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THE USES OF A RECEIVERSHIP OVER REAL PROPERTY

by *Lawrence M. Dudek**

The use of a receivership over real property is available in state circuit court where "allowed by law."[1] There are a number of specific statutory provisions which permit the appointment of a receiver over real property, including the use of a receiver as an aid in the enforcement of an assignment of rents, to prevent waste, and to complete construction of a project upon which construction liens have been filed. The use of a receiver can also be an important tool to utilize in connection with mortgage foreclosure proceedings.[2]

I. USE OF A RECEIVER AS AN AID IN THE EXERCISE OF AN ASSIGNMENT OF RENTS.

The State of Michigan is a "lien" state; the granting of a mortgage does not transfer title to the mortgagee, but, instead, provides the mortgagee with a lien against the mortgaged property.[3] The mortgagor has an equity of redemption, which permits the mortgagor to redeem the property from the lien of the mortgage by making payment of the indebtedness owed under the mortgage.[4]

In addition to the equity of redemption, the State of Michigan provides for a statutory right of redemption following a foreclosure sale.[5] During the statutory redemption period, the mortgagor (and any party claiming an interest in the property through the mortgagor) may redeem the property from the foreclosure sale.[6] The redemption price is an amount equal to the amount bid at the sale together with interest from the time of the sale at the rate set forth in the mortgage.[7] In order to redeem, it may also be necessary to make payment of any amounts advanced by the purchaser at the sale for taxes or insurance premiums for the property.[8]

Prior to the expiration of the statutory redemption period, the mortgagor is entitled to the rights and incidents of possession of the mortgaged property, including the right to collect rentals from tenants of the property.[9]

In response to the need of commercial lenders, the Michigan legislature enacted Act No. 210 of the Public Acts of Michigan of 1953, entitled "Assignment of Rents to Accrue As Additional Security," MCL 554.231, MSA 25.1137(1), which provides that a mortgagee may, in conjunction with a mortgage on certain commercial or industrial property, other than an apartment building of less than six apartments, obtain an assignment of rents from the mortgaged property as additional security.[10]

In order to be enforceable, the assignment must be recorded.[11] The right of the mortgagee to collect rents from the occupants of the property will typically be triggered upon the existence of an event of default under the terms of the mortgage or the assignment, and compliance with any notice or other requirements in the mortgage or assignment.

The assignment becomes binding upon the occupants of the mortgaged property from the date that the mortgagee files a notice of default with the register of deeds and serves the notice and a copy of the assignment upon the occupants of the property.[12]

The exercise of the assignment has the effect of severing one incident of possession (the right to collect the stream of rental payments) from other incidents of possession, such as the right to manage the property and the responsibility to make payment of the expenses associated with the management and operation of the property. Deprived of the right to collect rental payments, the mortgagor may lack the financial ability to pay the operating costs for the property.

Problems with the enforcement of the assignment of rents can result if the occupants of the property cease making any rental payments, because of concern as to which party is entitled to receive the rents. Tenants may become concerned about incurring liability to pay the rents twice by making payment to the wrong party.

Additional problems can result if the mortgagor fails to cooperate with the exercise of the assignment of rents or actively interferes with the mortgagee's exercise of the assignment.

Under such circumstances the mortgagee may seek the appointment by a court of a receiver to aid in the enforcement of the assignment of rents. The nature of the mortgagee's rights under an assignment of rents and the ability to obtain the appointment of a receiver to aid in its enforcement was set forth by the Michigan Supreme Court in **Smith v Mutual Benefit Life Insurance Company**[13], as follows:

1. The collection of rents is not merely an incident to the right of possession of the mortgaged property, but is a distinct remedy and additional security held by the mortgagee.

2. While the right to collect rents is security, the right is a direct assignment of rents and not a mortgage of the rents.

3. The assignment becomes effective against the mortgagor at once upon default and prior to the mortgagee's initiation of foreclosure proceedings.

4. The mortgagee becomes entitled to collect the rents upon default and performance of the statutory conditions, which include recording and service of the notice of default and a copy of the assignment on the occupants of the mortgaged property.

5. A court will give aid, in an appropriate manner and on just terms, to conserve the rents of the mortgagee by appointing a receiver over the mortgaged property.

6. Under the Act, a receiver may be appointed to collect the rents and to apply them to the accrued interest, maintenance costs, insurance, and taxes. If there remains a deficiency following a sale, the receiver may continue to collect the rents following the sale and to make payments on the deficiency until expiration of the statutory redemption period.[14]

II. USE OF A RECEIVER TO PREVENT WASTE RESULTING FROM NONPAYMENT OF TAXES OR INSURANCE PREMIUMS.

In addition to the appointment of a receiver to aid in the exercise of an assignment of rents, such an appointment is also proper where necessary to prevent the commission of waste, such as the mortgagor's failure to pay real estate taxes or insurance premiums for the mortgaged property. MCL 600.2927, MSA 27A.2927 permits the parties to a mortgage to provide that the failure of the mortgagor to pay real property taxes or insurance premiums will be deemed waste and that a receiver may be appointed to prevent waste.[15]

The statute which permits the parties to define waste to include nonpayment of taxes and insurance was first enacted in 1937. There are a number of cases decided prior to the effective date of the statute which hold that it is only appropriate to appoint a receiver for nonpayment of taxes where a tax sale is imminent or likely to occur prior to the expiration of the statutory redemption period.[16] Arguably, the statute preempts the holding of these earlier cases and evidences a legislative intent to permit the appointment of a receiver for nonpayment of taxes even if there is no danger of a tax sale prior to the expiration of the statutory redemption period.[17]

In any event, a court is not required to appoint a receiver solely because the parties have agreed to such

relief by contract; the decision to appoint a receiver ultimately lies with the sound discretion of the court's exercise of its equitable powers.[18] In ruling upon a request for a receiver, the court can be expected to consider all of the attendant facts and circumstances.

The factors to be considered could include the amount of any unpaid taxes or insurance premiums, the length of time for which any payments of taxes or insurance have been past due, and whether the mortgagor has experienced difficulties in the enforcement of the assignment of rents. The court might further consider the value of the mortgaged property which secures the debt; the amount of any likely deficiency which will exist following a sale; the nature of the recourse, if any, available to the mortgagor for any deficiency; and the likelihood that any deficiency will be collectable from the mortgagor or any guarantors.

In determining whether to appoint a receiver, the court might also consider whether the mortgagor has been guilty of any misconduct or mismanagement, such as misappropriating rents for purposes other than preservation of the property, and the management abilities and capabilities of the mortgagor. In the final instance, the determination whether to appoint a receiver will lie in the sound discretion of the trial judge.[19]

There is a wide range of responsibilities which might be conferred upon a receiver appointed to aid in the enforcement of the assignment of rents. A receiver could be appointed for the very limited purpose of collecting rents from the tenants, making payment of expenses, including taxes and insurance, and reporting to the court and the parties. At the other extreme, a receiver could be afforded full authority to manage the property, to negotiate and enter into leases with occupants of the property, to make tenant improvements and to enforce the rights of the owner against occupants of the property.

Initially, the scope of the receiver's rights and responsibilities will be determined by the ability of a mortgagee and mortgagor to reach a consensual agreement. If the mortgagor and mortgagee are unable to agree upon the scope of the receiver's responsibilities, the court will probably consider a number of factors, including those upon which the decision was made to appoint a receiver.

III. USE OF A RECEIVER AS ANCILLARY TO FORECLOSURE PROCEEDINGS.

As a general rule, it is said that a receiver is available only as ancillary relief and that there is no independent remedy of the right to a receiver.[20] A request for appointment of a receiver may be sought as ancillary relief in a pending judicial foreclosure action. The remedy of a receiver should also be available where the mortgagee seeks to foreclose by advertisement if the appointment is necessary to aid in the enforcement of an assignment of rents or to prevent waste.[21]

Although foreclosure by advertisement may not be used if there is a lawsuit pending for recovery of the debt secured by the mortgage, an action for appointment of a receiver does not constitute such an action for recovery of the debt.[22] Therefore, the mortgagee may concurrently pursue foreclosure by advertisement and the appointment of a receiver to aid in the enforcement of the assignment of rents and prevent waste. If a receiver is appointed over the mortgaged property prior to a foreclosure sale, it will be necessary to obtain the approval of the court before proceeding to sale.[23]

The use of a receiver as an adjunct to foreclosure by advertisement can be an especially effective means for a mortgagee to preserve the value of the property prior to the foreclosure sale and expiration of the statutory redemption period. In addition to the use of a receiver ancillary to mortgage foreclosure proceedings, there is statutory authorization for the appointment of a receiver in connection with a construction lien foreclosure action.

IV. USE OF A RECEIVER TO COMPLETE CONSTRUCTION WHERE CONSTRUCTION LIENS HAVE BEEN FILED.

The State of Michigan Construction Lien Act[24] (the "CLA") authorizes the court to appoint a receiver, under certain circumstances, over property against which a construction lien has been filed.[25] A request for appointment of a receiver may be made by a construction lien claimant or by a mortgagee if the improvement covered by the lien has not been completed.[26]

The court may appoint a receiver upon finding that: (i) a substantial unpaid construction lien exists, or (ii) that the mortgage is in default and the lien claimant and/or mortgagee "are likely to sustain substantial loss if the improvement is not completed."[27]

The court-appointed receiver may petition the court to permit completion of construction of the improvement in full or in part, to borrow money to complete the construction, and to grant security, by way of mortgage or otherwise, for the borrowing.[28] The receiver may also petition the court for authority to borrow funds for other purposes, "including such purposes as preserving and operating the real property."[29] The type of security that the court might authorize could include a mortgage lien or an assignment of rents as additional security.

The court is to determine the priority of any security granted by the receiver, and may authorize the grant of a lien which will prime an existing mortgage and other liens against the property.[30] This will be helpful where the priority of the construction loan mortgage over the construction liens is in dispute and the construction lender is willing to advance additional funds only if repayment is secured by a lien with priority over the construction liens. In that instance, the construction lender can (with the approval of the court) make a new loan to the receiver and be granted a super-priority lien as to proceeds advanced under the new loan.

In order to appoint a receiver under the CLA, the court is required to make a finding that the "value added to the real property which will result from the construction is likely to exceed the cost of the additional construction."[31] In determining the cost of the additional construction, the court is to include direct costs, all estimated overhead and administrative costs, and the cost of any interest expense on the funds which are borrowed to complete construction.[32]

A party seeking the appointment of a receiver under the CLA to complete construction should be prepared to establish that the value added will exceed the cost of the additional construction. This will require expert testimony or other proofs of the "as is" value of the improvement, the cost of the construction proposed to be completed, and the projected value of the project once the work is completed. In many instances of income-producing property, the value should be enhanced by completing construction in an amount greater than the cost of completing construction.

The ability to secure the appointment of a receiver in connection with a construction lien action is a valuable tool which can be used to preserve and increase the value of the security available to the mortgagee and lien claimants, without being required to await the conclusion of the foreclosure action.

V. EFFECT OF BANKRUPTCY FILING ON A REAL PROPERTY RECEIVERSHIP.

An owner of real property can prevent a mortgage or construction lien foreclosure sale by filing a petition for relief under Chapter 11 of the Bankruptcy Code.[33] Upon the filing of a petition for relief, the mortgagor becomes a debtor in possession under the Bankruptcy Code[34] and the automatic stay arising pursuant to Section 362(a), 11 USC 362(a), will prevent a foreclosure sale from taking place until such time as the stay is lifted. The automatic stay provision and other provisions of the Bankruptcy Code will affect the ability of the mortgagee to enforce an assignment of rents and the right of a court-appointed receiver over property owned by the debtor to continue acting as such.

The mortgagor, as debtor in possession, may seek permission of the bankruptcy court to use the rental income of the mortgaged property as cash collateral.[35] There is a split of authority as to whether the debtor retains any interest in the rents where the mortgagee has performed all actions necessary to collect the rents prior to the bankruptcy filing. These actions include the recording of a notice of default and service of the notice together with a copy of the assignment on the occupants of the mortgaged property.

In re P.M.G. Properties[36] held that the assignment of rents became effective against the mortgagor immediately upon default and would not permit use of the rents as cash collateral even though the mortgagee had not recorded or served the required notice of default prior to the bankruptcy filing. The court further stated that it was presumed that the mortgagor would use the rents to preserve the property.

In re Mount Pleasant Limited Partnership[37] held that where the mortgagee has complied with all of the recording and notice requirements (i.e., notice of default has been recorded and served on the occupants of the property together with a copy of the assignment) and any other contractual requirements are complied with, the debtor has lost the legal right to collect the rents. Under such circumstances, the rents do not become property of the estate and are not available for use as cash collateral even if the debtor is able to provide adequate protection of the mortgagee's interest in the rents.

Finally, **In re Coventry Commons Associates**[38] suggests that even if the mortgagee has complied with all of the recording and notice requirements, the debtor does have an interest in the rents and may use the rents as cash collateral if able to provide adequate protection to the mortgagee.

The question of whether the debtor retains an interest in the rents after all of the statutory requirements have been complied with is certain to generate additional litigation before it is fully resolved.

If a state or federal court receiver has been appointed prior to the bankruptcy filing, the Bankruptcy Code will affect the ability of the receiver to continue as such. A court-appointed receiver over property owned by a debtor which has filed for Chapter 11 is deemed a custodian of the property.[39] Pursuant to Section 543 of the Bankruptcy Code, the receiver, as custodian, is obligated to deliver to the debtor in possession (or trustee) any property of the debtor "that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case."[40] The receiver is further obligated to file an accounting of any such property.[41]

Section 543(d)(1) of the Bankruptcy Code authorizes the court to excuse a custodian from complying with the turnover provisions of 543(a) "if the interests of creditors...would be better served by permitting a custodian to continue in possession, custody, or control of such property...."[42] In making this determination the court will consider "(1) the likelihood of a reorganization, (2) the probability that funds required for reorganization will be available, and (3) whether there were instances of mismanagement by the debtor."[43]

Where the mortgaged property is the only asset owned by the debtor and the value of the property is less than the amount of the indebtedness owed to the mortgagee, the court should continue the receivership if it provides the most likely vehicle of enhancing the value of the property. One court recognized that the mortgagee is more likely to advance additional funds for tenant improvement or operating expenses if the receivership is continued, and that such a consideration may be a basis to excuse the receiver from the turnover requirement.[44]

VI. CONCLUSION

The ability to obtain a court-appointed receiver over real property may provide a useful remedy in connection with mortgage or construction lien foreclosure proceedings brought with respect to commercial properties. The appointment of a receiver provides a means to preserve and protect the value of the improved real property which acts as security for the debt. Such a receivership provides a vehicle for the enforcement of an assignment of rents and for the use of the rental income to preserve the value and ongoing operation of the property for the benefit of all persons having an interest in the property. The receivership may, in some instances, be used as a means to enhance and maximize the value of the property — for example, by completing construction of a project when authorized to do so by the court. The potential availability of a receivership should be considered in many instances of commercial mortgage or lien foreclosure proceedings.

ENDNOTES

1. MCL 600.2926-.2927, MSA 27A.2926-.2927.
2. Michigan law provides two methods of foreclosing a mortgage. A mortgagee can proceed with a judicial foreclosure, by filing a complaint in a court having jurisdiction. MCL 600.3101, MSA 27A.3101. A mortgagee can foreclose by advertisement if the mortgage includes a power of sale which permits the property to be sold by public auction in the event of a default by the mortgagor in the terms and conditions of the mortgage, MCL 600.3201, MSA 27A.3201, and the mortgage and all assignments of the mortgage have been recorded. MCL 600.3204(3), MSA 27A.3204.
3. This principle is well recognized as set forth in the 1877 decision of the Michigan Supreme Court in **Wagar v Stone**, 36 Mich 363, 366 (1877):

   It has become the well settled doctrine in this state that a mortgage conveys no title to the mortgagee. It is but a security for the debt, and until the title passes upon a foreclosure and sale of the property, the mortgagee has no legal interest in the land, and is not entitled to possession. (citations omitted)

   The mortgagor is entitled to the possession during the proceedings taken to foreclose the mortgage and until a sale has been made and the title of the purchaser has become absolute, and until the title has become absolute upon a foreclosure of the mortgage, an action of ejectment cannot be maintained by the mortgagee, his assigns or representatives, to recover possession of the mortgaged premises.

   Also see: **McKeighan v Citizens Commercial & Savings Bank**, 302 Mich 666, 5 NW2d 524 (1942); **Equitable Trust Co. v Milton Realty Co.**, 263 Mich 673, 249 NW 30 (1933)

4. While the mortgagor may sell and convey the equity of redemption by a separate and distinct contract entered into in good faith and for good consideration, any agreement by the mortgagor to do so will be viewed suspiciously by a court of equity and will be carefully scrutinized. The exchange must be fair, frank, honest and without fraud, misconduct, undue influence, apprehension or unconscionable advantage of the poverty, distress or fears of the mortgagor. **Russo v Wolbers**, 116 Mich App 323, 323 NW2d 383 (1982).

5. The redemption period following a foreclosure pursuant to a judgment of foreclosure is 6 months. MCL 600.3140, MSA 27A.3140. Where the foreclosure is by advertisement and the mortgage was executed on or after January 1, 1965, on commercial or industrial property, or multifamily residential property in excess of four units, the redemption period is six months. Different periods will apply to other mortgages. MCL 600.3240(3), MSA 27A.3240.

6. Titus v Cavalier, 276 Mich 117, 267 NW 799 (1936).

7. MCL 600.3140, MSA 27A.3140 (judicial foreclosure); MCL 600.3240, MSA 27A.3240 (foreclosure by advertisement).

8. MCL 600.3140, MSA 27A.3140 (judgment in judicial foreclosure action may provide that redemption price includes amounts advanced by the purchaser for taxes or insurance); MCL 600.3240, MSA 27A.3240 (where foreclosure by advertisement, the purchaser may file an affidavit and receipts with regard to all taxes and insurance premiums paid and the redemption price will include these amounts).

9. The right of the mortgagor to continue to collect the rents arises out of the right to possession. As set forth in the early decision of **Wagar v Stone**, supra at 366:

   Since the passage of this act (PA 1843, No. 62), which prevents the mortgagee from obtaining possession until he has acquired an absolute title to the mortgaged premises, the mortgage binds only the lands. The rents and profits of the land do not enter into or form any part of the security. At the time of giving the security both parties understand that the mortgagor will, and that the mortgagee will not, be entitled to the rents, issues or profits of the mortgaged premises, until the title shall have become absolute upon a foreclosure of the mortgage. Until the happening of this event, the mortgagor has a clear right to the possession and to the income which he may derive therefrom, and the legislature by the passage of this statute contemplated that he should have such possession and income to aid him in paying the debt.

   Also see: **Freeman v Massachusetts Mutual Life Ins. Co.**, 81 F2d 698 (6th Cir 1936).

10. MCL 554.231, MSA 25.1137(1).

11. MCL 554.232, MSA 25.1137(1).

12. MCL 554.231(2), MSA 26.1137(1).

13. 362 Mich 114, 106 NW2d 515 (1960).

14. Also see: **Bennos v Waderlow**, 291 Mich 595, 289 NW 267 (1940).

15. MCL 600.2927(2), MSA 27A.2927(2)

16. See, for example, 600.2927(2), MSA 27A.2927(2).

17. Cameron, Michigan Real Property Law, (2d Ed 1993) §18.72.

18. **Nusbaum v Shapiro**, 249 Mich 252, 228 NW 785 (1930).

19. Denby v Ozeran, 255 Mich 477, 238 NW 218 (1931).

20. **Lewis v City of Grand Rapids**, 222 F Supp 349 (WD Mich 1963); **National Lumberman v Lake Shore Machinery Co.**, 260 Mich 440 (1932).

21. The dispute in **Smith v Mutual Benefit** involved the right to receive rents coming due after the foreclosure sale where there existed a deficiency following the sale. The mortgage was non-recourse. An assignment of rents had been granted as additional security pursuant to the statute. The mortgagor filed suit to seek an injunction against any attempt by the mortgagee to continue collection of rents following the sale. The mortgagee filed a counterclaim seeking the appointment of a receiver to collect the rents. The trial court appointed a receiver, even though it does not appear that the request of the mortgagee for appointment of a receiver was ancillary to any other requested relief.

22. Foreclosure by advertisement is not available if there is any lawsuit pending for recovery of the debt which is secured by the mortgage, unless the suit is discontinued or a judgment entered and a writ of execution returned unsatisfied in whole or in part. MCL 600.3204, MSA 27A.3204. An action on the debt that will prohibit foreclosure by advertisement includes "proceedings in which judgment may be rendered and execution issued against a debtor's property." Michigan Land Title Standard 16.13. An action for appointment of a receiver does not constitute an action on the debt that will prevent use of foreclosure by advertisement. **Calvert Associates v Harris**, 469 F Supp 922 (ED Mich 1979).

23. **Kuschinski v Equitable & Central Trust Co.**, 277 Mich 23, 268 NW2d 797 (1936), citing **In re Petition of Chaffee**, 262 Mich 291, 247 NW 186 (1933). Michigan Land Title Standard 16.10.

24. MCL 570.1101 et seq., MSA 26.316(101).

25. MCL 570.1122, MSA 26.316(122); **Michigan Bank Midwest v D.J. Reynaert, Inc.**, 165 Mich App 630 (1988).

26. MCL 570.1122(1), MSA 26.316(122).

27. MCL 570.1122(1), MSA 26.316(122).

28. MCL 570.1123(1), MSA 26.316(123).

29. MCL 570.1123(1), MSA 26.316(123).

30. MCL 570.1123(1), MSA 26.316(123).

31. MCL 570.1123(1), MSA 26.316(123).

32. MCL 570.1123(1), MSA 26.316(123).

33. Section 362(a)(5) of the Bankruptcy Code, 11 USC 362(a)(5), operates as a stay of "any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title."

34. A debtor in possession is empowered to continue the operation of the debtor's business and is further granted the powers that a trustee has under the Bankruptcy Code. 11 USC §§1107, 1108.

35. For an excellent discussion on the ability of the debtor to use rents as cash collateral, see Moreno and Eisele, "Assignment of Rents in Bankruptcy Under Michigan Law," 19 Mich Real Prop Rev. 137 (1992).

36. 55 Bankr. 864 (Bankr. E.D. Mich. 1985).

37. 144 Bankr. 727 (Bankr. W.D. Mich. 1992).

38. **In re Coventry Commons Associates**, 134 B.R. 606 (Bankr. E.D. Mich. 1991) and 149 B.R. 109 (Bankr. E.D. Mich 1992). Judge Rhodes stated that the debtor retains an interest in the rents even where the mortgagee has complied with all statutory requirements, because the right to collect the rents would revert to the mortgagor if the property were redeemed by payment of the indebtedness prior to the foreclosure or by payment of the redemption price after sale during the statutory redemption period. 134 B.R. at note 7, p. 610.

39. **In re Foundry of Barrington Partnership**, 129 B.R. 550, 558 (Bankr. N.D. Ill. 1991); **In Re Poplar Springs Apartments of Atlanta, Ltd.**, 103 B.R. 146, 149 (Bankr. S.D. Ohio 1989)

40. 11 USCA 543(b)(1).

41. 11 USCA 543(b)(2).

42. See **In Re Poplar Springs Apartments of Atlanta, Ltd.**, 103 B.R. 146, 149 (Bankr. S.D. Ohio 1989); **In re Sundance Corp.**, 83 B.R. 746, 749 (Bankr. Mont. 1988); **In re CCN Realty Corp.**, 19 B.R. 526, 528-529 (Bankr. S.D.N.Y. 1982).

43. **In Re Poplar Springs Apartments of Atlanta, Ltd.**, 103 B.R. 146, 150 (Bankr. S.D. Ohio 1989).

44. **In re Foundry of Barrington Partnership**, 129 B.R. 550, 558 (Bankr. N.D. Ill. 1991).

SINGLE-ASSET CHAPTER 11 REAL ESTATE CASES: BAD FAITH, NEW DEBTOR SYNDROME, AND OTHER PITFALLS

by *Lisa Sommers Gretchko**

The current real estate market has left some real estate developers extremely overextended. The over-building of the 1980's, the economic downturn, and the continuing conservatism on the part of many lenders has resulted in "see-through" buildings, negative cash flows, and the developer's inability to refinance.

In an effort to hold onto their real estate, several developers have resorted to Chapter 11 bankruptcy, hoping that the bankruptcy court will force the lender to refinance in the context of a confirmed Plan of Reorganization. However, the tactic of using bankruptcy as the ultimate trump card with the lender usually upsets the lender, who is anxious to get either its money, or "its" property.

While some believe that entities possessing a single asset consisting of distressed real estate are simply ineligible for reorganization under Chapter 11 of the Bankruptcy Code, bankruptcy courts located in Michigan have not reached this conclusion.[1] Indeed, several single-asset Chapter 11 real estate bankruptcies have reorganized successfully.[2] However,

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Ms. Gretchko received her BA with honors from the University of Michigan in 1976 and was a member of the Phi Beta Kappa Honor Society. She received her JD, cum laude, from the University of Detroit in 1978, where she was awarded the National Order of the Barrister and elected a member of the Justice Frank Murphy Honor Society. In addition, Ms. Gretchko was an associate editor of the University of Detroit *Journal of Urban Law* in law school.

other single-asset Chapter 11 real estate bankruptcies have been unsuccessful, and have been dismissed for "bad faith," or have had the automatic stay lifted or annulled. Often, the difference between the success and failure of a single-asset Chapter 11 real estate case depends upon the debtor's pre-bankruptcy planning — which sometimes includes dismemberment of a real estate empire, creation of a new entity into which a single, troubled real estate project is transferred, or a Chapter 11 bankruptcy filed minutes before a foreclosure sale. All of these maneuvers raise red flags for bankruptcy courts. Since August 12, 1992, federal courts in Michigan have issued several written opinions either dismissing single-asset Chapter 11 real estate cases, or granting the lender some sort of relief from the automatic stay, based on a finding that the bankruptcy was filed in bad faith.[3] Dismissal of the bankruptcy case or relief from the automatic stay enables the mortgagee to foreclose. Each of these decisions is a victory for the mortgagee and a defeat for the debtor; and each case is very instructive.

In order to successfully represent either a debtor or a mortgagee in a single-asset Chapter 11 real estate case, it is important for the practitioner to understand these recent decisions. As debtor's counsel, the attorney must try to steer clear of facts and circumstances which courts have found to constitute a bad-faith bankruptcy filing. As lender's counsel, the attorney should understand these cases and be prepared to use them to gain appropriate relief.

1. In re Laguna Associates Limited Partnership, 147 B.R. 709 (Bankr. E.D. Mich. 1992), issued on August 12, 1992, granted a lender relief from the automatic stay due to the debtor's bad-faith filing of a single-asset Chapter 11 real estate case. The property at issue was a 384-unit apartment complex. Before bankruptcy this apartment project was owned by Beztak Company, a Michigan co-partnership ("Beztak"). 147 B.R. at 710.

Aetna Casualty and Surety Company ("Aetna") held, inter alia, a first mortgage to secure repayment of its $19.5 million loan given to finance the acquisition and construction of the apartment complex. 147 B.R. at 710. Aetna's mortgage recited the importance of the knowledge, experience, background, and creditworthiness of Beztak and its partners. 147 B.R. at 711. The loan agreement permitted **one** transfer of the property from Beztak to another entity on certain conditions, including the following: (1) there was no default, (2) Aetna received at least 30 days' prior written notice of the transfer, plus, inter alia, (3) evidence satisfactory to Aetna that the proposed transfer met Aetna's standards of credit-worthiness, or alternatively, certain of Beztak's partners retained at least a 5% general partnership interest in the transferee, together with practical control over the business and management of the apartment project. 147 B.R. at 711.

On February 28,1992, Beztak sent Aetna a letter purporting to constitute the 30-day notice required to transfer the project to Laguna Associates Limited Partnership ("Laguna Associates"). 147 B.R. at 711. Laguna Associates had been formed on February 11, 1992 (the date that the Michigan Department of Commerce accepted the required filing). Although the Certificate of Limited Partnership was received by the Michigan Department of Commerce on February 10, 1992, it recited that it was signed "as of January 2, 1992." 147 B.R. at 711. The Certificate of Limited Partnership named Beztak as the sole **limited** partner (and owner of a 99% interest) and named a corporation "Laguna General, Inc." ("Laguna General") as the sole general partner. 147 B.R. at 711. Laguna General had **no assets**. 147 B.R. at 713.

The letter recited that Laguna Associates was a "permitted transferee" under the loan agreement, and stated that the transfer was for estate planning purposes. 147 B.R. at 711-712. An executed but unrecorded quitclaim deed was enclosed with the letter. Although the deed was stated to be "Effective as of January 3, 1992," it was acknowledged by a Notary Public on February 19, 1992. 147 B.R. at 712. The deed recited that $10.00 in consideration was paid for the transfer. 147 B.R. at 712.

Since Beztak had not paid the real property taxes for the years 1990 and 1991, Beztak was in default under the loan agreement as of the date of the letter. 147 B.R. at 712. Beztak's February 28, 1992 letter to Aetna, with its enclosures, did not supply Aetna with any of the required evidence from which Aetna could determine whether the transferee met Aetna's customary credit and experience standards. 147 B.R. at 713. Since none of the required Beztak partners owned a 5% **general** partnership interest in Laguna Associates, Aetna argued that Laguna Associates was subject to Aetna's credit review and that Laguna Associates was **not** a "permitted transferee" as defined in the loan documents since it was self-evident that Laguna Associates would not meet Aetna's credit requirements. See 147 B.R. at 713. Although some of

the required partners at Beztak were **shareholders** in Laguna General (the sole general partner of Laguna Associates), their interest as shareholders was not equivalent to a general partnership interest. 147 B.R. at 713. On March 5, 1992 — just 9 days after the February 28, 1992 letter to Aetna — the quitclaim deed was recorded, transferring the project to Laguna Associates. 147 B.R. at 712. **The next day**, March 6, 1992, Laguna Associates filed a voluntary Chapter 11 petition. 147 B.R. at 712.

Shortly after Laguna Associates filed bankruptcy, Aetna filed a Motion for Relief of the Automatic Stay for "cause" under 11 U.S.C. §362(d)(1) arguing, inter alia, that Laguna Associates filed bankruptcy in bad faith, as indicated by the transfer of the property from Beztak to Laguna Associates on the eve of bankruptcy. In its argument, Aetna relied, in part, upon the "New Debtor Syndrome" — a pattern of facts recognized by other circuits as providing a basis for either dismissing a bankruptcy petition or granting relief from the automatic stay.

The New Debtor Syndrome has been identified as a certain pattern of conduct evidencing bad faith. The case most often relied upon is **In re Yukon Enterprises, Inc.**, 39 B.R. 919, 921 (Bankr. C.D. Cal. 1984). The factors consistently focused upon in the case law include the following (147 B.R. at 716):

(1) transfer of distressed real property into a newly created or dormant entity, usually a partnership or corporation;

(2) transfer occurring within close proximity to the filing of the bankruptcy case;

(3) no consideration being paid for the transferred property other than stock in the debtor;

(4) the debtor having no assets other than the recently transferred, distressed property;

(5) debtor having no or minimal unsecured debts;

(6) debtor having no company and no on-going business; and

(7) debtor having no means, other than the transferred property, to service the debt on the property.

In **granting** Aetna's motion, Judge Shapero first held that Aetna had the initial burden of showing that "cause" exists for granting relief from the automatic stay. However, once Aetna made a prima facie showing of "cause," the burden of going forward shifted to the debtor, and the debtor had the ultimate burden of persuasion pursuant to 11 U.S.C. §362(g). 147 B.R. at 714. The court rejected the debtor's notion that Aetna had a heavy burden of proof in order to establish that the case was filed in bad faith. 147 B.R. at 715.

The court ruled that in determining whether the bankruptcy was filed in bad faith, the court could consider **any factors** which evidence an intent to abuse the bankruptcy process, or that the bankruptcy petition was filed to delay a secured creditor's legitimate effort to enforce its rights. 147 B.R. at 716. The court then found that whether bad faith existed in this case was best analyzed according to the elements of the New Debtor Syndrome as set forth in **Yukon, supra**, (147 B.R. at 717), because it included, inter alia, the following salient facts (147 B.R. at 718):

(1) a flawed eleventh-hour attempt of Beztak and its partners to transfer the property to the debtor;

(2) a transferee, asset-less debtor, which appeared to have been created solely for the purpose of holding the property and, by inference, for essentially isolating it from the remaining operations of Beztak as transferor;

(3) a situation wherein the property cannot support its expenses and required debt payments;

(4) the filing of bankruptcy in close proximity to the transfer or attempted transfer of the property;

(5) the fact that the day-to-day management of the property remains in the same managerial hands (an entity associated with Beztak) regardless of the transfer;

(6) the apparent lack of consideration being paid for the transfer other than the transferred interests in the Debtor; and,

(7) harm to Aetna — namely a loss of its bargained-for relationship with Beztak, the transferor.

Therefore, Judge Shapero concluded that Aetna had established a prima facie case of bad faith, and that

the debtor failed to carry its burden of going forward and its ultimate burden of persuasion on the good faith issue. Consequently, Judge Shapero found that "cause" existed for granting Aetna relief from the automatic stay, and the automatic stay was lifted. However, Judge Shapero granted the debtor's request for a stay pending appeal.

Laguna Associates appealed to the United States District Court for the Eastern District of Michigan (where it was assigned Case Number 92-75390). On April 12, 1993, District Judge Edmunds affirmed Judge Shapero's ruling, holding that his finding that Laguna Associates filed bankruptcy in bad faith was not an abuse of discretion as it was well supported by the record. (Judge Edmunds' Opinion, pg. 10.) Judge Edmunds also confirmed Judge Shapero's ruling on the burden of proof issue, and held that the great weight of authority supports the notion that once Aetna made a prima facie showing of "cause" for relief from the automatic stay (i.e., that the petition was filed in bad faith), Laguna Associates had the burden of proof to show that it filed for bankruptcy in good faith. (Judge Edmunds' Opinion, pg. 12.)

The debtor appealed to the Sixth Circuit Court of Appeals. Oral argument was held in May, 1994; the opinion had not yet been issued as this article went to print.

2. On October 22, 1992, District Judge Edmunds issued a written appellate opinion in **In re Seven Lakes of Northville, Case No. 92-76146 (E.D. Mich. October 22, 1992)**. **Seven Lakes** involved a bankruptcy filing shortly before a foreclosure sale. Seven Lakes of Northville was a Michigan limited partnership that owned a 350-acre parcel of land in Northville Township, Michigan. Alexander Hamilton Life Insurance Company of America and Home Federal Service Corporation, the holders of the first mortgage on the property, filed a foreclosure action in state court in March, 1991 due to the debtor's monetary and non-monetary defaults. After months of litigation, the lenders obtained a judgment, and the state court ordered the foreclosure sale. The sale was scheduled for August 5, 1992. (Judge Edmunds' Opinion, pgs. 1-2.)

A few days before the scheduled sale, D & T Construction Company, a general partner of the debtor, ("D & T") filed an involuntary Chapter 11 bankruptcy petition against the debtor. The lenders then filed a motion seeking three alternative types of relief: (1) dismissal of the debtor's bankruptcy for lack of good faith, (2) relief from the automatic stay, or (3) abstention. The lenders' motion was supported by several exhibits, including an affidavit from the debtor's other general partner which stated that the property generated no cash flow and that unless the debtor received a cash infusion, the debtor was unlikely to reorganize. (Judge Edmunds' Opinion, pg. 2.)

On October 1, 1992, the bankruptcy court held a hearing on the lenders' motion, at the end of which the court granted the lenders relief from the automatic stay; an order to this effect was entered on October 13, 1992. On October 14, 1992, the bankruptcy court entered its Memorandum and Order denying the Ex-Parte Motion of D & T for a Stay Pending Appeal. D & T then brought its Motion for a Stay Pending Appeal before Judge Edmunds of the United States District Court. (Judge Edmunds' Opinion, pp. 2-3.)

Judge Edmunds first ruled that the bankruptcy court's denial of the stay pending appeal was entitled to deference and was to be reviewed according to the "abuse of discretion" standard. (Judge Edmunds' Opinion, pg. 3.) Judge Edmunds then applied the following standards for a stay pending appeal:

> (1) There must be a strong showing of a likelihood of success on the merits of the appeal;
>
> (2) The appellant will suffer irreparable harm unless the stay is granted;
>
> (3) The other parties will not suffer substantial harm if the stay is granted; and,
>
> (4) The public interest will be served by granting the stay.

(Judge Edmunds' Opinion, pp. 3-4.)

Judge Edmunds affirmed the bankruptcy court's denial of D & T's request for a stay pending appeal, finding that D & T could not make the required strong showing of a likelihood of success on the merits of the appeal. (Judge Edmunds' Opinion, pgs. 7-8.) D & T argued that a real estate venture **never** has cash flow during the development stage, and that **if** cash flow is required for a Chapter 11, a real estate venture is virtually ineligible for Chapter 11. The court rejected this argument, stating:

> This argument is not valid. A real estate partnership could reorganize under Chapter 11 if it had binding loan or other cash infusion

> commitments. In this case, the Debtor had no such binding commitments .... The bankruptcy court found that the stay was not intended to protect the debtor while the debtor continues to speculate in an uncertain market. Chapter 11 is intended to provide a time period for a debtor to reorganize. Where there is no possibility of a reorganization, the automatic stay should be lifted. (Judge Edmunds' Opinion, pg. 5.)

Judge Edmunds noted that neither D & T nor the debtor had submitted a credible plan of reorganization (Judge Edmunds' Opinion, pg. 6.), but instead seemed to be hoping for new financing. A mere hope of refinancing was simply not enough. (Judge Edmunds' Opinion, pg. 7.) Judge Edmunds also denied the stay pending appeal because she found that D & T brought its Motion for a Stay Pending Appeal for the purpose of delay. (Judge Edmunds' Opinion, pg. 7.) The automatic stay was lifted with respect to the property.

3. On December 8, 1992 Bankruptcy Judge Rhodes issued a written opinion in **In re Ocean Beach Properties, 148 B.R. 494 (Bankr. E.D. Mich. 1992)**, granting relief from an automatic stay. **Ocean Beach** involved two related general partnerships named Ocean Beach Properties and Ocean Shore Investments, respectively. These two general partnerships owned three undeveloped parcels on an island off the eastern coast of Florida. 148 B.R. at 495. First National Bank and Trust Company of the Treasure Coast was the primary secured lender ("Bank"). 148 B.R. at 495. The property had never generated income, nor was any income expected in the short term. 148 B.R. at 497. The debtors had not yet obtained all the permits necessary to develop the property. 148 B.R. at 498. Moreover the debtors required approximately $3 million to finish the project and to place buildable lots on the market for sale. 148 B.R. at 498. The Bank sought to foreclose; the debtors filed bankruptcy on the eve of foreclosure. 148 B.R. at 495. The Bank then filed a Motion for Relief from the Automatic Stay for "cause" under 11 U.S.C. §362(d)(1), alleging that the debtors' bankruptcy was filed in bad faith and therefore "cause" existed for granting relief from the automatic stay. 148 B.R. at 495.

Judge Rhodes first held that under 11 U.S.C. §362(g)(2) the debtors had the burden of showing that bankruptcy was filed in good faith. 148 B.R. at 495. Next, Judge Rhodes concluded that he should evaluate the evidence before him based on the 3-prong test articulated in **In re Winshall Settlor's Trust**, 758 F.2d 1136, 1137 (6th Cir. 1985), namely:

> (1) Whether the debtors have assets;
>
> (2) Whether the debtors have an ongoing business to reorganize; and
>
> (3) Whether there is a reasonable probability that the debtors can propose a viable plan of reorganization. 148 B.R. at 496.

After concluding that the debtors had assets (which was a complex issue in the context of this case), the court considered whether the debtors had an ongoing business to reorganize. The Bank argued that the debtors had no on-going business to reorganize because no income had ever been received from this business, nor would any be received in the short term. 148 B.R. at 497. Judge Rhodes acknowledged that in this circumstance it was difficult to find that the debtors had a business to reorganize:

> As noted in **Winshall Settlor's Trust**, the purpose of Chapter 11 is to reorganize the business. It is certainly true that reorganization might in appropriate cases consist of either **rehabilitation** of the debtors' business or the orderly **liquidation** of the debtors' assets. The law as it has developed under Chapter 11 permits either course of action or a combination of both courses of action. ... Nevertheless, neither rehabilitation nor an orderly liquidation is involved in this case. This case involves two entities which resemble start-up operations with insufficient capital, which invoke Chapter 11 in an effort to get their business to the point where it will become operational with income to pay its debts. The Court concludes that such a use of Chapter 11 is questionable. The Court is not prepared to hold that such is always inappropriate, because the Court concludes that in certain circumstances, it may, nevertheless, be appropriate to allow such a business the benefit of Chapter 11. Therefore, this Court holds that the most persuasive evidence that an enterprise with no current income has an ongoing business for the purposes of Chapter 11, is evidence of a reasonable possibility of reorganization. 148 B.R. at 497.

Judge Rhodes then analyzed the final and pivotal issue: whether there was a reasonable probability that

the debtors could reorganize. After reviewing the evidence, Judge Rhodes concluded that the debtors failed to establish any reasonable prospect for reorganization. 148 B.R. at 498. Although they had made substantial progress in obtaining some (but not all) of the permits necessary to develop the project, the evidence failed to show that the debtors had any firm plans for obtaining the $3 million in financing which was needed to finish the project. 148 B.R. at 498. The court found that the debtors' hopes for future financing were not credible because the debtors had failed to raise required financing in the past, even among partners who had a stake in the project. 148 B.R. at 498. Moreover, the property was in a remote location on the island, near a nuclear power plant and far away from shopping and other facilities. 148 B.R. at 498. Considering all of these facts, Judge Rhodes concluded that the debtors did not have any reasonable prospect of reorganization. 148 B.R. at 498.

At the end of his opinion, Judge Rhodes confirmed that enterprises that lack current income, such as start-up enterprises, are generally not viable candidates for a Chapter 11 reorganization:

> The Court's ultimate conclusion is that although an enterprise without current income may be eligible for Chapter 11, such an enterprise faces substantial obstacles in establishing a reasonable prospect of reorganization, if only because it lacks a record and a history of operation. In appropriate circumstances, such a case might be a good faith filing, but the Court concludes there is insufficient evidence of that in this case. 148 B.R. at 499.

In a footnote at the conclusion of the case, Judge Rhodes explained that his ruling was not motivated by the fact that this was a single-asset real estate case or that it was filed on the eve of foreclosure:

> In this Court's view, it is of no particular weight or moment in judging the good faith issue that the case involves a single asset, that the assets are real estate, or that the case was filed on the eve of foreclosure. These factors are certainly important in providing the context of issues to be addressed, but by themselves do not play any substantial role in determining whether the case was filed in good faith. In this Court's view, the number of assets is insignificant. That the case was filed on the eve of foreclosure only suggests that the debtor is in need of financial reorganization. Likewise, the mere fact that the case involves real estate as opposed to some other kind of asset is insignificant. 148 B.R. at 499.

4. In **In re Grand Traverse Development Company Limited Partnership**, 150 B.R. 176 (Bankr. W.D. Mich. 1993), the secured creditor sought relief from the automatic stay and the debtors sought confirmation of a plan. In a complex opinion, Bankruptcy Judge Stevenson denied plan confirmation and granted the motion for relief from the automatic stay.

The case involved three debtors: Grand Traverse Development Company Limited Partnership ("Partnership"), Grand Traverse Development Company, Inc. ("Development Company") and Grand Traverse Condominium Developers, Inc. ("Condominium Developers"). The Partnership owned the Grand Traverse Resort Hotel consisting of hotel rooms, restaurants and bars, conference and meeting rooms, retail stores and two golf courses. 150 B.R. at 179. The Development Company was a Michigan corporation which held the liquor license for the Grand Traverse Resort Hotel's bars and restaurants, and operated all of the hotel business pursuant to an operating agreement. 150 B.R. at 179. Condominium Developers was the real estate development and sales component of the Grand Traverse Resort. 150 B.R. at 179.

The undersecured creditor of the debtors was the General Retirement System of the City of Detroit ("Retirement System"). 150 B.R. at 178. The General Retirement System established a separate corporation named Grand Hotel Corporation ("Hotel Corp."). 150 B.R. at 179. (General Retirement System and Grand Hotel Corporation are hereinafter collectively called "GRS".) Retirement System held a secured note in the original principal amount of approximately $37 million. This note and other security documents were assigned to Hotel Corp. In March of 1992, Massachusetts Mutual Life Insurance Company ("Massachusetts Mutual") assigned its secured note in the principal amount of $35 million and related security documents to Retirement System. 150 B.R. at 179. The debtors defaulted on these loans in January 1992. Since the parties were unable to resolve their financial differences, GRS began a foreclosure action in the Grand Traverse County Circuit Court. 150 B.R. at 179.

On April 16, 1992 — **minutes before** the foreclosure sale — the debtors filed their first voluntary Chapter 11 petition. 150 B.R. at 179. In their April, 1992 bankruptcy schedules the debtors listed GRS as being owed approximately $47 million. GRS, however, claimed to be owed approximately $82 million, as a result of its direct loans to the debtors **and** its purchase of the secured debt owing to Massachusetts Mutual. 150 B.R. at 179.

One week after the debtors filed bankruptcy — on April 23, 1992 — GRS filed a Motion for Relief from the Automatic Stay. 150 B.R. at 179. Shortly thereafter, GRS and the debtors appeared to reach a resolution of their controversy. On May 1, 1992 the debtors filed a motion seeking to dismiss the Chapter 11 proceeding. That Motion to Dismiss contained the following language:

> Although there is little or no possibility that pre-petition unsecured creditors will be paid **because the Debtor has no reasonable likelihood of rehabilitation and an inability to effectuate a plan**, GRS will continue The Grand Traverse Resort Operation furnishing the unsecured creditors new business and revenue. 150 B.R. at 179-180.

On May 14, 1992, the court entered a stipulated order granting GRS relief from the automatic stay. On June 3, 1992, the court entered a dismissal order based upon the parties' agreement that GRS would hire an experienced hotel management company to run the resort, the foreclosure sale would proceed as scheduled, and the debtors would have an opportunity to redeem the property within the six-month redemption period for a dollar figure significantly less than the total debt. 150 B.R. at 180.

Difficulties developed after entry of the June 3, 1992 dismissal order. The debtors filed a lawsuit in the Grand Traverse County Circuit Court seeking to restrain the second foreclosure sale. 150 B.R. at 180. That lawsuit alleged that the debtors had been fraudulently induced into entering into the security agreement with GRS, and that GRS was not a true secured creditor but, instead, was a partner. 150 B.R. at 180. The state circuit court apparently denied the debtors' request for temporary injunctive relief. 150 B.R. at 180. On July 7, 1992 — **minutes before the second scheduled foreclosure sale** — the debtors filed their second voluntary Chapter 11 bankruptcy petition. 150 B.R. at 180.

Even though this was the debtors' second journey into bankruptcy within three months, the second Chapter 11 petition looked somewhat promising because the debtors filed a proposed plan of reorganization with their second bankruptcy petition, and quickly removed their lawsuit against GRS from the Grand Traverse County Circuit Court to the Bankruptcy Court. 150 B.R. at 180.

On July 15, 1992, eight days after the debtors' filed their second bankruptcy petition, GRS filed its Motion for Relief from the Automatic Stay both for "cause" pursuant to 11 USC §362(d)(1), and for lack of equity and lack of need of the property for a successful reorganization under 11 USC §362(d)(2). 150 B.R. at 182. Since the debtors represented that they could move swiftly toward confirmation of a plan, the court decided that it would hear GRS' Motion for Relief from the Automatic Stay on a consolidated basis with the debtors' motion to confirm their plan. 150 B.R. at 180. The debtors' disclosure statement was approved on October 28, 1992. 150 B.R. at 180. A valuation hearing was scheduled for late November, at the conclusion of which the court determined that the three parcels comprising the Resort property had an aggregate value of $24.8 million. 150 B.R. at 180.

On November 30, 1992, the court began the hearing on GRS' Motion for Relief from the Automatic Stay. By December 4, 1992 GRS had met its burden of proving a prima facie case for relief from the stay. 150 B.R. at 181. On December 15, 1992, minutes before commencing their defense to GRS' Motion for Relief from the Automatic Stay, the debtors filed an amended plan of reorganization (their fourth). On December 22, 1992 — five days later — the debtors' filed a **fifth** amendment to their plan of reorganization, which the court considered in its opinion. 150 B.R. at 181. In order for the debtors' fifth plan to be feasible, the secured claim of GRS had to be reduced from $82 million to approximately $15.8 million. 150 B.R. at 182. The debtors argued that, despite the apparent enormity of the task, **if,** inter alia, the debtors won their pending lawsuit against the GRS, and reduced the value of one of the parcels by $2.5 million, then GRS' secured claim would be reduced and the fifth amended plan would be feasible. 150 B.R. at 182. Therefore, feasibility of the debtors' plan assumed that the court's valuation of the real property was in error. 150 B.R. at 184.

In early 1993, the court addressed GRS' Motion for Relief from the Automatic Stay, and granted it.

First, Judge Stevenson noted that since GRS had made a prima facie showing that it was entitled to relief from the automatic stay, 150 B.R. at 181, the debtors had the burden of proof pursuant to 11 U.S.C. §362(g). 150 B.R. at 183. In order to carry this burden under 11 USC §362(d)(2), the debtors would have to prove that the property was necessary for their reorganization **and** that an effective reorganization was in prospect. 150 B.R. at 183. The court concentrated on whether an effective reorganization was "in prospect" and acknowledged that the debtors' burden on this issue becomes increasingly difficult as bankruptcy proceedings progress. Due to the circumstances of this case (i.e., the bankruptcy case had been pending for six months and the confirmation hearing had been pending for two months), the court held that the debtors had a heavy burden of proof and must show that confirmation of a plan is virtually guaranteed. 150 B.R. at 183.

Judge Stevenson concluded that the debtors' ability to reorganize rested entirely upon the outcome of their lawsuit against GRS, and therefore the debtors could not show that an effective reorganization was "in prospect." 150 B.R. at 183. In so ruling, the bankruptcy court rejected the debtors' argument that it was required to resolve the lawsuit between the debtors and GRS before granting GRS' motion for relief from the automatic stay. 150 B.R. at 187. Based on the legislative history of 11 U.S.C. §362(d), Judge Stevenson held that a lift of stay hearing was not the appropriate time in which to consider the merits of the debtors' lawsuit against GRS. 150 B.R. at 188. The court then raised its foremost concern, namely whether the **purpose** of the automatic stay would be served, or hindered, by allowing the automatic stay to remain in force pending the bankruptcy court's determination on the merits of the debtors' adversary proceeding against GRS (which was removed from state court to bankruptcy court when the debtors filed their second bankruptcy). 150 B.R. at 189. Noting that the automatic stay may be an inappropriate means of barring GRS' exercise of its legitimate state law remedies, 150 B.R. at 189, the court stated:

> On the record already before the court it is clear that, even if the Debtors could establish that they were entitled to a preliminary injunction at this point in time, the policies of the automatic stay would not be furthered by the continuation of that stay as a surrogate for a preliminary injunction. What we have here is a case of the tail wagging the dog. Reorganization hinges completely upon the Debtors' success in this adversary suit. If the Debtors can prevail in the adversary proceeding, they can confirm any number of plans. If the adversary proceeding fails, it has little hope of obtaining more than a liquidation or surrender of its assets. In such a situation, the Chapter 11 case serves as little more than an attaching point for the adversary proceeding which absent bankruptcy would be a state court case. The only advantage gained by the Debtors by being in Chapter 11 is the automatic stay. 150 B.R. at 190.

Since the only purpose of the automatic stay in the debtors' case was as a substitute for a preliminary injunction, the court concluded that was an inappropriate use of the automatic stay. 150 B.R. at 191. Therefore, Judge Stevenson held that the appropriate remedy was to lift the automatic stay and remand the debtors' lawsuit against GRS to state court, where the debtors could seek a preliminary injunction. 150 B.R. at 191.

Having already ruled that the automatic stay should be lifted pursuant to 11 U.S.C. §362(d)(2), the court proceeded to lift the automatic stay for "cause" under 11 U.S.C. §362(d)(1) due to the debtors' bad faith. 150 B.R. at 191. The court concluded that the debtors' initial cooperation in the second bankruptcy proceeding had deteriorated to tactics of desperation and delay. 150 B.R. at 193. After the valuation hearing the debtors were consumed with fending off GRS, rather than moving forward toward confirmation of any realistic plan. 150 B.R. at 194. The court noted the debtors' strategy of filing multiple last-minute plans. 150 B.R. at 194. The court found that the several instances of inconsistency in the debtors' positions and arguments constituted a "bellwether of bad faith." 150 B.R. at 194. In the debtors' first bankruptcy case, the debtors stipulated that the liens of GRS were valid and enforceable; however, in their second bankruptcy the debtors sought to divest GRS of its entire claim. 150 B.R. at 195. In dismissing their first bankruptcy, the debtors stipulated that a reorganization was not possible; in the second bankruptcy the debtors insisted that reorganization was possible and that the court should give them the chance to reorganize. 150 B.R. at 195. Based upon all these factors, the court granted GRS' Motion for Relief from the Automatic Stay for "cause" pursuant to 11 USC §362(d)(1). An order to this effect was entered on February 8, 1993. On February 9, 1993, Judge Stevenson denied the

debtors' motion for a stay of her February 8, 1993 order. 151 B.R. at 795.

The debtors appealed to the United States District Court for the Western District of Michigan, and sought a stay pending appeal. In an 18-page opinion, (151 B.R. 792 (W.D. Mich 1993)) District Judge Quist denied the debtors' motion for a stay pending appeal, concluding that the debtors did not demonstrate a likelihood of success on the merits (151 B.R. at 799) and that the other parties, and the public interest, would be harmed if a stay was issued, especially since the debtors admitted that they would "run out of cash shortly" and that they needed more than $1 million to keep the Resort open through 1993. 151 B.R. at 800. On balance, the court ruled that the four factors for a stay pending appeal[4] militated against the debtors and therefore Judge Quist declined to enter an order staying Judge Stevenson's February 8, 1993 order regarding lift of the automatic stay.

5. In re Trident Associates Limited Partnership, Case No. 93-46907-G, issued on September 30, 1993, granted a lender relief from an automatic stay in a single-asset Chapter 11 real estate case. The debtor's only asset was a commercial building in Farmington Hills, Michigan known as Tri Atria Center. (Judge Graves' Opinion, pg. 3.) Metropolitan Life Insurance Company ("Metropolitan") held, inter alia, a mortgage on the property to secure repayment of a $23 million loan. (Judge Graves' Opinion, pg. 3.) A default occurred under the mortgage, namely failure to pay the 1990 and 1992 real property taxes. (Judge Graves' Opinion, pg. 3.) Metropolitan recorded a Notice of Default under the mortgage with the Oakland County Register of Deeds, and thereafter began foreclosure by advertisement. (Judge Graves' Opinion, pg. 3.) The foreclosure sale was originally scheduled for June 15, 1993, but was adjourned to June 22, 1993.

Judge Graves found that the debtor's pre-bankruptcy strategy "revealed a methodical plunge into bankruptcy." (Judge Graves' Opinion, pg. 2.) On June 14, 1993, a bankruptcy petition was prepared in the name of "Trident Associates Limited Partnership," and was signed by a representative of "Trident General, Inc." as the general partner of the debtor. However, Trident General, Inc. was not yet formed on June 14, 1993, when its representative signed the debtor's bankruptcy petition; it was not incorporated until June 15, 1993. (Judge Graves' Opinion, pg. 2.) Also on June 15, 1993, and without the permission of Metropolitan as required, a certificate of Amendment of the Limited Partnership was filed changing the name of the limited partnership to "Trident Associates Limited Partnership." (Judge Graves' Opinion, pg. 2.) Judge Graves noted that it appeared that the limited partnership was reconstituted to create a new entity without the required notice to Metropolitan. (Judge Graves' Opinion, pg. 3.)

The foreclosure sale was held at 10:00 a.m. on June 22, 1993, and at 10:05 a.m. Metropolitan made a bid in the amount of $19 million. Metropolitan was the successful bidder. (Judge Graves' Opinion, pg. 3.) **Minutes** later, at 10:09 a.m., the debtor filed its Chapter 11 bankruptcy petition.

Metropolitan filed a motion seeking relief from the automatic stay. The debtor admitted that it had no equity in the property and that it did not have any other ongoing business to reorganize. (Judge Graves' Opinion, pg. 5.)

After noting that it is rare for the Court to lift the automatic stay for "bad faith," Judge Graves noted that under **Society National Bank v Barrett**, 964 F.2d 588 (6th Cir. 1992), the determination of "bad faith" is to be made based upon the totality of the circumstances. (Judge Graves' Opinion, pg. 4.) Judge Graves found that this case was "representative of the archetype bad faith case" (Judge Graves' Opinion, pg. 4.), and that the facts of this case portrayed "unambiguous manifestations of bad faith." (Judge Graves' Opinion, pg. 5.) Judge Graves stated that the fact that this case was a single-asset real estate case did not, by itself, constitute cause for dismissal of the debtor's case; it did, however, "give rise to further inquiry." (Judge Graves' Opinion, pg. 5.) Judge Graves found the timing of the debtor's bankruptcy filing to be "pernicious" and an attempt to delay Metropolitan's foreclosure efforts. (Judge Graves' Opinion, pg. 5.) Based on, inter alia, these findings, Judge Graves granted relief from the automatic stay.

The debtor appealed to the United States District Court (where it was assigned Case Number 93-CV-72996-DT). On November 19, 1993, District Judge Barbara Hackett affirmed Judge Graves' decision. The debtor appealed to the Sixth Circuit Court of Appeals; briefs have been filed and that appeal remains in progress as this article goes to print.

6. On February 25, 1994 United States District Court Judge Gadola issued an Opinion and Order affirming the Bankruptcy Court's dismissal of a single

asset Chapter 11 bankruptcy case in **In re Gateway North Estates**, Civil Case No. 93-70519 (E.D. Mich. February 25, 1994). The debtor was a land-holding corporation whose only assets were three undeveloped parcels of real estate, two located in Florida, and one located in Michigan. (Judge Gadola's Opinion, pg. 2.) On August 7, 1992 a Florida state court entered a judgment of foreclosure regarding the Florida parcels; the sale was scheduled for October 6, 1992. (Judge Gadola's Opinion, pg. 2.)

On October 1, 1992 the debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court for the Eastern District of Michigan. (Judge Gadola's Opinion, pg. 2,) A one-page proposed plan of reorganization accompanied the Chapter 11 petition. The plan proposed to sell the Florida parcels and pay the sale proceeds to the Judes, who were apparently the secured creditors. (Judge Gadola's Opinion, pg. 2.) On November 5, 1992 the United States Trustee filed a motion to convert the debtor's Chapter 11 to a Chapter 7 liquidation, or, alternatively, to dismiss the bankruptcy case. (Judge Gadola's Opinion, pg. 1.) The Judes concurred in this motion. On January 21, 1993 the Bankruptcy Court granted the U.S. Trustee's motion and dismissed the bankruptcy case after finding that there was no hope for the debtor's reorganization, and that the facts surrounding the debtor's bankruptcy were inconsistent with the purposes of Chapter 11. (Judge Gadola's Opinion, pg. 2.) The debtor appealed to the Federal District Court.

Judge Gadola ruled that bankruptcy court provides a safe harbor only so long as a Chapter 11 debtor continues to show evidence that an effective reorganization of the enterprise is reasonably possible. (Judge Gadola's Opinion, pg. 4.) Relying upon **In re Winshall Settlor's Trust**, 758 F.2d 1136 (6th Cir. 1985), Judge Gadola held that a debtor without assets, creditors, or ongoing business cannot effectively rehabilitate itself. (Judge Gadola's Opinion, pg. 4). The court then found that the debtor had no assets other than the three parcels of undeveloped real estate — two of which were the subject of foreclosure proceedings. The debtor admitted that it had no employees or income, and there was no evidence of any ongoing business. (Judge Gadola's Opinion, pg. 4.) The debtor admitted that its sole purpose was to hold the land until the optimum time to sell. (Judge Gadola's Opinion, pg. 4.) Applying the factors set forth in **Winshall,** supra, Judge Gadola held that there was no reasonable probability that this debtor could reorganize. The Court also found that the debtor's bankruptcy filing a mere five days before the foreclosure sale was in bad faith, and an obvious tactic to delay that sale. Therefore, Judge Gadola affirmed the bankruptcy court's dismissal of this case.

The debtor appealed to the Sixth Circuit Court of Appeals. That appeal remains in progress as this article goes to print.

CONCLUSION

There is no foolproof way to ensure that a single-asset Chapter 11 real estate case will survive a motion for dismissal or relief from the automatic stay based on bad faith. However, the cases discussed above are very instructive and enable the practitioner to distill several factors which render a single-asset Chapter 11 real estate case vulnerable to the lender's motion for dismissal or relief from the automatic stay, such as:

1. Filing of the bankruptcy on the eve of a foreclosure, which is often held to constitute evidence of an intent to delay or frustrate the legitimate efforts of the secured creditors to enforce their rights.

2. A transfer of distressed real estate into a newly-created or dormant entity, especially if there are anomalies in the formation of the new or dormant entity.

3. A transfer of the distressed real estate occurring within close proximity to the filing of the bankruptcy.

4. Anomalies in the transfer document such as back-dating the effective date, or little or no consideration being paid for the transferred property.

5. Evidence that the transfer of the real estate to the debtor was not an "arms length" transaction.

6. The debtor's lack of means, other than the distressed property, to service the debt on the property.

7. The debtor having few unsecured creditors whose claims are relatively small.

It also appears that start-up entities are questionable candidates for Chapter 11 reorganization.

Debtor's counsel in a single-asset Chapter 11 real estate case should carefully analyze the written opinions discussed in this article **before** filing a

bankruptcy petition to determine how many of the "red flags" are present, and to advise the debtor regarding the likelihood of the lender receiving relief from the automatic stay or dismissal of the bankruptcy case. Otherwise, the debtor risks incurring significant costs with no real benefit.

ENDNOTES

1. Judge Rhodes made his feeling on this subject abundantly clear in footnote 3 of his opinion in **In re Ocean Beach Properties**, 148 B.R. 494, 499 (Bankr. E.D. Mich. 1992):

   In This court's view, it is of no particular weight or moment in judging the good faith issue that the case involves a single asset, that the assets are real estate....

2. These cases are beyond the scope of this article but include, **inter alia**, e.g. **In Re Eastland Partners Limited Partnership**, Case No. 91-03149-R (Dec. 8, 1992) in which Judge Rhodes issued an opinion confirming the debtor's plan of reorganization.

3. The status of the opinions in one case, **In Re Washtenaw Huron Investments Corp. No. 8**, 150 B.R. 31 (Bankr. E.D. Mich. 1993), affirmed by District Judge Edmunds on April 12, 1993 in Case No. 92-76851, was uncertain as this article went to print. Therefore those opinions will not be discussed in this article.

4. The four factors are:

   (a) Likelihood that the party seeking the stay will prevail on the merits of the appeal.

   (b) The movant will suffer irreparable injury unless the stay is granted.

   (c) Other parties will suffer no substantial harm if the stay is granted.

   (d) The public interest will not be harmed if the stay is granted.

ANALYZING LEASE TAX CLAUSES IN RESPONSE TO POTENTIAL TAX RESTRUCTURING

by *Alan M. Hurvitz* and *Kenneth F. Posner**

The enactment of 1993 PA 145 (Senate Bill 1) by the Michigan legislature last year and the resultant passage in March of Proposal A have caused a profound change in the manner in which revenue is generated by the State of Michigan. Ad valorem real estate taxes levied against commercial properties have been, in most instances, significantly reduced. Several existing taxes have been increased to compensate for the loss in revenue caused by the reduction in ad valorem real estate taxes, including increases in the sales tax, real estate transfer tax, and taxes on tobacco products. A new tax has been created with respect to interstate telephone calls. Finally, annual assessment increases are now limited to the lower of 5% or the rate of inflation until reassessment upon sale or other transfer.

These changes to the Michigan tax structure have caused many landlords and tenants doing business in the State of Michigan to review the tax clauses in their leases to determine who will benefit from the reduction in real

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estate taxes, and who will be burdened by the increases in existing taxes and the creation of new taxes. While it is hard to imagine a method by which a landlord could pass through the 2% increase in sales tax, a tenant with a broad substitute tax clause in its lease might find itself subject to the increased transfer tax upon the sale of the commercial development of which it is a part. Furthermore, a tenant signing a lease in the year before a sale of the development occurs might experience a tremendous increase in taxes as a result of a reassessment upon sale, although the tenant received none of the benefit of lower taxes in previous years.

The tax restructuring has also caused many real estate attorneys to reexamine the tax clauses which they are currently using when drafting or reviewing leases to determine, in the first instance, whether the clauses are sufficiently clear with respect to each party's obligation as to taxes other than ad valorem real estate taxes in order that the intent of their client is properly reflected. The taxes and assessments for which a tenant may be held responsible under a lease are generally determined by the intent of the parties, as gathered from a construction of the lease as a whole. **Black vs. General Wiper Supply Co.**, 305 N.Y. 386, 113 N.E.2d 528 (1953). If a lease merely specifies that a tenant will pay its share of real estate taxes, the tenant may not have the responsibility for taxes on rents, transfer taxes, water or sewer taxes, or any special assessments. On the other hand, if the real estate tax clause has been broadly drawn, it is possible that the tenant will be responsible for transfer taxes, taxes on rents, income taxes, and even, through special assessments, the cost of construction of portions of the development of which the tenant's premises forms a part. Under Proposal A, specific attention should now be given to the allocation of costs upon the sale or transfer of the development in which a tenant's premises is located. Will the landlord be able to pass through that portion of the transfer tax which was enacted as a substitute for real estate taxes? Will a tenant be responsible for its proportionate share of the large increase in taxes which may occur at the time of a transfer because of the reassessment provision? Will a tenant under a gross lease be able to insist upon a reduction in gross rent because of the reduced tax liability and resulting savings to the landlord?

While landlords have been creative in drafting real estate tax clauses in order to anticipate substitute tax problems, few if any reported decisions are available. Most of the literature reflects a more practical or analytical approach to the drafting or interpretation of real estate lease clauses. For example, Emmanuel B. Halper's 1991 article in *The Practical Real Estate Lawyer*, pp. 49-68 (May 1991), is similar to the treatment he provides in his treatise. Halper, E., Shopping Center and Stores Leases, §§5.05-5.09 (Law Journal Seminars - Press 1993). He provides a very detailed and helpful discussion of the drafting and interpretation of real estate tax clauses, but very little discussion of the cases interpreting these clauses.

Similarly, in his treatise, *Friedman on Leases*, Milton C. Friedman provides exhaustive research on the multitude of issues that must be considered with respect to the drafting of the entire real estate tax provisions of a lease, but provides little case background with respect to litigation regarding the interpretation of substitute tax or definitional clauses. Friedman, M., *Friedman on Leases*, §5.201, p. 117, note 24 (Practicing Law Institute, 1990, supp. 1992). Finally, there are some helpful practical guides that may assist in analyzing existing or potential real estate tax clauses.[1]

Many of the issues raised by Proposal A will be cases of first impression in Michigan, and the exact language set forth in a tax clause will probably be the determining factor in ascertaining the rights of the parties. The impact of Proposal A, however, reaches far beyond the specific issues arising from the substance of the statute. Discussions as to possible alternative tax devices have caused landlords, tenants, and their attorneys to realize that the hypothetical situations often contemplated by lengthy and comprehensive tax clauses can be a reality. An attorney must take care to protect his client by carefully drafting the real estate tax clause to contemplate not only the current state of affairs, but what may happen in the future.

To assist the attorney in drafting a clear, comprehensive clause, either from the landlord's or tenant's viewpoint, we have collected several real estate tax clauses and have reviewed the clauses to determine, from both a landlord's and a tenant's viewpoint, how the clauses could be revised to be more inclusive or exclusive, as the case may be. We have not, however, analyzed the clauses in terms of calculating a tenant's pro rata share, prorating taxes for the start and end of a lease term, and other important issues that should be evaluated when drafting such a clause.

DETROIT BOARD FORM

The Detroit Board Form lease does not contain any language concerning the payment of real estate taxes or assessments. Generally, a court will not imply an

obligation on the part of a tenant to pay taxes if the lease is silent on the point, **Greenberg v Madison Heights**, 124 Mich. App. 168, 170, n.2, 333 N.W.2d 614 (1983), although if real estate taxes increase as the result of improvements made for the sole benefit of the tenant, the tenant may be found to be liable for such increase. **Wycoff v Gavriloff Motors, Inc.**, 362 Mich. 582, 107 N.W.2d 820 (1961). Unless the landlord intends that the rent stated in the lease be inclusive of taxes, the landlord must add a rider to the Detroit Board form containing a provision requiring the tenant to pay taxes and assessments and contemplating the issues raised in this article.

MODEL CLAUSE A

> "Real Estate Taxes" means (i) all general or ad valorem real estate taxes and (ii) assessments, both general and special, for public improvements for benefits, which shall, during the term hereof, be levied or assessed (and in the case of any prior assessments, the installments thereof which shall be payable during the term hereof) against or upon the land, buildings and other improvements within the Tax Parcel; provided, however, that with respect to any assessments levied against or upon the Tax Parcel and the improvements thereon which under the laws then in force may be paid in installments, there will be included within Real Estate Taxes with respect to any tax year only the installments(s) of such assessment for such tax year. In the event LANDLORD contests the amount of any Real Estate Taxes, the cost of such contest will be deducted from any resulting reduction to determine Real Estate Taxes. The term Real Estate Taxes does not include any income, gross income, franchise, personal property, devolution, estate, inheritance or gift taxes.
>
> Should any governmental taxing authority acting under any present or future law, ordinance, or regulation, levy, assess, or impose a tax, excise and/or assessment (other than net income or franchise tax) upon or against this lease, the execution hereof and/or the rentals payable by TENANT to LANDLORD, either by way of substitution for or in addition to any existing tax on land and buildings or otherwise, and whether or not evidenced by documentary stamps or the like, TENANT agrees to be responsible for and to pay such tax, excise and/or assessment, or to reimburse LANDLORD for the amount thereof, as the case may be.

Landlord's Perspective:

This clause has many of the characteristics of a sophisticated real estate tax clause. The definition of real estate taxes includes both taxes and assessments. A lease clause which requires the tenant to pay taxes but is silent with respect to assessments may not obligate the tenant to pay any share of any assessments levied against the property. **Blake v Metropolitan Chain Stores**, 247 Mich. 73, 225 N.W. 587 (1929). Furthermore, in terms of assessments, the clause speaks to assessments for both public "improvements and benefits." Since an assessment may be levied for a purpose other than the construction of a public improvement, the landlord will at least have an argument that such assessment is included in the tenant's obligations so long as the assessment is levied for a purpose which "benefits" the public. For example, in 1986 San Francisco passed an ordinance which required landlords to contribute to a job training program for unemployed residents based upon the square foot area of their developments. If the ordinance characterized the contribution as a special assessment, the developer should be able to pass on this cost to the tenant under this clause, since the purpose of the assessment was to benefit the public, although no physical improvement was to be constructed.

On the other hand, the language in this example may not be broad enough if the new levy imposed by the municipality is characterized as a "fee" or an "imposition," as opposed to an "assessment." Furthermore, the language defining taxes has been limited to general or ad valorem real estate taxes and general and special assessments. This language may not cover other taxes which the landlord may wish to include, such as the Michigan Single Business Tax or the transfer tax. Depending upon the utilities clause in the lease, this language may not even be broad enough to include sewer or water impositions. Given the creativity which the Michigan legislature demonstrated in finding ways to replace the revenue lost by the real estate tax reductions, the landlord will want to have language which covers any type of fees, impositions, or levies which the governing body may create in lieu of, or in addition to, existing real estate taxes.

The last sentence of the clause does contemplate some other types of taxes. This sentence, typically

referred to as a "substitute tax clause," has been drafted to include taxes which are either passed in substitution of **or in addition to** existing taxes. This protects the landlord in a situation where the existing real estate tax base is unchanged, but a new tax is created or an existing tax is increased in lieu of raising real estate taxes. A factual issue may arise in determining whether such new or increased tax was passed in lieu of an increase in real estate taxes, although the language in this model clause does not clearly mandate that the tax may only be passed through to the tenant if the tax is in lieu of an increase in real estate taxes. The language, however, has been narrowly drafted to cover only certain classes of taxes, i.e. taxes imposed against the lease, the execution of the lease, or the rentals by tenant to the landlord. Taxes imposed upon mortgages encumbering the shopping center, increases in the Single Business Tax or the transfer tax, the new telephone tax or taxes based on the number of parking spaces are only some of the classes of taxes which arguably would not be covered by this clause.

Finally, this clause excludes, **inter alia**, gross income and personal property taxes. This could exclude the landlord's liability for Single Business Tax. The Single Business Tax could be characterized as a rent tax because it is calculated on gross rents. From a landlord's viewpoint, a rent tax should be properly includable.

The exclusion for personal property could also cause unanticipated exposure to the landlord, unless the taxes payable upon the landlord's maintenance machinery, on-site office equipment, and so forth are covered in the common area maintenance recovery clause. Furthermore, in some jurisdictions, pylon signs, monuments and other signs are taxed as personal property. Unless this is specifically covered elsewhere in the lease, the landlord could wind up paying for these types of taxes.

Tenant's Perspective:

There are two different approaches that can be taken by a tenant in responding to a clause similar to Model Clause A. The first approach, which could be termed the "laundry list" approach, is to list all of the different types of taxes that the tenant would exclude from the definition of "substitute taxes." While Clause A specifically excludes "income, gross income, franchise, personal property, devolution, estate, inheritance, or gift taxes," other taxes to exclude are taxes on profits, gross receipts, rents, sales, use, occupancy, possession, single business, value added, transfer, corporate, real estate transfer, documentary stamps, recording fees, facilities fees, and capital levies.

The other approach to limiting the definition of taxes would be to create definitional criteria that can be applied to any purported tax to determine whether or not it meets the intention of the parties. From the tenant's perspective, a tax should not be considered a valid charge under the lease unless that tax is imposed upon all commercial real property owners as a class. A different criteria, that may also be used in conjunction with the prior criteria, would be to provide that in order to qualify as a tax, the entire charge would have to be treated as a tax if the property where the premises are located was the landlord's sole property and the income from that property was the landlord's sole income. The use of either of these approaches would provide greater protection than the short laundry list provided at the end of the first paragraph of Model Clause A.

The issue regarding assessments can be a particularly sore point for tenants. While there may be no need to distinguish between general or ad valorem real estate taxes on the one hand and general assessments on the other, tenants under a short term lease should be able to maintain that they should not be responsible for "special assessments," as required under this clause. While the tenant is arguably responsible for the cost of providing governmental services on an on-going basis (of the type that would be associated with a general assessment), the tenant can rationally maintain that special assessments affect the value of the landlord's continuing interest in the shopping center, well beyond the term of the lease. This is particularly true if the special assessment relates to specific municipal services to be provided to the landlord's property (i.e., mass transit, new roadways, etc.). The tenant, as a temporary user of the space, will not recognize an increase in the value of its property as a result of the expenditure of these funds. The landlord, on the other hand, stands to reap long-term benefits. A compromise solution with respect to special (or perhaps, general) assessments is to provide that any assessments during the last few years of the lease will be amortized over the original term of the lease and chargeable only during those last few years.

With respect to the "substitute tax" provisions contained in the second paragraph of this clause, the tenant should argue that it is entering into this lease based upon certain projections regarding the current taxes upon the premises. The landlord, as developer, is in a better position to evaluate the likelihood of changes

in the taxation of real property and, therefore, to protect itself in these regards. For this reason, the tenant should insist upon the deletion of the phrase "in addition to" existing taxes. While it is reasonable for the landlord to protect itself from a revamping of the tax system, there is no reason that the landlord should obtain a windfall from the tenant with respect to the imposition of a new tax, not previously contemplated by the parties. Obviously, the landlord will continue to insist that the new tax is merely an additional operating cost which is passed through to the tenant under this net lease situation. However, this should not prevent the tenant from asserting its position.

MODEL CLAUSE B

> A. **Definition.** Landlord shall pay or cause to be paid all Real Estate Taxes (as hereinafter defined) assessed or imposed upon the Landlord's Tract which become due or payable during the Lease Term. As used in this section, the term Real Estate Taxes shall mean and include all real estate taxes, public and governmental charges and assessments, including all extraordinary or special assessments, or assessments against any of Landlord's personal property now or hereafter located in the Center, all costs, expenses and attorneys' fees incurred by Landlord in contesting or negotiating with public authorities (Landlord having the sole authority to conduct such a contest or enter into such negotiations) as to any of the same and all sewer and other taxes and charges, but shall not include taxes on Tenant's business in the Premises, machinery, equipment, inventory or other personal property or assets of Tenant, Tenant agreeing to pay, before delinquency, all taxes upon or attributable to such excluded items without apportionment.
>
> B. **Other Taxes.** Tenant's proportionate share of any governmental tax or charge (other than income tax) levied, assessed, or imposed on account of the payment by Tenant or receipt by Landlord, or based in whole or in part upon, the rents in this Lease reserved or upon the Center or the value thereof shall be paid by Tenant.

Landlord's Perspective:

While this clause is broader than Model Clause A, it suffers from many of the same deficiencies. The clause includes all "real estate taxes," but it is not clear what would constitute a real estate tax. Is a transfer tax, or a tax on rents, or a tax on mortgages, a real estate tax? The clause does include all public and governmental charges and assessments, but it is possible, given the order of this sentence, that the clause could be construed to be limited to charges relating to assessments, and not the types of taxes listed above. Assessments against the landlord's personal property are included, but arguably not personal property taxes. The end of the clause includes "sewer and other taxes and charges," but it is not clear if this is meant to include other charges similar to sewer, such as water and other utility charges, or whether it should be broadly construed. If broad construction is intended, what must such taxes and charges relate to in order to be includable? Single Business Tax is probably not includable. Unlike Model Clause A, costs of a tax contest are includable regardless of the success of the contest. There is not a substitute tax clause, but the "Other Taxes" clause would include the types of taxes typically covered by a substitute tax clause, although it is arguably limited to rents, levies upon the center itself, and the value of the center. Increases in income taxes, Single Business Taxes, or the creation of a mortgage tax would not be covered by this clause.

Tenant's Perspective:

Like Model Clause A, this clause should be strengthened from the tenant's perspective by specifically excluding various items of tax. Unlike the prior clause, this clause specifically refers to "extraordinary" assessments. Such additional assessments should be excluded for the same reasons set forth above.

This clause refers to assessments on the landlord's "personal property." While it is standard for the tenant to agree to be responsible for all personal property taxes associated with its own property, there is little justification for placing the burden for the landlord's personal property on the tenants. While many landlords insist that all of these taxes must be passed through in a net lease situation, the tenant may try to distinguish these taxes from real property taxes associated with the use or occupancy of the space.

The broad language in the middle of Section A, referring to "all sewer and other taxes and charges," is unnecessarily vague. In the first place, it is not clear whether the tenant is agreeing to pay all sewer charges, as opposed to sewer taxes. In the second place, this language could be interpreted broadly to include not only other "taxes," but other charges which might more appropriately be identified or categorized as common

area maintenance expenses. The tenant's objections to this clause should focus upon this language and should require further specificity with respect to the particular types of taxes or charges contemplated by the parties. In the absence of this clarification, the tenant runs the risk that the ambiguity in the broad language will be interpreted to its disadvantage.

Finally, the "other taxes" clause is quite vague. While it could be interpreted to apply only to the rents under the lease, the rents "upon" the center [sic], or the value of the rents, it could also be interpreted to apply to any tax or charge "upon the center" or upon the "value" of the center. This ambiguity presents a difficult problem for the tenant. On the one hand, the tenant may benefit from the ambiguity construed against the drafter, and applying only to "rent taxes." On the other hand, if the lease provision is not clarified, the tenant runs the risk that new taxes, such as the real estate transfer tax under Proposal A, are interpreted to be "a government tax or charge . . . based in whole or in part upon . . . the value thereof." The tenant's decision whether to require clarification of these provisions depends upon the context in which the negotiations are taking place.

MODEL CLAUSE C

> For the purposes of this Section, the word "Taxes" shall include all taxes attributable to: improvements now or hereafter made to the Shopping Center or any part thereof; or attributable to the present or future installation in the Shopping Center or any part thereof of fixtures, machinery or equipment; all real estate taxes, assessments, water and sewer and other governmental impositions and charges of every kind and nature whatsoever, nonrecurring as well as recurring, special or extraordinary as well as ordinary, foreseen, and unforeseen, and each and every installment thereof, which shall or may during the term of this Lease be levied, assessed or imposed, or become due and payable or become liens upon, or arise in connection with the use, occupancy or possession of, or any interest in, the Shopping Center or any part thereof, or any land, buildings or other improvements there, less amounts paid, if any, as taxes to landlord or the taxing authority by the occupants of any "Excluded Areas" (as hereinafter defined). The word "Taxes" shall not include any charge, such as water meter charge and sewer rent based thereon, which is measured by the consumption by the actual user of the item or service for which the charge is made. If at any time during the term of this Lease, under the laws of any one or more jurisdictions in which the Shopping Center is located, a tax, imposition, charge, assessment, levy, excise or license fee is levied on, imposed against or measured, computed or determined, in whole or in part, by: (1) rents payable hereunder (Fixed Minimum, Percentage, Tax and/or additional); or (2) the value of any lien placed against the Shopping Center or against the real property comprising the Shopping Center or any obligations secured thereby; or if any other tax (except income tax), imposition, charge, assessment, levy, excise or license fee, however described or denoted, shall be levied or imposed by any such jurisdiction, to the extent that the cost of any of the foregoing shall be imposed, either directly or indirectly, on Landlord, such tax, imposition, charge, assessment, levy, excise or license fee, shall be deemed to be included as "Taxes" for the purpose of this section.

Landlord's Perspective:

This clause represents a more comprehensive clause than the previous two. Taxes include all taxes, not merely real estate taxes and general and special assessments. Water and sewer charges are specifically covered, as are all governmental assessments, impositions, or charges which arise in connection with the use, occupancy, or any interest in the shopping center. This language should be broad enough to include, for example, the tax imposed by San Francisco relating to job retraining, since landlord's obligation for payment of this amount arose in connection with the landlord's interest in the shopping center. The language also seems broad enough to include taxes such as the Michigan Single Business Tax, the state transfer tax and the telephone tax (to the extent calls relate to the development), as all arise as a result of the landlord's interest in the shopping center. The substitute tax language is also very broadly drafted and does not rely on the new tax being imposed in lieu of real estate taxes or increases in real estate taxes.

There may be some concern, however, that this clause is overly broad. For example, the Michigan Single Business Tax is not clearly included and it is arguable whether such a tax is properly includable in the broad categories set forth in this clause. While positions could be taken that almost any type of tax, including income,

franchise, transfer, and so forth, relating to the project or to the landlord's ownership or income therefrom are includable, by the use of such broad and vague language, the landlord may cause a court to look critically at the clause and attempt to define the clause as narrowly as possible.

Tenant's Perspective:

While all of the issues discussed above should be handled in any negotiation with respect to this clause, several additional points need to be addressed. The definition of the rent tax should be clarified. While most shopping center leases define the rent to include all charges under the lease (including not only fixed minimum rent, but also percentage rent, taxes, common area maintenance, sewer, insurance, etc.), there is no reason why these additional charges should also provide a basis for the calculation of the tax. Arguably, the determination of the tax basis will be made by the taxing authority, in deciding whether or not these charges are, in fact, the rental due to the landlord. Nonetheless, the tenant may be able to buttress its position vis-à-vis the landlord, by maintaining that there is no reason why it should pay taxes based upon items that are tantamount to services provided solely by the landlord.

The tax upon the value of liens placed upon the shopping center is dubious. There appears to be little rational basis for tying the amount of the tax to the amount of equity that the landlord is willing to carry with respect to a particular development. This type of tax would provide an unreasonable incentive to the landlord to mortgage property which otherwise might remain unencumbered. Moreover, it provides the landlord with a great degree of control to affect the amount of taxes. When the landlord is responsible for the payment of the taxes, the tenants could expect the landlord to take whatever actions are necessary in order to keep them at a minimum. If, however, as in this clause, the landlord can pass those taxes directly on to the tenant, there is virtually no incentive to take whatever other actions might be necessary in order to reduce the tax obligation.

MODEL CLAUSE D

> Tenant shall pay to Landlord its proportionate share of all taxes and assessments which may be levied or assessed by any lawful authority during the term of this Lease, or with respect to each fiscal tax year falling in whole or in part during the term of this Lease, against the land, buildings and improvements comprising the Shopping Center, and of all other taxes which Landlord becomes obligated to pay with respect to the regional retail development, irrespective of whether such taxes are assessed against real or personal property (including, without limitation, the so-called "Michigan Single Business Tax" of Landlord as the same presently exists and as the same may be amended in whole or in part from time to time). The portion of such taxes and assessments allocated to the common areas of the Shopping Center, and the portion of such taxes allocated to the "net building area" (gross building area less the sum of gross leasable floor area and common areas) of the Shopping Center, shall be deducted from the total of such taxes and assessments and charged to Tenant in accordance with the provisions of this Lease. Tenant's proportionate share of the remaining taxes and assessments shall be equal to the product obtained by multiplying such taxes and assessments by a fraction, the numerator of which shall be the number of square feet of floor area in the leased premises and the denominator of which shall be the total number of square feet of gross leased and occupied floor area in the Shopping Center. In the event that any present or future enactment of the State or any political subdivision thereof or any governmental authority having jurisdiction thereover either: (a) imposes a direct or indirect tax and/or assessment of any kind or nature upon, against or with respect to the rentals payable by tenants or occupants in the regional retail development to Landlord derived from the regional retail development or with respect to the Landlord's, or the individuals' or entities' which form the Landlord herein, ownership of the land and buildings comprising the regional retail development, either in addition to or by way of substitution for all or any part of the taxes and assessments levied or assessed against such land and such buildings, including without limitation, any net profits tax or any comparable tax imposed on any portion of Landlord's revenues from the Shopping Center; and/or (b) imposes a tax or surcharge of any kind or nature, upon, against or with respect to the parking areas or the number of parking spaces in the Shopping Center, then in either or both of such events, Tenant shall be obligated to pay its proportionate share thereof as provided

herein. For purposes hereof, the term "regional retail development" shall, in any event, be deemed to include any land upon which temporary or permanent offsite utility systems and any wooded area, lake, shoreline thereof or island park serving the Shopping Center are located with all improvements situated thereon.

Landlord's Perspective:

From a landlord's perspective, there are few, if any, deficiencies in this clause. The clause would include all taxes and assessments, as opposed to just real estate taxes, levied against the shopping center, as well as any other tax which landlord may be obligated to pay with respect to the shopping center. The clause specifically includes the Single Business Tax, and the substitute tax clause is comprehensive, although a mortgage tax might not be covered specifically under the clause. The shopping center has been broadly defined in this clause in order to include offsite areas for which the landlord will have tax liability, even though such areas may not be included within the definition of the shopping center for other purposes of the lease. This is an important concept which is often overlooked when preparing these clauses on behalf of the landlord. Furthermore, transfer tax is not specifically mentioned, although same is arguably a tax which landlord would become obligated to pay with respect to the shopping center.

The landlord will want the clause to be as comprehensive as possible to preserve the integrity of the "net" deal which was originally made. In a net transaction, it should be the understanding of the parties that the tenant, and not the landlord, is taking the business risks of increased costs, so that it is the landlord's return on its investment, and not the tenant's costs, which will remain constant during the term of the transaction. A broad clause such as this clause accomplishes that goal.

While this is a fairly comprehensive clause, Model Clause E, below, offers more clarity in determining what is intended to be covered under taxes.

Tenant's Perspective:

This section requires the tenant to pay its proportionate share of all taxes which the landlord "becomes obligated to pay . . . ." The tenant should insist that its obligations to pay be contingent on the landlord's obligation. If the landlord does not, in fact, pay the taxes, then the tenant's obligation should be removed.

The use of the parenthetical phrase describing the Michigan Single Business Tax creates an unusual problem for the landlord under this clause. This parenthetical language clearly contemplates the tax "as it presently exists and as the same may be amended in whole or in part from time to time." Clearly, the tenant executing this lease will be held to be responsible for any changes in the Michigan Single Business Tax. By negative implication, however, changes in other taxes may not be similarly treated. In other words, a court might infer that the lease's failure to specify the effect of amendments or changes in other taxes spelled out in the earlier sections makes those changes non-binding on the tenant. While this position may have some facial appeal, it is unlikely that the argument would prevail over the extremely broad definitional language earlier in the clause.

The substitute tax language of this clause contains an explicit reference to an "indirect" tax. Without greater specification, this language could be used by a crafty landlord to pass through governmental charges, fees, or other expenses charged to the landlord personally, or in connection with the landlord's other business activities.

The clause's reference to taxes upon the ownership of the land and buildings by the "individuals or entities which form the landlord" seems overbroad. There is little conceptual basis for making the tenant responsible for taxes incurred by the developer's partners, shareholders, or beneficial owners. If a tax is not imposed at the level of ownership of the shopping center, there is arguably little basis to pass that charge through to the tenant. While the ultimate responsibility for payment of the tax may lie with the shareholders or partners of the ownership entity, the tax obligation should only be placed upon the tenants of the shopping center if, in fact, the obligation rests with the owner of the real estate.

MODEL CLAUSE E

The term "Taxes" shall mean and include:

(a) any form of assessment (including, without limitation, special assessments), property tax (whether real or personal), license fee, license tax, service or use fee or charge, commercial rental tax, levy, penalty, or other tax levied, assessed, or otherwise imposed or to be levied, assessed or otherwise imposed by any authority having the direct or indirect power to tax against any legal or equitable interest of Landlord in the Premises or in the Center;

(b) any tax on Landlord's right to receive rent or other income, or to conduct any business at, from or in any portion or all of the Center;

(c) any tax allocable to or measured by the area of the Premises or the Center or the rental payable hereunder, including, without limitation, any gross income tax or excise tax levied by or permitted by any governmental body with respect to the receipt of such rental, or upon or with respect to the possession, leasing, operation, management, maintenance, alteration, repair, use or occupancy by Tenant of the Premises, or any portion thereof;

(d) any tax, assessment or fee upon this transaction or upon any document to which Landlord or Tenant is a party which creates or transfers an interest or an estate in the Center or in the Premises; and

(e) any tax, assessment or fee invoiced to Landlord or Landlord's property that is rendered against an interest in the Center or the property or improvements thereon or therein that Landlord is unable to determine the party responsible for payment upon review of such invoice.

Notwithstanding the preceding paragraph:

(i) franchise, estate, inheritance, succession, capital levy, transfer, net income and excess profits taxes imposed upon Landlord shall be excluded from the definition of "Taxes" (except that real property taxes altered by inheritance, succession, transfer or sale of the Center, or any portion thereof, shall not be excluded from the definition of "Taxes").

(ii) with respect to any assessment which may be levied against or upon the Center or the Premises and which under the laws then in force may be evidenced by improvement or other bonds, or may be paid in annual installments, there shall be included within the definition of "Taxes", with respect to any tax fiscal year, only the amount currently payable on such bond for such tax fiscal year, as hereinafter defined, or the current annual installment of such tax fiscal year.

The term "Taxes applicable to the Center" shall mean all Taxes levied, assessed or payable in any tax fiscal year (as such year is determined by applicable law) during the term hereof, against the land and improvements comprising the Center, less the payments received by Landlord or paid on behalf of Landlord to taxing authorities from or in connection with Major Stores, Non-Owned Buildings and Outside Buildings, provided that the taxes applicable to the partially completed and unoccupied buildings shall be excluded from the definition of Taxes applicable to the Center and such buildings shall be excluded from the gross leasable floor area of the Center.

Landlord shall pay to the taxing authority the Taxes applicable to the Center, subject to payment or reimbursement by Tenant as provided in this lease.

Landlord's Perspective:

This clause is as comprehensive as Model Clause D, but offers more clarity with respect to the more questionable types of taxes. The clause clearly includes income taxes, rent taxes, and mortgage taxes. The broad list of exclusions, however, creates some contradictions with the broad list of inclusions which precede it. For example, clause (d) would seemingly clearly include a transfer tax, since a transfer tax is a tax upon a document (the deed) which "creates or transfers an interest or an estate in the center." Clause (i) of the exclusions, however, seems to exclude a "transfer" tax imposed upon landlord, except when a real property tax is "altered" by the transfer of the center, which is an unclear concept. This contradiction points out that, when granting tenant exclusions based on classifications of taxes, merely including a boiler plate "laundry list" of tenant exclusions may have unanticipated consequences if the landlord does not carefully consider the effect of each and every class of exclusion, when compared to the broad classifications included within the inclusion of "taxes." The comprehensive nature of the clause would seem to render a substitute tax clause unnecessary, although if some tax were passed in lieu of existing real estate taxes or increases in real estate taxes, and such tax were not in some way related to the center, the landlord would not be able to pass the tax through.

Tenant's Perspective:

This clause is a tenant's nightmare. The degree of specificity in this clause will require extensive negotiation by the tenant's counsel, in order to obtain any significant

benefit. As indicated above, the ability to obtain these concessions will depend, in great degree, upon the relative bargaining position of the parties. Presumably, a landlord that has been this specific in identifying the taxes it intends to pass along to the tenants, is unlikely to be willing to modify this clause for a single tenant.

The explicit reference to penalties, in subparagraph (a) of this clause, should be particularly objectionable to tenants. There is no apparent reason why the tenant should agree to pay any taxes associated with the landlord's failure to comply with its tax obligations in a timely or complete manner. Any penalties or interest associated with the landlord's failure to comply with any tax provisions should be the sole responsibility of the developer. Obviously, if the landlord is not responsible for the interest or penalties, it will have no incentive to avoid them in the future and will merely pass the charges along to the tenants.

The provision of paragraph (e), regarding taxes where the landlord is "unable to determine the party responsible," is curious. This does not appear to be a meaningful criterion for determining whether or not the charge should be passed along to the tenants. Obviously, the ability to make this determination is solely within the landlord's control and, therefore, may be illusory. Perhaps, with some more specific drafting, the parties may be able to agree upon a definition of "intangible" or "indirect" taxes. That definition should not, however, leave all of the discretion with the landlord.

It is interesting that this model clause, which contains the broadest definition of taxes of all of the clauses, also contains the broadest exclusion of taxes, in subparagraph (i). In fact, this clause would exclude the transfer tax which is a component of Proposal A. The language contained in the parenthesis in this section (which operates as a double negative) is ambiguous. It is not clear whether the sale of the center "alters" real property taxes. This ambiguity may operate in the tenant's favor.

The discussion regarding assessments in subparagraph (ii) may create more problems for the landlord than the landlord might have intended. In particular, this language is limited to the "laws then in force." There is no such limitation on the prior definitions of taxes, assessments, or fees in the definitional sections. A tenant seeking to avoid obligations under a new tax, such as Proposal A, might argue that this language clearly indicates that the parties contemplated a definition of taxes by reference to only those in force at the time the lease was executed.

Unlike all of the other clauses, this clause contains an explicit obligation by the landlord to pay the taxes. As indicated above, this obligation should be specified in any tax clause to which the tenant agrees.

CONCLUSION

The passage of Proposal A has focused attention on the importance of careful drafting in lease tax clauses. While interest in further tax revision may subside in Michigan, a strong argument can be made that the legislature will need to address this issue again soon, in order to provide further revenue enhancement to local school districts. As a result, it is likely that the next several years will bring new and innovative approaches to taxation.

In light of the issues that will be raised by these anticipated efforts to create new tax revenues, landlords and tenants should review their approach to tax issues and the negotiation of lease tax clauses. This article has provided some "talking points" that both landlords and tenants can use in drafting a new generation of tax clauses to address these issues.

ENDNOTE

1. M.P. Chemodurow, Leasing Professional, June/July 1993, P.O. Box 5675, Scottsdale, Arizona 85261 ("Retooling the Tax Clause for the 1990's"); Leasing Professional, April 1987, ("Special Real Estate Tax Issue").

MICHIGAN'S NEW SELLER DISCLOSURE ACT: *SELLER BEWARE*

by *Gregg A. Nathanson**

INTRODUCTION

The rules of the game have changed, when it comes to selling residential real estate. Until recently, with few exceptions, the seller would not be liable for problems with a home, so long as the seller did not make any representation or warranty as to the condition of the property and the purchaser agreed to accept the home "as is." The most notable exception to this general rule is that the seller has a duty to disclose known, concealed defects.[1] On the whole, however, the seller did not have an affirmative duty of disclosure.

All this has changed with the passage of Michigan's new Seller Disclosure Act, Public Act No. 92 of 1993, MCL 565.951 **et seq** (the "Act").[2] The Act, which became effective on January 8, 1994, requires most sellers of used homes to provide the purchaser with a detailed disclosure statement ("Disclosure Statement") before a binding purchase agreement is executed by the seller.[3] If the seller fails to provide the Disclosure Statement, the purchaser has the right to terminate an otherwise binding purchase agreement.[4] If the seller delivers the Disclosure Statement timely, but a change in the condition of the property occurs any time before closing, the seller must immediately disclose this change to the purchaser, and the purchaser has the right to terminate the transaction.[5] The purchaser's right of termination expires when the deed is delivered at closing.[6]

This article discusses the basic provisions of the Act and highlights certain of the Act's problems and ambiguities.

BACKGROUND

Michigan is not the first state to pass a mandatory seller disclosure law. At least 18 other states have some type of law requiring sellers of residential real estate to disclose information about the property to prospective

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buyers.[7] In theory, mandatory disclosures benefit both sellers and buyers (especially inexperienced buyers) by providing reassurance about a home and by minimizing unpleasant surprises that can occur after a buyer takes possession.[8] Ensuring that at least a required minimum amount of information is provided on the home results in better-informed buyers.[9] This, in turn, means fewer disappointed buyers, fewer lawsuits and fewer disrupted sales.[10] Everyone benefits, at least in theory.

WHAT THE ACT REQUIRES

Standard Disclosure Form. The Act requires most sellers of used homes and/or their real estate agents to furnish the purchaser or the purchaser's agent with a fully completed, fairly detailed Disclosure Statement before the purchase agreement is signed. The Act contains a standard form entitled "Seller's Disclosure Statement," and everyone must use the same form.[11] A copy of the form appears at the end of this Article.

Timing of Delivery. A completed Disclosure Statement must be delivered to the prospective purchaser before the seller executes a binding purchase agreement, and the seller must indicate compliance with the Act on the purchase agreement, an addendum or on a separate document.[12] If the seller accepts an offer to purchase before the purchaser receives the Disclosure Statement, the purchaser has the right to terminate the purchase agreement.[13] The purchaser's right of termination may be exercised by delivering written notice of termination to the seller within seventy-two (72) hours after delivery of the Disclosure Statement, if the Disclosure Statement is personally delivered to the purchaser, or within one hundred twenty (120) hours after delivery of the Disclosure Statement, if the Disclosure Statement is delivered to the purchaser by registered mail.[14] If, after the initial disclosure, there are any changes in the condition of the property, the seller must immediately disclose the change(s) to the purchaser.[15] The purchaser then has either seventy-two hours or one hundred twenty hours after receipt of notice of the change(s) to terminate the purchase agreement, depending upon whether such notice was delivered to the purchaser by personal service (72 hours) or registered mail (120 hours).[16] In any event, the purchaser's right to terminate the purchase agreement under the Act expires when the deed is delivered at closing.[17]

Contents of Disclosure Statement. The Disclosure Statement requires the seller to disclose a great deal of information concerning the condition of the property. All disclosures must be made in "good faith," based on the best information available and known to the seller.[18] If, at the time of disclosure, a required item of information is unknown or unavailable to the seller, the seller may state that the information is unknown.[19]

The Disclosure Statement requires the seller to represent whether a laundry list of household appliances, systems and services are in working order.[20] The seller also must disclose specific kinds of information relating to both the dwelling structure and the land. The seller must disclose problems such as evidence of water in the basement, roof leaks, heating, plumbing and electrical information, structural problems, history of infestation, flooding, encroachments, major casualty damage, environmental concerns and other specific kinds of information valuable to a prospective purchaser.[21] A city, township, or county may require disclosures in addition to those required by the Act.[22]

WHEN DOES THE ACT APPLY?

The Act applies to most arms-length transfers of residential real estate in Michigan. The Act applies to the transfer of any interest in real estate consisting of one to four residential dwelling units.[23] The transfer may be by sale, exchange, installment land contract, lease with an option to purchase, any other option to purchase, ground lease coupled with proposed improvements by the purchaser or the tenant, or transfer of stock in a residential cooperative.[24]

The Act's disclosure requirements do **not** apply to any of the following:

A. Transfers pursuant to court order, transfers by a trustee in bankruptcy and transfers by eminent domain.

B. Transfers to a mortgagee by a mortgagor who is in default.

C. Mortgage foreclosure sales.

D. Transfer by a nonoccupant fiduciary in the course of the administration of a decedent's estate, guardianship, conservatorship or trust.

E. Transfer from one co-tenant to one or more co-tenants.

F. Transfers made to a spouse, parent, grandparent, child or grandchild.

G. Transfers between spouses resulting from a judgment of divorce.

H. Transfers or exchanges to or from any governmental entity.

I. Transfers made by licensed builders of newly constructed residential property that has not been inhabited.[25]

The most notable exception to the Act's disclosure requirements is for the sale of newly constructed homes. In Michigan, an implied warranty of habitability and fitness extends to the sale of new homes. **Weeks v Slavik Builders**, 24 Mich App 621, 180 NW2d 503, **aff'd**, 384 Mich 257, 181 NW2d 271 (1970). The implied warranty of habitability and fitness runs only to the first purchaser of a new home, however, and it does not extend to the sale of used homes. **McCann v Brody-Built Construction**, 197 Mich App 512, 496 NW2d 349 (1992); **lv den**, 442 Mich 935, 503 NW2d 905 (1993). On the one hand, the Act contains an exemption from its disclosure requirements for builders of new homes, presumably because those sellers are subject to implied warranties of habitability and fitness. On the other hand, the Act does not go so far as to codify these judicially created implied warranties, or state whether such implied warranties can be disclaimed.

LIMITATIONS ON LIABILITY

One key feature of the Act is that it limits the liability of sellers and real estate agents. Neither the seller nor the seller's agent is liable for any error, inaccuracy, or omission of any information delivered pursuant to the Act, as long as such error, inaccuracy or omission was not within the seller's personal knowledge or was based entirely on information provided by pubic agencies or other independent experts, and ordinary care was exercised in transmitting the information.[26] The seller is not required to disclose information that could be discovered only through inspection of inaccessible areas or only by someone with expertise in a science or trade beyond the knowledge of seller.[27] Apparently, a professional builder, architect or engineer selling their own home may be held to a higher standard of care in making disclosures. In establishing compliance with the Act's exemption from liability, the seller may rely upon an opinion or report prepared by a professional licensed engineer, surveyor, geologist, pest control operator, contractor or similar expert, if the purchaser requested the report.[28] Notwithstanding this permitted reliance, the seller cannot conceal knowledge of a known defect or condition even if it contradicts information provided by a public agency or other independent expert.[29]

WHAT ABOUT BROKERS?

Real estate brokers approve of the Act. The Michigan Association of REALTORS® supported the Act,[30] and with good reason. As mentioned above, the Act limits the liability of real estate agents. An agent shall not be liable for any violation of the Act by a seller, unless the agent knowingly acts in concert with the seller to violate the Act.[31] Moreover, the Disclosure Statement provides that all representations contained therein are "made solely by the seller and are not the representations of the seller's agent(s)," and that "in no event shall the parties hold the broker liable for any representations not directly made by the broker or broker's agent."[32] Real estate brokers and real estate salespersons hope the Act will reduce the possibility of lawsuits against them if an item disclosed on the form was not correctly represented by the seller.[33] Even if purchasers pursue litigation, agents hope to spend less time, money and energy defending the action. As noted in a real estate agent newsletter, mandatory property condition disclosures "are designed to reduce REALTOR® liability."[34]

The Act's protection of real estate agents from liability should be read in conjunction with companion legislation, Public Act No. 93 of 1993,[35] which amended portions of the Michigan Occupational Code dealing with licensed real estate brokers and real estate salespersons. Public Act No. 93 seeks to limit an agent's liability in two important respects. First, the law protects real estate agents from liability for failing to disclose so-called psychological, non-physical defects that may tend to stigmatize the property. These "defects" include the fact that the former occupant of the property had a "handicap" such as AIDS, or that the property had been the site of a homicide, suicide or other illegal occurrence which had no material effect on the condition of the real estate.[36] It is curious that, while brokers are immune from liability for failing to disclose psychological defects, the Seller Disclosure Act does not provide sellers with similar protection.

Public Act No. 93 also protects brokers by mandating agency disclosure requirements. The law requires all licensed real estate brokers and salespersons to disclose to potential purchasers and sellers whether the agent works for the seller, the purchaser, or both (as a dual agent) or neither (as a transaction coordinator).[37] The agent must make the disclosure, in writing, before the purchaser or seller shares any confidential information with that agent.[38] This is expected to prevent lawsuits by purchasers who disclose confidential information to someone they view as "their agent," without realizing that the agent owes a legal allegiance to the seller.

THE ACT'S PROBLEMS AND AMBIGUITIES

No Penalty For Violations. The Act's greatest "defect" is a lack of adequate remedies. If the seller fails to deliver a Disclosure Statement, the purchaser has the right to terminate the purchase agreement, and that right of termination lapses at closing.[39] That is the **only** remedy the Act provides if the seller violates the Act. The transfer is not invalidated solely because of failure to comply with the Act.[40] While the Act purports to require certain disclosures to be made, it carries no penalties for violations.[41]

In fact, one could argue that the seller has an incentive to avoid compliance. If the seller does not give a Disclosure Statement, the purchaser can back out before the closing. As a practical matter, however, the purchaser wants to buy the home. Most likely the purchaser is selling another home, relocating or simply "in love with the house." By the time the purchaser has signed and delivered a purchase agreement, the purchaser has made a conscious and often emotional decision to buy the home. It is possible, but not likely, that the purchaser will back out simply because the seller failed to provide a Disclosure Statement. If the seller does not provide the Disclosure Statement, the seller's worst case consequence is the purchaser backing out of the transaction.

On the other hand, by furnishing a Disclosure Statement, the seller may increase his or her potential liability to the purchaser. While the Act does not provide specific or independent remedies for noncompliance, it does not "limit or abridge any obligation for disclosure created by any other law regarding fraud, misrepresentation or deceit."[42]

Assume that the seller delivers a Disclosure Statement and contracts to sell the property in "as is" condition. Generally, the purchaser bears the risk of loss in an "as is" contract unless the seller fails to disclose concealed defects known to the seller. **Lenawee County Board of Health v Messerly**, 417 Mich 17, 331 NW2d 203 (1982); **Conahan v Fisher**, 186 Mich App 48, 463 NW2d 118 (1990). An "as is" clause, however, does not preclude a purchaser from alleging fraud or misrepresentation. **Messerly, supra** at 32, fn 16; **Conahan, supra** at 49. Under the theory of innocent misrepresentation, for example, a statement by a seller of real estate, which proves to be untrue, could be the basis for an action for misrepresentation even though it was made innocently. **United States Fidelity & Guaranty Co. v Black**, 412 Mich 99,313 NW2d 77 (1981). With the use of a Disclosure Statement, it may be easier for a purchaser to establish a cause of action for fraud, misrepresentation or innocent misrepresentation. To prove innocent misrepresentation, for example, the purchaser/plaintiff merely has to prove that the representation contained in the Disclosure Statement was untrue, and that the plaintiff suffered damages as a result of reliance on that representation. The seller could be liable irrespective of whether the seller acted in good faith in making the representation. **United States Guaranty & Fidelity, supra** at 116. Thus, if the seller does not make written representations to the purchaser, it may be more difficult for the purchaser to prove a claim for misrepresentation.

If the Act is to have its intended force and effect, it should impose some sort of penalty upon the seller for noncompliance with the disclosure requirements. It is curious that the legislative history identifies the absence of penalties as a major argument against the Act,[43] yet the Act was not amended to address this apparent weakness.

Since the Act has just recently taken effect, it is too soon to know how the Michigan courts will interpret it. In fact, perhaps inadvertently and admittedly inconsistent with the above analysis, it is possible that the courts in a given case will interpret the Act to strengthen the doctrine of caveat emptor. Since all disclosures must be made in good faith, the court may be predisposed to assume that the seller who provided a Disclosure Statement acted in good faith in making the disclosures, thereby placing the burden upon the purchaser to prove not only that the disclosure was inaccurate, but that the seller made the disclosure intending to mislead or defraud the purchaser.

Pitfalls of Disclosing Changes to Property. Assume that the seller dutifully complies with the Act

and furnishes the purchaser with a Disclosure Statement before the purchase agreement is executed. If any change occurs in the structural/mechanical/ appliance systems of the property from the date of the disclosure form to the date of closing, the seller must immediately disclose the change to the purchaser.[44] The purchaser may terminate the purchase agreement within seventy-two hours or one hundred twenty hours after delivery to the purchaser of written notice of the change.[45] The Act does **not** state that the change must be material to permit the purchaser to terminate the agreement; there need only be a "change."

I worked on a transaction a few years ago where the water heater failed one day before closing. Fortunately, there was a buyer home warranty protection plan in effect. The sellers paid the deductible, the company which issued the policy paid to install a new water heater, the purchasers obtained a brand new water heater at no additional cost, and the transaction closed on schedule. Here, the sellers had contracted to purchase a new residence and reasonably expected to purchase the new residence with proceeds from the sale of their old residence. Under the new Act, the seller would have been required to disclose the broken water heater problem to the purchaser and permit the purchaser an opportunity to rescind the transaction. The Act would have given the purchaser an "out" at the seller's expense, even though the purchaser would not have suffered any harm as a result of the nondisclosure.

This creates a "Catch 22" situation for the seller. If the seller complies with the Act, the seller could jeopardize the sale, and perhaps risk breaching an agreement to purchase a new residence, all because of a broken water heater which was replaced at no cost to the purchaser. On the other hand, if the seller violates the Act, the purchaser's right of termination would expire at closing, and the purchaser would have trouble proving actual damages as a result of the non-disclosure. Under this type of scenario, the Act unfairly benefits the purchaser at the seller's expense and thus encourages non-compliance.

Seller's Duty to Inspect. The Act does not specifically impose upon the seller an affirmative duty to inspect, merely a duty to disclose information in "good faith." The information contained in the Disclosure Statement "shall be based upon the best information available and known" to the seller.[46] If the seller does not know the condition of an appliance, may the seller simply check "unknown" as to whether the appliance is in working order, or does "good faith" require the seller to make some type of inquiry? The seller does not violate the Act by failing to disclose information that could be obtained only through inspection of inaccessible areas such as the foundation or insulation.[47] Does this mean the seller has a duty to exercise reasonable care to inspect accessible areas? The answer is not clear.

Other states which have passed seller disclosure laws seem to hold sellers to a lesser inspection standard. In Illinois, for example, the seller disclosure statute require sellers to disclose problems of which they "are aware."[48] "Aware" means to have actual notice or actual knowledge without any specific investigation or inquiry.[49] In Illinois the stated purpose of disclosure requirements is to provide prospective purchasers with information about material defects in the property.[50] Michigan's statute, in contrast, seems more pro purchaser (consumer). Required disclosures are not limited to "material defects." In fact, changes triggering the need to deliver an amended Disclosure Statement and offer the purchaser a preclosing right of rescission are not even required to be "material."

The seller may be at risk, unless he or she conducts a thorough inspection of the property or hires an independent inspector to conduct an inspection and incorporates the results of the inspection into the Disclosure Statement.

When to Deliver Disclosure Statement. The Disclosure Statement shall be delivered to the prospective purchaser or the purchaser's agent before the seller executes a binding purchase agreement with the prospective purchaser.[51] This creates a loophole where the seller can comply with the letter of the law while defeating its spirit. Consider a typical "for sale by owner" situation. First, the purchaser delivers to the seller an offer to purchase. Next, the seller, having the identity of a potential purchaser, delivers the Disclosure Statement. The next day the seller then accepts the offer to purchase, thereby executing a binding purchase agreement, and indicates compliance with the Act on the purchase agreement. This is a reasonable scenario. Technically, the seller has complied with the Act, while effectively eliminating the purchaser's rights. If the purchaser receives the Disclosure Statement after delivering the offer to purchase, but before the seller "executes a binding purchase agreement," the purchaser is denied both the opportunity to have considered the information contained in the Disclosure Statement before making

the offer, and the right of rescission. While this could not be the intent of the Act, a plain reading of the language of the Act permits this outcome. A conscientious seller would be prudent to return the offer to purchase to the purchaser, together with a completed Disclosure Statement, have the purchaser acknowledge receipt of the Disclosure Statement on the offer to purchase, and have the purchaser resubmit the offer. The offer to purchase then would show that the purchaser received the Disclosure Statement before submitting the offer and, therefore, before execution of a binding purchase agreement.

Disclosure Statement Not Part of Contract Between Purchaser and Seller. The Disclosure Statement specifically provides that it is "a disclosure only and is not intended to be part of any contract between the buyer and seller."[52] Why not? The purchaser and seller are in privity and the Act requires the seller to make the disclosures contained in the Disclosure Statement to the purchaser. The Act goes so far as to permit a purchaser to rescind the transaction if the Disclosure Statement is not received. A prudent purchaser may wish to add a provision to the offer to purchase stating that the representations contained in the Disclosure Statement are incorporated into the purchase agreement; however, the seller may likely object to such a provision.

Representations But Not Warranties. The Disclosure Statement contains representations made by the seller. The Disclosure Statement also states that it is not "a warranty of any kind by the seller or any agent representing the seller in this transaction, and it is not a substitute for any inspections or warranties the buyer may wish to obtain." [53] The standard Disclosure Statement form also states in capital letters that "UNLESS OTHERWISE AGREED, ALL HOUSEHOLD APPLIANCES ARE SOLD IN WORKING ORDER EXCEPT AS NOTED, WITHOUT WARRANTY BEYOND DATE OF CLOSING."[54] The seller appears to be representing, but not warranting, that all household appliances are in working order as of the date of closing. Who is protected by distinguishing between representations, which the seller is making, and warranties, which the seller is not making? Also, by using the phrase "without warranty beyond date of closing," does this imply that there is some type of warranty up to the date of closing?

A prudent purchaser may wish to state in the offer to purchase that the seller represents and warrants the condition of all items as indicated in the Disclosure Statement, and specify the remedies available if a representation proves to be untrue or a warranty is breached. On the other hand, the seller will want to disclaim all warranties, express or implied; state that all representation and warranties, if any, do not survive the closing; and require the purchaser to accept possession of the property in "as is" condition.

Facsimile Delivery. The Act states that delivery of a Disclosure Statement or amendment thereto shall be by personal delivery, facsimile delivery or registered mail.[55] Manner of delivery is important, because it affects the amount of time provided for the purchaser to terminate the purchase agreement. If a disclosure is delivered after the seller executes a binding purchase agreement, the purchaser has a fixed number of hours after such delivery to provide written notice of termination to the seller. The purchaser has 72 hours, if the seller's disclosure was delivered to the purchaser in person, or 120 hours, if the seller's disclosure was delivered to the purchaser by registered mail.[56] What if the purchaser received the disclosure document by facsimile delivery? The Act permits facsimile delivery, but does not indicate whether the purchaser will have 72 hours or 120 hours to terminate the agreement. A prudent seller will allow the purchaser the full 120 hours to terminate if the seller's delivery was made by facsimile.

Waiver of Right to Terminate. A prudent seller may provide in the purchase agreement that, if a change occurs in the condition of the property any time before closing, the purchaser cannot terminate the agreement so long as the problem is corrected at seller's expense. This raises the question: does the purchaser have the power to modify or waive its right of termination as set forth in the Act? The Act does not address this issue. Since the purchaser's right terminates at closing, it seems reasonable that a purchaser could modify or waive the right to terminate. In this scenario, the seller would be advised to obtain a written waiver and to recite some type of valid consideration in exchange for obtaining the waiver.

CONCLUSION

The Seller Disclosure Act changes the rules of the game when it comes to the sale of used homes in Michigan, because it imposes mandatory disclosure obligations upon the seller. If the seller fails to satisfy these disclosure obligations, the purchaser may respond by terminating an otherwise binding purchase agreement. The Act limits the liability of sellers, and

real estate agents, while placing valuable information in the hands of purchasers. The Act is not without ambiguities and shortcomings, however, including a lack of adequate remedies for seller noncompliance. Certain technical amendments to the Act also appear to be appropriate. In the final analysis, however, the Act's ultimate impact on purchasers, sellers, real estate agents and attorneys will not be known until the Act has been tested in the courts.

ENDNOTES

1. **Conahan v Fisher**, 186 Mich App 48, 49; 463 NW2d 118, 119 (1990).
2. MCLA 565.951 **et seq.**
3. MCLA 565.954(1).
4. MCLA 565.954(3).
5. MCLA 565.957.
6. MCLA 565.954(4).
7. National Association of REALTORS®, Political and State Affairs Division, Property Condition Disclosure Matrix prepared September 24, 1993.
8. House Legislative Analysis, Home Seller Disclosures, House Bill 4375 (3-25-93) (hereinafter "House Legislative Analysis").
9. **Id.**
10. **Id.**
11. MCLA 565.957.
12. MCLA 565.954(1) and (2).
13. MCLA 565.954(3).
14. **Id.**
15. MCLA 565.957.
16. MCLA 565.962.
17. MCLA 565.954(4).
18. MCLA 565.956; 565.960.
19. MCLA 565.956.
20. MCLA 565.957.
21. **Id.**
22. MCLA 565.959.
23. MCLA 565.952.
24. **Id.**
25. MCLA 565.953.
26. MCLA 565.955(1).
27. **Id.**
28. MCLA 565.955(2) and (3).
29. **Id.**
30. House Legislative Analysis.
31. MCLA 565.965.
32. MCLA 565.957.
33. National Association of REALTORS®, Public Affairs Division, **Talking Points**, "Disclosure" (November, 1990).
34. House Legislative Analysis.
35. MCLA 339.101; 339.2501 **et. seq.**
36. MCLA 339.2518.
37. MCLA 339.2517(1).
38. **Id.**
39. MCLA 565.954(3) and (4).
40. MCLA 565.964.
41. House Legislative History.
42. MCLA 565.961.
43. House Legislative History.
44. MCLA 565.957.
45. MCLA 565.954(3).
46. MCLA 565.956.
47. MCLA 565.955(1).
48. 1993 Illinois Laws Public Act 88-111, Section 35 (effective October 1, 1994).
49. **Id.**
50. **Id.**
51. MCLA 565.954(1).
52. MCLA 565.957.
53. **Id.**
54. **Id.**
55. MCLA 565.963.
56. MCLA 565.954(3).

SELLER'S DISCLOSURE STATEMENT

Property Address: _____
Street

_____, Michigan
City, Village, or Township

Purpose of Statement: This statement is a disclosure of the condition of the property in compliance with the seller disclosure act. This statement is a disclosure of the condition and information concerning the property, known by the seller. Unless otherwise advised, the seller does not possess any expertise in construction, architecture, engineering, or any other specific area related to the construction or condition of the improvements on the property or the land. Also, unless otherwise advised, the seller has not conducted any inspection of generally inaccessible areas such as the foundation or roof. This statement is not a warranty of any kind by the seller or by any agent representing the seller in this transaction, and is not a substitute for any inspections or warranties the buyer may wish to obtain.

Seller's Disclosure: The seller discloses the following information with the knowledge that even though this is not a warranty, the seller specifically makes the following representations based on the seller's knowledge at the signing of this document. Upon receiving this statement from the seller, the seller's agent is required to provide a copy to the buyer or the agent of the buyer. The seller authorizes its agent(s) to provide a copy of this statement to any prospective buyer in connection with any actual or anticipated sale of the property. The following are representations made solely by the seller and are not the representations of the seller's agent(s), if any. This information is a disclosure only and is not intended to be a part of any contract between buyer and seller.

Instructions to the Seller: (1) Answer ALL questions. (2) Report known conditions affecting the property. (3) Attach additional pages with your signature if additional space is required. (4) Complete this form yourself. (5) If some items do not apply to your property, check N/A (nonapplicable). If you do not know the facts, check UNKNOWN. FAILURE TO PROVIDE A PURCHASER WITH A SIGNED DISCLOSURE STATEMENT WILL ENABLE A PURCHASER TO TERMINATE AN OTHERWISE BINDING PURCHASE AGREEMENT.

Appliances/Systems/Services: The items below are in working order:

	Yes	No	Unknown	N/A
Range/Oven	___	___	___	___
Dishwasher	___	___	___	___
Refrigerator	___	___	___	___
Hood/fan	___	___	___	___
Disposal	___	___	___	___
TV antenna, TV rotor & remote controls	___	___	___	___
Electrical system	___	___	___	___
Garage door opener & remote control	___	___	___	___
Alarm system	___	___	___	___
Intercom	___	___	___	___
Central vacuum	___	___	___	___
Attic fan	___	___	___	___
Pool heater, wall liner & equipment	___	___	___	___
Microwave	___	___	___	___
Trash compactor	___	___	___	___
Ceiling fan	___	___	___	___
Sauna/hot tub	___	___	___	___
Lawn sprinkler system	___	___	___	___
Water heater	___	___	___	___
Plumbing system	___	___	___	___
Water softener/conditioner	___	___	___	___
Well & pump	___	___	___	___
Septic tank & drain field	___	___	___	___

	Yes	No	Unknown	N/A
Sump pump	___	___	___	___
City Water System	___	___	___	___
City Sewer System	___	___	___	___
Central air conditioning	___	___	___	___
Central heating system	___	___	___	___
Furnace	___	___	___	___
Humidifier	___	___	___	___
Electronic air filter	___	___	___	___
Solar heating system	___	___	___	___
Fireplace and chimney	___	___	___	___
Wood burning system	___	___	___	___

Explanations (attach additional sheets if necessary)

_____

_____

_____

_____

_____

UNLESS OTHERWISE AGREED, ALL HOUSEHOLD APPLIANCES ARE SOLD IN WORKING ORDER EXCEPT AS NOTED, WITHOUT WARRANTY BEYOND DATE OF CLOSING.

Property conditions, improvements & additional information:

1. **Basement:** Has there been evidence of water? yes ___ no ___
   If yes, please explain: _____
2. **Insulation:** Describe, if known _____
   Urea Formaldehyde Foam Insulation (UFFI) is installed? unknown ___ yes ___ no ___
3. **Roof:** Leaks? yes ___ no ___
   Approximate age if known _____
4. **Well:** Type of well (depth/diameter, age and repair history, if known): _____
   Has the water been tested? yes ___ no ___
   If yes, date of last report/results: _____
5. **Septic tanks/drain fields:** Condition, if known: _____
   _____
6. **Heating System:** Type/approximate age: _____
7. **Plumbing System:** Type: copper ___ galvanized ___ other ___
   Any known problems? _____
8. **Electrical system:** Any known problems? _____
   _____
9. **History of infestation, if any:** (termites, carpenter ants, etc.) _____
10. **Environmental Problems:** Substances, materials or products that may be an environmental hazard such as, but not limited to, asbestos, radon gas, formaldehyde, lead-based paint, fuel or chemical storage tanks and contaminated soil on the property. unknown ___ yes ___ no ___
    If yes, please explain: _____
    _____

Other items: Are you aware of any of the following:

1. Features of the property shared in common with the adjoining landowners, such as walls, fences, roads and driveways, or other features whose use or responsibility for maintenance may have an effect on the property? unknown ___ yes ___ no ___
2. Any encroachments, easements, zoning violations, or nonconforming uses? unknown ___ yes ___ no ___
3. Any "common areas" (facilities like pools, tennis courts, walkways, or other areas co-owned with others) or a homeowners' association that has any authority over the property? unknown ___ yes ___ no ___
4. Structural modifications, alterations, or repairs made without necessary permits or licensed contractors? unknown ___ yes ___ no ___
5. Settling, flooding, drainage, structural or grading problems? unknown ___ yes ___ no ___
6. Major damage to the property from fire, wind, floods, or landslides? unknown ___ yes ___ no ___
7. Any underground storage tanks? unknown ___ yes ___ no ___
8. Any area environmental concerns (i.e., proximity to a landfill, airport, shooting ranges, etc.)? unknown ___ yes ___ no ___

If the answer to any of these questions is yes, please explain. Attach additional sheets, if necessary: _____

_____

_____

_____

_____

The most recent state equalized valuation of the property provided by the local taxing unit to the seller was $_____ as of _____ (date). The seller has lived in the residence on the property from _____ (date) to _____ (date). The seller has owned the property since _____ (date) and makes representations only since that date. The seller has indicated above the history and condition of all the items based on that information known to the seller. If any changes occur in the structural/mechanical/appliance systems of this property from the date of this form to the date of closing, seller will immediately disclose the changes to buyer. In no event shall the parties hold the broker liable for any representations not directly made by the broker or broker's agent.

Seller certifies that the information in this statement is true and correct to the best of seller's knowledge as of the date of seller's signature.

BUYER SHOULD OBTAIN PROFESSIONAL ADVICE AND INSPECTIONS OF THE PROPERTY TO MORE FULLY DETERMINE THE CONDITION OF THE PROPERTY.

Seller _____ Date _____

Seller _____ Date _____

Buyer has read and acknowledges receipt of this statement.

Buyer _____ Date _____ Time:_____

Buyer _____ Date _____ Time:_____

ALCAN AND BELL PETROLEUM: THE FEDERAL COURTS RECONSIDER JOINT AND SEVERAL LIABILITY IN SUPERFUND CASES

by *Jack D. Shumate**

For nearly ten years, federal courts have been routinely imposing strict joint and several liability on responsible parties, including property owners, in Superfund cases. This has had a chilling effect on many real estate transactions. Owners of industrial and commercial property may be afraid to lease their property for a use which could generate pollution subjecting the owner to enormous cleanup costs. Potential buyers have been reluctant to acquire property if there was a possibility of historic contamination. Even if the owner could ultimately recover the cleanup cost from previous owners and operators or polluting tenants, this sometimes meant incurring large costs and facing years of expensive contribution litigation.

Now, there is hope that the federal courts may be starting to reconsider the imposition of joint and several liability in all Superfund cases. Recent decisions by the Courts of Appeals for the Second, Third, and Fifth Circuits, after taking a fresh look at the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund),[1] its legislative history, and some of the early CERCLA decisions, have decided that imposition of joint and several liability is not always appropriate.

The question of whether there should be joint and several liability in CERCLA cases is one that has troubled Congress and the courts from the time the Act was drafted. CERCLA resulted from parallel bills which moved, more or less simultaneously, through the House and Senate in 1980. The House passed a bill which called for "strict joint and several" liability, but also adopted an amendment to the bill proposed by then - Representative Albert Gore, Jr.

The Gore Amendment softened the concept of joint and several liability by authorizing the courts to undertake an equitable allocation of liability based upon six specific factors, the oft-cited "Gore" factors.

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The Senate Bill, as introduced, also would have imposed joint and several liability but the Senate deleted the term "joint and several," feeling that it was too harsh. The Conference Committee used the House Bill as a vehicle for compromise, but struck everything except the title and, for the most part, substituted the Senate Bill.[2] Consequently, the liability section imposed "strict" liability but deleted both the terms "joint" and "several" and the reference to the Gore factors.

In early CERCLA cases, defendant potentially responsible parties (PRPs) argued that the deletion of the term "joint and several" from CERCLA evidenced Congressional intent that liability should be several, rather than joint. The courts uniformly rejected this contention. Concluding that the imprecision and ambiguity in the drafting of CERCLA evidenced a Congressional intent for the courts to develop a federal common law for implementation of CERCLA, the early cases concluded that the propriety of joint and several liability was one of the areas in which federal common law should be developed. The first case which reached this conclusion was **U.S. v Chem-Dyne Corp.**, 572 F. Supp. 802 (S.D. Ohio 1983). **Chem-Dyne** has been consistently cited, and to some extent followed, by virtually every other court which has addressed the issue of joint and several liability.

In **Chem-Dyne**, the court disposed of an early motion by a group of PRPs for a determination that they were not jointly and severally liable. In denying this motion, the court analyzed the legislative history of CERCLA and analogized the Act to Section 311 of the Federal Water Pollution Control Act.[3] The court concluded:

> A reading of the entire legislative history and context reveals that the scope of liability and term joint and several liability were deleted to avoid a mandatory legislative standard applicable in all situations which might produce inequitable results in some cases. (Citations omitted.) The deletion was not intended as a rejection of joint and several liability. (Citations omitted.) Rather, the term was omitted in order to have the scope of liability determined under common law principles, **where a court performing a case by case evaluation of the complex factual scenarios** associated with multiple-generator waste sites **will assess the propriety of applying joint and several liability on an individual basis**. (Emphasis added.)[4]

After concluding that the development of a federal common law, rather than application of the law of the forum state, was appropriate, the court turned to the **Restatement (2d) of Torts** for guidance and concluded:[5]

> An examination of the common law reveals that when two or more persons acting independently caused a distinct or single harm for which there is a reasonable basis for division according to the contribution of each, each is subject to liability only for the portion of the total harm that he has himself caused. **Restatement (2d) of Torts**, §§433A, 881 (1976) Prosser, **Law of Torts** (4th ed. 1971), pp. 313-314; (case citations omitted).
>
> * * *
>
> Furthermore, where the conduct of two or more persons liable under §9607 has combined to violate the statute, and one or more of the defendants seeks to limit his liability on the ground that the entire harm is capable of apportionment, the burden of proof as to apportionment is upon each defendant. **Id.** at §433B; **Id.** These rules clearly enumerate the analysis to be undertaken when applying 42 U.S.C. §9607 and are most likely to advance the legislative policies and objectives of the Act.

Finally, the court noted that "The question of whether the defendants are jointly and severally liable for the cleanup costs turns on a fairly complex factual determination" and found that "There is an insufficient evidentiary basis, with unresolved factual questions, which precludes the resolution of this case in the form of a summary judgment motion."[6]

Chem-Dyne thus clearly stands for the propositions that (i) whether imposition of joint and several liability is proper must be made on the basis of the facts of each case and involves a "fairly complex factual analysis" and (ii) the burden of proof in making this complex factual analysis is on the party seeking to escape joint and several liability. There is nothing in the court's language to suggest that it favored a uniform rule of joint and several liability for all CERCLA cases.

The next significant case to consider the issue was **U.S. v A & F Materials Co., Inc.**, 578 F. Supp. 1249 (S.D. Ill. 1984). After reviewing the legislative history of the Act and the relevant principles of the Restatement, the court agreed with the conclusion of the **Chem-Dyne** court that the decision whether to

impose joint and several liability should be made based upon the facts of each case. The **A & F Materials** court, however, concluded that some relaxation of the approach of the Restatement, permitting an equitable allocation of liability, was appropriate for CERCLA cases:

> After reviewing the legislative history, the Court concludes a rigid application of the Restatement approach to joint and several liability is inappropriate. Under the Restatement approach, any defendant who could not prove its contribution would be jointly and severally liable. This result must be avoided because both Houses of Congress were concerned about the issue of fairness, and joint and several liability is extremely harsh and unfair if it is imposed on a defendant who contributed only a small amount of waste to a site. The Senate expressed its sensitivity to the fairness issue by rejecting a mandatory legislative standard in lieu of allowing the courts to impose joint and several liability on a case by case basis.
>
> Moreover, the House expressed its sensitivity to the fairness issue by passing a bill which contained a moderate approach to joint and several liability. * * * [T]he House passed the Gore Amendment which softened the modern common law approach to joint and several liability. * * * Under the Gore Amendment, a court had the **power** (emphasis by court) to impose joint and several liability whenever a defendant could not prove his contribution to an injury, however, a court could still apportion damages in this situation. * * *[7]
>
> The Court finds that the moderate approach to joint and several liability * * * is both persuasive and consistent with the intent of Congress. * * *

From the beginning, therefore, the federal courts recognized that there were situations where divisibility or equitable apportionment of liability was appropriate and that the most stringent standard was that of the Restatement.

Congress has expressly approved the **Chem-Dyne** rule. The House Committee on Energy and Commerce Report on the bill which became the Superfund Amendments and Reauthorization Act (SARA), 1986 U.S. Code Cong. and Adm. News 2835 states:[8]

> No change has been made in the standard of liability that applies under CERCLA. * * * **Where appropriate**, liability under CERCLA is also joint and several, **as a matter of federal common law**.
>
> Explicit mention of joint and several liability was deleted from CERCLA in 1980 to allow courts to establish the scope of liability through a case-by-case application of 'traditional and evolving principles of common law' and pre-existing statutory law. (Citations omitted). The courts have made substantial progress in doing so. The Committee fully subscribes to the reasoning of the court in the seminal case of **United States v Chem-Dyne Corporation**, (citation omitted) which established a uniform federal rule allowing for joint and several liability **in appropriate CERCLA cases**.
>
> * * *
>
> The Committee believes that this uniform federal rule on joint and several liability is correct and should be followed. * * * Thus, nothing in this bill is intended to change the application of the uniform federal rule of joint and several liability enunciated by the **Chem-Dyne** court. (Emphasis added.)

It is not clear whether Congress was endorsing only the **Chem-Dyne** analysis of when imposition of joint and several liability is appropriate or was also addressing the court's ruling on burden of proof.

Many federal courts, however, seem to have read **Chem-Dyne** as establishing merely that imposition of joint and several liability is acceptable under CERCLA. Consequently, by the mid-1980's, courts were routinely imposing joint and several liability, citing **Chem-Dyne**, but failing to make the necessary factual inquiry. It appears that in many instances, this was done as a matter of policy because the court felt that the imposition of joint and several liability was the best way to promote the legislative goals of CERCLA.

In **State of Colorado v Asarco, Inc.**, 608 F. Supp. 1484 (D. Co., 1985), the court observed:[9]

> CERCLA's primary goal is the expeditious cleanup of hazardous waste sites. Joint and several liability is a powerful tool to achieve that goal. It enables a plaintiff to select one primarily responsible party as the defendant, determine liability as to that defendant, and collect the total amount of damages from that one defendant. If a plaintiff were required to sue all potentially responsible parties

> (hundreds in this case) in order to ensure a comprehensive cleanup, delays inherent in such massive lawsuits would surely delay cleanup of the site. **Once cleanup is assured**, however, no goal of CERCLA would be promoted by requiring one of the responsible parties to continue to bear the full costs of injuries caused in part by others. I conclude, therefore, that the majority rule allowing **contribution** among responsible parties is consistent with CERCLA's statutory purpose and scheme. (Emphasis added).

The district courts increasingly adopted this view that liability should be joint and several and that consideration of equitable apportionment should be deferred to a contribution action after the site was cleaned up. Thus, in **U.S. v Stringfellow**, 661 F. Supp. 1053 (C.D. Cal. 1987) the court said:[10]

> Imposing joint and several liability carries out the legislative intent by insuring that responsible parties will fulfill their obligation to clean up the hazardous waste facility. The Court has discretion to use equitable factors in apportioning damages in order to mitigate the hardships of imposing joint and several liability upon defendants who have only contributed a small amount to a potentially large indivisible harm. However, **the Court's discretion in apportioning damages among the defendants during the contribution phase does not affect the defendants' liability**. (Emphasis added.)

In **U.S. v Western Processing Co., Inc.**, 734 F. Supp. 930 (W.D. Wash. 1990) at 938, the court stated that only one case, **A & F Materials**, supported the use of equitable apportionment and described that case as an "aberration."

In **Allied Corp. v Acme Solvents Reclaiming, Inc.**, 691 F. Supp. 1100 (N.D. Ill. 1988), the court cited the **A & F Materials** decision with approval and applied the Gore factors. Reviewing the legislative history of SARA, the court concluded that there is nothing in the statements of Congress rejecting the multiple factor analysis of the moderate approach and elected to apply that approach. This was a contribution action, however, and the court noted in a footnote, at page 1118, "In employing the moderate approach in the present case, this court makes no ruling as to the propriety of the approach in cost recovery claims involving the government as plaintiff."

The Court of Appeals for the Sixth Circuit also seemed to favor deferring considerations of equitable allocation to the contribution stage. **U.S. v R.W. Meyer, Inc.**, 889 F.2d 1497 (6th Cir. 1989). In that case, the government obtained a judgment of joint and several liability against Meyer (who was the property owner), the company which operated a polluting business on the leased property, and the president and sole shareholder of that business. The court declined to disturb the finding of the district court because it felt that it was "not clearly erroneous," since Meyer had strict liability as the owner of the property during the period when the pollution occurred. The court concluded:[11]

> To the extent that Meyer can demonstrate the divisibility of the harm and that it paid more than its fair share, it will be entitled to relief **in its action for contribution** currently pending against the other defendants. Accordingly, we conclude that the district court did not err in finding the defendants jointly and severally liable. (Emphasis added.)

Thus, the Federal courts had reached the point of routinely imposing joint and several liability and deferring consideration of equitable apportionment to a later contribution action between PRPs. This consideration frequently did not occur, however, because the threat of joint and several liability - the "powerful tool" as the **Asarco** court described it - forced PRPs to settle with the government. Having once settled, they obtained contribution protection, i.e., statutory immunity from contribution actions by other PRPs against whom the government brought enforcement actions. This has significantly reduced the number of cases in which judicial allocation has occurred. Recently, however, the Courts of Appeals for three different circuits have rejected this approach. They have returned to the rationale of **Chem-Dyne** and the principles of the Restatement.

U.S. v Alcan Aluminum Corp., 964 F.2d 252 (3rd Cir. 1992) (Alcan I), involved a situation where the government sued 20 defendants, including Alcan, to recover cleanup costs at a Superfund site. The other 19 settled, leaving more than $473,000 in unrecovered government response costs.

Alcan argued that its waste contained such low concentrations of hazardous constituents that it could not have caused or contributed to the harm because the concentration of hazardous constituents in its waste was less than background. Nevertheless, the district court granted judgment to the government.

The Court of Appeals, after reviewing a number of prior decisions on joint and several liability and §433(A)

of the Restatement, rejected the government's argument for strict joint and several liability. The court vacated the judgment and remanded the case to the district court for a factual hearing, concluding:[12]

> These provisions underscore the intensely factual nature of the "divisibility" issue and thus highlight the district court's error in granting summary judgment for the full claim in favor of EPA without conducting a hearing. For this reason, we will remand this case for the court to determine whether there is a reasonable basis for limiting Alcan's liability based on its personal contribution to the harm to the Susquehanna river.
>
> * * *
>
> We observe * * * that Alcan's burden in attempting to prove the divisibility is substantial, and the analysis will be factually complex as it will require an assessment of the relative toxicity, migratory potential and synergistic capacity of the hazardous waste issue. (Citation omitted.) But Alcan should be permitted this opportunity to limit or avoid liability. If Alcan succeeds in this endeavor, it should only be liable for that portion of the harm fairly attributable to it.
>
> * * *

Thus, the court adopted the rationale and result of the **Chem-Dyne** decision. Where **Chem-Dyne** had denied summary judgment to the defendants on the joint and several liability issue without a hearing, **Alcan I** denied summary judgment to the government without a factual hearing. The **Alcan I** court, like **Chem-Dyne**, also strictly adhered to the Restatement principle of placing the burden of proof on the PRP seeking divisibility.

U.S. v Alcan Aluminum Corp., 990 F.2d 711 (2nd Cir. 1993) (Alcan II) involved essentially the same facts as **Alcan I**. Once again, Alcan was the only non-settlor, facing liability for $3.2 million of unrecovered response costs. Again, Alcan argued that its waste could not have caused or significantly contributed to the harm because of the minimal concentrations of hazardous substances in the emulsion. The district court granted summary judgment to EPA and the State of New York.

The Court of Appeals addressed the issue of causation at length and concluded that the government did not have to prove that Alcan's waste caused the harm in order to recover. Then, it turned to **Chem-Dyne**, a handful of other Federal Court of Appeals decisions, and §433(A) of the Restatement and concluded that it might be appropriate for the damages to be apportioned. It also placed the burden of proof on Alcan to establish that divisibility or apportionment was appropriate. The court confused the issues, however, by observing:[13]

> In so ruling, we candidly admit that causation is being brought back into the case - through the back door, after being denied entry at the front door - at the apportionment stage. We hasten to add nonetheless that causation - with the burden on defendant - is reintroduced only to permit a defendant to escape payment where its pollutants did not contribute more than background contamination and also cannot concentrate. To state this standard in other words, we adopt a special exception to the usual absence of a causation requirement, but the exception is applicable only to claims, like Alcan's, where background levels are not exceeded. * * *

Alcan II confuses the issue by mixing the question of causation with divisibility and equitable apportionment. The language limiting the effect of the court's ruling leaves it unclear what the court was actually saying, except that it felt that imposition of $3.2 million in liability on Alcan for disposal of a substance with minimal hazardous content was simply unacceptable. The court did remand the case, however, to give Alcan a chance to make an evidentiary record supporting apportionment of liability.

The final case in the recent trilogy is **In the Matter of Bell Petroleum Services, Inc.**, 3 F.3d 889 (5th Cir. 1993), decided September 28, 1993. It involved a situation where EPA was seeking recovery of response costs against three former owners of a chrome plating facility which had contaminated the groundwater. Each company had operated the same plant, with similar operations, but for different numbers of years. In this case, the district court had not granted summary judgment. Joint and several liability was imposed after an evidentiary hearing.

On appeal, the Fifth Circuit concluded that there were three distinct approaches to the issue of joint and several liability. First is the **Chem-Dyne** approach, adopting the principles of the Restatement with respect to apportionment of liability and burden of proof. The second was the approach of the two **Alcan** decisions, which the court, through reasoning which is unclear, considered different because those cases held that the government is not required to prove causation

and that the defendant could escape liability altogether with an appropriate evidentiary showing. (**Chem-Dyne** dealt with an early motion for summary judgment based only on legal issues. It did not address the government's burden of proof or the **extent** to which a PRP could reduce its liability, so it appears questionable whether the **Alcan** decisions, especially **Alcan I**, are distinguishable from **Chem-Dyne**.) The third approach identified by the court was the "moderate" approach of **A & F Materials**.

The court concluded that certain basic principles were common to all these approaches, including the fact that Congress intended the imposition of joint and several liability only in appropriate cases and then on the basis of common law principles. The court identified the major differences between the three approaches as timing of the resolution of the divisibility question, whether equitable factors should be considered, and whether a defendant can avoid liability for all, or only some portion, of the damages. Finally, the court concluded that even where commingled waste of unknown toxicity, migratory potential, and synergistic effect are present, the defendant may be able to demonstrate a reasonable basis for apportionment, noting, however, that such attempts are rarely successful.

The court stated that the **Chem-Dyne** approach is preferable for resolving issues of joint and several liability. It then seemed to back away from **Chem-Dyne's** strict adherence to the Restatement principles on burden of proof, saying, "* * * we nevertheless recognize that the Restatement principles must be adapted, where necessary, to implement Congressional intent with respect to liability under the unique statutory scheme of CERCLA."

Applying all these conclusions, the court decided that there was a single, indivisible harm to the groundwater, but that there was a reasonable basis for equitable apportionment. The court apportioned liability based on the basis of the number of years that each defendant operated the facility.

There was a strongly worded dissent in **Bell Petroleum**. The dissent agreed with the applicability of **Chem-Dyne** and the Restatement principles, but would have placed a heavy burden of proof on the defendants and left it to the discretion of the district court to determine whether this burden of proof was met. The dissent also accuses the majority of departing from the Restatement principles and adopting a "rule of thumb" method of apportionment.

CONCLUSION

While the rationale of **Alcan I**, **Alcan II** and **Bell Petroleum** differ, they agree in rejecting the routine imposition of joint and several liability and deferring the question of divisibility or equitable apportionment to a later contribution action. Also, they all return to the **Chem-Dyne** rationale, i.e., the principles of the **Restatement (2d) of Torts** should apply to the issue of joint and several liability. Finally, they all agree that the question of joint and several liability is factually intensive and complex, requiring an appropriate evidentiary record prior to decision in the district court.

Both **Alcan** cases and **Bell Petroleum** addressed the question of joint and several liability of generators of hazardous waste. These cases did not involve a party which merely had status liability as an owner, but it seems that the principles of apportionment of liability enunciated in the Restatement should apply even more clearly to a property owner who did not contribute to the contamination. The problems of applying the Restatement principle on burden of proof and determining proper bases for apportionment of liability would certainly be more complicated in a matter involving both active polluters and a passive property owner, but they should not be insoluble.

If the federal courts follow the trend which seems to have been established by the **Alcan** and **Bell Petroleum** decisions, therefore, property owners may begin to receive some relief in Superfund cases.

ENDNOTES

1. 42 USC 9601 et seq.
2. 126 Cong. Rec. H11787 (Dec. 3, 1980); (no Conference Committee Report was published on CERCLA).
3. 33 USC 1251 et seq.
4. 572 F.Supp. at 808.
5. Ibid. at 810.
6. Ibid. at 811.
7. 578 F.Supp. at 1256-1257.
8. 1986 U.S. Code Cong. & Adm. News at 2856.
9. 608 F.Supp. at 1491.
10. 661 F.Supp. at 1060.
11. 889 F.2d at 1508.
12. 964 F.2d at 269.
13. 990 F.2d at 722.

APPELLATE COURT OVERTURNS EPA'S LENDER LIABILITY RULE

by *Peter D. Holmes**

As discussed in my article in a previous issue of the *Review*,[1] the U.S. Environmental Protection Agency's ("EPA") 1992 rule (the "Rule") clarifying the security interest exemption under the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), 42 U.S.C. §9601 **et seq.**, went a long way towards protecting lenders from CERCLA liability for the cleanup of contaminated property.[2] Section 107 of CERCLA imposes strict liability on persons responsible for a release or threatened release of hazardous substances into the environment, including certain past or present owners or operators of the facility at which the release occurs or is threatened.[3] However, the security interest exemption excludes from the definition of "owner or operator" a person who, without participating in management of the facility, holds indicia of ownership primarily to protect a security interest in the facility.[4] Among the most significant provisions of the Rule were: (1) its definition of "participation in management" to mean actual participation in the management or operational aspects of the facility, as opposed to either a mere capacity to influence facility operations or actual participation in financial or administrative aspects of the enterprise; (2) its continuation of the exemption for lenders who purchase the property pursuant to foreclosure as long as the lender promptly seeks to sell or otherwise divest the foreclosed-on property; and (3) its guidance regarding permissible activities during workout or other stages of the lending relationship that will not cause the lender to lose the exemption. Unfortunately, the February 1994 decision by the D.C. Circuit in **Kelley v EPA**[5] invalidated the Rule (by a 2-1 vote) on the grounds that it exceeded EPA's statutory authority.

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The Court's Decision.

The plaintiffs in **Kelley** were the State of Michigan and the Chemical Manufacturers Association. The American Bankers Association and four other trade associations intervened in support of the Rule. The petitioners argued: (1) that EPA lacked statutory authority to define by regulation the scope of lender liability under CERCLA; and (2) that the substance of the Rule was contrary to the plain meaning of CERCLA. Because the court majority agreed with the petitioners that the Rule exceeded EPA's statutory authority, it did not address the Rule's substantive validity.

Although the court rejected the petitioners' claim that EPA lacked authority to promulgate any substantive regulations under CERCLA, it held that with respect to any specific regulation, EPA must show that it has been explicitly or implicitly delegated interpretative authority. The court rejected EPA's contention that its responsibility under Section 105 of CERCLA to promulgate the National Contingency Plan setting forth the actions and procedures to be taken in response to contamination, and in particular Section 105's broad language authorizing EPA "to reflect and effectuate the responsibility and powers created by this chapter,"[6] provided EPA with the power to define the scope of liability under Section 107.

EPA also argued that CERCLA provisions granting EPA authority to recover cleanup costs financed through the Superfund by bringing a cost recovery action against liable parties or, alternatively, to issue administrative orders directing such parties to perform the cleanup themselves, require that EPA first decide whether a party is actually liable before taking such enforcement action. Thus, EPA contended that CERCLA implicitly grants it the power to define the scope of liability. The court rejected this argument on the grounds that any government prosecutor must determine for itself whether a potential defendant violated the law before deciding to bring a civil action, but typically lacks authority to issue substantive regulations to interpret the scope of statutory liability.

The court also rejected what it described as EPA's strongest argument — that EPA's authorization under Section 106(b)(2)[7] (to preliminarily determine, subject to judicial review, whether a private party that has cleaned up a contaminated site pursuant to an administrative order is entitled to reimbursement of its costs) gives it implicit authority to define liability. Under that provision, reimbursement is required if the party is not liable under CERCLA or, even if liable, the party demonstrates that the ordered cleanup was unlawful. The court concluded, however, that if EPA denies reimbursement because it contends that the party is liable and the party challenges that decision in court, EPA's contention is not entitled to judicial deference. Rather, the court viewed the private right of action as reflecting Congress' deliberate intent to designate "the courts and not EPA as the adjudicator of the scope of CERCLA liability."[8]

Finally, the court also rejected EPA's alternative argument that the Rule is at least entitled to judicial deference as an interpretative rule. The court held that not only does the Rule bear little resemblance to an interpretative regulation that defines specific statutory terms, but judicial deference to an interpretative rule was improper for the same reason that EPA could not issue the Rule as a substantive regulation: "Congress meant the judiciary, not EPA, to determine liability issues."[9]

In dissent, Judge Mikva argued that Congress implicitly delegated authority to EPA to define which parties are liable under CERCLA. Judge Mikva then addressed the issue of the Rule's substantive validity. He found that the term "owner or operator" and the secured creditor exemption are ambiguous and that EPA's Rule construes the exemption in a reasonable manner. Thus, Judge Mikva would defer to EPA's interpretation under the Chevron Doctrine and uphold the Rule.[10]

The Impact of the Decision.

On April 11, 1994, EPA and the banking industry intervenors petitioned the D.C. Circuit for rehearing **en banc**. If the ruling stands, the lending community's avenue of recourse will be in Congress. Indeed, the **Kelley** court recognized that its decision placed lenders in a precarious position and invited EPA to seek Congressional relief. The Clinton Administration's CERCLA reauthorization bill[11] provides EPA with general rulemaking authority and with express authority to promulgate regulations to define statutory terms as they apply to lenders and other financial service providers, and trustees and other fiduciaries. If CERCLA reauthorization stalls, lenders probably will press for passage of a stand-alone bill to address lender liability.

While lenders may view the invalidation of EPA's lender liability rule as placing them in the same

uncertain position that existed before EPA promulgated the Rule, that concern may be somewhat overstated. Although the Rule is no longer entitled to judicial deference and the precedential value of cases that had applied the Rule is now questionable, EPA is likely to look to the Rule to guide its enforcement proceedings under CERCLA. Nevertheless, lenders are again likely to become increasingly cautious with respect to property that is known or suspected to be environmentally contaminated.

Ironically, despite the State of Michigan's successful challenge to the Rule, lenders in Michigan face less uncertainty under state law. Public Act 310 of 1994, which was enacted on December 28, 1993, amended the Michigan Environmental Response Act ("MERA"), M.C.L. §299.601 **et seq.**, to define "participation in management" for purposes of the secured creditor exemption to incorporate substantial aspects of the EPA Rule. Thus, MERA now expressly provides that the mere capacity to influence or unexercised right to control facility operations does not constitute participation in management.[12] MERA also now incorporates the Rule's test for participation in management: the lender must exercise decision-making control over the borrower's environmental compliance, undertake responsibility for the borrower's hazardous substance handling or disposal practices, or exercise managerial control over operational aspects of the borrower's enterprise.[13] The new MERA provisions further specify certain workout and other loan activities that do not constitute participation in management.

Finally, the **Kelley** decision also has significant implications for EPA's rulemaking authority in other areas of CERCLA. For example, EPA proposed a rule in August 1992 to standardize EPA cost recovery procedures under Section 107 of CERCLA.[14] Because the proposed rule attempts to define the costs that will be recoverable in a Section 107 action and to interpret the governing statute of limitations, the **Kelley** rationale may mean that EPA's views on this issue are subject to no more judicial deference than its views on who is a liable party. Given such potentially broad-ranging implications of the D.C. Circuit's decision, EPA will continue to try to overturn it either in court or through legislative amendment.

ENDNOTES

1. Peter D. Holmes, **Navigating to CERCLA's Safe Harbor: EPA's Lender Liability Rule**, 20 *Mich. Real Prop. Review* 161 (Winter 1993).
2. 57 Fed. Reg. 18344 (Apr. 29, 1992).
3. 42 U.S.C. §9607(a)(1) and (2).
4. 42 U.S.C. §9601(20)(A).
5. Nos. 92-1312 and 92-1314, 1994 U.S. App LEXIS 1715 (D.C. Cir. Feb. 4, 1994).
6. 42 U.S.C. §9605(a).
7. 42 U.S.C. §9606(b)(2).
8. 1994 U.S. App LEXIS at *9.
9. **Id.** at *10.
10. Chevron U.S.A. Inc. v Natural Resources Defense Council, Inc., 467 U.S. 837 (1984) (if Congress did not address the issue in question, the reviewing court should defer to the agency's statutory interpretation as long as it is reasonable).
11. H.R. 3800 and S.1834.
12. M.C.L. §299.603a(1).
13. M.C.L. §299.603a(1)(A)-(C).
14. 57 Fed. Reg. 34742 (Aug. 6, 1992).

LEGISLATIVE STATUS REPORT
ACTION ON LEGISLATION OVER THE LAST THREE MONTHS

by *Gregory L. McClelland* and *Deborah A. Lee*

HB 4284 — Amends downtown development authority act to provide for state reimbursement for lost school operating revenues — introduced by Rep. Pitoniak on 2/17/93 and referred to Committee on Taxation; 3/11/93, second reading with substitute; 5/31/94 substitute, placed on third reading, placed on immediate passage, passed, given immediate effect.

HB 4285 — Amends tax increment finance authority act to provide for state reimbursement for lost school operating revenues — introduced by Rep. Bobier on 2/17/93 and referred to Committee on Taxation; 3/11/93, second reading with substitute; 5/31/94, placed on third reading, placed on immediate passage, passed, given immediate effect.

HB 4286 — Amends local development finance act to provide for state reimbursement for lost school operating revenues — introduced by Rep. Sikkema on 2/17/93 and referred to Committee on Taxation; 3/11/93, second reading with substitute; 5/31/94, placed on third reading, placed on immediate passage, passed, given immediate effect.

HB 4789-4790 — Establishes civil fines for the littering of public and private property and provides for forfeiture of property under certain circumstances — introduced by Rep. Anthony on 5/18/93 and referred to Committee on Conservation, Environment & Great Lakes; 5/3/94, reported with recommendation with substitute; referred to second reading; 5/24/94, substitute; 5/26/94, substitute adopted; placed on third reading, placed on immediate passage, passed; 5/31/94, referred to Committee on Natural Resources & Environmental Affairs. (4790) referred to second reading; 5/24/94, substitute adopted; 5/31/94, re-referred to Committee on Conservation, Environmental and Great Lakes.

HB 4935 — Amends the act concerned with the levy and collection of taxes to change the date real and personal property taxes become a lien to December 31 of the prior year—introduced by Rep. Bullard, Jr. on 7/13/93 and referred to Committee on Taxation; 10/13/93, reported with recommendation; 10/26/93, placed on third reading; 10/27/93, passed, given immediate effect; 10/28/93, referred to committee on finance; 3/10/94, reported favorably without amendment; 3/17/94, reported by committee of the whole favorably without amendment, placed on order of third reading; 3/23/94, passed, given immediate effect bill ordered enrolled; 4/12/94, presented to the Governor, approved by the Governor, filed with Secretary of State, assigned PA 80 with immediate effect.

HB 4965 — Amends the act creating the revenue division of the department of the treasury, to require, in instances where the department of treasury has recorded a lien in error, that the release contain a notice stating that lien was filed in error — introduced by Rep. Martin on 7/21/93 and referred to Committee on Taxation; 3/3/94, reported with recommendation with substitute; 3/15/94, substitute adopted, placed on third reading; 3/17/94, passed, given immediate effect; 3/22/94, referred to Senate Committee on Finance.

HB 5018 — Repeals "truth in taxation" and "truth in assessing" provisions of general property tax act — introduced by Rep. Bullard on 8/31/93 and referred to Committee on Taxation; 5/26/94, reported with recommendation with substitute, referred to second reading.

HB 5019 — Amends property tax act to establish guidelines for granting property tax poverty exemptions — introduced by Rep. Bullard on 8/31/93 and referred to Committee on Taxation; 3/10/94, reported with recommendation with substitute; 3/22/94, substitute adopted, placed on third reading; 3/23/94, amended, passed, given immediate effect; 3/24/94, referred to Senate Committee on Finance.

HB 5234 — Amends the enterprise zone act to provide for modification of the specific tax rate for commercial, industrial or utility property located in an enterprise zone area — introduced by Rep. Brackenridge on 12/9/93 and referred to Committee on Taxation; 5/11/94, reported with recommendation with substitute, referred to second reading; 5/18/94, substitute adopted, placed on third reading, placed on immediate passage; 5/31/94, amended, passed, given immediate effect.

HB 5245 — Amends the act permitting the State Conservation Commission to acquire land and undertake improvement programs at certain state parks to provide immunity from civil liability to department volunteers — introduced by Rep. Middaugh on 12/17/93 and referred to Committee on Conservation, Environment & Great Lakes; 2/22/94, reported with recommendation; 2/23/94, placed on third reading, placed on immediate passage, passed, given immediate effect; 2/24/94, referred to Senate Committee on Natural Resources & Environmental Affairs; 3/15/94, reported favorably without amendment; 3/17/94, reported by Committee of the Whole favorably without amendment, placed on order of third reading; 3/22/94, passed, given immediate effect, billed ordered enrolled; 4/12/94, presented to the Governor, approved by the Governor, filed with secretary of state, assigned PA 78 with immediate effect.

HB 5308 — Provides amendments to the general sales tax act to exempt the sale of electricity, natural gas or home heating fuels for residential use from the 2% sales tax increase — introduced by Rep. Whyman on 2/2/94 and referred to Committee on Taxation; 3/24/94, substitute adopted, substitute adopted, placed on third reading, placed on immediate passage, passed, given immediate effect; 4/12/94, referred to Committee on Finance; 4/26/94, motion to discharge committee, motion to discharge committee approved, referred to general orders, placed on immediate passage, passed, given immediate effect, bill ordered enrolled; 4/27/94, presented to the Governor; 5/3/94, approved by the Governor, filed with secretary of state, assigned PA 111 with immediate effect.

HB 5313 — Provides amendments to the tax tribunal act to revise the interest rate on excess property taxes paid under protest to one percentage point above the adjusted prime rate per annum after March 31, 1994 — introduced by Rep. Dombroski on 2/3/94 and referred to Committee on Taxation; 2/23/94, reported with recommendation with substitute; 3/10/94, substitute amended and adopted, placed on third reading, placed on immediate passage, passed, given immediate effect; 3/15/94, referred to committee on finance; 5/31/94, motion to discharge committee, motion to discharge committee approved, placed on immediate passage, placed on order of third reading.

HB 5341 — Provides amendments to the state real estate transfer tax act to impose a 1% tax of the total value of property being transferred beginning January 1, 1995 — introduced by Rep. Schroer on 2/15/94 and referred to Committee on Taxation; 4/20/94, reported with recommendation with substitute, referred to second reading; 4/26/94, substitute adopted, placed on third reading, placed on immediate passage; 4/27/94, passed, given immediate effect; 4/28/94, referred to Committee on Finance; 5/5/94, reported favorably without amendment.

HB 5345 — Amends the general property tax act to provide for and prescribe a procedure for claiming a homestead exemption from property taxes used for school purposes — introduced by Rep. Freeman on 2/15/94 and referred to Committee on Taxation; 2/16/94, reported with recommendation with substitute; 2/22/94, substitute defeated; 2/22/94, substitute amended and adopted; 2/22/94, passed, given immediate effect; 2/23/94, referred to Committee on Finance; 5/24/94, reported favorably with substitute, referred to General Orders.

HB 5369 — Provides amendments to the Michigan penal code to provide that an individual who places an object in a tree with intent to inhibit or discourage the removal of that tree or cause injury to a person attempting to remove the tree, is guilty of a misdemeanor and, should injury occur to a person attempting to remove the tree, guilty of a felony — introduced by Rep. Anthony on 2/23/94 and referred to Committee on Agriculture and Forestry; 4/26/94, reported with recommendation with amendment(s), referred to second reading; 5/18/94, substitute adopted, placed on third reading, placed on immediate passage, passed; 5/19/94, referred to Committee on Agriculture and Forestry.

HB 5374 — Amends the charter and livery boat safety act to provide for the assumption of risk of injury for canoers who rent, lease or operate canoes owned by a boat livery — introduced by Rep. Bodem on 2/24/94 and referred to Committee on Tourism & Recreation; 5/26/94, reported with recommendation with substitute, referred to second reading.

HB 5380 — Amends the act concerned with home solicitation sales to exclude from coverage sales made at the buyer's home pursuant to a contact with the seller initiated by the buyer — introduced by Rep. Jersevic on 3/1/94 and referred to Committee on Business and Finance; 3/17/94, reported with recommendation.

HB 5395 — Amends the school code of 1976 to permit districts to differentiate taxes levied in 1993 for the operation of a community swimming pool from operating millage and to permit school districts that operate a community swimming pool to levy a tax for the maintenance and operation of the community pool with the approval of the school electors — introduced by Rep. Dalman on 3/8/94 and referred to Committee on Education; 5/19/94, reported with recommendation with substitute, referred to second reading; 5/26/94, substitute, placed on third reading, placed on immediate passage, passed, given immediate effect; 5/31/94, referred to Committee on Finance.

HB 5403 — Amends the electrical administrative act to revise the expiration and renewal dates of licenses — introduced by Rep. Jacobetti on 3/1/94 and referred to Committee on Labor.

HB 5405 — Amends the Forbes mechanical contractors act to revise the expiration and renewal dates of licenses and address issuance and renewal of licenses for persons who have an outstanding fee or fine resulting from non-payment of a check or overdraft — introduced by Rep. Jacobetti on 3/10/94 and referred to Committee on Labor.

HB 5407 — Creates an act requiring a state department or agency purchasing real property on behalf of the state to publish notice of the state's intention to purchase the real property and hold a public hearing on the matter — introduced by Rep Vorva on 3/10/94 and referred to Committee on State Affairs.

HB 5409 — Amends the state education tax act to define agricultural use and include in the definition of homestead certain farms meeting specified requirements — introduced by Rep. Gustafson on 3/10/94 and referred to Committee on Taxation.

HB 5417 — Amends the act concerned with public hearings on budgets of local units of government to require local governmental units to hold a public hearing on their proposed budgets and include in their notice of hearing that the property tax millage rate proposed to be levied to support their proposed budget will be the subject of the hearing — introduced by Rep. Bullard Jr. on 3/17/94 and referred to Committee on Taxation.

HB 5420 — Amends the general property tax act to specify the procedure for reviewing clerical errors or mutual mistakes of fact regarding correct assessment figures and provide for interest on refunds — introduced by Rep. Jaye on 3/17/94 and referred to Committee on Taxation.

HB 5438 — Creates the Michigan ginseng act concerned with licensing and regulating the harvest, sale and distribution of american ginseng — introduced by Rep. Randall on 3/23/94 and referred to Committee on Agriculture and Forestry; 4/20/94, reported with recommendation with substitute, referred to second reading; 5/18/94, substitute adopted, placed on third reading, placed on immediate passage, passed; 5/19/94, referred to Committee on Agriculture and Forestry; 5/31/94, reported favorably without amendment.

HB 5445 — Amends the school code of 1976 to prescribe limits on intermediate school district vocational-technical millage rates — introduced by Rep. Walberg on 3/24/94 and referred to Committee on Education.

HB 5450 — Amends the general property tax act to provide procedures for claiming a homestead exemption from tax under the school code of 1976 including provisions for claiming an exemption by filing an affidavit before May 1 for summer property tax levies or October 1 for December property tax levies — introduced by Rep. Whyman on 3/24/94 and referred to Committee on Taxation.

HB 5470 — Amends the general property tax act to provide additional procedures for the filing of homestead exemption affidavit including the ability of buyers of an existing or newly constructed home to file an affidavit immediately after taking ownership and possession of the property, for subsequent affidavits to automatically rescind earlier affidavits and for an appeal process should the department of treasury determine that a particular property is not the homestead of the owner — introduced by Rep. Middleton on 4/19/94 and referred to Committee on Taxation.

HB 5485 — Amends the general sales tax act to provide for the refund of the additional 2% sales tax collected by retailers from persons engaged in the business of construction, repairing or improving real estate for others pursuant to an agreement made before May 1, 1994 — introduced by Rep. Profit on 4/20/94 and referred to Committee on Taxation.

HB 5486 — Amends the act concerned with the rights and duties of parties to home solicitation sales to add a provision granting buyers 75 years of age or older additional time (15 business days) to terminate an agreement or offer to purchase made pursuant to a home solicitation — introduced by Rep. LeTarte on 4/20/94 and referred to Committee on Senior Citizens.

HB 5499 — Provides general amendments to the subdivision control act of 1967 — introduced by Rep. Stille on 4/26/94 and referred to Committee on Local Government.

HB 5500 — Creates an act to prohibit certain real estate development unless unreasonable impacts on services and facilities arising from the development are eliminated — introduced by Rep. Stille on 4/26/94 and referred to Committee on Local Government.

HB 5501 — Amends the county rural zoning enabling act to authorize counties to establish land management plans and adopt zoning ordinances pursuant to the plan, provide for the classification of districts on the basis of public facilities and services, permit the purchase and transfer of development rights, grant the power of eminent domain, among other things — introduced by Rep. Stille on 4/26/94 and referred to Committee on Local Government.

HB 5502 — Amends the township rural zoning enabling act to authorize townships to establish land management plans and adopt zoning ordinances pursuant to the plan, provide for the classification of districts on the basis of public facilities and services, permit the purchase and transfer of development rights to grant the power of eminent domain, among other things — introduced by Rep. Stille on 4/26/94 and referred to Committee on Local Government.

HB 5503 — Creates an act permitting local units of government, by ordinance, to establish procedures, requirements and standards for considering and entering into development agreements with persons having a vested interest in private real estate located within the governing bodies' borders — introduced by Rep. Stille on 4/26/94 and referred to Committee on Local Government.

HB 5504 — Creates an act which provides a standard for determining when property is specially benefited by an improvement financed by special assessments — introduced by Rep. Stille on 4/26/94 and referred to Committee on Local Government.

HB 5505 — Creates an act to provide for maps for designating existing and proposed public facilities, regulate or prohibit construction within the boundaries of existing or propcsed public facilities and provide for the acquisition of property for certain public facilities — introduced by Rep. Stille on 4/26/94 and referred to Committee on Local Government.

HB 5506 — Creates an act to provide for and authorize cities and villages to establish land management plans and adopt zoning ordinances pursuant to the plan, provide for the classification of districts on the basis of public facilities and services, permit the purchase and transfer of development rights, grant the power of eminent domain, among other things — introduced by Rep. Stille on 4/26/94 and referred to Committee on Local Gcvernment.

HB 5520 — Amends the solid waste management act to revise and add various planning requirements — introduced by Rep. Middleton on 5/3/94 and referred to Committee on Conservation, Environment and Great Lakes.

HB 5527 — Amends the general property tax act to eliminate the property tax administration fee — introduced by Rep. Martin on 5/4/94 and referred to Committee on Taxation.

HB 5528 — Amends the act concerned with establishing a state parks endowment fund to provide for the implementation of a constitutional amendment to create the Michigan state parks endowment fund within the state treasury — introduced by Rep. Alley on 5/4/94 and referred to Committee on Appropriations; 5/24/94, reported with recommendation, referred to second reading; 5/25/94, placed on third reading, placed on immediate passage, passed, given immediate effect; 5/31/94, referred to Committee on Natural Resources & Environmental Affairs.

HB 5534 — Amends the condominium act to require bylaws to provide for co-owner attendance at all board of directors meetings and provide written notice of any such meeting — introduced by Rep. Bullard, Jr. on 5/5/94 and referred to Committee on Housing and Urban Affairs.

HB 5535 — Amends the act concerned, in part, with prohibiting the holding of incompatible public offices, to permit village and township officers or employees to serve as a member of various tax increment financing boards — introduced by Rep. Lowe on 5/5/94 and referred to Committee on Local Government; 5/24/94, reported with recommendation, referred to second reading.

HB 5536 — Amends the city income tax act to create and provide incentives to participate in an "adopt-a-lot" program — introduced by Rep. Young, Jr. on 5/10/94 and referred to Committee on Taxation.

HB 5540 — Amends the act which provides for city and village zoning and land use to require city or village zoning ordinances to authorize family day care homes and group day care homes in all residential zones, subject to certain conditions and limitations — introduced by Rep. Dolan on 5/10/94 and referred to Committee on Local Government.

HB 5541 — Amends the school code of 1976 to allow a summer tax collection for 1994 if a resolution of the school board is adopted before June 1, 1994 — introduced by Rep. Porreca on 5/10/94 and referred to Committee on Taxation.

HB 5551 — Amends the school code of 1976 to allow electors to establish or increase a permanent charter millage rate for taxes levied for the operation of a community college — introduced by Rep. Dobronski on 5/12/94 and referred to Committee on Local Government.

HB 5553 — Amends the general property tax act to provide reimbursement to local tax collecting units for all expenses incurred in administrating homestead exemption affidavits — introduced by Rep. Whyman on 5/12/94 and referred to Committee on Appropriations.

HB 5554 — Amends the fire prevention code to require a fire suppression system be installed in new construction and renovation of any public lodging — introduced by Rep. Curtis on 5/12/94 and referred to Committee on State Affairs.

HB 5556 — Amends the solid waste management act to exempt methane gas recovery facilities from the ban on yard waste disposal — introduced by Rep. Palamara on 5/12/94 and referred to Committee on Conservation, Environment and Great Lakes.

HB 5557 — Amends the scrap tire regulatory act to address abandoned scrap tires and allow funding for cleanup of scrap tires on certain private property — introduced by Rep. Leland on 5/12/94 and referred to Committee on Conversation, Environment & Great Lakes.

HB 5593 — Amends the uniform partnership act to establish and regulate limited liability partnerships — introduced by Rep. Profit on 5/31/94 and referred to Committee on Business and Finance.

HB 5594 — Creates an act concerned with establishing a manufactured housing recovery fund — introduced by Rep. Olshove on 5/31/94 and referred to Committee on Transportation.

SB 144 — Provides general amendments to economic and industrial development act — introduced by Sen. Cisky on 1/26/93 and referred to Committee on Local Government & Urban Development; 5/3/94, reported favorably with substitute; 5/4/94, referred to Committee on Local Governments and Urban Development; 5/18/94, reported favorably with substitute; 5/31/94, amended, substitute and amendment(s) adopted, reported by Committee of the Whole favorably with substitute and amendment(s), substitute and amendment(s) concurred in, placed on order of third reading with substitute and amendment(s), amendment(s) defeated, passed.

SB 155 — Amends the occupational code to exempt certain real estate brokers and associate brokers providing market analyses for a fee from appraiser licensure requirements — introduced by Sen. Dunaskiss on 1/26/93 and referred to Committee on State Affairs & Military/Veteran Affairs; 6/15/93, general orders; 6/17/93, third reading; 6/23/93, passed; 6/23/93, Committee on State Affairs; 2/22/94, reported with recommendation with substitute; 3/2/94, substitute adopted, placed on third reading; 4/13/94, passed, given immediate effect, returned to senate; 4/26/94, house substitute concurred in, given immediate effect, ordered enrolled; 5/4/94, presented to the Governor; 5/18/94, approved by the Governor, filed with secretary of state, assigned PA 125 with immediate effect.

SB 288 — Amends general property tax act to require assessor to use the amount determined by board of review for following year's assessment — introduced by Sen. Bouchard on 1/26/93 and referred to Committee on Finance; 1/27/94, reported favorably without amendment; 2/1/94, reported by Committee of the whole favorably without amendment; 5/26/94, reported with recommendation with amendment(s), referred to second reading.

SB 688 — Amends fertilizer act of 1975 to provide for the protection of groundwater and to require compliance with the groundwater and freshwater protection act — introduced by Sen. McManus on 6/8/93 and referred to Committee on Agriculture & Forestry; 3/1/94, reported favorably with substitute; 3/9/94, reported by Committee of the

whole favorably with substitute, substitute concurred in, placed on order of third reading with substitute; 3/10/94, passed, referred to Committee on Agriculture and Forestry; 5/25/94, reported with recommendation, referred to second reading.

SB 882 — Amends the general property tax act to eliminate the State Tax Commission and State Board of Equalization and reassign their duties to entities such as the Department of Treasury and County Board of Commissioners and eliminates certain property tax appeal procedures — introduced by Sen. Bouchard on 10/13/93 and referred to Committee on School Finance Reform; 1/27/94, referred to committee on finance; 5/24/94, reported favorably with substitute, placed on immediate passage, placed on order of third reading, amended, amendment(s) defeated, substitute and amendment(s) adopted, passed, vote reconsidered, amended, substitute and amendment(s) adopted, passed, referred to Committee on Taxation; 5/26/94, reported with recommendation with substitute, referred to second reading.

SB 936 — Amends the act providing for the levying and collection of taxes by cities, to require a city with a population of more than one million to provide, by ordinance, a procedure to finance snow removal from streets, mosquito abatement, and security services by special assessments and authorize the use of petitions to initiate the establishment of a special assessment district — introduced by Sen. O'Brien on 12/1/93 and referred to Committee on Finance; 3/10/94, reported favorably with recommendation for referral to Committee on Natural Resources & Environmental Affairs, recommendation concurred in, referred to Committee on Natural Resources & Environmental Affairs; 3/22/94, reported favorably without amendment; 3/22/94, amended, reported by Committee of the Whole favorably with amendment(s), amendment(s) concurred in, placed on order of third reading with amendment(s); 3/24/94, passed, referred to Committee on Conservation, Environment and Great Lakes; 4/26/94, substitute adopted, reported by Committee of the Whole favorably with substitute, substitute concurred in, placed on order of third reading with substitute; 4/27/94, passed, referred to Committee on Local Government.

SB 952 — Creates the Michigan state parks foundation act which creates a Michigan state parks foundation whose purpose is to support the overall enhancement of the Michigan state parks system — introduced by Sen. Ehlers on 12/8/93 and referred to Committee on Finance; 4/12/94, reported with recommendation, referred to second reading; 5/4/94, given immediate effect, ordered enrolled; 5/12/94, presented to the Governor; 5/25/94, approved by the Governor; filed with Secretary of State, assigned PA 130 with immediate effect.

SB 970 — Amends the act concerned with state conservation and state park improvement programs to provide general amendments including renaming the act the Michigan state parks systems act — introduced by Sen. Hoffman on 1/18/94 and referred to Committee on Natural Resources & Environmental Affairs; 3/15/94, reported favorably with amendment(s); 3/17/94, reported by Committee of the Whole favorably with amendment(s), amendment(s) concurred in, placed on order of third reading with amendment(s); 3/22/94, passed, referred to Committee on Conservation, Environment and Great Lakes; 4/12/94, reported with recommendation, referred to second reading; 4/19/94, amended, placed on third reading; 4/27/94, passed, given immediate effect, returned to Senate; 5/4/94, house amendment(s) concurred in, given immediate effect, ordered enrolled; 5/12/94, presented to the Governor; 5/18/94, approved by the Governor, filed with secretary of state, assigned PA 120 with immediate effect.

SB 971 — Amends the act concerned with conservation and the improvement of certain state parks to establish an "adopt-a-park" program that will allow volunteer groups to assist state park staff in maintaining and enhancing state parks — introduced by Sen. Hoffman on 1/18/94 and referred to Committee on Natural Resources & Environmental Affairs; 3/15/94, reported favorably without amendment; 3/17/94, reported by Committee of the Whole favorably without amendment, placed on order of third reading; 3/22/94, passed, referred to Committee on Conservation, Environment and Great Lakes; 4/12/94, reported with recommendation, referred to second reading; 5/4/94, given immediate effect, ordered enrolled; 5/12/94, presented to the Governor; 5/18/94, approved by the Governor, filed with secretary of state, assigned PA 121 with immediate effect.

SB 1007 — Provides amendments to the environmental response act to bring about the citizens review board established by the act and, in addition, to provide that one member of the review board be appointed by a republican leader and one by a democratic leader of the House of Representatives — introduced by Sen. Hoffman on 2/8/94 and referred to Committee on Natural Resources & Environmental Affairs; 4/12/94, reported favorably without amendment, reported by Committee of the Whole

favorably without amendment; 4/14/94, placed on order of third reading; 4/26/94, amendment(s) defeated, passed, referred to Committee on Conversation, Environment and Great Lakes.

SB 1008 — Provides amendments to the act concerned with prohibiting obstructions and encroachments on public highways to permit certain utility lines to be constructed within limited access highway right of ways and otherwise allow utility companies to enter upon, construct and maintain certain facilities and require standards — introduced by Rep. Hoffman on 2/8/94 and referred to Committee on Technology & Energy; 4/12/94, reported favorably without amendment; 4/14/94, reported by Committee of the Whole favorably without amendment, placed on order of third reading; 4/26/94, passed, referred to Committee on Transportation.

SB 1029 — Provides amendments to the school code of 1976 to provide that in the event a 6% sales tax is implemented, 18 mills be levied on homestead property before mills are levied uniformly on all property and provide an exemption from this requirement for certain school districts — introduced by Sen. Bouchard on 2/22/94 and referred to Committee on Education; 3/1/94, reported favorably with substitute.

SB 1036 — Amends the revised judicature act of 1961 to permit licensed real estate brokers and sales persons to represent landlords in small claims court on security deposit disputes under certain circumstances — introduced by Senator Hoffman on 3/02/94 and referred to Committee on Judicature; 5/12/94, reported favorably without amendment; 5/19/94, reported by committee of the whole favorably without amendment, placed on order of third reading; 5/24/94, passed, referred to committee on judiciary.

SB 1038 — Amends the mortgage brokers, lenders, and servicers licensing act to include in its list of exempted entities nonprofit corporations established pursuant to the neighborhood reinvestment corporation act — introduced by Senator Schwarz on 3/2/94 and referred to Committee on Corporations and Economic Development; 3/17/94, reported favorably without amendment; 3/22/94, reported by Committee of the Whole favorably without amendment, placed on order of third reading; 3/23/94 passed, referred to Committee on Business and Finance; 5/12/94, reported with recommendation, referred to second reading.

SB 1039 — Amends the act concerned with secondary mortgages and other unsecured loans to exempt from application nonprofit corporations established pursuant to the neighborhood reinvestment corporation act — introduced by Senator Schwarz on 3/2/94 and referred to Committee on Corporations and Economic Development; 3/17/94, reported favorably without amendment; 3/22/94, reported by Committee of the Whole favorably without amendment, placed on order of third reading; 3/23/94 passed, referred to Committee on Business and Finance; 5/12/94, reported with recommendation, referred to second reading.

SB 1096 — Amends the condominium act to provide for the rights of co-owners to attend meetings of the Board of Directors of the Association and provide for notice of meetings of the Board of Directors — introduced by Sen. Honigman on 4/14/94 and referred to Committee on Local Government and Urban Development.

SB 1100 — Creates a bill to authorize the transfer or conveyance of certain real estate owned by the state in Kalamazoo county and for the department of management and budget's demolition or disposal of certain surplus buildings — introduced by Sen. Welborn on 4/19/94 and referred to Committee on State Affairs & Military/Veteran Affairs; 5/24/94, reported favorably without amendment, referred to general orders; 5/25/94, placed on immediate passage, placed on order of third reading, passed, referred to Committee on State Affairs.

SB 1104 — Creates the Michigan state preservation, empowerment, and economic development authority act to promote historic preservation and economic growth within economically distressed local governmental areas — introduced by Rep. Kelly on 4/20/94 and referred to Committee on Corporations and Economic Development.

SB 1106 — Amends the occupational code to delete references to "commissions" — introduced by Rep. Wartner on 4/20/94 and referred to Committee on Commerce; 5/12/94, reported favorably without amendment; 5/19/94, amended, reported by committee of the whole favorably with amendment(s), amendment(s) concurred in, placed on order of third reading with amendment(s); 5/24/94, amendment(s) defeated, passed, referred to Committee on Business and Finance.

SB 1108 — Amends the occupational code to repeal the article regulating community planners and delete references to community planners from the occupational code — introduced by Sen. Wartner on 4/20/94 and referred to Committee on Commerce; 5/12/94, reported favorably with substitute; 5/19/94, reported by committee of the whole favorably with substitute, substitute concurred in, placed on order of third reading with substitute; 5/24/94, passed, referred to Committee on State Affairs.

SB 1111 — Amends the school code of 1976 to make technical revisions and provide for implementation of the homestead property tax exemption — introduced by Sen. Emmons on 4/20/94 and referred to Committee on Finance; 5/24/94, reported favorably with substitute, placed on immediate passage, placed on order of third reading, amendment(s) defeated, amended, amended; 5/25/94, amended, substitute and amendment(s) adopted, substitute defeated, passed by 3/4 vote, referred to Committee on Taxation.

SB 1117 — Amends the farm land and open space preservation act to provide for annual reductions in liens provided for under the act under certain conditions — introduced by Rep. Berryman on 4/27/94 and referred to Committee on Finance.

SB 1123 — Amends the state education tax act to delete certain definitions and provide for state treasurer certification of the levy of tax under the act — introduced by Sen. Emmons on 4/27/94 and referred to Committee on Finance; 4/28/94, reported favorably with amendment(s); 5/4/94, reported by Committee of the Whole favorably with amendment(s), amendment(s) concurred in, placed on order of third reading with amendment(s); 5/5/94, passed, referred to Committee on Taxation; 5/26/94, reported with recommendation with amendment(s), referred to second reading.

SB 1135 (Same as House Bill 5520). — Amends the solid waste management act to revise and add various planning requirements — (HB 5520) introduced by Rep. Middleton on 5/3/94 and referred to Committee on Conservation, Environment and Great Lakes — (SB 1135) introduced by Sen. Dunaskiss on 5/3/94 and referred to Committee on Natural Resources & Environmental Affairs; 5/5/94 reported favorably with substitute; 5/10/94, reported by committee of the whole favorably with substitute, substitute concurred in, placed on order of third reading with substitute; 5/12/94, passed, referred to Committee on Conservation, Environment & Great Lakes; 5/24/94, reported with recommendation with amendment(s), referred to second reading; 5/25/94, amended, placed on third reading, placed on immediate passage, amended, passed, given immediate effect, returned to senate.

SB 1139 — Amends the environmental response act to provide general amendments — introduced by Sen. Kelly on 5/4/94 and referred to Committee on Natural Resources & Environmental Affairs..

SB 1142 — Amends the state real estate transfer tax act to include land contracts and certain other transfers — introduced by Sen. Carl on 5/5/94 and referred to Committee on Finance; 5/24/94, reported favorably with substitute, referred to general orders; 5/31/94, reported by committee of the whole favorably with substitute, substitute concurred in, placed on order of third reading with substitute, placed on immediate passage, amendment(s) defeated, passed.

SB 1153 — Amends the property tax limitation act to provide general and technical amendments — introduced by Sen. Smith, Jr. on 05/12/94 and referred to Committee on Finance; 5/19/94, reported favorably without amendment; 5/24/94, placed on immediate passage, placed on order of third reading, substitute adopted, passed, referred to Committee on Taxation; 5/26/94, reported with recommendation, referred to second reading.

SB 1164 — Amends the uniform transboundary pollution reciprocal access act to include Canadian provinces within reciprocating jurisdictions — introduced by Sen. Kelly on 5/24/94 and referred to Committee on Natural Resources & Environmental Affairs.

SB 1176 — Amends the housing law of Michigan to revise housing inspection procedures — introduced by Sen. Bouchard on 5/25/94 and referred to Committee on Corporations and Economic Development.

SB 1177 — Amends the tax tribunal act to provide for general amendments — introduced by Sen. Emmons on 5/25/94 and referred to Committee on Finance.

RECENT DECISIONS

by *Joseph Lloyd*
Chard & Lloyd
201 E. Washington
Ann Arbor, Michigan 48104

G&A Incorporated v Nahra, 204 Mich App 323; ___ NW2d ___ (1994)

Landlord/Tenant - Payment of Taxes, Special Assessments

Plaintiff and Defendant were tenant and landlord of commercial property. The lease charged the tenant with "paying all of the real property taxes" on the property during the lease term. The question before the court was whether a special assessment for improvement of adjacent off-street parking was within the scope of this provision. The trial court ruled on motion for summary disposition that the special assessment was not included in "real property taxes." The Court of Appeals, hearing the case de novo, ruled that the special assessment was for the purpose of providing a lasting benefit to the property and, following the reasoning of Kadzban v City of Grandville, 442 Mich 495; 502 NW2d 299 (1993), affirmed the trial court.

City of Ann Arbor v National Center for Manufacturing Sciences, Inc, 204 Mich App 303; ___ NW2d ___ (1994)

Tax Exemption - Michigan Strategic Fund

The Michigan Strategic Fund Act, MCL 125.2001; MSA 3.541(201) grants exemption from ad valorem property taxes to certain research facilities funded by the State of Michigan. Plaintiff municipality brought an action for declaratory judgment seeking to have that act held unconstitutional. Plaintiff argued that the tax violated the Uniformity of Taxation Clause in the Michigan Constitution, Article 9, Section 3, and that it unconstitutionally delegated legislative power to the administrators of the fund. The trial court granted summary disposition in favor of the defendant and the Court of Appeals affirmed, finding that there was sufficient rational purpose and that there were sufficient standards and definitions in the act to pass constitutional muster.

Giannetti v Cornlillie, 204 Mich App 234; ___ NW2d ___ (1994)

Offer and Acceptance - Mirror Image Rule

The Plaintiffs offered to purchase the Defendants' home, submitting a standard real estate purchase offer. The defendant Sellers made a counteroffer, and the Plaintiffs purportedly accepted, but they changed the amount of the mortgage in the financing contingency from $124,000 to $128,000. The real estate agent did not submit this modified offer back to the defendants, but rather told them that the plaintiffs had accepted the counteroffer. Defendants sought to rescind the offer immediately prior to the closing.

The trial court found that there was a contract notwithstanding the change in the terms of the counteroffer, the Court of Appeals disagreed and reversed. The Plaintiffs argued that the modification of the mortgage amount did not vitiate their purported acceptance because the mortgage amount was not a material term of the contract. The Court of Appeals held that any change, even one apparently minor, was sufficient to require reacceptance by the opposite party.

English v Augusta Township, 204 Mich App 33; ___ NW2d ___ (1994)

Mobile Home Parks - Exclusionary Zoning

The Plaintiffs own 49 acres in Augusta Township. They sought a change in their zoning classification from agricultural to mobile-home park zoning. Defendant denied the rezoning, and Plaintiff filed suit. At trial, the evidence showed that the Township had designated 96 acres for mobile homes, but that particular land was chosen for mobile home use because the Township believed that it would never be developed. The Township zoning official testified that he had been pressured to keep manufactured housing out of the Township. The trial court found that the Township had unconstitutionally excluded mobile home

parks by relegating them to an undevelopable area, and ordered the Township to rezone the subject parcel to a Mobile Home classification.

The Court of Appeals partially affirmed. It found that a zoning ordinance which totally excludes an otherwise legitimate use carries with it a strong taint of unlawful discrimination. The Court disagreed with the trial court, however, as to the form (if not the substance) of the remedy. The Court of Appeals ordered that the trial court not order the land rezoned, but it did order it to issue an injunction prohibiting the Defendant from interfering with the Plaintiff's reasonable use of their property as a mobile home park.

Duggan v Clare County Board of Commissioners, 203 Mich App 570; ___ NW2d ___ (1994)

Municipal Land Sales - Scope of Referendum
Re Landfill

The question before the court was whether a resolution of the County Board of Commissioners authorizing sale of certain property, and development of that land for a solid waste landfill pursuant to the Solid Waste Management Act, was subject to public referendum. After the sale in question, the plaintiffs initiated a petition drive and collected the signatures necessary to place the matter on the ballot. The Board refused to place the matter on the ballot and Plaintiff brought suit. The trial court granted defendants partial summary disposition, holding that the resolution was not legislation subject to referendum. The Court of Appeals affirmed.

Cheff v Edwards, 203 Mich App 548; ___ NW2d ___ (1994)

Foreclosure by Advertisement - Junior Liens

The Plaintiff held a junior lien on certain property. The first mortgage was foreclosed by advertisement and the second mortgage holder thereafter brought suit, seeking to declare that his mortgage remained as an encumbrance based on a theory that he was entitled to actual notice of the foreclosure proceedings. The trial court granted summary disposition for the defendant and the Court of Appeals affirmed. It was held that, however harsh, the statute authorizing foreclosure by advertisement was constitutional.

CONTINUING LEGAL EDUCATION

by
Jack D. Shumate, Chairperson
and
Arlene R. Rubinstein, Administrative Assistant

NINETEENTH ANNUAL SUMMER CONFERENCE
Treetops Sylvan Resort
Gaylord, Michigan
July 20-23, 1994

SUMMER CONFERENCE

Limited Accommodations Still Available!

Treetops Sylvan Resort, the location of this year's summer conference, offers something for every interest. Magnificent, championship golf courses plus many other recreation and leisure activities are available. Mix business with pleasure with these affordable rates!

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Rooms have been reserved at Treetops Sylvan Resort at the above daily rates. Per room per night. Please add 8% state and local taxes. Children 17 years and under sleep free when in room with parents.

Stephen E. Dawson of Dickinson, Wright, Moon, Van Dusen and Freeman has chosen a distinguished group of speakers to discuss the following timely and informative topics of interest to all real estate attorneys. Thursday morning, Mark L. McAlpine of Clark, Klein & Beaumont will speak on the basics of Alternative Dispute Resolutions. William B. Dunn of Clark, Klein and Beaumont and Russell A. McNair of Dickinson, Wright, Moon, Van Dusen & Freeman will follow with a discussion on drafting, focusing on practical concerns involved in utilizing provisions for dispute resolution alternatives in commercial real estate transactions.

Friday morning will begin with Gail A. Anderson of Dickinson, Wright, Moon, Van Dusen & Freeman speaking on new real estate laws. Next, Alan S. Levine of Butzel Long will discuss Michigan Real Estate Tax Sales. Lawrence D. McLaughlin of Honigman, Miller, Schwartz and Cohn will conclude Friday morning's lectures with State of the Law.

The popular "Hot Tips" portion of the conference will begin Saturday morning at 8:30 a.m. with the following topics and speakers:

Section 1031 - Tax Free Exchanges
Michael R. Atkins - Miller, Canfield, Paddock & Stone

Waterfront Access Rights
James Y. Stewart - Butzel Long

Bankruptcy Code §365(h) and Tenant Assignments and Subleases: Tenant Beware
Stephen E. Dawson - Dickinson, Wright, Moon, Van Dusen & Freeman

Residential Construction Contracts - Highlighting Your Worst Nightmare
Ronald P. Strote - May, Simpson & Strote

Tips on Negotiating the Office Lease from the Tenant's Perspective
Cameron H. Piggott - Dykema Gossett

Tips on Negotiating the Retail Space Lease from the Tenant's Perspective
John G. Cameron, Jr. - Warner, Norcross & Judd

Single Asset Chapter 11 Real Estate Cases - Bad Faith, New Debtor Syndrome and other Pitfalls
Lisa Sommers Gretchko - Pepper, Hamilton & Scheetz

Please look elsewhere in this issue for a Summer Conference Registration form.

HOMEWARD BOUND

The 1994-95 Homeward Bound Series will begin, Thursday, October 27, 1994 in Troy at the Management Education Center, 811 W. Square Lake Road. Due to low registrations, we will no longer present the Homeward Bound Series in Grand Rapids. We are sorry for any inconvenience this may cause members of the Section.

This year's program director is William B. Acker of Kemp, Klein, Humphrey and Endelman. Mr. Acker is in the process of finalizing this informative program. Topics to be discussed include: Update on Environmental Clean Up Requirements, RTC, Pre-Workout Agreements, Tax Free Exchanges, Bankruptcy, Residential Real Estate Transactions, Understanding Surveys and Boundary Disputes and Litigation, and Real Estate Malpractice Traps of the 90's. Information regarding the Series will be available later this summer.

For more information on any Section activity please call Arlene Rubinstein, Administrative Assistant at 810-644-7378.

COURSE CALENDAR

Set forth is a schedule of continuing legal education courses sponsored or co-sponsored by the Real Property Law Section through September 1994.

Key: HB = Homeward

ICLE = Courses co-sponsored by the Institute of Continuing Legal Education

DATE	LOCATION	PROGRAM	TOPIC
July 20-23	Treetops Sylvan Resort Gaylord	Summer Conference	Current Developments and Practice Tips 1994
Sept. 21	Cobo Hall Hotel Pontchartrain Detroit	Annual State Bar Meeting	Hot Tips on What's New in Real Estate Law

STATE BAR OF MICHIGAN
REAL PROPERTY LAW SECTION
NINETEENTH ANNUAL SUMMER CONFERENCE
CURRENT DEVELOPMENTS AND PRACTICE TIPS 1994
TREETOPS SYLVAN RESORT
GAYLORD, MICHIGAN

THURSDAY, JULY 21, 1994
9:00 A.M. - Noon

General Information:	Stephen E. Dawson, Esq. Program Coordinator Dickinson, Wright, Moon Van Dusen & Freeman
Alternative Dispute Resolution	Mark L. McAlpine, Esq. Clark, Klein & Beaumont
Real Estate Documentation and ADR: The Pitfalls and Pratfalls; Document Drafting Tips	William B. Dunn, Esq. Clark Klein & Beaumont and Russell A. McNair, Jr., Esq. Dickinson, Wright, Moon, Van Dusen & Freeman

FRIDAY, JULY 22, 1994
9:00 A.M. - Noon

New Real Estate Broker Laws	Gail A. Anderson, Esq. Dickinson, Wright, Moon, Van Dusen & Freeman
Tax Sales in Michigan: How they Work; Purchasing Tax Titles	Alan S. Levine, Esq. Butzel Long
State of the Law	Lawrence D. McLaughlin, Esq. Honigman Miller Schwartz and Cohn

SATURDAY, JULY 23, 1994
8:30 A.M. - 11:30 A.M.
"HOT TIPS"

Section 1031 - Tax Free Exchanges
Michael R. Atkins, Esq. - Miller, Canfield, Paddock & Stone

Waterfront Access Rights
James Y. Stewart, Esq. - Butzel Long

Bankruptcy Code §365 (h) and Tenant Assignments and Subleases: Tenant Beware
Stephen E. Dawson, Esq. - Dickinson, Wright, Moon, Van Dusen & Freeman

Residential Construction Contracts - Highlighting Your Worst Nightmare
Ronald P. Strote, Esq. - May, Simpson & Strote

Tips on Negotiating the Office Lease from the Tenant's Standpoint
Cameron H. Piggott, Esq. - Dykema Gossett

Tips on Negotiating the Retail Space Lease from the Tenant's Standpoint
John G. Cameron, Jr., Esq. - Warner, Norcross & Judd

Single Asset Chapter 11 Real Estate Cases: Bad Faith, New Debtor Syndrome and Other Pitfalls
Lisa Sommers Gretchko, Esq. - Pepper, Hamilton & Scheetz

---(tear and mail)---

NINETEENTH ANNUAL SUMMER CONFERENCE
TREETOPS SYLVAN RESORT
GAYLORD, MICHIGAN
JULY 20-23, 1994

Name_____

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Registration Fees: Section Members $200 Non-Section Members $225

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For further information, please call Arlene Rubinstein at 810-644-7378.

N E W

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PREPARED BY THE ENVIRONMENTAL LAW AND REAL PROPERTY SECTIONS OF THE STATE BAR OF MICHIGAN

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