if no objections are filed, "...the court shall appoint the receiver nominated by the party or parties...;" it granted discretion to the judge should he find "... that a different receiver should be appointed." The question then remains: which clause should be given deference in the judge's decision?

Court rules are interpreted using the same principles that govern statutory interpretation. The Court gives the language of court rules their "plain and ordinary meaning." "If the language poses no ambiguity, this Court need not look outside the rule or construe it, but need only enforce the rule as written." "Shall" indicates a mandatory provision.<sup>17</sup>

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Because the Legislature is presumed to understand the meaning of the language it enacts into law, statutory analysis must begin with the wording of the statute itself. Each word of a statute is presumed to be used for a purpose, and, as far as possible, effect must be given to every clause and sentence. The Court may not assume that the Legislature inadvertently made use of one word or phrase instead of another. Where the language of the statute is clear and unambiguous, the Court must follow it.<sup>18</sup>

Some have analyzed the choice of receiver and the discretion provided by MCR 2.622(B) as a teeter-totter. In this teeter-totter analysis, the mandate of "shall" contained in MCR 2.622(B), is given equal weight to the discre-

tion of the judge to choose otherwise. However, this is inappropriate given the Supreme Court's direction of "shall" and the unambiguous intent of subsection (B). The more accurate interpretation is that the judge should defer to the choice of the moving party, so long as the chosen receiver is qualified.

This interpretation of MCR 2.622(B) regarding the selection of the receiver is supported by the language of (B)(5):

(5) If a party objects under subsection (B)(2) or the court makes an initial determination that a different receiver should be appointed than the receiver nominated by a party under subsection (B)(1), the court shall state its rationale for selecting a particular receiver after considering the ...factors [listed in MCR 2.622(B)(5)(a)-(f)]...

(B)(5) contemplates a circumstance where the judge appoints a different receiver based upon the objection of the non-nominating party, or the court "sua sponte" appoints someone other than the one nominated by the petitioner. In that circumstance, the court is required to justify the appointment based on the list of factors set forth in (B)(5)(a)-(f). This language would be unnecessary (and is arguably rendered nugatory) if the judge is able to simply appoint someone other than the nominated receiver. The Supreme Court's use of "shall" and subsections (B)(1), (2), and (5) work together, to make it so that the presumption is in favor of the nominated receiver, and only is overcome by use of the factors listed in (B)(5).

MCR 2.622(B) unambiguously establishes the intent of the Committee<sup>19</sup> and the Michigan Supreme Court. The Committee expended a significant amount of effort in drafting the receiver selection process codified in MCR 2.622(B). The Supreme Court's admonition that the trial court "...shall appoint the receiver nominated by the party or parties..." should not be ignored or rendered nugatory. The trial court's exercise of its discretion should only be in those cases where the nominated receiver does not have "sufficient competence, qualifications, and experience to administer the receivership estate."<sup>20</sup>

Few areas of practice create more tension between the judge, the creditor's attorney, and the debtor's attorney than the nomination of a receiver.

# Receiver Selection and Appointment Process

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Petition Requests  
Appointment of Receiver

Court appoints Receiver  
sua sponte. (MCR 2.622(B))

## Requirements for appointment:

- Good cause shown MCR 2.622(B).
- Is the appointment provided by law? (MCR 2.622(A)-(B), MCL 600.2926, other statutory authority and common law)

## SELECTION OF RECEIVER

**By Petitioner**

**By Court  
sua sponte**

By Stipulation.  
(MCR 2.622(B)(1))

No objections.

No objections.  
filed within 14 days  
or the court reduces  
the time to object.  
(MCR 2.622(B)(1),  
MCR 2.622(B)(3))

Does the nominated receiver have  
sufficient competence, qualifications,  
and experience to administer the  
receivership estate, considering the  
factors listed in subsection (B)(5).  
(MCR 2.622(B)(1))

Is the proposed receiver unable to  
serve due to a  
conflict under MCR 2.622(B)(6)?

Entry of order appointing receiver  
which conforms  
with MCR 2.622(C).

## OBJECTIONS TO CHOICE OF RECEIVER

**By Court.** The court makes an initial  
determination that a different  
receiver should be appointed than  
the receiver nominated by a party  
under subsection (B)(1).

The court shall state its rationale for  
selecting a particular receiver after  
considering the factors in  
MCR 2.622(B)(5).

Does the nominated receiver have sufficient competence, qualifications, and  
experience to administer the receivership estate, considering the factors listed in  
subsection (B)(5). (MCR 2.622(B)(1))

Is the proposed receiver unable to serve due to a conflict under MCR 2.622(B)(6)?

Entry of order appointing receiver  
which conforms with MCR 2.622(C).

A party's objections to the court's  
selection of receiver must be filed  
within 14 days after the service of the  
order appointing receiver.  
(MCR 2.622(B)(2))

Objections must be served on all  
parties pursuant to MCR 2.107,  
together with a notice of hearing.  
(MCR 2.622(B)(4))

Hearing on objections.

**By Party.** Party objects under  
subsection (B)(2).

Objections must be served on all  
parties pursuant to  
MCR 2.107, together with a notice of  
hearing. (MCR 2.622(B)(4))

The objecting party shall describe  
how the alternative nominee meets  
the requirement in subsection (B)  
that a receiver selected by the court  
have sufficient competence,  
qualifications, and experience to  
administer the receivership estate,  
considering the factors listed in  
subsection (B)(5).  
(MCR 2.622(B)(2))

Hearing on objections.

Entry of order appointing receiver  
which conforms with MCR 2.622(C).

## NOTES

1. Thanks to Anne Boomer, Administrative Counsel to the Michigan Supreme Court. Three years ago, Anne offered to meet with me in my office regarding a new receivership court rule. Her comment, “The Court would be interested in a new rule,” is the reason that the revised MCR 2.622 exists today.

I want to congratulate and offer recognition for the hard work and commitment of my fellow Receivership Committee members.

Thank you to the hard working editor of this article, Seth A. Druker, Foster Swift Collins & Smith, P.C.

A final thank you to the justices of the Michigan Supreme Court. They supported changes that at times were controversial but were in the public’s interest.

2. Staff comment to MCR 2.622 (2014).  
3. *Petitpre v Taylor Sch Dist*, 104 Mich App 283, 294, n9, 304 NW2d 553 (1981).

4. MCL 600.601, 600.605, 600.611, and 600.2926.

5. Receivers can be appointed: under the motor vehicle service and repair act (MCL 257.1323), for a cemetery (MCL 456.529), over a savings bank (MCL 487.3601), to collect support (MCL 552.27(c)), to prevent waste (MCL 600.2972), under the Construction Lien Act (MCL 570.1122), for the voluntary dissolution of a corporation (MCL 600.3505), under the general equity statute (MCL 600.2926), or to assist in collection of a money judgment (MCL 600.3610(1), MCL 600.6104).

6. MCL 600.6104(4) states:

After judgment for money has been rendered in an action in any court of this state, the judge may, on motion in that action or in a subsequent proceeding:

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(4) Appoint a receiver of any property the judgment debtor has or may thereafter acquire;

7. Marks, Lawrence K., *Court-Appointed Fiduciaries: New York’s Efforts to Reform a Widely-Criticized Process*, 77 St. John’s L Review 29 (2003). “In light of the money-making potential of these appointments, they [receiverships] have long been the subject of close public scrutiny. This scrutiny, in turn, has led to widespread criticism that judges’ fiduciary appointments are influenced by inappropriate factors such as political favoritism and personal connections, particularly in cases involving substantial fees.” *Id* at 30.

8. MCL 600.2926.

9. *Petitpre v Taylor Sch Dist*, 104 Mich App 283, 304 NW2d 553 (1981)

10. *Petitpre* at 295 (internal citations omitted).

11. *Reed v Reed*, 265 Mich App 131, 161, 693 NW2d 793 (2005)

12. It has long been held that a court-appointed receiver is a ministerial officer of the court appointing him. In this capacity, he is charged with preserving the assets of the debtor for the benefit of both debtor and creditors and his jurisdiction over these assets is, in effect, that of the court itself. *Cohen v Bologna*, 52 Mich App 149, 151, 216 NW2d 586 (1973) (internal citations omitted).

13. Report of the Commission on the Bankruptcy Laws of the United States, July 1973, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. (1973) note 3, pt. I, at 85-98.

14. 11 USC 101 et seq.

15. 52 Mich App 149, 216 NW2d 586.

16. A flowchart describing the receiver selection process appears on page 35.

17. *Lamkin v Ingram*, 295 Mich App 701, 709, 815 NW2d 793 (2012)(internal citations omitted).

18. *Robinson v City of Detroit*, 462 Mich 439, 459, 613 NW2d 307 (2000)(internal citations omitted).

19. See staff comment to MCR 2.622.

20. MCR 2.622(B).



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# *MCR 2.621 and MCR 2.622 – The New Playing Field for State Court Receivership: The View From the Bench*

## **Panel Participants:**

Hon. Kirsten Frank Kelly, Michigan Court of Appeals  
Hon. Robert J. Colombo, Jr., Chief Judge, Wayne County Circuit Court  
Hon. John C. Foster, Chief Judge, Macomb County Circuit Court  
Hon. Christopher P. Yates, Kent County Circuit Court

## **Moderator:**

Judith Greenstone Miller, Partner  
Jaffe Raitt Heuer & Weiss, P.C.  
Southfield, Michigan

Miller: Good morning. It's Judy Miller and I am here to moderate the Panel which is "The View from the Bench." I would like to introduce to you the esteemed Judicial Panel that we have and I am so appreciative, as I know you are, that they've joined us this morning to give us some idea of how they think, practically, the new rule is going to operate and some of their perspectives about the rule. Seated to my far right is the Hon. Kirsten Frank Kelly. She is a Judge from the Michigan Court of Appeals and she was a member of the Receivership Rule Committee. Next to Judge Kelly is the Hon. John C. Foster, who is the Chief Judge for the Macomb County Circuit Court and he was also appointed to the Business Court for the Macomb County Circuit Court. Next to Judge Foster is the Hon. Christopher P. Yates, who is a Judge for the Kent County Circuit Court and he also serves on the Business Court Docket for that Court and, finally, directly to my right is the Hon. Robert J. Colombo, Jr. who is the Chief Judge for the Wayne County Circuit Court. I thank you all for being with us this morning.

**Judges, what are the practical differences for appointing a receiver under the new rule versus the old rule? Do you like the new rule - do you think it is going to help?**

Kelly: Well, yes.

(Laughter fills the room)

Foster: She wrote it.

Kelly: No, I think in the past the receivership rules were really kind of "loosey goosey," at least in State Court and so the concept was to develop a rule so it would be a list of, almost as a check off, so there is some uniformity, and it's the ability to create a record so that if it comes up on appeal we know what the trial courts are doing - what the lawyer is thinking about and having a four corners of an order of a receivership that is cogent, complete and concise, even though it is long, it is concise. I think the new rules are just outstanding, although there is some question as to interpretation already. Talk to my colleagues.

Yates: Right. I think that a lot of people mistakenly believe that we like to have lots of

discretion. That is not true, particularly in circumstances like this. You know what you are doing and whenever someone comes in and applies for the appointment of a receiver I always assume there is a very good reason for it and, as Judge Kelly says, now that we have this check list and we have matters we have to consider we understand what to defer to the nomination of a receiver. We understand what would lead to disqualification. That actually makes our lives a great deal easier so count me as one of the people who is happy to have less discretion and more guidance. I think the rule provides that.

Foster: My perspective is very similar to that. As long as I am not handcuffed, I am satisfied with having something that you can live by, you know what you need to do in each court. I am a big proponent in having these things, receivership rules, things of that nature, including discovery rules, be more along the lines of statewide because you, as practitioners, have to find from judge to judge to judge how does he or she want this done and it makes it more difficult for your practice, more expensive for your clients and more difficult for you to get the result that you need to get. So, the more we can bring these things together, especially now that we have a business court, the better it is going to be for you and for us.

Yates: I think it provides some balance that was necessary that we were missing under the old rule because I would think when someone came in and requested a receiver, is this person competent, is this person independent, what is the charge going to be. Then the lawyer would be thinking does the Judge have some other motivation, does the Judge want to appoint a friend. So this rule requires us to take into account certain factors and I think it provides balance with respect to the creditor and the court making that determination.

Miller: **Do you have any specific expectations of how you expect the moving party to demonstrate that the particular nominee is qualified? Are there specific forms you'd like to see used?**

Foster: I do not have any expectations except that they are going to present to us and we will have a chance to look at it and judge it against the rule. Again, I think you people do this day in and day out. We read them, we sign the orders but the more that your bar, the ADR Committees, and the Business Law Committees can agree on format and the way of presenting things to us, the easier it is for all of us including you. So I think you are going to start following into the rules. One of the questions further down the line is, should there be standardized orders. I strongly believe in some of that simply because as time goes on you can always adjust it.

Kelly: It is also easier from an appellate perspective if there is consistency and uniformity across the counties as well because, if there is a format that everyone is following, we are more likely to accept it and then determine whether there was reversible error within the four corners of that type of framework.

Yates: I'm glad to hear Judge Kelly make that point because I was fascinated when we, as business court judges, started talking about the proposed rules, that there are substantial differences and different sorts of difficulties from court to court. I've never had a problem with the receivers who were nominated to serve in any of the receivership proceedings in the Kent County Circuit Court and, with only one notable exception, I never had a problem with the performance of a receiver. I was surprised to hear that in some other counties though, it has been a matter of great dispute whether somebody should be permitted to serve and whether the judge, for example, would have somebody the judge would prefer would serve in that role. I think in every single case where I have been asked to appoint a receiver, even under the old regime, I always deferred to the nominated receiver and with great results every time. So I do think that, to the extent that we can provide uniformity,



that's all to the good and it's something that the business court is trying to achieve in any event.

Colombo: I would like to see an affidavit from the receiver that demonstrates what the receiver has done and with particular emphasis in the type of business that is the subject of the receivership. I would like to see a resume or a curriculum vitae. I would like to see some marketing materials. Those are the kinds of things that would help me in terms of making a determination as to whether I think this person is acceptable

Miller: **The rule provides that the Court shall appoint the individual nominated, assuming the person is qualified, but also provides that the Court can exercise its discretion to find that a different receiver should be appointed. The rule *per se* does not set forth a standard for making that determination. What standard do you believe the courts will, or should, exercise under those circumstances to justify appointing someone else?**

Kelly: Well, actually, I talked to some of my colleagues about this after the rule came out and the Court of Appeals' interpretation of the court rule is going to be *de novo*. But the ultimate decision to appoint a receiver is going to be viewed for abuse of discretion and what we have in the court rule is it says "appoints for a good cause shown." But, when the judge is exercising its discretion to appoint a different receiver, the court rule does not say "for good cause shown." So it is whether or not the whole rule is read that he or she is going to appoint a receiver. Is it for a good cause shown that the proposed nominee is not qualified and so for appellate review purposes the courts, if it determines not to accept the nomination of the parties and appoints an alternative, have to be extremely careful to go through the reasons like in B(5) that identify the reasons that they are appointing an alternative, why that person should be picked and why the other should not be picked. And that is where the record is going to be so important for the Court of Appeals as this litigation bubbles up.

Yates: The same way that the Court of Appeals has standards of review is their stock in trade, we, I think, all appreciate when we have substantial discretion and when we don't. My view of the language in B(1) is that, unless we have an extraordinary good reason to choose somebody else, we ought to defer and that deference, I think, is something you can expect from all of us. This was a point of substantial contention when all of us were talking about submitting our comments and I think we all recognize that, by the Supreme Court adopting this language, it is a pretty clear mandate that we are supposed to be quite deferential.

Colombo: Now, I don't agree with Judge Yates on that. I think that it is an abuse of discretion standard and I agree with Judge Kelly that you've got to go through and make the findings under the rule. But I think if you make the findings under the abuse of discretion standard, if there is more than one principled outcome, you have the choice between two then you have not abused your discretion and the Court of Appeals is going to have to affirm you. So I don't think we have to give deference. I think we can make a determination independently as long as we go through and make findings and the person we select can be supported by those findings that are consistent with the requirements in the court rule.

Kelly: Because I think you have to give deference, if you pick an alternative receiver, that has to overcome that deference so the cogent reasons are supported by record evidence would have to overcome the original nomination. So it is an abuse of discretion standard clearly, but when you are analyzing that framework there still has to be an abuse of discretion that overcomes that first hump. So I would agree that the court still has the discretion to appoint its own receiver, but I think it has to be more than just like a 50/50 explanation.

Foster: As Judge Yates was saying, when this first came out, business court judges were actually having a conference and we began working on it and a letter was drafted and sent to the Supreme Court relative to this issue indicating that we did not agree with that language necessarily. We wanted there to be more discretion available to us. You can see what we got.

(Laughter filled the room)

Miller: **Under what circumstances might you exercise your discretion *sua sponte* to appoint a receiver, and if you were going to exercise those powers how might you tee it up for the parties?**

Yates: I struggle a great deal with doing almost anything *sua sponte* because I always assume, particularly when people are represented by able counsel, that counsel has thought through these decisions and, if there is no request for an appointment of a receiver, there must be something going on beneath the surface that perhaps I can't perceive. I would always set it for some sort of hearing and give everybody an opportunity to be heard because, if there is one thing you learn as a trial judge, it's that if lawyers on both side don't want you to do something it is probably not a good idea to do that thing unless you really understand the lay of the land. So I certainly appreciate the fact that we can do it but I would be very sparingly about using that power.

Foster: The only time I would be considering it generally would be if some litigation had been going on and on for a while, some point you really need to step in and say, look at, this is what I'm going to do if you don't do something because you are wasting your client's money, the businesses are not benefitting by this, remember we also have to worry about the creditors, businesses, shareholders, corporations, as well, separately from that. And it's only after the litigation had been somewhat prolonged and clearly in a difficult state that I would consider it.

Miller: **Appointment of an emergency receiver in less than 14 days – are you comfortable with doing that? Are there special things that you are going to want to see under those circumstances? What if someone objects later on and wants to have someone else appointed?**

Foster: I can envision circumstances where I would certainly do so. There are a couple of cases that support it – *Tuller v Webster*<sup>1</sup> and *Weatheroane Windows v White Lake Construction*.<sup>2</sup> They, at least, say that you have the authority to do it and when it's really bad, you need to do it and get it done. I would certainly, if I had to do that, it would be done and you'd have a hearing as quickly as possible to determine how to go forward. But, as Judge Yates said, it's not the same as just appointing somebody to do something. You've got a receiver now and it's a big step in the process and we got a lot of things to do in that. So it would never be done very lightly.

Yates: Right. With each passing year, and I've been a judge now for only six years, but with each passing year I've become less and less inclined to do anything on an *ex parte* basis because what happens is the other side invariably comes in and says you've only heard half the story and all sorts of facts come out that I didn't know and what seemed like an easy decision is no longer an easy decision. And, as Judge Foster points out, it's one thing, for example, for us to sign off on a TRO. It's a limited duration under the court rule. And there's a process by which we can unwind things if the TRO is improvidently granted. It's quite another thing to put a receiver in place on an emergency basis because, once you've done that, you've really taken a big step down the road. At the very least, if I had to do it on

an emergency basis, I would certainly give everybody an opportunity to come in and be heard, even if it's only on 24/48 hours' notice because, once the receiver shows up, a great deal of what happens is already dictated and you can't just take that down so easily.

Miller: **One of the abuses that the rule was drafted to address was compensation and double-dipping by individuals serving as receivers and also separately being compensated as an attorney, an accountant or a broker for the party or creditor. Judges, do you want to address some of these issues?**

Kelly: Well, I think in terms of the compensation issue, if you want that upheld in the Court of Appeals, make sure that every single thing that you are asking for is supported. That includes detailed time records, whether or not the charges are consistent with that field of appraisals, consistent with a non-receiver situation, and that the objections are delineated specifically and that the trial court rules on each and every one because, if it's not raised and ruled on, we'll disregard it. There was one receivership case we had recently that the receiver had charged for things that were outside the receivership order. If you are going to file the objections, that would be one of the arguments. If you are asking for the fees, then make sure that every single charge is represented within four corners of that document. And that way, when the trial court makes its decisions and findings of fact on the record, we can uphold that.

Colombo: I think detailed billing is very important because it gives everybody who may be opposed to the receiver an opportunity to see exactly what the receiver did and make the objections and, it gives me a certain comfort level that, when I go on the record and ask if there are any objections, we can talk about any particular item that's billed. So I'm very much in favor of detailed billing for receivers.

Yates: Now in the context of requests for attorneys' fees, which we see on a regular basis, the Supreme Court has given us great guidance in *Smith v Khouri*.<sup>3</sup> We have the three step process we have to apply. So when I find myself enmeshed in some of these disputes over attorneys' fees, it's much easier to go through the analysis when I have the certain detail of billing records and I would say the same about compensation for receivers. Judge Colombo is exactly right. The more detail we have the easier it is to sign off on these.

Miller: **There are various disqualifiers for appointment of receiver. Are those waivable? Let's say that the person that was suggested to serve as receiver had been a creditor but had a minor claim and they wanted to waive their claim so that they could purge the disqualifier.**

Colombo: The court rule doesn't indicate one way or the other what the answer to that question is. It was suggested when we were talking about this right before we came out here if you take a look at the language it has a relationship to the action or proceeding that will interfere with the impression or discharge of the receiver's duties. It uses the word "has," not "had." I suppose that could be an argument for it being waivable, but I know myself, if someone wanted to waive that, I would be suspicious and want to know why they wanted to do that and would probably be reluctant to appoint anyone who had a claim and was willing to waive it as a receiver.

Kelly: Well I also think the subsection J says "relationship," and I think that would disqualify it. I would agree with Judge Colombo that it just raises so many red flags and, if its objected to, I think that's a reversible issue.

Yates: Whenever you see something like this, where a creditor is willing to take down

a claim in order to take on the role of receiver, you have to wonder whether it's about remuneration and the claim is so small relatively to what they think they can make as a receiver that they are willing to forego in order to make all the money as a receiver. That makes me nervous right out of the box.

Miller: **What concerns from an appellate perspective do you have with respect to the procedures implementing the rule and how are the provisions of the rule going to be analyzed by an appellate court? Judge Kelly?**

Kelly: Well, as I indicated before, the actual rule itself is going to be reviewed *de novo*, but the decisions are going to be reviewed for an abuse of discretion on the part of the trial court. The real key here is the trial courts are going to be making findings of fact on the elements of this particular rule. And as long as there's any evidence in the record that supports that particular finding of fact, we're going to hope that the court exercised an appropriate amount of discretion in a global sense. So what I would urge everybody to do here is just make sure that everything that's necessary, even to the *n*<sup>th</sup> degree, is on the record, whether that's an attachment, whether it's a CV, whether it's the qualifications of the receiver, or the detail necessary to support the appointment of a receivership in the very first place. And then, it's very common that lawyers will have in-chambers conferences about stuff and then just come out and put the ruling on the record, but what they discuss in chambers never makes it up to us, so we don't know it. So make sure that you summarize any in-chambers conferences because if the judge is relying on anything that was received in chambers, it's got to be on the record – otherwise, their findings of fact won't be supported. So I think the key in the beginning of the litigation in deciding what this rule says and what it means and how it's going to be applied, is going to depend on the clarity of the record that comes up to us. And then we'll make that decision and you know it's going to be litigated to the next level as well. So just protect the record. If you want something, you explain it inside, backwards, forward, everything. And then the trial court can rely on that, and we can rely on the trial court.

Miller: **Any particular concerns from a trial court's perspective of what kind of evidence and proof that you are going to want proffered? Are you going to want the proposed nominee to be in court the day of the hearing?**

Yates: I always appreciate having a witness or two and the proposed receiver in court. We have several attorneys in the Grand Rapids' area who are terrific about making an excellent record even when there appears to be no basis for an objection. I can't tell you how much easier that makes my life when I just have to listen to 20 minutes or a half hour of testimony and the receiver acknowledges the appointment; accepts it on the record because then we don't have to worry about the appellate issues. I think there's this natural inclination when nobody's objecting to simply let the record go and not fill it out, but there are problems that can surface later, as Judge Kelly points out. If you just do your homework at the front end, it just makes things so much easier at the back end. So from my perspective, if you can bring a witness or two and the receiver to court, that makes our lives awfully easy.

Miller: **Judge Yates, if there are no objections, are you going to have a problem with an offer of proof based upon what the witness would testify to or based on the qualifications set forth in the affidavit? Are you going to actually want live testimony?**

Yates: I'm happy to take an offer of proof, but there are some attorneys who really insist on putting on some live testimony. I can tell you, for appellate purposes, that it is invaluable because an offer of proof is sufficient, but if problems arise later you are so much better off if somebody has come in and explained the details on the

record under oath. And I agree with Judge Kelly's point too that, even if there is a meeting in chambers beforehand, you still have to go out and make your record because all of you may understand at the moment that you've reached an agreement, but there's no reason that the Court of Appeals would know that unless we put something on the record.

Kelly: You don't want your orders vacated and sent back down. It wouldn't be reversed; it would be vacated because it wasn't supported. That means you start all over from the beginning.

Foster: From your point of view then, what do you think of the affidavit?

Kelly: I don't have a problem with the affidavit. I think, however, you want to do it as long as there's no objection, you have affidavits that are signed and that's perfectly appropriate because they're supportable. Your findings of fact would be supported by the affidavits because there's no objection at that point. Just make it as clear as possible. If you anticipate a future problem, then maybe you should bring in live testimony.

Miller: **Judge Foster, I know that a number of the court websites have protocols and procedures on them. Do you think it would be helpful for the court to develop approved forms to implement some of the requirements under the new rule and/or is it better to see, from your perspective, how the rule operates first for some time period and then develop forms that work or should the bench and the bar be working together now to develop these forms?**

Foster: I always find that it's easier if something is on the table to work from, a document is there, somebody has put the job together and now we can work on that document. So I would be a proponent of having it done soon. And then as time goes on, they will evolve and develop and then you go to the judge and maybe this case needs things to change a little bit, but at least there is a standardization that makes life a little bit easier. Again, I go back, I've been pushing with all the business court judges the pre-filing discovery protocol that we have on our website. I really think it can make it easier for you to be able to call the other side before you file the case and say, look, he's going to require this anyway. Let's exchange this and see where it puts us right now. So if you have things that you know we are going to expect from you, it's got to be so much easier for you and so I do very much support the idea of having these standardized to some degree. Obviously, there are some judges, and we do have disagreements when we sit down and talk about this, live by those things. I don't live by them. I think again, you get old like me, things have changed a lot over the years, and you ought to be willing to sing and dance and maybe tap with things once in a while.

Colombo: I agree with Judge Foster. I think it makes a lot of sense and if we have to tweak them as we go on, we can do that. But I think forms are helpful.

David:\* **You mentioned a pre-court rule change receivership. Let's talk about the mandates of notice. Let's say a receivership didn't give the notice that the rule now requires. Would you expect the receiver now to go through each receivership and give the notice that was required?**

Yates: That's one of the difficult situations where essentially you've passed the point procedurally where it would have made sense to do it, and I'm not sure in that situation that it makes a great deal of sense to go back and give notice in every single case. I mean we have one receiver who is serving in dozens of cases that I have. For them to go through all their files and send out a notice to anybody who

\* "David" refers to David Findling, one of the presenters at the conference.

could possibly be affected would be an awful lot of work for not much return. But, if anybody came in and demanded that the order be amended to conform to that required notice, I would gladly sign off on an amended order because I would presume then in that case there's some reason to do it. And so I would be more than happy to amend the order to reflect that requirement.

David: **So when you talk about dates, so for example, the inventory, I'm just thinking of my checklist on dates, so you're saying that if the date has passed, you wouldn't expect that somebody would have to go back and prepare an inventory now for a receivership that is three years old.**

Kelly: Right.

Foster: Right. Again, unless somebody came in and asked that the order be amended to include it because once somebody raises the point, then it seems to me it is incumbent upon us to try to conform our order to the new language of the rule.

Miller: **Any of the other judges have any other response to that question before I go to the next question?**

Foster: I think that's correct. Why would you bother anyway at that point because if they don't have notice, they don't have notice. But if they're a party and have some interest in the case, they would have had notice anyway. So just do something to follow a rule that is new is a waste of time.

Kelly: I think going forward if you are going to request compensation from a pre-court ruled change receivership that is going to file for compensation, then follow the new rule.

Miller: **There's questions from the audience. Michael Lieb?\***

Mike: **Technical question about a situation where lender or creditor comes in with a prospective receiver and the court believes a different receiver should be appointed. Lender comes in with two witnesses; somebody from the lender and the proposed receiver. Court says I want so and so, but that person is not in the courtroom. How would you handle that situation where the creditor or any other interested party says, well I'd like to ask a few questions.**

Colombo: Well, I think the court receiver would have to be produced for the hearing, myself. So I'd have to adjourn.

Foster: Yeah, I think that's why you have the hearing. If somebody wants to ask questions, let them do so. If they're just wasting your time, though, you cut them off.

Yates: Because of the judicial deference [requirement], it seems to me what I would do is start the hearing, listen to what the proposed receiver's qualifications are, and then after hearing that I rethink my decision about whether I even want to go forward and consider appointing someone else because this rule, as far as I read it, requires us to be pretty deferential and so as long as the evidentiary hearing establishes sufficient evidence to support the appointment of the proposed receiver, I'd be inclined to do it, even if I'd rather have somebody else serving in the capacity of the receiver in that case. That's just the nature of deferring. The Court of Appeals deals with this much more often than we do with the trial courts, but often times you have to affirm a decision, for example, even though that wouldn't have been the one you made in the first instance because of the level of deference.

\*\* Michael Lieb was one of the presenters at the conference.

Foster: I wasn't thinking along the lines of somebody I wanted, I'm thinking along the lines of the creditor coming in and causing that, saying look at, I don't like this person, and next thing you know, you've got the hearing. But they have to have that chance to ask some questions, and if they want to propose somebody and say why it's better, absolutely, you are going to listen to it and have them at the hearing.

Miller: **Are there some circumstances where, despite the fact that someone facially is qualified to serve as the receiver, you nevertheless won't appoint them? Can you think of any circumstances where that would come about?**

Colombo: You know I talked to our judges about that and they said they've had some bad experiences with receivers.

Colombo: And consequently, they would not appoint that person so that would be one for sure.

Foster: I think you could have a circumstance where there's more than one creditor and another creditor comes in and say, look at, we need to have somebody that is a little more neutral on this and so there would be a reason to consider it, but there is a reason for the hearing and to let everybody have a chance to present their witnesses and testimony.

Miller: **So if anything, what you are saying, as sort of a practice point, is not only know that your receiver is qualified on paper but that from an experience basis they haven't really done anything to upset the "apple cart" in terms of actually fulfilling the responsibilities, because at the end of the day those are things that may come back to haunt the party who is moving for the appointment if the experience that you've had has been negative.**

Yates: Yes.

Foster: Yes.

Miller: **Other questions? Scott Wolfson?**

Scott: **In bankruptcy you have an unsecured creditor's committee. The first thing they do is look at the secured lender's filings, does it have a lien out of the box or see if they've done anything wrong. Do you believe that a receiver has the responsibility at that point to investigate the secured creditor's liens and see if there's any claims against it and particularly in the case where you may have it revealed that the unsecured [creditors]—they're out of the money. So effectively, the secured lender is plumbing the case.**

Foster: I don't have an answer for you. It would be interesting to see. Bring it to us and then we got to decide it.

Yates: I would say that under Rule 2.622(A) the receiver is appointed under the sections of fiduciary for the benefit of all persons appearing in the action or proceeding and so to the extent that they're acting at the behest or the benefit of unsecured creditors as against secured creditors, I think it's the receiver's obligation to think about whether they are fulfilling their obligation to all affected parties.

Miller: **Other questions? Yes.**

Speaker: **When the court considers the qualifications of a receiver and I know that there's sort of a catchall phrase here, so to speak, in those discussions in developing the**

**rule was the issue of prior or current federal taxes that the proposed receiver may have listed on the record been something that the court considered when they developed this rule, and if not, how would you consider that going forward?**

Kelly: Well I think I'm going to have to defer to David Findling on that one because I don't recall that discussion at all.

David: Are you speaking of the receiver itself?

Speaker: Yes.

David: Well then part of that was about the bonding issue. I can tell you personally when I obtained my bond, the bonding company had been out to my office, they've asked me about my accounting practices. A lot of lenders would say, well, we don't want that bond premium. Well, anybody from a probate experience would know that probate bonding agencies make sure that the person who is handling money is not going to default, cater to, or take some action that they're incapable of managing appropriately. So if they can't get bonded, they're not going to be able to serve as a receiver. So that's where a surety bond really becomes important, even if it's a small premium. My half million dollar bond only costs me \$1,500 a year. It's been the same premium for 12 years. So it's not a lot of money for a surety bond, but you've got a bonding agency actually vetting that receiver for you.

Miller: **Other questions? Yes, in the back.**

Speaker: **I have a question on the timing. The rule doesn't seem to have a required timing for the hearing to appoint of the receiver.**

Yates: Yes. Well in my view, the essence of due process is notice and an opportunity to be heard. And so I wouldn't worry quite so much about complying with a time line that is not expressly prescribed so long as people are given notice and an opportunity to be heard. Now I know it can be difficult when people are only given a few days' notice to come in, but we do that all the time, for example, when there's a TRO in place, we've got to move to an injunction so I don't see that as a problem. I think it's sufficient for purposes of constitutional requirements and, in the absence of a specific directive to hold it at a certain point, I think if we can play that by ear and if there is a pressing need for the appointment of a receiver, so long as I'm satisfied that you've notified the people who would be affected by the appointment, I would be willing to go forward.

Miller: **Judy Calton?\*\*\***

Judy: **Some of the orders appointing a receiver are like a book. The lender is putting all kinds of things I find kind of questionable on this. My peeve is the receiver is given all the rights of an assignee for the benefit of creditors, but he's not an assignee and doesn't have any of the assignee's responsibilities. Once that's been signed by a court, what does a dissenting party do? What about moving to have those kinds of provisions removed?**

Foster: It's not offensive to me because I've been frank about this since I've got into the business court. I don't have that strong of a business background. You are the folks that are educating me. That's fine. I'm having the best time I've ever had on the bench the last couple of years, frankly, and you folks are making it that way. I'm learning new things, an old guy. But you've raised those issues. They're something I get to consider and think about, and I'm very happy to do that because it shows you're doing your job, and then it makes me do mine.

\*\*\* Judy Calton was one of the presenters at the conference.



- Miller: **Okay. Any final comments or suggestions for operating under the new rule?**
- Kelly: Well, I know I kind of sound like a broken record on this but this court rule is going to be litigated, particularly in some counties, so just make your record is as thorough as possible so that we can apply the rule to the findings of fact and affirm the trial court's decision as an exercise of discretion.
- Foster: I think that's very important. Those of you that know me know I kind of hurry a lot. Make me make that record with you and that's fine. I don't get too upset about that. I'm happy to do it for you, but you really need to make sure I follow the rule as well as anybody else involved.
- Yates: We all recognize the language of the rule gives you more power in who gets selected to be the receiver. The one thing that I would suggest though is that, if you are getting resistance from the court, understand that we still want you to make your record because, as Judge Colombo pointed out, we still have discretion. And some of us feel very strongly about it. Others less so, but in any event I think for judges who are used to operating under a system where we had almost complete discretion up until this court rule change, some old habits die hard. So the better you make the record for the appointment of your chosen receiver, the easier you are going to make life for all of us.
- Colombo: And I would say pick independent people who have knowledge of the particular business that they are going to be the receiver of and charge reasonable rates. Give the judges a comfort level that the people that you are picking are independent, knowledgeable, and inexpensive.
- Foster: Going along with that, now that you've got the rule you want, don't abuse it.
- Miller: **I'd like to thank all the judges for joining us here this morning and making time in their schedules. Having their insight and perspective, needless to say, is invaluable and I know that we'll look forward to continuing to see as the rule develops, the development of forms and protocols that will help each of us to better comply with the rule in force. We really appreciate that you all joined us this morning. If you are interested, there are order forms at the registration desk, and the form will also be posted to the Business Law Section website as well. I want to thank each of the participants who helped to put this program together and who participated. I want to thank the Receivership Committee for all the work that they've done over the last couple of years and they're all noted in the program materials, in getting us to this point where we now have a new rule that seems to provide more information as to how to really get a receiver appointed and how to comply. It fills in a lot of the nits that weren't there before.**

## NOTES

1. 243 Mich 239, 219 NW2d 939 (1928).
2. 192 Mich App 316, 480 NW2d 337 (1991).
3. 481 Mich 519, 751 NW2d 472 (2008).



*Judith Greenstone Miller is a partner at Jaffe Raitt Heuer & Weiss, P.C. and a member of its Insolvency and Reorganization Practice Group. Judy focuses her practice bankruptcy and insolvency, creditors' rights and commercial litigation. She is also the Co-Chair of the Debtor/Creditors' Rights Committee of the Business Law Section of the State Bar of Michigan.*

# Receivership Forms

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By Judy B. Calton\*

One outcome of the seminar and judges' panel on receiverships was the formation of a Receivership Forms Committee to draft proposed official forms on receiverships to submit to the Michigan Supreme Court's Administrative Office ("SCAO") for consideration and potential adoption. That Committee consists of Honorable Annette Berry, Wayne County Circuit Court; Judy B. Calton, Honigman Miller Schwartz and Cohn LLP; Honorable Robert J. Colombo, Jr., Chief Judge, Wayne County Circuit Court; Gregory J. DeMars, Honigman Miller Schwartz and Cohn LLP; Robert J. Diehl, Jr., Bodman PLC; David M. Findling, Findling Law Firm PLC; Honorable John C. Foster, Chief Judge, Macomb County Circuit Court; Honorable Kirsten Frank Kelly, Judge, Michigan Court of Appeals; Kay Standridge Kress, Pepper Hamilton LLP; Michael S. Leib; Judith Greenstone Miller, Jaffe Raitt Heuer & Weiss, P.C.; and the Honorable Christopher P. Yates, Judge, Kent County Circuit Court.

The Committee prepared the following forms, which are included below:

1. Checklist For Motion For Order Appointing Receiver Under MCR 2.622;
2. Checklist For Order Appointing Receiver;
3. Receiver's Statement of Disinterestedness Pursuant to MCR 2.622(B)(6);
4. Acceptance of Appointment As Receiver Under MCR 2.622(D)(1);
5. Notice of Receivership Under MCR 2.622(D)(2);
6. Accounting of Receiver Pursuant to MCR 2.622(D)(4);
7. Notice of Request For Fees And Expenses By Receiver Under MCR 2.622(F)(4);
8. Final Report and Account Pursuant to MCR 2.622 (D)(7); and
9. Order Regarding (I) Discharge of Receiver, (II) Administration of the Receivership Estate, And/Or (III) Termination of the Receivership.

The checklists are designed to be helpful to the bar in preparing motions for appointment of a receiver and orders appointing a

receiver and are not necessarily to be filed with the court.

These proposed forms are being submitted to SCAO's General Civil and Miscellaneous Work Group Forms Committee, which meets in March 2015. The forms should be posted to SCAO's website for public comment. And if approved, the forms will be available on SCAO's website for download.

These forms may not be adopted by SCAO or may be adopted in revised forms. Nevertheless, pending adoption of official forms, the Receivership Forms Committee believes these will be helpful to the bar and receivers in preparing and filing receivership pleadings, and in the administration of receivership estates.



*Judy B. Calton is a partner at Honigman Miller Schwartz and Cohn LLP in Detroit, Michigan. She counsels clients in commercial law, corporate reorganization, and transactions. Ms. Calton has particular experience in insolvency related litigation.*

*\*The author gratefully acknowledges the assistance of Seth Drucker, Foster Swift Collins & Smith PC.*

<b>STATE OF MICHIGAN JUDICIAL COUNTY</b>	<b>CHECKLIST FOR MOTION FOR ORDER APPOINTING RECEIVER UNDER MCR 2.622</b>	<b>CASE NO.</b>
--------------------------------------------------	-------------------------------------------------------------------------------	-----------------

**Court address** **Court telephone no.**

Plaintiff's name, address, and telephone no.

v

Defendant's name, address and telephone no.

Plaintiff's attorney, bar no., address, and telephone no.

Defendant's attorney, bar no., address, and telephone no.

1

**CHECKLIST**

- Specific request for appointment of receiver.
- Identification of interested parties.
- Identification of property that constitutes receivership estate.
- Listing of property to be surrendered to receiver.
- Factual basis supporting request for appointment of receiver.
- Legal basis supporting request for appointment of receiver.
- Description of competence, qualifications and experience of nominated receiver.
- Description of duties, authority and powers of receiver.
- Identification of potential conflict issues under MCR 2.622(B)(6).
- Compensation to be paid to receiver, interim compensation procedures and source of payment.
- Amount of bond requested.
- Attach proposed order to motion for appointment of receiver.
- Reporting requirements of receiver.
- Proposed disbursements by receiver.

---

<sup>1</sup> This checklist is not intended to be filed with the Court. The items listed above are intended to assist the parties, assist the Court and develop uniformity of requests for appointment of receivers.

<b>STATE OF MICHIGAN</b> JUDICIAL DISTRICT JUDICIAL CIRCUIT COUNTY PROBATE	<b>CHECKLIST FOR ORDER          APPOINTING RECEIVER</b>	<b>CASE NO.</b>
-------------------------------------------------------------------------------------	-------------------------------------------------------------	-----------------

Court Address \_\_\_\_\_

Telephone Number \_\_\_\_\_

Plaintiff(s)		Defendant(s)

Probate      In the matter of \_\_\_\_\_

Although this checklist is not required by MCR 2.622, it may be filed to assist the Court in reviewing the proposed order. Please consult the Court's procedures to determine whether it requires this checklist to accompany a proposed order.

A copy of the proposed order is attached to this checklist. The movant has identified below, by page and paragraph number, the location in the proposed order of the following mandatory and optional provisions, if applicable.

A. MANDATORY PROVISIONS <sup>1</sup> MCR 2.622(C)	Location in Proposed Order
(1) Bonding amount (MCR 2.622(G))	Page ____, ¶ __
(2) Identification of receivership estate	Page ____, ¶ __
(3) Receiver's compensation	
(a) Source of compensation	Page ____, ¶ __
(b) Method and timing of payment	Page ____, ¶ __
(4) Description of the duties, authority and powers of receiver	Page ____, ¶ __
(5) Property to be surrendered to receiver	Page ____, ¶ __

**[FOR OPTIONAL PROVISIONS PLEASE SEE BACK SIDE OF FORM]**

---

<sup>1</sup> If a mandatory provision is not included in the proposed order, please attach an explanation.

There are several additional, optional, provisions that practitioners may add to a proposed order appointing receiver. The following list of provisions is not exclusive but illustrative, only:

<b>B. OPTIONAL PROVISIONS</b>	<b>If Contained in the Proposed Order</b>
(1) Appointment of receiver	
(a) Qualifications of receiver	Page ____, ¶ __
(b) Any findings necessary to disclose and resolve any potential conflict issues	Page ____, ¶ __
(2) Interim compensation provisions	Page ____, ¶ __
(3) Specific reports and frequency of such reports ( <i>e.g.</i> , cash flow statements, balance sheets, rent ledgers and occupancy rates)	Page ____, ¶ __
(4) Insurance requirements	Page ____, ¶ __
(5) Persons authorized to be retained by receiver ( <i>e.g.</i> , employees, brokers, management companies, attorneys)	Page ____, ¶ __
(6) Budgets or limitations on expenditures	Page ____, ¶ __
(7) Bank account information for receiver	Page ____, ¶ __
(8) Tax reporting and FEIN to be used by receiver	Page ____, ¶ __
(9) Licenses or permits to be obtained by receiver	Page ____, ¶ __
(10) Receiver's authority to borrow money	Page ____, ¶ __
(11) Injunction as to actions against property of receivership estate	Page ____, ¶ __
(12) Limitation of liability of receiver	Page ____, ¶ __
(13) Other pertinent provisions – please detail	

\_\_\_\_\_  
Date

\_\_\_\_\_  
Printed Name

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Title

<b>STATE OF MICHIGAN</b> JUDICIAL DISTRICT JUDICIAL CIRCUIT COUNTY PROBATE	<b>RECEIVER'S STATEMENT OF          DISINTERESTEDNESS PURSUANT TO          MCR 2.622(B)(6)</b>	<b>CASE NO.</b>
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Court Address

Telephone Number

Plaintiff(s)		Defendant(s)
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Probate In the matter of \_\_\_\_\_

Receiver's name, address and telephone number, State Bar No.(if applicable) and e-mail address:

The following statements are true to the best of my knowledge, information and belief (if any statement is untrue, check the box and specify why it is untrue, attaching additional pages as necessary):

1. I have conducted an investigation of whether there is a basis for my disqualification under MCR 2.622(b)(6) prior to submitting this Statement.

2. Except as described below, I am not a creditor or a holder of an equity security of the Receivership Estate.

None

Describe: \_\_\_\_\_

3. Except as described below, I have no connections with the Plaintiff(s), principals of the Plaintiff(s), insiders of the Plaintiff(s) or any other party or parties in interest in the captioned case.

None

Describe: \_\_\_\_\_

4. Except as described below, I have no connections with the Defendant(s), principals of the Defendant(s), insiders of the Defendant(s) or any other party or parties in interest in the captioned case.

None

Describe: \_\_\_\_\_

5. Except as described below, I have no connections with the Plaintiff's/(s)' attorneys, the Plaintiff's/(s)' professionals<sup>1</sup> or the Defendant's/(s)' professionals (i.e. accountants, attorneys, appraisers, financial advisers, brokers).

None

Describe: \_\_\_\_\_

6. Except as described below, I am not and have not been an investment banker for any outstanding security of the Receivership Estate.

None

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<sup>1</sup> Professionals include, but is not limited to: accountants, attorneys, appraisers, financial advisers, and real estate agents/brokers.

Describe: \_\_\_\_\_

7. Except as described below, I am not and have not, within the last three years, been an investment banker for a security of the receivership estate, or an attorney for such an investment banker, in connection with the offer, sale, or issuance of a security of the receivership estate.

None

Describe: \_\_\_\_\_

8. Except as described below, I am not and have not, within the last two years, been a director, an officer, or an employee of the receivership estate or of an investment banker that either (a) served as an investment banker in connection with any outstanding security of the receivership estate or (b) was engaged by the receivership estate for a security of the receivership estate within the last three years.

None

Describe: \_\_\_\_\_

9. Except as described below, I do not hold an interest adverse to the interest of any class of creditors or equity security holders by reason of any direct or indirect relationship to, connection with, or interest in the receivership estate or an investment banker that either (a) served as an investment banker in connection with any outstanding security of the receivership estate or (b) was engaged by the receivership estate for a security of the receivership estate within the last three years, or for any other reason.

None

Describe: \_\_\_\_\_

10. Except as described below, I do not hold or represent an interest adverse to the receivership estate or stand in any relation to the subject of the action or proceeding that would tend to interfere with the impartial discharge of my duties as an officer of the court.

None

Describe: \_\_\_\_\_

11. Except as described below, I do not and have not at any time within the last five years, represented or been employed by the receivership estate, any secured creditor of the receivership estate as an attorney, accountant, appraiser, or in any other professional capacity.

None

Describe: \_\_\_\_\_

12. Except as described below, I am not an "insider" as defined by MCL 566.31(g).

None

Describe: \_\_\_\_\_

13. Except as described below, I do not represent and I am not employed by a creditor of the receivership estate.

None

Describe: \_\_\_\_\_

14. Except as described below, I do not have a relationship to the above captioned action or proceeding that will



interfere with the impartial discharge of my duties as receiver.

- None
- Describe: \_\_\_\_\_

Name, address and telephone number of the person signing this Statement on behalf of the Receiver and the relationship of such person to the Receiver (specify):

Total number of attached pages of supporting documentation: \_\_\_\_\_

After conducting or supervising the investigation described in paragraph 1 above, I declare under penalty of perjury, that the foregoing is true and correct except that I declare that Paragraphs 1 through 13 are stated on information and belief.

I declare under penalty of perjury that the foregoing is true and correct.

\_\_\_\_\_  
DATE

\_\_\_\_\_  
Printed Name

\_\_\_\_\_  
Signature<sup>2</sup>

\_\_\_\_\_  
<sup>2</sup> If the receiver is an entity, the signature must be by an authored agent.

<b>STATE OF MICHIGAN</b> JUDICIAL DISTRICT JUDICIAL CIRCUIT COUNTY PROBATE	<b>ACCEPTANCE OF          APPOINTMENT AS RECEIVER          UNDER MCR 2.622(D)(1)</b>	<b>CASE NO.</b>
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Court Address

Telephone Number

Plaintiff(s)		Defendant(s)
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Probate In the matter of \_\_\_\_\_

Receiver's name, address and telephone number, State Bar No.(if applicable) and e-mail address:

1. I have been appointed receiver of the entity/person/property which is the subject of the receivership.
2. I accept the appointment, submit to personal jurisdiction of the Court, and agree to file reports and to perform the duties required by MCR 2.622 and the orders of this Court.

Dated : \_\_\_\_\_

\_\_\_\_\_  
 Signature<sup>1</sup>

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<sup>1</sup> If the receiver is an entity, the signature must be by an authorized agent.

<b>STATE OF MICHIGAN</b> JUDICIAL DISTRICT JUDICIAL CIRCUIT COUNTY PROBATE	<b>NOTICE OF RECEIVERSHIP          UNDER MCR 2.622(D)(2)</b>	<b>CASE NO.</b>
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Court Address \_\_\_\_\_

Telephone Number \_\_\_\_\_

Plaintiff(s)		Defendant(s)
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Probate In the matter of \_\_\_\_\_

Receiver's name, address and telephone number, State Bar No.(if applicable) and e-mail address:

**NOTICE TO THOSE HAVING A RECORDED INTERESTED IN PROPERTY HELD BY THE RECEIVERSHIP ESTATE:**

- Under MCR 2.622(D)(2), unless otherwise ordered, within 28 days after the filing of the acceptance of appointment, the receiver shall provide notice of entry of the order of appointment to any person or entity having a recorded interest in all or any part of the receivership estate. Such notice is hereby provided.
- \_\_\_\_\_ has been appointed receiver and filed an acceptance of appointment on \_\_\_\_\_.

Description of property	Recorded Interest Holder

Dated : \_\_\_\_\_

Signature<sup>1</sup> \_\_\_\_\_

---

<sup>1</sup> If the receiver is an entity, the signature must be by an authorized agent.

<b>STATE OF MICHIGAN</b> JUDICIAL DISTRICT JUDICIAL CIRCUIT COUNTY PROBATE	<b>ACCOUNTING OF RECEIVER          PURSUANT TO MCR 2.622(D)(4)</b>	<b>CASE NO.</b>
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Court Address \_\_\_\_\_ Telephone Number \_\_\_\_\_

Plaintiff(s)		Defendant(s)
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Probate In the matter of \_\_\_\_\_

Receiver's name, address and telephone number, State Bar No.(if applicable) and e-mail address:

The following statements are true to the best of my knowledge, information and belief:

1. I, \_\_\_\_\_, am the Receiver or the duly authorized representative of the Receiver and submit the following as my accounting, which covers the period from \_\_\_\_\_ to \_\_\_\_\_.

This accounting complies with the order of appointment and contains a correct and itemized statement of all income and disbursements of the receivership estate. If additional sheets are required for Schedules A or B, place all itemization on those sheets and include only category totals on these schedules.

**2. SUMMARY**

Balance on hand from last account (or value of Inventory <sup>1</sup> if first account).....	\$ _____
Add income in this accounting period (total from Schedule A) .....	\$ _____
<b>Total assets accounted for .....</b>	<b>\$ _____</b>
 Subtract disbursements in this accounting period (total from Schedule B).....	 \$ _____
<b>Total balance of assets remaining (itemize and describe in Schedule D).....</b>	<b>\$ _____</b>

SCHEDULE A: Income in this accounting period		SCHEDULE B: Expenses and other disbursements, including distributions to a party or parties and creditors	
Source of Income	Amount	Disbursement	Amount
<b>Total Income</b>		<b>Total Expenses and Disbursements</b>	

<sup>1</sup>The Inventory is the filing required by MCR 2.622(d)(3)

SCHEDULE C: Itemized assets remaining at end of accounting period  
 If additional sheets are required, indicate on Schedule "See attached sheets".

Asset	Value
BALANCE OF ASSETS REMAINING	

**I declare under the penalties of perjury that this accounting has been examined by me and that its contents are true to the best of my information, knowledge, and belief.**

Name, address and telephone number of the person signing this Inventory on behalf of the Receiver and the relationship of such person to the Receiver (specify):

Total number of attached pages of supporting documentation: \_\_\_\_\_

\_\_\_\_\_ Date

\_\_\_\_\_ Printed Name

\_\_\_\_\_ Signature<sup>2</sup>

<sup>2</sup>If the Receiver is an entity, the signature must be by an authorized agent.



STATE OF MICHIGAN

JUDICIAL DISTRICT  
JUDICIAL CIRCUIT  
COUNTY PROBATE

FINAL REPORT AND ACCOUNT

PURSUANT TO MCR  
2.622(D)(7)

CASE NO.

Court Address

Telephone Number

Plaintiff(s)		Defendant(s)
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Probate In the matter of \_\_\_\_\_

Receiver's name, address and telephone number, State Bar No.(if applicable) and e-mail address:

The following statements are true to the best of my knowledge, information and belief:

1. I have been appointed receiver of the receivership estate.
2. As receiver, I agreed to submit to the personal jurisdiction of the court, file reports and to perform all of my duties as receiver including those required by MCR 2.622.
3. Pursuant to MCR 2.622(D)(7), the Receiver submits that a Final Report and Account has been properly filed with the Court. A copy is attached. The Final Report and Account includes an accounting of the income and expenses of the receivership estate. ( NOTE: If there is a surplus in the receivership estate after distributions have been made to secured creditors and for expenses of the receivership estate including without limitation fees and expenses of the receiver and the receiver's attorneys, accountants, appraisers, brokers and other professionals, the Final Report and Account should contain a proposed distribution schedule of any remaining assets.)
4. All interested parties have been properly served a copy of the Final Report and Account as required by MCR 2.622(D)(7).

Total number of attached pages of supporting documentation: \_\_\_\_\_

I declare under penalty of perjury that the foregoing is true and correct.

Dated: \_\_\_\_\_ Printed Name \_\_\_\_\_ Signature<sup>1</sup> \_\_\_\_\_

<sup>1</sup> If the receiver is an entity, the signature should be by an authorized agent.

STATE OF MICHIGAN JUDICIAL DISTRICT JUDICIAL CIRCUIT COUNTY PROBATE	<b>ORDER REGARDING: (I) DISCHARGE OF RECEIVER, (II) ADMINISTRATION OF THE RECEIVERSHIP ESTATE, AND/OR (III) TERMINATION OF THE RECEIVERSHIP</b>	<b>CASE NO.</b>
------------------------------------------------------------------------------	---------------------------------------------------------------------------------------------------------------------------------------------------------------------	-----------------

Court Address

Telephone Number

Plaintiff(s)		Defendant(s)
--------------	--	--------------

Probate      In the matter of \_\_\_\_\_

Receiver's name, address, and telephone number, State Bar No. (if applicable) and e-mail address:

**ORDER REGARDING (I) DISCHARGE OF RECEIVER,  
(II) ADMINISTRATION OF THE RECEIVERSHIP ESTATE,  
AND/OR (III) TERMINATION OF THE RECEIVERSHIP**

Date of hearing: \_\_\_\_\_

Judge: \_\_\_\_\_

1. The receiver has fully performed the duties required by law and the order of appointment.
2. Except as expressly provided below, upon entry of this Order, the receiver shall have no further duties or responsibilities in connection with the administration of the receivership estate (as defined by MCR 2.622(A)) (the "Receivership Estate") or this receivership (the "Receivership").
3. The receiver and his employees, agents, and attorneys (collectively, the "Receiver") shall not be liable for any claim, obligation, liability, action, cause of action, cost, or expense arising out of or relating to the Receivership.
4. The Receiver shall have no liability and they shall have no claim asserted against them relating to the Receiver's administration of the Receivership Estate.
5. A claim may only be asserted against the Receiver relating to actions which were outside of the Receiver's official capacity and authority, including fraud, intentional tortious acts, breaches of fiduciary duty, gross negligence, gross or willful misconduct, acts committed in bad faith, malicious acts, and/or the failure to comply with this Court's orders.
6. The parties, their agents, claimants, creditors, and all other persons with notice of the Receivership or this Order Discharging Receiver are restrained and enjoined from asserting any claim or initiating any cause of action against the Receiver, without first seeking leave of this Court, in the above captioned cause of action.



7. Should leave be sought to assert a claim against the Receiver, it shall be by motion, with notice to the Receiver and all interested parties, in the above captioned cause of action. This paragraph does not stay the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power.

8. This Court retains exclusive jurisdiction to resolve all disputes related to this Order, the administration of the Receivership Estate and any person seeking to assert a claim against the Receiver.

9.  The Receiver's Final Report is accepted and allowed.

10.  This matter/Receivership Estate is not closed:

a.  The Receiver shall file his final accounting within \_\_\_\_\_ days of the entry of this Order.

b.  The Receiver shall file his final application for compensation within \_\_\_\_\_ days of the entry of this Order.

c.  Other requirements: \_\_\_\_\_ .

11.  The matter/Receivership Estate is closed. The Receivership is terminated and the Receiver is discharged from any duty or further responsibility to any interested party or creditor, in connection with the Receivership or the Receivership Estate. The Receiver's bond is cancelled.

# *Synthetic Equity in S Corporations: Avoiding Tax Traps When Planning for Key Employees*

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By P. Haans Mulder

## **Introduction**

The U.S. and Michigan economies are growing and businesses continue to hire new employees.<sup>1</sup> This has accelerated the search for talent as well as ways to incentivize and retain those top performers. Parallel to this emerging trend, a number of business owners in the baby boomer generation are looking to transition the ownership of their companies, and keeping key employees is an important part of this process.<sup>2</sup> This article discusses how synthetic equity can be used for attracting, incentivizing, and retaining key employees in S corporations and avoiding potential tax traps.

## **The Continued Importance of S Corporations**

S corporations and limited liability companies ("LLCs") are the entities of choice for businesses. S corporations accounted for 1.64 million entities in 1990, and that number increased more than 250% to 4 million in 2008.<sup>3</sup> That was addition to 3 million LLCs in 2008.<sup>4</sup>

Due to tax advantages, many LLCs (which are typically taxed as sole proprietorships or partnerships depending on the number of members) have filed an S election.<sup>5</sup> This has allowed these entities to be taxed under Subchapter S of the Internal Revenue Code.<sup>6</sup> Because of this federal tax election (and even with the state law popularity of LLCs), the S corporation tax structure remains critically important to small to mid-sized companies.

## **Synthetic Equity Defined**

There are many methods for incentivizing key employees using equity and non-equity (otherwise known as "synthetic equity"). Equity ownership consists of voting stock, non-voting stock, restricted stock,<sup>7</sup> and options.<sup>8</sup> Non-equity or synthetic equity consist of: bonus plans, performance unit plans, stock appreciation rights, phantom stock, deferred compensation, and rabbi trusts.<sup>9</sup> The main characteristic that distinguishes equity from

non-equity is that synthetic equity does not actually have any current or future rights to ownership in the company. Instead, it is a contractual right that is tied in some way to the performance of the company.

Due to this difference, there are a number of benefits for businesses to use synthetic equity over traditional equity ownership.<sup>10</sup> Synthetic equity does not afford any minority rights which can complicate corporate governance and ownership transitions or outright exits from the business.<sup>11</sup> In addition, there are no voting rights that can complicate the strategic and other business decisions. Further, synthetic equity does not cause any undesired dilution of the equity ownership because the rights are defined completely separate from the actual stock or units in the company.<sup>12</sup> Lastly, depending how they are structured and funded, synthetic equity should not cause the same financial hardship if the employee dies, retires, or there is a termination of employment.<sup>13</sup>

## **Types of Synthetic Equity**

As mentioned above, there are many types of synthetic equity. The most basic is a bonus plan.<sup>14</sup> Bonus plans are very flexible and can be defined in many ways. The most common is a percentage of the profits or an amount based on certain profits being generated.<sup>15</sup> This type of plan incentivizes employees to achieve the company's financial goals.

A second type of synthetic equity is a performance unit plan. This is very similar to a bonus plan. The main difference is that the award is tied to the fulfillment of corporate objectives over a period of time.<sup>16</sup> In contrast, bonus plans are determined on an annual basis. Performance unit plans will continue over a longer period of time.

Stock appreciation rights are a third type of synthetic equity. They are a contractual right to participate in the future appreciation of the company without any commitment to equity.<sup>17</sup> In other words, the company will award a percentage of appreciation that occurs between the date of grant and ex-

ercise. There is also a large amount of flexibility in stock appreciation rights.<sup>18</sup> They can be structured to be exercised at various times. It is also very common to “require” the exercise on certain events (like the termination of the employee). Similar to the performance unit plan, its purpose is to establish a matching of long-term incentives of the key employee and the company.

A fourth type of synthetic equity is phantom stock. This is similar to stock appreciation rights,<sup>19</sup> but it is more analogous to actual stock in that the ownership is determined by reference to shares of stock.<sup>20</sup> The appreciation in the phantom stock between the date of grant and exercise is what is paid. As with the actual stock, a phantom stock plan can even accrue and pay out dividends.

Lastly, rabbi trusts are a final type of synthetic equity. These are much less common and are used in very large companies. A rabbi trust is essentially an irrevocable trust that is held for the benefit of an executive<sup>21</sup> and is funded with assets that will pay benefits in the future. The benefit is that it is protected from creditors in contrast to the other types of synthetic equity.

### Taxation of Synthetic Equity

Taking the various types of synthetic equity one at a time, bonus plans are taxable to the employee under IRC 61 and are includable in the year received.<sup>22</sup> In addition, they are ordinary income as opposed to capital gain. The amounts paid are also a deduction to the employer when paid under IRC 404(a)(5).<sup>23</sup>

Performance unit plans are taxable in the same fashion. They are taxable when paid unless there is some unusual structure that requires constructive receipt.<sup>24</sup> Further, they are also deductible to the employer when paid.<sup>25</sup>

Stock appreciation rights and phantom stock are similar in that they are taxable to the key employee when paid and their character is ordinary income.<sup>26</sup> Any “dividends” that are paid under this type of synthetic equity are also considered ordinary income in the year received.<sup>27</sup> Likewise, the employer takes a deduction for any payments under stock appreciation or phantom stock plans.<sup>28</sup>

### Using Synthetic Equity in S Corporations

Unlike partnerships and C corporations, Subchapter S of the Internal Revenue Code has many requirements to qualify for this

tax status.<sup>29</sup> IRC 1361(b)(1)(D) provides that a “small business corporation” is qualified to be an S corporation.<sup>30</sup> One of the requirements for a small business corporation is that the corporation have only one class of stock.<sup>31</sup> This has historically posed challenges for business lawyers who creatively plan with their clients to incentive and retain key employees.<sup>32</sup>

The General Counsel Office issued a GCM that provides a flavor for the complicity of these types of plans and the legal reasoning involved in evaluating them under Subchapter S. In this determination, it addressed a synthetic equity plan that was made available to only certain employees, officers, and directors (and consisted of payments measured by the performance of the corporation on termination of employment, ongoing payments measured by payments to stockholders, and payments made to participants if the corporation had liquidated or sold).<sup>33</sup> It found that the plan was not a separate class of stock. It reasoned that voting rights, dividend rights, and liquidation rights were key elements for purposes of determining whether it is stock under subchapter S. It distinguished actual stock versus the terms of this plan by the loss of a taxpayer’s capital as opposed to a chance to share in the corporate success. Further, the GCM noted the plan’s lack of voting rights. While dividends could be paid, the plan did not allow participants to receive dividends per se. In addition, the GCM contrasted a normal liquidation right of shareholders (in that the unit holder was only entitled to proceeds that represented appreciation since the unit was granted) rather than a share in the total value of the corporation. The GCM concluded by finding that the unit holders did not have other similar rights of shareholders, including the right to inspect the books of the corporation, institute a suit on behalf of the corporation, and the participant’s interest in the profits was contingent on employment and other status in the company.

This issue has also been addressed in a number of private letter rulings. In PLR 8828029, the company assigned a value to units comparable to one share of common stock and that these units must be redeemed at the termination of employment (and also prohibited transferability of this right, denied any voting rights and did not grant any claim to a portion of the assets upon liquidation of the company).<sup>34</sup> The IRS followed the analysis noted above and determined that the

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There are many methods for incentivizing key employees using equity and non-equity (otherwise known as “synthetic equity”).

plan was not a second class of stock. In PLR 8834085, the IRS reviewed a proposed plan from a corporation that was currently taxed as a C corporation but desired to become a S corporation after a restructuring of its ownership.<sup>35</sup> The company planned to issue an incentive structure to certain key employees as well as officers and directors (with a payment plan measured by the performance as of the termination of their employment, an ongoing payment measured by payments to common stockholders, and a right on liquidation of the company). In analyzing the proposed plan, the IRS contrasted attributes of immediate stock ownership and these rights. The IRS noted that the participants were not going to have a vote, a right to inspect the books, and could not institute a suit on behalf of the company. It further stated that profit was contingent on their employment, and the issuance of the shares did not alter the capital structure. On this basis, the IRS ruled that it was not a second class of stock. In PLR 8838049, the IRS reviewed a proposed plan for select executive employees.<sup>36</sup> These executives were entitled to receive cash payments equal to a dividend paid multiplied by the number of units which in addition to the payment on the occurrence of certain events (i.e. termination of employment, merger, or liquidation). They were also a vesting schedule under this proposed plan, were not transferable, and conferred no voting rights. Based on the previous authority, the IRS ruled that this proposed plan was not a second class of stock.

In 1990, the IRS proposed regulations that addressed the single class of stock among other issues, and this resulted in a proposed legislative override. Then in 1992, the IRS issued regulations provided clarify for planning by established a safe harbor for these types of synthetic equity plan. It provided:

(4) Treatment of deferred compensation plans. For purposes of subchapter S, an instrument, obligation, or arrangement is not outstanding stock if it –

- (i) Does not convey the right to vote;
- (ii) Is an unfunded and unsecured promise to pay money or property in the future;
- (iii) Is issued to an individual who is an employee in connection with the performance of services for the corporation or an individual who is an indepen-

- dent contractor in connection with the performance of services for the corporation (and is not excessive by reference to the services performed); and
- (iv) Is issued pursuant to a plan with respect to the employer or independent contractor is not taxed currently on income.

A deferred compensation plan that has a current payment feature (e.g., payment of dividend equivalent amounts that are taxed currently as compensation) is not for that reason excluded from this paragraph (b)(4).<sup>37</sup>

In other words, this safe harbor has four requirements. First, the plan must not grant the right to vote. Second, the payment mechanism under the plan must be both unfunded and unsecured. Third, income must be issued to an employee or independent contractor who performs the services and not be excessive compared to the services performed. Lastly, the plan must provide that the benefit is not currently taxable.<sup>38</sup>

Since these regulations, the IRS has reviewed this issue in a number of private letter rulings. In PLR 9413023, a company adopted a stock appreciation rights plan that was available to full-time employees who satisfied certain requirements and allow them to transfer these rights.<sup>39</sup> The IRS analyzed the plan under Treas Reg. 1.1361-1(b)(4) and in doing so, noted that the plan did not grant any voting rights, it was unfunded and unsecured, it was also issued to employees in conjunction with the performance of services. This conclusion was also reached in PLR 9421024 and 9421011.<sup>40</sup> The one major difference between this ruling and the other two were that the company provided for a dividend equivalent that was currently taxable. The IRS also held that this plan was not considered a second class of stock. The regulations allow for a dividend equivalent to be paid.

In a more recent private letter ruling, the IRS addressed a S corporation that had two unrelated shareholders and unrelated key employees.<sup>41</sup> The shareholders had different retirement goals but agreed to transfer certain amounts of “incentive stock” to key employees. They also desired to transfer the balance of the stock to key employees at certain times in the future. The company issued non-voting stock and also as incentive stock that would pay a bonus equal to a percent-

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Unlike partnerships and C corporations, Subchapter S of the Internal Revenue Code has many requirements to qualify for this tax status.

age of distribution paid to the founders. The bonus was unfunded and unsecured. It also provided that if the employment was terminated, the bonus would be paid at that time plus any book appreciation. The IRS determined that this was not a second class of stock. In another more recent ruling, an S corporation had an unfunded deferred compensation plan was to be offered to one employee, and that employee could earn four incentive shares each year over ten years.<sup>42</sup> There was also a bonus that could be paid both before and at retirement and on certain events, a lump sum or an amount greater than a lump sum could be paid. Finally, the proposed plan included a payment in the event of an involuntary termination and a sale of the company. The IRS reviewed each of the elements of the plan and found that it was not a second class of stock under Treas Reg. 1.1361-1(b)(4).

### Structuring Synthetic Equity

Based on the 1992 Regulations and the guidance discussed above, there are many ways to structure a synthetic equity plan. Among other creative elements, a business attorney should consider these elements:

- Award synthetic equity based on a value that is equivalent to the value of the employer's common stock;
- Make additions to synthetic equity at the same time that dividends are declared on the employer's common stock;
- Adjust the number of units to reflect changes in the capital structure of the employer (such as stocks or stock dividends);
- Considering making payments to the employee equal to the appreciation from the date of issuance to the occurrence of certain events;
- Determine what if anything is paid in the event of a sale or a dissolution;
- Make payment of the award either in a lump sum or a fixed number of installments;
- Require that the key employee remain at the company for a period of years or until retirement;
- Prohibit competition with the company for a certain period of time after termination and provide that a violation of the non-

compete will result in forfeiture of the synthetic equity;

- Prohibit the assignment or transfer of the synthetic equity; and
- Address what events terminate the plan or allow for the employer to amend it.<sup>43</sup>

Further, to avoid the risk of a plan being deemed a second class of stock (and terminating the S corporation status), the agreement or plan should explicitly state it does not include any of the four elements in the 1992 Regulations. That is, the plan does not grant the right to vote, is unfunded as well as unsecured, the payment could be made to an employee or independent contractor, and is not currently taxable. To further address the third requirement and depending on the size as well as scope of the plan, a company could retain its accountant or a business appraiser to determine whether the benefit to be granted is not excessive compared to the services to be performed by the participants.

### Conclusion

The stage of the U.S. economy and demographics of business owners necessitate that companies continue to look at incentivizing and retaining their key employees. The S corporation tax status remains a very common structure, whether for state law corporations or LLCs that were formerly taxed as partnerships or for disregarded entities that have since elected to be taxed under Subchapter S. Due to these trends, it is vital for planners to be aware of compensative structures to retain and incentivize key employees. Fortunately, the tax law allows for many different types of synthetic equity in the context of S corporations and should be utilized to their fullest extent.

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[T]he tax law allows for many different types of synthetic equity in the context of S corporations and should be utilized to their fullest extent.

### NOTES

1. U.S. economy added 321,000 jobs in November; unemployment rate holds at 5.8%, <http://www.washingtonpost.com/blogs/wonkblog/wp/2014/12/05/u-s-economy-added-321000-jobs-in-november-unemployment-rate-holds-at-5-8/> December 5, 2014; Michigan outpaces nation in economic growth for 2013, [http://www.mlive.com/lansing\\_news/index.ssf/2014/08/michigan\\_outpaces\\_nation\\_in\\_ec.html](http://www.mlive.com/lansing_news/index.ssf/2014/08/michigan_outpaces_nation_in_ec.html) August 8, 2014.

2. In a study by Carey McMann of SME Research estimates that the number of businesses that will be available for sale in the next ten to twenty years (with owners 45 years old or older as of 2012) will be 2.5 to 3.8 million and 50 to 75% of all business owners will want to sell their companies. <http://apexexit.com/>

- business-transition-in-the-baby-boomer-retirement-era/#sthash.2KCMMKC5.dpuf.
3. Testimony of Martin A. Sullivan, Ph.D., Chief Economist, Before the Committee on Ways and Means U.S. House of Representatives, March 7, 2012, Passthrough Business, Small Business, and Tax Reform. Retrieved from <http://waysandmeans.house.gov/uploadedfiles/sullivantest03.07.2012.pdf> (March 7, 2012).
  4. *Id.*
  5. The election is accomplished by filing form 2554.
  6. In doing so, the entity retains its state law status as a limited liability company, but is taxed under subchapter S. This is very common for businesses owners who want to minimize their employment taxes.
  7. Restricted stock is typically characterized by vesting and forfeiture provisions.
  8. The two types of options are: non-statutory or “incentive stock options” and statutory options.
  9. Blau, Richard D. & Lemons, Bruce N. & Rohman, Thomas P., *Planning for Non-Cash Executive Compensation in S Corporations*, 69 J. Tax’n 338 (1991).
  10. Mancoff, Neil A. & Weiner, David M., *Non-Qualified Deferred Compensation Arrangements* Section 5:02 (2013).
  11. *Id.*
  12. Canan, Michael J. & Mitchell, William D., *Employee Fringe and Welfare Benefit Plans*, Section 7:18 (2014).
  13. *Id.*
  14. Sollee, William L. & Schneider, Paul J., *Non-Qualified Stock Plans Can Be Adapted to Meet the Needs of Privately Held Companies*, 82 J Tax’n 100 (1995).
  15. *Id.*
  16. *Id.*
  17. *Id.*
  18. Apfel, Kenneth S. & Hoosein-Rediess, Brenda J., *Stock Appreciation Rights*, 49 Taxation for Accounting 345 (1992).
  19. Christian, William R. & Grant, Irving G., *Subchapter S Taxation*, Section 9.09 (2014).
  20. *Id.*
  21. *Id.*
  22. Blau, Richard D. & Lemons, Bruce N. & Rohman, Thomas P., *Planning for Non-Cash Executive Compensation in S Corporations*, 69 J. Tax’n 338 (1991).
  23. *Id.*
  24. *Id.*
  25. *Id.*
  26. Madden, Robert E., *Tax Planning for Highly Compensated Individuals*, Tax Planning for Highly Compensated Individuals, §5.05 (2014). See also Koren, Edward F., *Estate, Tax and Personal Financial Planning*, §2:76 (2014).
  27. *Id.*
  28. *Id.*
  29. Gissel, Henry L. Jr., *Creative Uses of S Corporations*, C777 ALI-ABA 117 (1992).
  30. 26 CFR 1.1361-1.
  31. General Counsel Memorandum (GCM) 39750. See also *The S Corporation Handbook*, Section 2:20 (2013). See also Dupee, Daniel S., *Practical Tax Strategies*, 44 Taxation for Accounting 138 (1990).
  32. See Porcaro, Gregory A., *Practical Tax Strategies*, 21 Taxation for Law 72 (1992).
  33. GCM 39750 (May 18, 1988).
  34. PLR 8828029, 1988 WL 572061.
  35. PLR 8834085, 1988 WL 572535.
  36. PLR 8838049, 1988 WL 572816.
  37. Treas. Reg. 1.1361-1(b)(4).
  38. See Traum, Sydney S. & Traum, Judith Rood, *The S Corporation Answer Book Question*, Section 1:145 (2014).
  39. PLR 9413023, 1993 WL 614587.
  40. PLR 9421024, 1994 WL 222006; PLR 9421011, 1994 WL 221993.
  41. PLR 200118046, 2001 WL 470592.
  42. PLR 200130008, 2001 WL 847719.
  43. Mancoff, Neil A. & Weiner, David M., *Non-Qualified Deferred Compensation Arrangements* (2013).



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# Case Digests

## **Commercial Mortgage-backed Securities—Validity of Nonrecourse Mortgage Loan Act**

*Borman LLC v 18718 Borman LLC*. In June 2005, defendant-borrower obtained an \$8.7 million commercial mortgage-backed securities (CMBS) loan secured by commercial property. The borrower's principal guaranteed all obligations on the loan for which borrower might become personally liable. Borrower used the loan to purchase the property from and lease it back to a subsidiary of the Great Atlantic & Pacific Tea Company for use as a grocery distribution center. In December 2010, the grocery chain's subsidiary filed for bankruptcy and the bankruptcy court eventually permitted the subsidiary to terminate the lease and abandon the property. Borrower tried and failed to locate a replacement tenant or to sell the property for its pre-recession value. In October 2010, the lender's loan servicer sent borrower a formal notice of default, and borrower turned the property over to a receiver. A year later the servicer foreclosed on the property and purchased it with a \$2.1 million credit bid. After the auction, either the lender or its loan servicer took possession of approximately \$1.76 million in escrow and a \$500,000 letter of credit from the borrower's principal, both deposited as additional collateral under borrower's loan. Neither the lender nor the servicer sought a deficiency judgment. In 2012, the loan servicer marketed the property on Auction.com, advertising that borrower held the property subject to a nonrecourse loan before foreclosure. Purchaser's principals obtained the property, then appraised at \$4.6 million, and an assignment of the lender's rights under the loan agreement with a high bid of \$756,000. Purchaser's principals stated in their depositions that they never read the underlying loan documents before executing the sale and that they purchased the property because of the low asking price. Several months later purchaser filed the instant action seeking a deficiency judgment and taking the position that it stood in the shoes of the lender, arguing that the borrower lost its single-purpose-entity status on default and—along with its principal—became personally liable for a deficiency of \$6 million plus interest. Each party moved for summary judgment, and the district court granted it to borrower and its principal, finding that the Nonrecourse Mortgage Loan Act (NMLA; 2012 PA 67): (1) rendered a solvency covenant in borrower's CMBS loan unenforceable; (2) did not violate either the Contract or Due Process Clauses of the United States and Michigan Constitutions; and (3) complied with Michigan's constitutional provision mandating the separation of governmental powers.

The Sixth Circuit held that the district court correctly found that borrower's loan qualified as a "nonrecourse loan" under the NMLA, which defines it as any "commercial loan secured by a mortgage on real property located

in this state and evidenced by loan documents" containing one or more enumerated nonrecourse provisions. MCL 445.1592(b). Although the purchaser argued that the loan was transformed on borrower's default into a recourse loan before the March 29, 2012 effective date of the NMLA, the court held that the borrower's loan documents continued to exist past that date and contained one of the enumerated triggering provision, thus barring the purchaser's deficiency claim. The court rejected the purchaser's argument that the covenant it sought to enforce was not a post closing solvency covenant prohibited by the NMLA. The Sixth Circuit also affirmed the district court's rejection of the purchaser's arguments that the NMLA was unconstitutional under the Contract or Due Process Clauses of the United States and Michigan Constitutions or that it violated the Michigan constitution's separation-of-powers provision.

## **Employment—Compensation for Meal Breaks under Fair Labor Standards Act**

*Ruffin, et al v MotorCity Casino*. Plaintiff security guards at defendant casino were entitled under the parties' collective bargaining agreement to a paid, thirty-minute meal period. The parties stipulated that the guards on their breaks were, among other things, free to eat, drink, socialize with other employees, and use their cell phones and the Internet. The casino did restrict how guards could spend their meal periods by not permitting them to leave casino property, have food delivered to the casino, or receive visitors. The guards were responsible for listening to their radios and responding to an emergency in the casino. A guard who did not respond to a mid-meal emergency call was subject to discipline. Other than monitoring the radio, the guards performed no job duties during meal periods.

The Fair Labor Standards Act (FLSA) requires employers to compensate employees for hours in excess of 40 per week at a rate of 1 1/2 times the employees' regular wages. Although the FLSA does not define "work," the courts have stated that "work" means physical or mental exertion that is controlled or required by the employer and pursued primarily for the employer's benefit. Time spent mostly for the employer's benefit during a period that designated as a meal break nevertheless constitutes working time that is compensable under the FLSA, but the employee is relieved of duty and is not entitled to compensation under the FLSA so long as the employee can pursue the mealtime adequately and comfortably, is not engaged in the performance of any substantial duties, and does not spend time predominantly for the employer's benefit. Whether time is spent predominantly for the employer's or employee's benefit depends on the totality of the circumstances, and the employee has the burden to prove that a meal period is compensable. The court noted that monitoring a radio is generally a peripheral activity that an employee can perform while spending meal breaks and the absence of any evidence that plaintiffs performed a substantial job duty during their meal breaks supported the district court's



judgment that those breaks were predominantly for the guards' own benefit.

Although evidence that emergencies regularly interrupted an employee's meal periods has been held to make those periods compensable, plaintiffs' enjoyment of their meals without regular interruptions showed that the meal periods predominantly benefitted the guards. Another aspect of this inquiry is whether the employer requires an employee to take meals on the premises as an indirect or round-about way of extracting unpaid work from the employee. In this case the casino's requirement that the guards take their meals on casino property did not show that the meal periods predominantly benefitted the casino because plaintiffs spent their meal periods doing exactly what one might expect an off-duty employee to be doing on a meal break: eating, socializing, reading, surfing the web, and conducting personal business on their smartphones.

After examining the totality of the circumstances, the court affirmed the district court's grant of summary judgment for the casino because the evidence was undisputed that plaintiffs perform no substantial job duties during meal breaks, emergency calls rarely if ever interrupted the guards' meals, and the guards pursued their "mealtime adequately and comfortably." In these circumstances, no reasonable jury could find that plaintiffs' meal periods predominantly benefitted the casino.

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# SECTION CALENDAR

## Council Meetings

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DATE	TIME	LOCATION
June 4, 2015	3:30 p.m.	Jaffe Raitt Heuer & Weiss, Southfield
September 25, 2015*		Amway Grand Plaza, Grand Rapids, MI

## Seminars

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### Business Law Institute

DATES	LOCATION
September 25, 2015	Amway Grand Plaza, Grand Rapids, MI

\*Annual Meeting