

Finance, Insolvency & Restructuring Alert - The Michigan Supreme Court Addresses the Priority of Receivership Expenses in the Context of a Mortgage Foreclosure by Advertisement Proceeding

Article By:

John T. Gregg

Patrick E. Mears

Like the common law of most other states, Michigan law generally grants to a court-appointed receiver a first priority claim in the receivership proceeding for payment of the receiver's fees and expenses incurred in that proceeding. See, e.g., *In re Dissolution of Henry Smith Floral Co.*, 260 Mich. 299, 244 N.W. 480 (1932); *Cohen v. Cohen*, 125 Mich. App. 206, 335 N.W.2d 661 (1983). In receivership litigation commenced by the holder of first priority mortgage lien on real estate and rents, these fees and expenses will be charged against the mortgagee's collateral when the mortgagee has requested the receiver's appointment. See, e.g., *Fisk v. Fisk*, 333 Mich. 513, 53 N.W.2d 356 (1952); *Bailey v. Bailey*, 262 Mich. 215, 247 N.W. 160 (1933).

The Michigan Supreme Court, in its recent decision of *In re Receivership of 11910 South Francis Road*, 2012 WL 3028463, ___ N.W.2d ___ (Mich. Sup. Ct. July 30, 2012), addressed a factual situation where the receivership action was not commenced by the holder of the first mortgagee on real estate located in Ingham County, Mich., but by two judgment creditors of an individual who had inherited the realty a few months prior to the commencement of the action. At the time of the inheritance, there was approximately \$180,000 in equity in the real estate beyond the mortgage balance due the first mortgagee, Dart Bank. The request for the appointment of a receiver was made by the judgment creditors under MCL 600.6104(4), which permits a court to appoint a receiver over a judgment debtor's property in order to sell it and pay the creditors from the proceeds. Important to this decision is MCR 2.622, which fleshes out the procedures used in judgment creditor receiverships under MCL 600.6104(4). Subsection (D) of MCR 2.622 permits a circuit court, when presented with the receiver's application, to fix the receivership's compensation and to impose liability for payment of these sums on the party requesting the appointment of a receiver.

Although Dart Bank was the first mortgagee of record concerning this realty, the bank received no notice of the judgment creditor's motion to appoint a receiver. In April, 2008, the Ingham County Circuit Court granted the relief requested in this motion and appointed Thomas Woods, an experienced receiver in the Lansing metropolitan area, as the receiver for this property. In Woods'

order of appointment, he was granted the power to take possession of the realty and “to expend the property’s equity or borrow funds for the repair, maintenance, and operation of the property necessary to preserve the property make it saleable.” On account of the realty being “uninhabitable,” Woods was permitted to borrow \$20,000 “to finance substantial repairs.”

In the meantime, the judgment debtor defaulted on Dart Bank’s mortgage loan made to her devisor and, in mid-April, 2008, the bank commenced mortgage foreclosure by publication proceedings on the mortgage lien pursuant to the publications and postings procedures specified in MCL 600.3201, et seq. In a letter dated May 27, 2008, before the scheduled foreclosure sale, the receiver acknowledged that he was aware of the bank’s pending foreclosure proceeding “and indicated that he did not intend to interfere with the process.” At the foreclosure sale held on June 5, 2008, Dart Bank was the sole bidder and purchased the property with a credit bid of the balance due on the mortgage debt, viz., \$169,312.50, subject to a one-year redemption period. Almost one year later, however, Woods moved to void this sale, arguing that the bank had interfered with the maintenance and operation of the realty in violation of the Ingham County Circuit Court’s order appointing receiver. The bank thereafter intervened in the action and opposed the receiver’s motion. After a hearing, the court denied the receiver’s motion but extended the redemption period until August 25, 2009. In the interim, Woods had been unable to sell the realty and, on August 26, 2009, the bank acquired fee simple absolute title to the property.

Two months later, the receiver filed a motion with the trial court seeking to surcharge the bank for \$41,874.57, as expenses of administration. This amount included expenses for repair and maintenance of the realty while in the receiver’s possession, marketing costs to sell the property, and the fees and expenses of the receiver and his attorneys. In support of this motion, the receiver argued that because the bank had acquiesced in the receivership and the receiver’s cash outlays, the bank was therefore liable for these expenses. In response, the bank argued that, because it did not affirmatively consent to these expenditures, it could not be held liable for their payment. The Ingham County Circuit Court granted the relief requested in the receiver’s surcharge motion and granted the receiver a lien on the real estate senior to the bank’s mortgage. Dart Bank appealed to the Michigan Court of Appeals from this surcharge order, but that court affirmed the trial court’s decision below. In re Receivership of 11910 South Francis Road (*Price v. Kosmalski*), 292 Mich. App. 294, 806 N.W.2d 750 (2011). On Dart Bank’s further appeal to the Michigan Supreme Court, that court reversed the decisions below, concluding that (i) because Dart Bank had, as senior lienor of the property, purchased the real estate at the foreclosure sale, the effect of that sale under MCL 600.3236 was to avoid all junior liens on the property, including the receiver’s lien for his unpaid fees and expenses; and (ii) because Dart Bank did not unambiguously consent to a surcharge of the receiver’s fees and expenses, those charges would not be imposed upon the bank.

A. MCL 600.3236 Trumps the Common Law of Liability for Receivership Fees and Expenses

The Michigan Supreme Court relied upon the provisions of MCL 600.3236 in reaching its conclusion that the lien of the receiver imposed by the Ingham County Circuit Court on the real estate to secure payment of his fees and expenses incurred as the receiver was junior to Dart Bank’s first mortgage lien and, as a consequence of the foreclosure sale and expiration of the receiver’s redemption period, the receiver’s lien was foreclosed out and disappeared. This statute addresses the legal consequences of a mortgage foreclosure sale by advertisement on the mortgagor and all other liens in the real estate. According to the Supreme Court, liens senior to the mortgage lien foreclosed upon (viz., “any valid, subsisting lien upon the mortgaged premises, or any part thereof, created before the lien of any such mortgage took effect”) are not prejudiced or otherwise affected by the foreclosure

but liens created after the foreclosing mortgage are wiped out when the redemption period expires and the mortgage is vested with “all the right, title, and interest which the mortgagor had at the time of the execution of the mortgage.” According to the Supreme Court,

“[b]y logical implication, this first clause [of MCL 600.3236] renders absolute the mortgagee’s title to the property it purchased in a foreclosure proceeding, extinguishing any ‘right, title, and interest’ created subsequent to the creation of the mortgage being foreclosed upon, which includes liens created after the execution of the mortgage.”

The receiver argued that, notwithstanding this statutory language, the common-law rule granting first priority to receivership fees and expenses trumps the effect of this statute, thereby rendering the bank liable for the receiver’s expenses. The Supreme Court, however, rejected this argument based upon the absence of any reported case law granting these expenses priority in a situation involving both a receivership case and mortgage foreclosure by advertisement proceeding. According to the Supreme Court,

“[t]o apply the common-law rule despite the imperative of the plain statutory language, providing the holder of a prior recorded mortgage with a right of priority over all subsequently created interests in the property, would impermissibly shift a receivership lien that is created subsequent to the time at which the mortgage subject to foreclosure took effect to the first priority position.”

B. Acquiescence in the Receivership Does Not Equal Consent to the Receiver’s Appointment

The next issue addressed by the Michigan Supreme Court on appeal was whether Dart Bank, as the senior secured creditor, should be obligated to pay the receiver’s fees and expenses on the ground that the bank acquiesced in the receivership. The Supreme Court also rejected this argument advanced by the receiver, holding that in order to be surcharged for these expenses, Dart Bank must have explicitly consented to the appointment of the receiver or the reordering of the lien priorities between the bank and the receiver. Although a party is empowered to waive its statutory rights under Michigan law, any such waiver must rise to the level of an intentional abandonment of a known right.” Michigan’s waiver jurisprudence “generally does not recognize mere acquiescence as a means to waive a known right.” In addition, the Supreme Court criticized the Court of Appeals decision below, which declared that a party that benefits from a receivership may, on that basis alone, be held liable for payment of the receiver’s expenses.

C. The Supreme Court’s Cautionary Advice to Receivers Concerning Payment of Their Fees and Expenses

Finally, the Michigan Supreme Court discussed at various points in its decision the applicability in this receivership proceeding of MCR 2.622(D) and the receiver’s failure to raise the issue of liability for his expenses with the Court. Acknowledging the need “for guidance with regard to priority and payment of receiver’s liens,” the Supreme Court noted that circuit courts, when they appoint receivers, should nevertheless make provision for the payment of receivership expenses and should be aware of the order of priority of any competing interests and other relevant collateral issues that could affect a receiver’s compensation.” The Supreme Court opined that had the receiver invoked the provisions of MCR 2.622(D) at the outset of this proceeding, the judgment creditors requesting the imposition of the receivership could conceivably have been held to be obligated to pay these expenses.

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