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Finance, Real Estate & Bankruptcy News

Summer 2014

MICHIGAN RECEIVERSHIP RULES GET A TUNE-UP

-Scott Hogan and Patricia Scott

Effective May 1, 2014, the Michigan Supreme Court adopted new rules which significantly change how receiverships are administered. The changes to Michigan Court Rules 2.621 and 2.622 were made at the recommendation of the Receivership Committee of the Business Law Section of the State Bar of Michigan. The order adopting the changes can be viewed here: http://1.usa.gov/1Ah1IOF

A receiver is an officer of the court who takes possession, custody and control of specified real or personal property and then disposes of that property for the benefit of creditors. Previously, receivers in Michigan (mainly) operated according to common law rules. The new rules are intended to expand and update the receivership process while clarifying the rules and requirements for receivers. The amendments to MCR 2.621 and 2.622 deal with the following issues (among others):

Receiver Appointments. The new rules impact the receiver appointment process. In considering a proposed receiver, the court may, but need not, defer to the petitioning party's selection. Even in a case where the appointment is stipulated to or uncontested, the court has the final say. The amendment to MCR 2.622 states that "the court shall appoint the receiver nominated by the party . . . unless the court finds that a different receiver should be appointed." After the court makes an "initial determination" that a different receiver should be appointed, it must "state its rationale" for the appointment, taking into account the same criteria that the parties were required to use in their receiver proposal.

Qualifications, Competence and Experience. Amended MCR 2.622 requires a receiver to have "sufficient competence, qualifications, and experience to administer the receivership estate." The party seeking appointment of a receiver must describe how the proposed receiver is qualified according to specified factors, including experience in the operation or liquidation of the type of assets to be administered, relevant business, legal and receivership knowledge, and the ability to obtain a bond. The amended rule also lists 10 provisions addressing when a proposed receiver is disqualified from serving.

The Order of Appointment. The amended rule contains six provisions that must be included in the receiver order of appointment, plus a catch-all for any other provision "the court deems appropriate." The mandatory provisions include: (1) bonding amounts and requirements; (2) identification of receivership property; (3) procedures related to the receiver's compensation; (4) reports to be produced and filed by the receiver; (5) a description of receiver's duties, authority and powers; and (6) a listing of property to be surrendered to the receiver.

Receiver Duties. Amended MCR 2.622 delineates seven receiver duties. The duties include: (1) filing an acceptance of the receivership within seven days of the order of appointment; (2) serving a notice of acceptance of appointment within 28 days after filing the acceptance to all persons having a recorded interest in the receivership estate; (3) filing an inventory of

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property of the receivership estate within 35 days after entry of the order of appointment; (4) accounting for all receipts, disbursements and distributions of property of the estate; (5) if there are sufficient funds, requesting creditors file proofs of claim; (6) furnishing information concerning the estate to any party after a reasonable request; and (7) filing with court a final written report and a final accounting of the administration of the estate.

Receiver Powers. In a section that was previously entitled "Powers and Duties," but now is simply entitled "Powers," the actions that a receiver may take are identified. These include authorization to bring suit, liquidate personal property of the receivership into money, and to pay the ordinary expenses of the receivership, among others. The receiver may not sell real property without a separate order of the court. Additionally, while the receiver may pay expenses of the estate, it may not distribute funds of the estate to a party without an order of the court.

Compensation Procedures. Amended MCR 2.622 contains a provision dealing with the now standardized manner in which receivers are to be compensated. The order of appointment must identify "the source and method of compensation of the receiver," and the order must provide that interim compensation may be paid to the receiver, but that all compensation is "subject to final review and approval of the court." A receiver must file an application for fees with the court, and if no objection is filed, the application may provide for the fees to be deemed approved after the seven day objection period passes.

The changes to the receivership rules are very expansive. The majority of the amendments have been highlighted here. While it is too early to tell what effect the new rules will have in practice, the amendments and clarifications should assist receivers and creditors in the administration of the receivership estate. If you have any questions about the rule changes, or receiverships in general, please contact a Foster Swift attorney.

DISCUSSED WITH EXAMINERS: COMMON ISSUES IN EXAMINATIONS

- Randall Harbour, Esq.

I recently had the opportunity to lead a discussion of prudential regulators and examiners at a meeting of the Banking Law Committee of the American Bar Association. Our topic was identifying the more frequent issues and problems they are seeing in their examinations of smaller financial institutions. The regulators included one from the FDIC, FRB, and a state regulator. I also spoke with regulators and general counsel of the NCUA. All had similar concerns. These conversations revealed some "red flags" and actions to seriously consider.

All the regulators agreed that the principal areas of concern included violations of the Bank Secrecy Act (BSA), anti-money laundering rules (AML), and commercial real estate concentrations. Other problems, such as IT issues, were also identified. These are issues that have been of frequent occurrence and particular focus in the examinations of the smaller (less than $10 Billion) institutions.

One of the primary BSA issues, which has caused enforcement actions to be taken, is the weakness of the organization to perform proper or sufficient risk assessments. Performing proper stress testing is important in identifying areas that are weak and to support your position that a desired activity or concentration does not negatively impact your safety and soundness. The finding of insufficient stress testing gives the examiners concern that the institution's culture on BSA is not adequate. This can impact your "M" (CAMEL) rating also.

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TENANTS, TRESPASSERS AND SQUATTERS - NEW MICHIGAN LAWS IMPACT LANDOWNERS' RIGHTS REGARDING THOSE ON, OR WITH A POSSESSORY INTEREST IN, THEIR PROPERTY

-Steve Owen

Two bills were recently signed into law by Governor Snyder that impact the rights of real property owners in Michigan. House Bill No. 5335, now Public Act No. 226, codifies that a possessor of real property does not owe a duty of care to a trespasser and is not liable to a trespasser for physical harm, except in certain circumstances. House Bill 5069, now Public Act No. 223, sets forth liability for damages if a landlord interferes with a tenant's possessory interest without justification, and protects property owners when evicting squatters.

PUBLIC ACT NO. 226

Premises liability relates to a landowner's liability and responsibility for injuries suffered by persons who are present on the premises. The duty of care owed by a landowner varies depending on the visitor's status, which may be that of invitee (generally someone who comes onto the land for a purpose that benefits the landowner), licensee (generally someone who is on the land because landowner consents to it, either by invitation or permission, but not necessarily for a business purpose), or trespasser.

Public Act No. 226, which addresses premises liability as it relates to a trespasser, was signed into law by Governor Snyder on June 21, 2014, and became effective on June 26, 2014. It provides that a possessor of real property owes no duty of care to a trespasser and is not liable to a trespasser for physical harm. However, a possessor of real property may be held liable for injury or death to a trespasser if any of the following apply:

The possessor injured the trespasser by willful and wanton misconduct.

The possessor was aware of the trespasser's presence on the property, or in the exercise of ordinary care should have known of the trespasser's presence on the property, and failed to use ordinary care to prevent injury to the trespasser arising from active negligence.

The possessor knew, or from facts within the possessor's knowledge should have known, that trespassers constantly intrude on a limited area of the property and the trespasser was harmed as a result of the possessor's failure to carry on an activity involving a risk of death or serious bodily harm with reasonable care for the trespasser's safety.

The trespasser is a child injured by an artificial condition on the property and all of the following apply:

- The possessor knew or had reason to know that a child would be likely to trespass on the place where the condition existed.
- The possessor knew or had reason to know of the condition and realized or should have realized that the condition would involve an unreasonable risk of death or serious bodily harm to a child.
- The injured child, because of his or her youth, did not discover the condition or realize the risk involved in intermeddling with it or in coming within the area made dangerous by it.
- The utility to the possessor of maintaining the condition and the burden of eliminating the danger were slight as compared with the risk to the child.
- The possessor failed to exercise reasonable care to eliminate the danger or otherwise to protect the child.

The law also makes clear that it is not intended to increase the liability of a possessor of land, and does not affect any immunity from or defenses to liability under statutes or common law. The specificity of the statute leaves less room for interpretation by judges in cases involving a landowner's duty of care to a trespasser.

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PUBLIC ACT NO. 223

Landlord-tenant disputes are a fact of life. From tenants who overstay their lease terms, to squatters who never should have been there in the first place, landlords and property owners frequently need to access their property and, in some instances, remove someone from it. Public Act No. 226 was signed into law by Governor Snyder on June 21, 2014, and became effective on June 26, 2014. It sets forth liability for damages if a landlord interferes with a tenant's possessory interest without justification, and protects property owners when evicting "squatters" from their property.

The law sets forth a damages and liability framework for circumstances in which tenants are ejected from property, or have had their possessory interest in property interfered with, without justification. The law identifies a number of actions that constitute "unlawful interference with a possessory interest" including use or threat of force, boarding of premises, and removal of locks, to name a few. It also identifies actions that are permitted, such as an owner's actions pursuant to a court order, or actions needed to make repairs or inspect the property.

With respect to "squatters," the law clarifies and codifies that property owners are not liable for ejecting a person from their property who entered by force or is holding the property by force. Property owners can lawfully remove the squatter using force so long as their actions are not undertaken by any means that would constitute a criminal offense.

Also signed into law were House Bills 5070 and 5071, now Public Act Nos. 224 and 225, which define "squatting" as the occupation of a single or two family dwelling without consent. Squatting is a criminal offense and is classified as a Class G property crime. For a couple of recent squatting nightmares in the news:

- http://cbsloc.al/VpkpzZ
- http://wapo.st/1oRi2lO

If you have any questions about this legislation and its impact on landowners please give a Foster Swift attorney a call.

FINANCING THE CREATIVE

-Deanna Swisher

It is time to turn around the phrase "creative financing" to consider financing the creative. Lansing Michigan's newest incubator, The Runway, will open in August. At The Runway, ten fashion designers-in-residence will be learning how to get their creative ideas to market and move their fledgling Michigan business to the next level. When The Runway's designers and other members of Michigan's creative class look for ways to finance their vision, what should they expect?

They can expect to face an uphill challenge if they walk into their local bank and seek traditional financing. Ideally a designer has no inventory – they produce to meet purchase orders and place goods in the hands of the retailer as quickly as possible. A designer is not likely to own valuable equipment. The value of the new designer's trademark is nominal. Valuation of a "fashion business" is difficult, even in an established market. In New York City, home to a very well-established fashion industry, only designers with two or more years of successful production could hope to obtain a traditional loan.

So the creative need to be creative about their financing, early in their career. As a result, my conversations with newly minted designers, professors and industry experts at Fordham Law's Fashion Institute's 2014 Summer Intensive Program frequently turned to non-traditional financing. Three sources of non-traditional financing are of particular interest to a fledgling designer: crowdfunding; loans from family or friends; and factoring.

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Other weaknesses they see in the BSA area, which can lead to enforcement actions, include Know Your Customer ("KYC") rules on both the deposit side and loan side. Given the growing fraud problems in the industry, KYC is higher on the list of concerns. You must also have controls in place to be sure that you are filing all required Suspicious Activity Reports (SARs). The examiners have found frequent weaknesses in those filings. Depending on severity and the actions and omissions of management, they may result in a more frequent issuance of corrective action and Consent Orders. To show that you are properly addressing these issues, you need to provide adequate training for all your staff. This will be reviewed by the examiners. Find and hold on to a knowledgeable BSA officer who can also perform customized training. They are in high demand.

Circumstances that can cause a more in-depth examination into BSA issues are when there is merger activity, significant growth in a product area or new products are being introduced, or if you hire a new BSA officer. Not all BSA problems will cause a Consent Order to be issued, but they may cause consideration and debate for such an order.

Potentially detrimental concentrations are closely monitored in examinations. The biggest concerns are in the commercial real estate loan ("CRE") area. Stress testing is important here. Be sure you have adequate policies for CRE lending, and follow them. Violations have been found when the institution has a good CRE policy but then does not follow it in practice.

Test for various types of CRE. Not all CRE lending is equal, although the differences may not be what you think. It is a common belief that owner-occupied CRE is less risky than non-owner-occupied CRE. Some studies and reviews have found that, upon closer examination and testing that may not be the case. Generally, a regulator's policy limits CRE concentration to 300 percent. You may have a greater concentration, but perform the stress tests and be ready to show that higher limits will not negatively affect your safety and soundness. This also goes for all other types of concentrations. Stress those portfolios and review the results in light of your capital.

More and more importance is being placed on stress testing. Besides operational risks, corporate governance is being examined closely. As always, documentation is highly important. But, also, is the issue of succession planning, which is a part of corporate governance. Give thought and planning to not only upper management succession, but also to what may be important middle management personnel like your BSA officer. Board composition is an important item to consider and plan for. Remember that succession may be caused by events other than a planned retirement.

An issue of growing concern is the financial market generally and its effect on liquidity. Liquidity has generally not been an issue. But there is concern that, given the low Fed funds rate, that there is a push to go for higher yields in the bond market. The concern there is that when interest rates rise, there could be a significant downward movement in the capital accounts as most of these securities are available for sale, and this marked-to-market through the capital accounts of the institutions.

Again, stress testing these portfolios and the internal rate of return is important. You should consider the interest rate risk and the internal rate of return exposure, and have a contingency plan in place. To further show that management is properly addressing these issues, describe it to your board in both dollar and percentage terms so that they truly understand the risks.

More emphasis is being given to the board's awareness of the institution's activities. It is not to promote micro-management by the board, but to ensure that the board is aware of all the issues that may affect the institution's safety and soundness. It is incumbent on management to be sure that they truly understand the risks and rewards.

Consult with your advisors and plan ahead to avoid an enforcement action, or to properly respond to one that is being proposed during an exam. A proper, concerned response to the examiners by management and its legal and financial advisors can assist in mitigating enforcement actions, and thus be of value-added to the institution.

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Although not without its challenges, crowdfunding can be used to raise money and "market test" new designs. Where it has become common to offer a reward to prospective investors, designers may offer a variety of garments or accessories as a reward and use the choices made by investors to learn what is likely to sell. Also, if their goal is met, the designer is benefitted by the fact that they are effectively producing in response to pre-paid orders.

Family and friends who will invest can be a great, and in many instances the most likely, form of start-up funding for a designer. However, the designer and the prospective investor need to have a very candid conversation – to begin with "what happens if these amazing clothes or accessories just don't sell?" Is the investor going to suffer the loss, and can they afford to suffer the loss? Is this instead a loan that the designer will repay and on what terms? Equally important – what happens if the designer succeeds? Friends and family will know when the orders are coming in – is that when they see a return? Ideally, from the designer's perspective, their payback obligation will arise only when the designer's gross exceeds a specified percentage. Both possibilities – failure and success, need to be addressed in a written agreement.

Although a friend or family member may provide enough start-up money to get the designer to the point of getting their creations in front of interested buyers, what happens when the designer receives their first order? Where most buyers pay net 45 or 90, the designer has to have a plan for paying the cost of material, the cost of production, their commissioned sales agent, and anyone else that won't wait 45 to 90 days for payment. For decades, designers have bridged this funding gap by relying on a factor. A factor makes a loan to the designer, usually when delivery to the buyer is confirmed, for an amount that is likely to range from 50 to 90 percent of the total invoice. The factor will take a security interest in accounts receivables, file a UCC-1 on general intangibles, and of course charge interest on the loan. Where the factor will be repaid when the buyer pays the invoice, an experienced factor knows the creditworthiness of the prospective buyer, and as a result can steer the new designer away from unreliable buyers. The factor will also issue invoices and provide collection services for the designer. While an experienced factor can be very important to an inexperienced designer, the designer needs to appreciate that the factor is charging both a fee for their invoicing and collection services and interest on the money lent.

Deanna leads Foster*fashion*, a team of Foster, Swift attorneys that provide specialized services to designers, manufacturers, exporters, importers, and retailers.

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