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The Section encourages interested members of the Bar to contribute articles and other publishable material relating to real property law and of interest to the profession. Manuscripts are reviewed by attorneys experienced in the subject matter covered by each article.

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SUMMARY OF DECISIONS UNDER THE CONSTRUCTION LIEN ACT

by *Matthew Norris, Marty A. Burnstein,* and *Ronald L. Cornell, Jr.**

Broad procedural and substantive changes were enacted into the Michigan Construction Lien Act, which replaced the Mechanic's Lien Act in 1982.

What follows is a summary of reported cases since the enactment of the Construction Lien Act, MCLA 570.1101 **et seq**.

1. APPLICATION OF CONSTRUCTION LIEN ACT.

In **Oerther Bros Excavating, Inc v Woodcraft Square Ltd Dividend Housing Ass'n**, 135 Mich App 813 (1984), the court addressed the issue of whether the new Construction Lien Act, MCLA § 570.1101 or the Mechanic's Lien Act, MCLA § 570.1 determined the

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rights of the respective parties. The Construction Lien Act superseded and repealed the Mechanic's Lien Act, effective March 1, 1982.

In, **Oerther**, plaintiffs Oerther, and excavator, and Barron, a supplier, contracted with the Walker Construction Company to provide materials, labor and equipment to the Woodcraft Square project owned by Woodcraft Square Limited Dividend Housing Association ("Woodcraft"). Woodcraft contracted with the Douglas Company, as general contractor, on November 9, 1981. Neither Oerther nor Barron was paid and each took steps to perfect a construction lien pursuant to the Construction Lien Act, MCLA § 570.1101, **et seq.**

The defendants filed a motion for partial summary judgment arguing that the court should apply the Mechanic's Lien Act to decide the rights of the parties because the initial contract between Woodcraft and Douglas was executed on November 9, 1981, before the effective date of the Construction Lien Act. Plaintiffs filed a counter-motion for summary judgment arguing that the November 9, 1981 contract was not effective until Woodcraft acquired a fee interest in the property on May 7, 1982 and therefore, the Construction Lien Act applied. The trial court granted the plaintiffs' motion and the defendants appealed.

The Court of Appeals affirmed. The determinative issue on appeal was when Woodcraft became a "contracting owner" under MCLA § 570.1301(3),(4). Under Section 570.1301(3), the Construction Lien Act controls where a "contracting owner" enters into a construction contract after March 1, 1982. Under Section 570.1301(4), the Mechanic's Lien Act controls where a "contracting owner" enters into a construction contract before March 1, 1982. The court held that the term "owner" was defined by MCLA § 570.1105(3) as "a person holding a fee interest in real property or an equitable interest arising out of a land contract." Consequently, because Woodcraft did not acquire a fee title interest in the subject property until May 7, 1982, it was precluded from being considered a "contracting owner" within the meaning of the statute until May 7, 1982, after the effective date of the Construction Lien Act.

The court also addressed the application of the former Mechanic's Lien Act in **Ruggeri Electrical v Algonac** 196 Mich App 12 (1992). In **Ruggeri**, Ruggeri entered into a contract with the private owner of a building in 1976. When Ruggeri had not been paid in 1978 it filed suit, recorded its lien and recorded a lis pendens but failed to allege enforcement of the lien in its Complaint. The Complaint was a suit on the contract only. The building was later sold to the City of Algonac.

In 1982, Ruggeri received a judgment on its original suit against the former owner for breach of contract. It was not until 1990 that Ruggeri filed suit to foreclose its lien on the property.

The Court of Appeals held that the former Mechanic's Lien Act applied, because the contract was entered into prior to the effective date of the new Construction Lien Act.

The court further held that, where the original Complaint did not allege enforcement of the lien, and the second Complaint was filed beyond one year after recording of the lien, Ruggeri was not entitled to foreclose its lien, and summary disposition against Ruggeri was affirmed.

2. PERFECTION OF CONSTRUCTION LIENS.

In **Superior Steel Systems v Nature's Nuggets, Inc**, 174 Mich App 368 (1989), the Court of Appeals held that merely picking up a piece of equipment from a job site did not constitute "last minute clean-up" sufficient for furnishing of labor for purposes of complying with the 90 day requirement of MCLA § 570.1111.

In **Superior Steel**, Delene had a contract to perform cement work, which work ceased in 1985. However, Delene left a compactor on the site until August 23, 1986, when his payroll records indicated his son picked up the compactor. Delene relied upon the date the compactor was picked up for purposes of filing his lien within 90 days after last furnishing of labor or material for the improvement. While reaffirming the holding of **Blackwell v Bornstein**, 100 Mich App 550 (1980) (that last minute clean-up for picking up tools constitutes the furnishing of labor for purposes of the Mechanic's Lien Act), the Court of Appeals distinguished the facts of **Blackwell**. In **Blackwell**, the "last minute clean-up" was done within 4 days from the time the contractor left the job site; in **Superior Steel**, the contractor left the equipment on the site for months after any meaningful work. The court did not overrule the trial court on its finding of fact (that the last day of the work was the date the compactor was picked up) as clearly erroneous, but the court decided as a matter of law that to allow a contractor to leave equipment on a job site would invite absurd results, such as leaving a tool box for years after ceasing work and being able to later file a construction lien.

In **In re Craft**, 120 B.R. 84 (E.D Mich. 1989), the court addressed several issues to determine the validity of a contractor's lien.

Mr. and Mrs. Craft contracted for major remodeling of their home, but had difficulty obtaining loan financing to pay for the remodeling. The bankruptcy court allowed trim work performed within ninety days before recording the lien to validate the lien, even where the contractor may have left the work undone merely as a "safety valve" in order to preserve his lien. The court held trivial items may be considered work pursuant to the contract to keep lien rights alive, even under previous strictly construed statutes.

The court then held that the contractor who omitted the license number from the written contract was not precluded from obtaining a valid lien, where his actual license was in effect at all times.

The court also rejected the debtors' claim that a sworn statement which omitted $3,988 in materials (of a total $19,350 project) would preclude the contractor from having a valid lien, since the contractor substantially performed the requirement of providing a sworn statement.

The court rejected the debtors' argument that failure to state the proper date of commencing the work invalidated the lien claim.

In **Fischer-Flack, Inc v Churchfield**, 180 Mich App 606 (1989), the Court of Appeals had occasion to rule on whether a Notice of Furnishing provided **prior to** first furnishing of supplies constitutes compliance with the Construction Lien Act.

In a two-to-one opinion, the Court of Appeals held that an electrical materials supplier substantially complied with Section 109(1) of the Construction Lien Act when it served its Notice of Furnishing approximately 3 months before it first furnished supplies to the property. (MCLA § 570.1109(1) requires that a supplier . . . shall provide a Notice of Furnishing . . . **within twenty days after furnishing the first labor or material** . . . .) In interpreting a California appellate decision and the substantial compliance requirements of the Michigan Construction Lien Act, the court held that the statute does not specify a date before which the notice may not be given, but merely provides a deadline after which notice may not be served. The court held that to accept defendants' position would result in holding that the plaintiff gave **too much** notice.

The court further overruled the trial court holding which limited liability to the amount which was owed to the subcontractor at the time the general contractor first informally learned that plaintiff intended to claim a lien. The court awarded the plaintiff supplier the entire amount of its lien, which presumably included amounts for materials furnished after the general contractor received informal notice that a lien would be filed.

In dissent, Judge Kelly found nothing ambiguous in the statute which would trigger liberal construction of the statute.

In the case of **In re Michigan Lithographing Company**, 140 B.R. 161 (W.D. Mich. 1992), the court considered whether a lien claimant's failure to record a notice of lis pendens with the Register of Deeds renders its construction lien unenforceable against the bankruptcy Trustee under the Bankruptcy Code's "strong arm" clause. Owen-Ames-Kimball ("OAK") Company performed construction work for the debtor, and recorded its lien on February 3, 1989. On December 20, 1989, OAK commenced suit to foreclose its construction lien. On February 8, 1990 (one year and five days after the recording of the lien), an involuntary petition was filed against the debtor.

The Trustee claimed that OAK's lien could be defeated by the trustee, standing in the shoes of a hypothetical **bona fide** purchaser of the debtor's property who became a bona fide purchaser and perfected the transfer at the moment the bankruptcy petition was filed.

The court rejected the Trustee's argument that the recording of a notice of lis pendens is the exclusive method to give constructive notice of the enforcement of a construction lien. The court distinguished the provisions of the former Mechanic's Lien Act, which required the filing of a notice of lis pendens "to continue the lien," reasoning that the absence of similar language in the Construction Lien Act indicated the legislature's intent to remove any harsh effects of the previous statute.

The court held it was the legislature's intent to make filing the foreclosure suit, rather than filing a lis pendens, the necessary step to extend the validity of the lien. This was partly based on the existence of a statutory scheme to allow a certificate to be procured to the effect that no litigation had been commenced to foreclose the lien. (The court further found the Michigan Land Title Standard to be informative, but of no binding precedential value.)

The court held the Trustee to the standard of "inquiry notice," that of any honest person, using ordinary caution to make further inquiries concerning the possible rights of another entity in real estate. Based on the facts of the specific case (including the fact that the "hypothetical purchaser" would have come into existence merely five days after the lien would have ceased to be effective, and that any person could have determined the existence of the lawsuit by a phone call to the Kent County Circuit Court), the court granted summary judgment to a construction lien claimant and denied summary judgment to the Trustee.

3. LIEN VALIDITY WHERE AMOUNT STATED IS DETERMINED TO BE EXCESSIVE.

In **Tempo, Inc v Rapid Electric Sales & Service, Inc**, 132 Mich App 93 (1984), the court addressed the validity of a lien claim where the amount stated in the claim of lien was determined to be excessive.

Tempo subcontracted with Rapid Electric Sales and Service, Inc. ("Rapid") for the performance of all electrical work in connection with construction of an apartment project. Rapid filed a lien on the project property when Tempo failed to pay remaining amounts due for electrical work performed. Tempo and West Highland Limited Dividend Housing Association ("West"), the owner of the project, then filed suit seeking an order invalidating the lien and a judgment for damages on the grounds that Rapid had breached its contract by failing to perform according to the written plans and specifications and that no further amounts were due to Rapid in light of their defective performance. Rapid counter-sued, claiming that Tempo and West were liable for damages for breach of contract, unjust enrichment and fraud.

The jury found no cause of action on Tempo and West's claim for damages, but returned a verdict for Rapid in the amount of $180,000.00. The trial court decided that the liens were valid and held that Rapid was entitled to a lien in the amount of $102,000.00. Tempo and West appealed the jury verdict and judgment. Rapid cross-appealed.

Part of Tempo and West's appeal challenged the validity of Rapid's liens. Tempo and West alleged that Rapid filed the liens in bad faith because the liens were filed for an excessive amount. The liens filed totaled $161,629.00. Tempo and West argued that Rapid's testimony at trial demonstrated that only $102,000.00 was owed on the contract and, therefore, the liens were excessive and filed in bad faith. The court concluded that where the amount of the lien filed is found to be excessive, the lien is lost only where bad faith is evident. If the error in the amount was due to a good faith mistake, the appropriate remedy is simply to reduce the amount of the lien. In this case, the court found that affidavits submitted to the trial court indicated an improper method of calculation, but no bad faith.

4. PERFECTION OF LIEN WITH AUTOMATIC BANKRUPTCY STAY.

In **In re Hamlin**, 34 B.R. 673 (E.D. Mich. 1983), the court addressed the ability of a contractor to perfect an inchoate lien after commencement of bankruptcy proceedings and, if perfected, whether the lien was avoidable by the trustee or debtor stepping into the trustee's shoes.

In **Hamlin**, Sears-Roebuck and Company ("Sears") installed an air conditioning system in the home of Michael and Barbara Hamlin. Twelve days after the work was completed, the Hamlins filed a Chapter 7 petition under the Bankruptcy Code. Approximately one month later, Sears filed a Claim of Lien on the home pursuant to Section 570.1117 of the Michigan Construction Lien Act. Sears then filed a complaint to foreclose on the property to satisfy its lien. Hamlin argued that, under Bankruptcy Code, Sears was precluded from taking any action to perfect or enforce its lien and accordingly the lien was not perfected and invalid. Alternatively, Hamlin contended that if Sears' lien was valid, it was subject to attack by the trustee and that Hamlin could step into the shoes of the trustee and avoid the lien because the trustee had failed to do so. The court rejected both arguments.

The court concluded that the Bankruptcy Code's automatic stay did not preclude Sears from perfecting its lien after commencement of the bankruptcy action, and that the lien, as perfected, was not avoidable by the trustee or the debtor.

The court held that the filing of bankruptcy petition did not operate as a stay on Sears' ability to perfect its interest in the property, which was acquired prior to the time of perfection. Under the Bankruptcy Code, the filing of a petition does not operate as a stay on an act to perfect an interest in property to the extent the trustee's rights are subject to such perfection. The Code provides that the trustee's avoiding powers are subject to any applicable law that permits post-petition perfection of an interest acquired before perfection. Thus, if the Construction Lien Act provides for post-petition perfection, Sears' lien was valid. The court held that it did.

Under MCLA § 570.1111, a lien is timely perfected if, within 90 days of the last furnishing of labor and material, a claim of lien is recorded in the office of the Register of Deeds. Under Section 570.1110(3), a lien timely perfected takes priority over all other interests, liens or encumbrances which may attach **subsequent** to the first actual, physical improvement. Thus, because Sears' lien attached to the first actual physical improvement which occurred before the filing of the bankruptcy petition, Sears was not precluded from perfecting its lien.

Second, the court held that the lien, as perfected, could not be avoided by the trustee or debtor pursuant to Bankruptcy Code Section 544. Hamlin argued that under Section 570.1112(3) of the Construction Lien Act, a bona fide purchaser who purchased property prior to the recording of the claim of lien would take the property free of the lien. Consequently, because Bankruptcy Code Section 544 treated a trustee as a bona fide purchaser at the time of petition, the trustee could avoid any lien not recorded at the time of petition. The court disagreed.

The court stated that though Section 570.1112(3) states that a claim of lien operates as constructive notice to purchasers, it did not provide these purchasers with the right to take the property free of an inchoate lien in existence when the purchase was made. Section 570.1112(3) must be read consistent with Section 5701.1119(3) and the purpose of the Construction Lien Act to protect contractors and subcontractors. Section 570.1119(3) deals with priority of liens and clearly provides that a perfected lien attaches at the time of first actual physical improvement. Thus, because the lien attached prior to the bankruptcy petition, neither the trustee nor the debtor, acting as a trustee, had a right to avoid the lien. A contrary result would deprive the lien claimant of the very protection the statute was designed to provide.

5. LIEN PRIORITY INVOLVING MORTGAGES.

The Court of Appeals addressed whether the lien of a general contractor would "relate back" where the lien claimant continued work after an original general contractor had been terminated, in **M.D. Marinich, Inc v Michigan National Bank**, 193 Mich App 437 (1992). The facts in **Marinich** involve the rehabilitation and addition to a building originally commenced by a general contractor before the recording of a mortgage on June 4, 1985. However, the original contractor was terminated and Marinich took over in November, 1985. The contractor recorded its lien and filed suit to foreclose, claiming priority over the mortgage.

The plaintiff claimed the priority of its lien would "relate back" to the original commencement of work by the first contractor. The defendant claimed that there should be no relation back, and that the bank's mortgage enjoyed lien priority in part because disbursements were made pursuant to sworn statement according to MCLA § 570.1119(4). The defendant bank further claimed that plaintiff had more than one contract for work, and that plaintiff would only have priority with respect to certain contracts.

The Court of Appeals held, first, that the argument that priority afforded pursuant to reliance upon sworn statements according to MCLA § 570.1119(4) had been abandoned on appeal, and would have been inapplicable because construction had begun before the mortgage was recorded. After discussing the history of priority provisions under the former Mechanic's Lien Act, the court affirmed the trial court holding that MCLA § 570.1119(3) applied, giving plaintiff priority because first actual physical improvement preceded the recording of the mortgage. The court held that based on the long-standing tradition of affording priority to laborers, contractors, and suppliers, and the "visible notice" by which a mortgagee could easily determine its lack of priority, plaintiff's lien would relate back to the work performed by the original contractor. The court also refused to set aside the trial court's finding of fact regarding whether plaintiff worked on more than one project or pursuant to more than on contract. The court reasoned that the Construction Lien Act anticipates that changes and modifications are made in contracts during the course of work, and that a lien claimant can enter into any number of contracts to be given priority under the Act. The court refused to set aside the trial court's findings regarding whether rehabilitating the existing building and adding a structure to the building constituted part of the original project.

Lastly, the Court of Appeals rejected the argument that affording priority to the contractor would have a chilling effect on construction lenders, because the court apparently felt a lender may protect itself by recording a mortgage interest before the first actual physical improvement, or by receiving sworn statements from a contractor upon disbursement.

In the recent case of **Great Lakes Glass, Inc, et al v Parker-Woodward Corporation, Resolution Trust Corp, et al.** (E.D. Mich., January 8, 1993, **adopting** Magistrate Judge's Opinion and Order of December 10, 1992, Consolidated Case Nos. 89-73475 and 89-73476), the District Court addressed the priority provision of Section 119(3) of the Construction Lien Act.

In **Parker-Woodward**, a motion for priority of all lien claimants was filed by the contractor, as the first actual physical improvement predated the recording of the mortgage.

The Resolution Trust Corporation (as conservator of the lender) argued that, by attending loan closings and introducing the owner to the mortgage broker, the general contractor participated in a "scheme" to secure additional funds, and should be equitably estopped from claiming priority of its lien over the bank mortgage.

The District Court rejected the RTC argument that the priority position of the lien holder should be altered where the surrounding circumstances render it inequitable, because general contractors often assist owners in securing construction mortgages and the "exception would swallow the rule." The court further held that there was no implied waiver of priority of the contractor's construction lien. Therefore, pursuant to MCLA § 570.1119(3), since the mortgage was recorded after first actual physical improvement began, the mortgage interest was subordinate to that of the construction lien claimants.

6. RECEIVERSHIP AND JUDGMENT FORECLOSURE REMEDY.

The case of **Michigan Bank-Midwest v D J Reynaert, Inc**, 165 Mich App 630 (1988), addresses multiple issues in three consolidated cases arising out of a construction loan. The issue pertinent to the Construction Lien Act was whether a receiver appointed under the Act was required to adjudicate the right to a deficiency judgment against contracting parties in default.

In **Michigan Bank**, defendants Reynaert and Montieth entered into a $600,000.00 construction loan agreement with plaintiff, Michigan Bank-Midwest (the "Bank"). The loan was used to construct a restaurant in Albion and was secured by a mortgage on the Albion site and a second mortgage on a warehouse in Detroit. Reynaert and Montieth defaulted on the loan. The Bank sued for foreclosure and named several defendants, including subcontractors on the Albion site. Reynaert and Montieth failed to answer and a default judgment of foreclosure was entered.

The Bank then moved for appointment of a receiver of the mortgaged properties under the Construction Lien Act. A receiver was appointed and the Albion property sold. The court entered an order which reserved the right of the Bank to seek a deficiency against Reynaert and Montieth. The court then ruled that Reynaert and Montieth lacked standing to challenge the foreclosure sale because of the default judgment, that a deficiency was shown at the time the property was sold and, therefore, there was no need for post-sale proceedings. Reynaert and Montieth appealed.

The Court of Appeal reversed and remanded to the trial court for an evidentiary hearing. The court held that Reynaert and Montieth had standing to challenge the accuracy of the deficiency judgment in a post-default judgment hearing. Under Section 570.1124(1) of the Construction Lien Act, once the plaintiff invokes its right to a receiver, the court is obligated to adjudicate the right, if any, to a deficiency judgment against a contracting party. Reynaert and Montieth were "contracting parties" within the meaning of MCLA § 570.1103(4) because they contracted with a series of contractors to build the restaurant. Moreover, a hearing was required even though the parties were in default. By utilizing Section 570.1124(1) of the Construction Lien Act, the Bank triggered a "necessary" hearing under MCR 2.603(B)(3)(b)(ii). Under MCR 2.603, a defaulted party has the right to participate in post-default judgment proceedings if a hearing is necessary to determine damages. The court deemed a post-default judgment hearing necessary in order to effectuate its obligation under Section 570.1124(1) to adjudicate the rights of contracting parties.

A judgment entered pursuant to acceptance of a mediation evaluation, and a foreclosure on property according to the judgment were addressed in **Dane v Royals' Wine and Deli**, 190 Mich App 287 (1991). Upon acceptance of mediation evaluation, the trial court entered a judgment in the amount of the evaluation, but ruled that the foreclosure action did not survive entry of the judgment. The Court of Appeals held that, where plaintiff's complaint requested the alternative remedies of money damages and construction lien foreclosure, acceptance of the mediation evaluation did not waive plaintiff's claim for equitable relief of foreclosure of the property.

Reasoning that the mediation evaluation (and resulting judgment upon acceptance) could not provide relief on plaintiff's claim for construction lien foreclosure, and because plaintiff's equitable claim was not in lieu of damages nor based on an alternative theory or liability, plaintiff's acceptance of the mediation evaluation did not prohibit plaintiff from maintaining its right to collect damages, as the remedy provided by the construction lien.

7. IMPACT ON TENANCY.

In **Norcross Co v Turner-Fisher Ass'n**, 165 Mich App 170 (1987), the court addressed three issues involving the interpretation of the Construction Lien Act during the course of bankruptcy proceedings.

In **Norcross**, Turner-Fisher Associates ("Turner") entered into a written option agreement with D. G. Investments ("D.G.") for the sale of certain property. The purpose of the option agreement was to allow D.G. to make alterations, renovations and improvements to buildings on the property that could then be sold or leased as retail or office space. D.G. took possession of the property and began making substantial improvements to the buildings. Various plaintiffs, including Norcross Company, supplied labor and materials to D.G. Ultimately D.G. fell into default under the option agreement and filed bankruptcy. The automatic bankruptcy stay was lifted, the rights of D.G. in the property were terminated, and the property was surrendered to Turner. During and after the commencement of the bankruptcy proceedings, the various plaintiffs filed construction lien claims against D.G. Plaintiffs then commenced suit against Turner to foreclose on their liens. The trial court entered judgment allowing plaintiffs to foreclose on the amounts of their respective liens, and awarded costs and attorney fees. Turner appealed.

Turner raised three issues on appeal. First, did the trial court err in ruling that the Construction Lien Act must be liberally construed to determine whether plaintiffs were entitled to relief as construction lien holders? Second, if the plaintiffs were lien holders, did their liens attach to the realty, or just the improvements? Finally, did the trial court err in granting one of the plaintiffs, Marter, Inc. ("Marter"), a construction lien after Turner had obtained a bankruptcy court order prohibiting any further improvements on the property?

On the first issue, the court held that the trial court's liberal interpretation of the lien statute was proper. The language of MCL § 570.1302(1) is clear and unambiguous. The statute explicitly indicates that the statute is remedial in nature and should be liberally construed. The court cited **Spartan Asphalt Paving Co v Grand Lodge Mobile Home Park**, 400 Mich 1984 (1977), as support for such a construction.

Second, the court held that, on the facts of the instant case, the plaintiffs' liens attached to Turner's interest in the realty. Turner argued that because the plaintiffs contracted with D.G., their liens could only attach to improvements and not the underlying realty because Turner did not require the improvements nor assent to any of them. The court rejected Turner's arguments. The court found that under Section 570.1107(1), Turner had "contracted" for the improvements based upon an implied agency agreement with D.G. Where a lessee becomes a lessor's agent with authority to contract for improvements, which will substantially benefit the lessor, the lessor's interest in the property may be reached by an action to foreclose a construction lien. The court found that in this case such an agency relationship existed and was implied from certain agreements entered into between Turner and D.G.

Finally, the court held that the trial court erred in allowing Marter a construction lien because Marter had supplied labor and material to the project after the bankruptcy court's order prohibiting any further improvements to the property. The court construed the bankruptcy order as an express intention of Turner that it no longer condoned or encouraged improvements to the property, thus destroying the implied agency relationship between Turner and D.G.

8. RESIDENTIAL BUILDERS LICENSING.

In the case of **Brown Plumbing & Heating, Inc v Homeowner Construction Lien Recovery Fund**, Docket No. 92347 (decided May 18, 1993), the Supreme Court interpreted the requirement that one who seeks recovery from the Lien Fund shall establish that the contractor "with whom the person claiming the construction lien contracted with, is licensed if required by law to be licensed" MCLA §570.1203(3)(h).

In **Brown Plumbing**, the plumbing contractor entered into a contract with Primus, who was constructing a residence, but Primus claimed to be "Mayflower Construction," utilizing license number 43237. The license number proved to be valid, but belonged to Mayflower Construction. Primus made representations of "being in association with" Mayflower Construction to both its subcontractors and its homeowner purchaser of other residences. Primus went so far as to file with the bank on the project in question a sworn statement that it was in fact Mayflower Construction.

The trial court found that the plumbing subcontractor need not investigate the license number provided by Primus or whether Primus was, in fact, licensed, and that the plumbing subcontractor had substantially complied with the licensing requirements in order to collect from the Lien Recovery Fund. Summary disposition was granted to the plaintiff by the trial court.

On appeal, the Fund did not dispute that the plaintiff substantially complied with the licensing requirements, but claimed the requirement should be strictly construed (i.e., that substantial compliance was insufficient). The Court of Appeals affirmed in favor of the plumbing subcontractor, 190 Mich App 709 (1991). The Court of Appeals found that substantial compliance was sufficient in light of the purpose and object of the Lien Act and because the statute is remedial to be interpreted in favor of the lien claimant.

The Supreme Court reversed. The Supreme Court held that substantial compliance referred to in §302 of the Act was not intended by the statute to apply to Part 2 of the Act, governing recovery from the Lien Recovery Fund. The court reasoned that, since Parts 1 and 3 of the Construction Lien Act were largely adopted from the former Mechanic's Lien Act, substantial compliance would apply only to Parts 1 and 3, and not to Part 2 of the Construction Lien Act. The court found §302 of the Construction Lien Act to be clear and unambiguous, needing no further legislative interpretation than the actual language of the statute.

The Supreme Court further found that, although the entire Construction Lien Act is to be liberally construed, liberal construction for this particular plaintiff would destroy the meaning of the statute (i.e., that plaintiff was required to establish the general contractor was licensed). The court found that liberal construction cannot nullify a clear and unambiguous requirement of the statute, and that the plaintiff's subjective belief that the general contractor was licensed was insufficient.

The dissent argued that the statute was designed to protect conscientious tradesmen from fraudulent contractors, and that it is sufficient for a lien claimant to substantially comply with the Act in order to recover from the Lien Recovery Fund. The dissenters argued that if the legislature intended §302 to apply only to perfecting a construction lien, the legislature could have placed §302 in Part 1 of the Construction Lien Act.

In the case of **Standale Lumber and Supply v Crandell and Lakeside Construction** (Court of Appeals unpublished No. 132368, August 12, 1992), the court held that a supplier who also provided installation and labor became a residential maintenance or alteration contractor, subject to the licensing requirements of the Residential Builders Act, MCLA §339.2412.

In **Standale Lumber**, Standale supplied lumber, and also installed carpeting and a linoleum floor. Standale was not a licensed residential building contractor, and the general contractor, Lakeside Construction, was also unlicensed.

The Court of Appeals held that Standale was subject to the licensing requirement because it installed materials. Since Lakeside was not licensed, Standale did not fall within any licensing exception, and therefore Standale was also barred from asserting its construction lien.

9. RESIDENTIAL HOMEOWNER CONSTRUCTION LIEN RECOVERY FUND CASES.

In **Titanus Cement Wall Co, Inc v Watson**, 158 Mich App 210 (1987), the Court of Appeals addressed an issue of first impression of whether contractors who supply materials and labor to a builder/developer for construction of a single-family residence may recover the contract price of the materials and labor from the Homeowner Construction Lien Recovery Fund, Section 201-207 of the Construction Lien Act, MCL §570.1101, **et seq**, if they are unable to collect the contract price from the builder/developer.

In **Titanus**, plaintiffs, Titanus Cement Wall Co. ("Titanus") and Erb Lumber Company ("Erb"), each supplied materials or labor to John Watson, doing business as Lumberjack Builders, for construction of a number of single-family residences. Watson owned the land on which the homes were being constructed. Watson failed to pay and Titanus and Erb each filed suit separately to foreclose construction liens. Titanus and Erb named the Homeowner Construction Lien Recovery Fund (the "Fund") as a defendant in each suit. By the time the complaints were filed, two homes had been purchased from Watson: one by the Stoddards, who were named as defendants in the Titanus suit; the other by the Heintzes, who were named as defendants in Erb's suit. The cases were consolidated.

The trial court granted the Fund summary disposition in both suits on the basis that, in the instant factual situation, the legislature did not intend to allow recovery from the Fund. The Stoddards and Heintzes appealed.

The Court of Appeals affirmed. The court held that Titanus and Erb were not parties entitled to receive payment from the Fund. MCLA §570.1203(6) expressly provides that payment from the Fund should only be ordered if the court finds that a "**subcontractor, supplier or laborer** is entitled to payment from the Fund." No provision of the Act provides for payment to "contractors." Titanus and Erb were contractors and not subcontractors, suppliers or laborers.

Furthermore, the Act was not designed to apply in this situation because the homes constructed by Watson were not "residential structures." A "residential structure," as defined by MCL §570.1106(3), is a structure in which the owner who contracted for improvements is residing, or will reside after the improvements are completed. Watson, the developer in this case, did not intend to reside in any of the homes he built.

In **Kitchen Suppliers, Inc v Erb Lumber Company**, 176 Mich App 602 (1989), the court addressed two issues involving liens upon residential structures and collection from the Homeowner Construction Lien Recovery Fund.

In a not uncommon factual scenario, Erb supplied lumber and materials to Liberty for construction of a house on property Liberty was purchasing on land contract from Shelby Woods, the fee owner. Mr. and Mrs. Johannes entered into an executory contract with Liberty to have a home built for them on the lot. (Whether the executory contract was entered into before or after the land contract to Liberty, or the materials were shipped by Erb, was uncertain.) After suit was commenced to foreclose the Erb lien, Mr. and Mrs. Johannes purchased the lot and received a deed from Shelby Woods. The Court of Appeals distinguished **Titanus** because the builder had commenced construction of the house on speculation in **Titanus**.

The trial court held that Liberty was the owner and Erb Lumber was therefore a "contractor," defined as one having a contract with the owner. By definition, a contractor is not entitled to recovery from the Lien Fund. The trial court further held that Mr. and Mrs. Johannes were "lessees" who intended to reside in the home upon completion, thereby rendering the project a "residential structure," and discharging liens on the property.

On appeal, the Court of Appeals held that the lumber supplier, in addition to being a "contractor," also fit the definition of "supplier." The court's reasoning was that Liberty did not commence construction of the house on speculation, but constructed the house on architectural plans and specifications provided by the Johanneses, thereby rendering Liberty a general contractor within the definition of the Act. By definition, Erb Lumber provided materials pursuant to a contract with a "contractor," and, therefore, Erb was a supplier entitled to reimbursement of its lien from the Fund.

The Court of Appeals affirmed the trial court on the second issue of whether the house was a "residential structure." The Johanneses were "lessees" as defined by the Act, pursuant to the executory contract to purchase the property and their intention to reside in the house on completion. The court found the house to be a "residential structure," discharging all liens against the property and reinstating claims against the Homeowner Construction Lien Recovery Fund.

In **Johnson Carpet Inc v Farmwald Development Corporation, Wheeler and Homeowner Construction Lien Recovery Fund** (unpublished No. 94155, December 20, 1989), the court interpreted the definition of "residential structure" in light of the **Titanus** and **Kitchen Suppliers** cases. In distinguishing the facts from **Kitchen Suppliers**, the Court of Appeals held that the home being built on speculation was not a "residential structure" within the meaning of the Construction Lien Act. The trial court granted partial summary judgment to plaintiff, precluding defendants from filing an affidavit pursuant to Section 203 of the Act, and the Court of Appeals affirmed. As in **Titanus**, the developer in **Johnson Carpet** did not intend to reside in the home, and the plans and specifications were not provided by the eventual homeowners (the Wheelers). Also, construction was commenced before the Wheelers had signed their contract with the developer. The court further held that the issue of whether the property was "a residential structure" was a proper issue for summary disposition pursuant to MCR 2.116(c)(7), as a matter of law.

In **Abode Building Materials, Inc v Webster**, 185 Mich App 655 (1990), the Court of Appeals considered whether a creditor of a bankrupt residential builder must pursue the builder into bankruptcy court to have the builder's debt held to be non-dischargeable before the creditor may collect from Homeowner Construction Lien Recovery Fund. The Court of Appeals held that the lien claimant need not pursue adversary proceedings in the bankruptcy court against the builder in order to collect from the Lien Fund.

The court refuted the arguments of the Lien Fund that the Lien Act was intended only to protect homeowners and that the Department of Licensing could only pursue the builder through the disciplinary licensing process. It was not persuaded that the financial integrity of the fund would be jeopardized by allowing the supplier to recover from the Fund without obtaining an order from the bankruptcy court.

The court concluded that the supplier had made a reasonable effort to obtain payment from the contractor and allowed to the claimant to recover against the Homeowner Construction Lien Recovery Fund.

RECOVERY OF CONSEQUENTIAL DAMAGES AND DELAY/DISRUPTION DAMAGES FROM PAYMENT BOND SURETIES

by *Clifford J. DeVine and Mark W. McInerney**

I. Introduction

On many construction projects, the general contractor is required to post both performance and payment bonds to assure the owner of the project that the work will be completed, and to assure the owner and subcontractors that payments will be made for labor and materials used in construction of the project. Such bonds are required by statute for nearly all public projects in Michigan, as well as for those performed by the federal government.[1] On private projects, payment bonds are often required by owners in an attempt to protect themselves from liability under the Construction Lien Act, MCLA §570.1101, **et seq.**

There is no question that payment bonds permit subcontractors or suppliers who have performed work or provided materials for which they have not been paid to

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recover from the surety for the actual direct costs of that labor or material, provided timeliness and notice requirements are met. But what of additional costs the subcontractor incurs — either additional labor costs, the costs of additional materials, or both — as a result of delays or disruptions occasioned by the general contractor's failure to properly schedule and coordinate the work on the project? What happens in the situation where the general contractor's failure to timely pay its subcontractor causes the subcontractor to lose work, incur tax penalties or the like; is the payment bond surety liable for those damages?

The answers to these questions are not apparent from the face of most payment bonds. The American Institute of Architects publishes two forms of payment bonds, which are frequently adopted in construction projects. AIA Document A 311, 1970 ed, entitled *Labor and Material Payment Bond,* defines the scope of the surety's liability as follows:

> NOW, THEREFORE, THE CONDITION OF THIS OBLIGATION is such that, if Principal shall promptly make payment to all claimants as hereinafter defined, for all labor and material used or reasonably required for use in the performance of the Contract, then this obligation shall be void; otherwise it shall remain in full force and effect, subject, however, to the following conditions:
>
> * * *
>
> 2. The above named Principal and Surety hereby jointly and severally agree with the Owner that **every claimant** as herein defined, who has not been paid in full before the expiration of a period of ninety (90) days after the date on which the last of such claimant's work or labor was done or performed, or materials were furnished by such claimant, **may sue on this bond** for the use of such claimant, prosecute the suit to final judgment **for such sum or sums as may be justly due claimant,** and have execution thereon. The Owner shall not be liable for the payment of any costs or expenses of any suit. (emphasis added)

AIA Document A 312, 1984 ed, entitled *Payment Bond,* though written in more modem and direct English, provides no additional insight as to the scope of the surety's obligation. Nor do the bond forms of most public bodies provide more specificity.

The authors have found no published opinions from Michigan courts which address the issue of whether consequential and delay/disruption damages are recoverable from a payment bond surety.[2] As a result, resolution of this issue requires a review of the general rules of contract construction, as well as analysis of federal and foreign cases in which the issue has been addressed.

II. Consequential and Delay/Disruption Damages in General

Before addressing the principal area of inquiry, a general review of Michigan law **vis á vis** the availability of consequential and delay disruption damages is in order.

It is axiomatic that an award of damages for breach of contract should put the injured party in as good a position as he or she would have been in had the breach not occurred. **Jim-Bob, Inc v Mehling**, 178 Mich App 71; 443 NW2d 451 (1989); **Rodgers v Fisher Body Div General Motors Corp**, 739 F2d 1102 (6th Cir 1984). Stated differently, the purpose of a damage award is to make the plaintiff whole. Adherence to this general rule protects the promisee's expectation interest in the promisor's performance, thus giving the innocent party "the benefit of the bargain." **Tel-Ex Plaza, Inc v Hardees Restaurants Inc**, 76 Mich App 131, 255 NW2d 794 (1977), **leave denied** 402 Mich 832 (1977).

In **Held Construction Co Inc v Michigan Nat'l Bank of Detroit**, 124 Mich App 472, 476-477; 335 NW2d 8 (1983), the court stated:

> Under the rule of **Hadley v Baxendale**, 9 Exch 341; 156 Eng Rep 145 (1854), as reiterated in **Kewin v Massachusetts Mutual Life Ins Co**, 409 Mich 401, 414; 295 NW2d 50 (1980), the damages recoverable for breach of contract are those that arise naturally from the breach or those that were in the contemplation of the parties at the time the contract was made.

Similarly, the following suggested jury instruction on contract damages is set forth in **Michigan Civil Procedure During Trial**, 2d ed 10-35 (R. Young & D. Kapka, eds , ICLE, 1989) and quoted with approval in 2 **Michigan Law of Damages**, 2d ed, p. 19-19 (N. Stockmeyer, ed., ICLE, 1989):

> On breaching a contract, the defendant is liable for whatever damages follow as a natural consequence and the proximate result of the breach, which may reasonably be supposed to have been within the contemplation of the parties when the contract was made. If you find that [the defendant] breached that contract, then

> you must determine the amount of [the plaintiff's] damages, if any. The plaintiff has the burden of proving damages.
>
> The measure of damages for [the defendant]'s breach, if any, is the profit that [the plaintiff] would have made from full performance by [the defendant]. **Damages must place the injured party in as good a position as he or she would have been in had the breach not occurred**. (emphasis added)

Based on these principles, consequential damages have been determined to be recoverable for breach of a construction contract. The leading case is **Tempo, Inc v Rapid Electric Sales & Service**, 132 Mich App 93, 347 NW2d 728 (1984). In **Tempo**, the subcontractor sought, in addition to an unpaid contract balance, consequential damages for "loss of credit, lost profits due to loss of bonding and additional interest due on payments to suppliers." 132 Mich App at 102. The court held, in essence, that so long as the method of calculating these damages "had a reasonable degree of certainty and was not based solely on conjecture and speculation," the issue was properly submitted to the finder of fact. **Id**, at 103. The court also held that it was for the jury to determine whether "these damages were the natural and proximate result of Tempo's breach." **Id**. The court thus affirmed the jury's award of consequential damages to the subcontractor.

With respect to delay/disruption damages, there never has been serious doubt as to the recoverability of these damages where properly proven. Rather, and in recognition that these damages are recoverable, owners or general contractors often include in contracts "no damage for delay" clauses. A typical such clause provides as follows:

> No claim for additional compensation or damages for delays, whether in the furnishing of material by Contractor, or delays by other subcontractors or Owner will be allowed by the Contractor, and such extension of time for the completion shall be the sole remedy of Subcontractor.

Though in theory "no damage for delay" clauses like the foregoing are enforceable, because of their harsh effects such clauses are strictly construed. **Phoenix Contractors, Inc v General Motors Corp**, 135 Mich App 787, 355 NW2d 673 (1984); **John E. Green Plumbing and Heating Co, Inc v Turner Construction Co**, 742 F2d 965, 966 (6th Cir, MI, 1984). **See generally** Anno: **Validity and Construction of "No Damage" Clause With Respect to Delay in Building or Construction Contract**, 74 ALR 3d 187. In addition, Michigan law recognizes several exceptions to the enforceability of such clauses:

> There are exceptions to the enforceability of such clauses. These exceptions include situations where the delay (1) was of a kind not contemplated by the parties; (2) amounted to an abandonment of the contract; (3) was caused by bad faith on the part of the contracting authority; or (4) was caused by the active interference of the other contracting party.

Phoenix Contractors, supra, 135 Mich App at 792. **See also** Anno, **supra**, 74 ALR 3d at 203-231.

The first of these exceptions was discussed at length in **E.C. Nolan Co, Inc v State of Michigan**, 58 Mich App 294, 227 NW2d 323 (1975). There, the court found that a no damage for delay clause contemplated and thus barred damages only for reasonable delay, and found that a 9 1/2 month delay in a project expected to take 24 months was unreasonable. The court stated:

> It is our opinion that the department was only relieved from liability for reasonable delays caused by third parties. To hold otherwise would be to say that regardless of how long a third party delayed, plaintiff would be required to perform its part of the contract without any hope of reimbursement for any increased costs caused by the delay. We do not believe the department intended the coordinating clause to so read, for if the effect of that clause were such as the department contends, **no reasonable contractor would have entered into a contract on this project for the simple reason that the contractor would have no way of knowing how much it could cost it to perform or when it could expect to be finished with the project.** A contractor can take a reasonably short delay into consideration when computing its bid on a project, but how could a contractor be expected to submit a competitive bid if it had to include in that bid expenses for a delay that could be of indefinite duration? We submit that a contractor could only compute a competitive bid if it were of the opinion that it would be reimbursed for additional expenses caused by unreasonable delays. It is our conclusion that this is precisely what occurred here. Plaintiff submitted its bid with the understanding that it would be compensated by the department for any additional expenses caused by unreasonable delays attributable to third parties.

58 Mich App at 302-303 (emphasis added).

In sum, then, damages for delays and disruptions and consequential damages, where properly proven, are recoverable for breach of a construction contract. The question is whether they are recoverable from a payment bond surety.

III. RULES OF CONSTRUCTION

As discussed above, the typical language of a payment bond does not specifically address the surety's liability for delay/disruption damages and/or consequential damages. Such bonds generally contain a reference to costs for "labor and materials." That clause alone excludes little or nothing, however, particularly since the damages arising under a delay/disruption claim are largely additional costs of labor and/or material occasioned by the general contractor's breach of its duties. Moreover, payment bonds frequently provide that claimants may recover "such sum or sums as may be justly due claimant," which would seem to broaden recoverable damages beyond merely the costs of labor and materials.

Surety bonds are generally construed using the same rules as govern construction of contracts. Bonds of surety companies or other sureties for hire (as opposed to gratuitous sureties) are construed strictly against the surety. In **General Electric Credit Corp v Wolverine Insurance Co**, 120 Mich App 227, 233, 327 NW2d 445 (1982), **aff'd** 420 Mich 176 (1984), the court stated:

> The contract of a surety company, acting for compensation, and of any other surety for hire, is construed most strongly against the surety and in favor of the indemnity which the obligee has reasonable grounds to expect. The contract of a compensated surety is generally regarded as in the nature of an insurance contract, and by analogy is governed by the rules applicable to insurance contracts.

See also PR Post Corp v Maryland Casualty Co, 68 Mich App 182, 187, 242 NW2d 62 (1976), **aff'd in part and rev'd in part on other grounds**, 403 Mich 543, 271 NW2d 521 (1978); 21 MLP **Suretyship**, §9; 74 Am Jr 2d **Suretyship**, §256, p. 169.

This rule, then, is no different than the general rules that insurance policies are construed against the insurer, and that contracts generally are construed against their drafters.

IV. THE CASE LAW

As indicated previously, no reported Michigan decisions have considered the issue of whether delay/disruption damages and/or consequential damages are recoverable from a payment bond surety. Courts in several other jurisdictions, however, have considered the issue of whether delay/disruption damages are recoverable. Based on those decisions, the majority rule, and the rule cited by the more recent cases, is that such damages are recoverable.

Most of the case law in this area arises under the federal Miller Act, 40 USC §270a, **et seq.**, or state law equivalents (called "Little Miller Acts"), requiring the posting of labor and material bonds on public projects. While some older cases held that delay and disruption damages were not recoverable from the general contractor's surety, recent cases have held otherwise. See, e.g., **United States ex rel Lochridge — Priest, Inc v ConReal Support Group, Inc**, 950 F2d 284, 287 (5th Cir 1992); **United States ex rel T.M.S. Mechanical Contractors, Inc v Millers Mutual Fire Insurance Co**, 942 F2d 946, 950-953 (5th Cir 1991); **United Statesex rel Pertun Construction Co v Harvesters Group, Inc**, 918 F2d 915, 918-919 (llth Cir 1990); **United States ex rel Superior Insulation Co, Inc v Robert E. McKee, Inc**, 702 F Supp 1298, 1301 (N D Tex, 1988); **General Federal Construction, Inc v D.R. Thomas Inc**, 451 A2d 1250 (Md Ct App, 1982); **Hartford Accident and Indemnity Co v District of Columbia**, 441 A2d 969 (DC Ct App, 1982); **United States ex rel Heller Electric Co, Inc v William F. Klingensmith, Inc**, 670 F2d 1227, 1231-1232 (DC Cir 1982); **United States ex rel Mariana v Piracci Construction Co, Inc**, 405 F Supp 904 (D DC 1975); **United States ex rel Otis Elevator Co v Piracci Construction Co, Inc**, 405 F Supp 908 (D DC 1975).

Several cases have held otherwise. **Lite-Air Products Inc v Fidelity & Deposit Co of Maryland**, 437 F Supp 801 (ED PA 1977); **WSA, Inc v Stratton**, 680 F Supp 375 (SD Fla 1988); **Salvino Steel & Iron Works, Inc v Fletcher & Sons Inc**, 580 A2d 853 (Pa Super, 1990).

Since 'Michigan has not spoken on the issue, the reasoning behind these decisions is as important for Michigan litigants as the decisions themselves. In general, two theories have been advanced by those courts that have upheld recovery of delay/disruption damages from sureties. The first is the idea that providing unpaid subcontractors with as much protection as possible is most consistent with the theory behind the Miller Act and Little Miller Acts. This reasoning was best described in **United States ex rel Pertun Construction Co, supra:**

> Surety liability for out-of-pocket costs of delay is consistent with both the language and the purpose of the Miller Act. The statute provides for recovery of the costs of labor and materials furnished or used by the subcontractor in performing contractual obligations. **Only by allowing a full recovery of these costs, including those portions caused by delay, can the purpose of the statute — to afford the subcontractor the financial protection of an action against the surety — be achieved**. If the surety is not liable for the portion of costs caused by delay, the subcontractor will either have to bear the burden himself or rely on his remedy for breach of contract against the prime contractor. **And it was Congress's view of the inadequacy of these very alternatives to assure full payment for labor and materials actually supplied to a federal project that prompted the enactment of the Miller Act.**

Id, at 918 (emphasis added). **See also United States ex rel T.M.S. Mechanical, supra**, 942 F2d at 951-952; **United States ex rel Heller Electric, supra**, 670 F2d at 1232; **United States ex rel Mariana, supra**, 405 F Supp 904, 906-907.

Cases have also focused on the breadth of the language typically used in bonds to describe the scope of the surety's liability. The court in **United States ex rel Pertun Construction, supra**, stated:

> Thus, based on both the language and the underlying policies of the Miller Act, we hold that a Miller Act surety's liability for **any "sum or sums justly due"** for labor or materials furnished in the performance of its agreement to work on the public project includes liability for all out-of-pocket expenditures for that labor or material, including additional or increased expenditures caused by delay.

918 F2d at 919 (emphasis added). **See also General Federal Construction, supra**, 451 A2d at 1256.

Cases holding against recovery of delay/disruption damages have by and large ignored policy considerations and looked to the language of the bonds. In **Lite-Air Products**, the bond language was more narrow than usual; rather than permitting a claimant to seek from the surety "any sum or sums justly due," the bond allowed the claimant only "to recover the amount due the claimant for such labor or material." 437 F Supp at 803. The court refused to go beyond that limitation. In **Salvino Steel** and **WSA, supra**, the courts found decisive the fact that the bonds did not expressly permit recovery of delay/disruption damages, thus interpreting silence to preclude recovery. 580 A2d at 856; 680 F Supp at 377.

One Michigan case, though not addressing the precise question at issue, may be instructive as to how Michigan courts would treat the issue. In **Price Brothers Co v Charles J. Rogers Construction Co**, 104 Mich App 369, 304 NW2d 584 (1981), **leave denied** 412 Mich 938 (1982), a supplier sought from the surety, in addition to unpaid material costs, a 1-1/2% per month service charge on such unpaid invoices, as called for in the invoices themselves. The court pointed out that the bond expressly permitted recovery of "all indebtedness . . . on account of any labor performed or materials or supplies furnished." 104 Mich App at 376. The court further observed that the bond was provided pursuant to the Michigan statute requiring bonds on public projects, Section 7 of which (MCLA §129.207) authorized a labor and materials claimant "to sue on the payment bond, prosecute such suit to final judgment 'for the sum justly due him' and have execution thereon." **Id**, at 377-378. Based on this broad language, and the determination that the service charge was an "integral part" of the contract between the supplier and the contractor, the court permitted recovery of the service charge from the surety.

V. WHAT WOULD MICHIGAN DO?

The authors believe that if confronted with the issue of whether delay/disruption damages and/or consequential damages are recoverable from a surety under a payment bond containing the typical broad description of the scope of the surety's liability, Michigan courts would determine that such damages are recoverable.

This conclusion is founded upon three primary bases. First, the Michigan law, as discussed above, is quite clear that ambiguity or uncertainty in bonds is to be construed against the surety. This rule is completely appropriate since, as between the surety and the unpaid subcontractor making a claim down the road, only the surety has the bargaining power to insist that the bond language be clear and unambiguous or the financial wherewithal to walk away if that language is unacceptable. If the bond is construed against the surety, provisions allowing a subcontractor to recover "such sum or sums as may be justly due" will be interpreted broadly, and the absence in the bond of any reference to delay/disruption or consequential damages will be interpreted to permit, rather than preclude, recovery of such damages.

Second, the weight of authority and the trend in the case law are clearly toward interpreting bonds broadly, and specifically toward permitting recovery of at least delay/disruption damages from payment bond sureties. Those courts that have held otherwise have done so based largely on a desire to interpret bond provisions narrowly, a principle which is contrary to Michigan law. There simply is no reason to suspect that Michigan would buck this trend. The Michigan Court of Appeals decision in **Price Brothers**, while answering a different question, appears indicative of an attitude to construe bond language broadly, and is thus consistent with the case law on this issue.

Third, the policy considerations which have played a central role in the development of the cases permitting recovery of such damages from sureties are compelling. Payment bonds are meant to protect subcontractors and suppliers, and a liberal construction tending to maximize the available protection is most consistent with such a purpose. Again, delay/disruption damages and consequential damages are recoverable from the general contractor where properly proven. There is no good reason why the ability of subcontractors and suppliers to recover such damages should be less in those situations where the general contractor defaults and the surety is called upon to make payments under its bond than it would be if the general contractor had remained solvent. This is particularly so when it is remembered that the surety has the opportunity to fully examine its principal's financial health before issuing the bond. The surety also generally has the protection of indemnification not only from its principal but also from the primary owners of its principal, and has the right to step into the project and take action to minimize or prevent damages prior to the complete collapse of the general contractor. If one party must bear the risk of the general contractor's demise, logic and public policy demand that it be the surety, who has these opportunities and rights, rather than the subcontractor who almost certainly does not.

VI. CONCLUSION

Until a Michigan appellate court confronts and decides the question of whether delay/disruption and consequential damages are recoverable from a payment bond surety, the answer to that question will be uncertain. Based on Michigan's rules governing the construction of bonds generally, the trends in the case law outside Michigan, and public policy considerations, however, it seems more likely than not that Michigan will ultimately permit the recovery of such damages from sureties.

ENDNOTES

1. **See** MCLA §129.201, **et seq**, requiring payment bonds in public contracts exceeding $50,000; MCLA §570.101, **et seq**, applying to state highway projects; and 40 USC §270, **et seq**, the federal Miller Act, requiring payment bonds for federal contracts exceeding $25,000.
2. The authors have recently completed as co-counsel a lengthy trial in which they successfully argued that consequential and delay/disruption damages are recoverable from a payment bond surety. An appeal is pending, and thus this issue may be resolved in the foreseeable future.

THE IMPACT OF PARTNERSHIP DISSOLUTION WITH RESPECT TO CLAIMS UNDER A POLICY OF TITLE INSURANCE

by *James F. Altman**

I. INTRODUCTION

In its present form, the Uniform Partnership Act (UPA) as adopted in Michigan and most other states may fail to adequately safeguard contractual rights of a partnership that the partnership intended to continue after a change in its underlying membership. Specifically, because the UPA may deem the continuing partnership a new entity, title insurance covering the original partnership real property may not protect the new entity from title defects. Therefore, in drafting partnership agreements for partnerships that own real estate, a lawyer should be acutely aware of the possible consequences of such a change in membership. A lawyer should draft the partnership agreement or design the title insurance contract to ensure that the continuing partnership has uninterrupted title insurance coverage for its real property.

The UPA strongly reflects the aggregate theory of partnership in its treatment of membership changes within a partnership. It was the aggregate theory which predominated when the UPA was drafted, rather than the entity theory. The common law followed the aggregate theory and, at the time, it was accepted in a majority of states.[1] Applying the aggregate theory in its purest forms, the withdrawal of a partner or other changes in the aggregate membership of a partnership caused an unavoidable dissolution of the partnership entity. Any continuation of the partnership business would be by a new entity, comprised of a new aggregate of members.

Such dissolution might be against the express intent or preference of the partners, and could wreak havoc on the continuing partnership's contractual relationships with third parties. In particular, title insurance covering specific partnership real property may not survive a change in membership.[2] Forced dissolution of the original entity could destroy the continuing partnership's privity of contract necessary to maintain title insurance coverage on partnership real property. The continuing partnership would be left wholly unprotected from a defect in title.

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This is what happened in **Fairway Development Co v Title Insurance Company of Minnesota.**[3] In **Fairway** three individuals formed a partnership. Later, two of three partners sold their interest to the remaining partner and a third party. After the sale the continuing partnership discovered a defect in the title of some partnership real property and sued the title insurer for a breach of contract under a title guarantee insurance policy. The insurer successfully defended the claim on the theory that the insured party was the initial entity of three and not the continuing partnership. The court held that after the change in membership the original partnership was dissolved. Thus, the new partnership had no standing to sue on the contract.

This is a clear example of a result quite opposed to the concept of the partnership as a separate and distinct entity, much like a corporation. It is precisely this result that suggests a need to revise the UPA as adopted in the State of Michigan and bring it closer to emerging trends and organization realities in today's business climate. Adopting an "entity theory" approach even with modifications will provide for continuity in contractual relationships, thereby allowing the benefits of title insurance and other contracts to survive a change in partnership membership.

This article reviews commentary and case law that suggest the need for revising the UPA to provide for dissociation without dissolution, thereby avoiding easy dissolvability and providing for continuity of the entity.[4] This continuity would also permit uninterrupted title insurance and protect the partnership from later-discovered title defects. Until this aspect of the UPA is revised, lawyers in Michigan should pay particular attention to the manner in which they draft partnership agreements and assist partnerships in obtaining title insurance on partnership property.

Part II of this article discusses historical partnership law including dissolution. Part III discusses recent developments in statutes and case law and articles that suggest a trend away from automatic dissolution and its negative effects. The article concludes with a practical approach whereby a lawyer in Michigan can avoid the "Fairway" horror.

II. PARTNERSHIP LAW AND DISSOLUTION

The Uniform Partnership Act: Aggregate Theory or Entity Theory

A partnership within the meaning of the Uniform Partnership Act (UPA) "is an association of two or more persons to carry on as co-owners a business for profit."[5] However, the "formulation of an all-encompassing definition of partnership is difficult, if not impossible, and it is probable that an accurate and comprehensive definition has not been stated."[6] This is largely because the drafters incorporated both the aggregate and entity theories into various parts of the Act.

One aspect of a partnership influenced by the differing theories is the concept of its constitution, which can be perceived in two ways. The "aggregate" theory views a partnership as a unique aggregate of individuals subject to dissolution upon a change in that aggregation. The "entity" theory views a partnership as a separate legal entity with a conceptual immortality like a corporation. Depending on the theory, a partnership may or may not be subject to dissolution and eventual termination upon a change in the membership. Also, contractual relationships with other entities may or may not be affected by a change in membership.

The original drafters struggled to determine which theory would be embodied in the text of the UPA.[7] At the time of its drafting, the aggregate theory was accepted in the majority of states.[8] As adopted "[t]he U.P.A. definition of partnership is neutral on whether a partnership is a legal entity or an aggregation of partners, and the Act itself includes both aggregate and entity-based features."[9]

The UPA reflects aggregate concepts with regard to the substantive liabilities and duties of the parties.[10] For example, § 15 of the UPA (§ 15 of the Michigan version, MCLA § 449.15) deals with the joint and several liability of the partners, and § 25 of the UPA (§ 25 of the Michigan version, MCLA § 449.25) deals with ownership of property by the individual partners rather than the partnership.[11]

Other areas of the UPA reflects the entity theory. Some areas of the Act that incorporate the entity approach are discussed in 59 Am. Jur 2d, Partnership § 7:

> An analysis of the Act suggests that many of its rules are based on the entity theory. The Act provides for the ownership and conveyance of property in the firm's name [§§ 8 & 10], the continuity of the partnership despite the assignment of a partner's interest [§ 27], the priority of partnership creditors in reference to partnership assets [§ 40] . . . .

Also, § 9 of the UPA (§ 9 of the Michigan version, MCLA § 449.9) concerns the partner as an agent of the partnership entity, and § 18 of the UPA (§ 18 of the

Michigan version, MCLA § 449.18) concerns internal financial relationships between the partner and the firm.[12]

In examining these sections, it is clear that the drafters did indeed incorporate both theories in the Act. Relevant to the issue of title insurance and other contractual rights, those sections concerning partnership property are influenced by both theories.

Partnership Real Property

Because at common law a partnership was considered an aggregate of individuals and not a separate entity, it did not have the capacity to hold real property; partnership property was held by the partners in a tenancy in common, or joint tenancy.[13] The UPA treats partnership property in the same manner. Partnership property is called "specific partnership property" and it is held in a tenancy in partnership. This limits its use to partnership purposes. The Michigan version of the UPA treats partnership property similarly. Part V, sections 24-28, MCLA 449.24-28, states, inter alia, that "a partner is a co-owner with his partners of specific partnership property holding as a tenant in partnership. . . ."

Despite the "aggregate" nature of holding partnership property in a tenancy in partnership, the manner in which the UPA treats partnership property strongly reflects the entity theory. For example, the UPA treats the partnership as an entity that can acquire, hold, and dispose of property. "With respect to real property the UPA recognized conveyances to and from the partnership in the 'partnership name' (§§ 8(3) and (10))."[14] Section 8(2) of the UPA (§ 8.2 of the Michigan version, MCLA § 449.8(2)) requires that property bought with partnership funds be considered partnership property."[15] Section 10(4) of the UPA (§ 10(4) of the Michigan version, MCLA § 449.10(4)) validates a conveyance in the "partnership name" of real property titled in "one or more or all the partners, or in a third person in trust for the partnership . . . ."[16] Also, partnership property remains partnership property even after the death of a partner.[17] The same holds true where the withdrawal was in contravention of the agreement.[18]

A partner's own interest in the partnership is only his share of the profits and surplus, and he may use specific partnership property only for partnership purposes because the specific partnership property belongs to the entity.[19] Moreover, where a partner merely assigns his interest in the partnership to a third party, the assignment does not dissolve the partnership. The assignment only entitles the assignee to receive the profits to which the assigning partner would be entitled. The assignee receives no interest in partnership property.[20]

Thus, the UPA incorporates entity concepts in sections applicable to partnership property. Although in most instances the UPA does not permit continuity of the entity in the event of dissociation of a partner, it does allow agreements that create survivorship in the beneficial ownership of specific partnership property and in each partner's interest in surplus.[21]

Some states also permit agreements to include similar provisions when partners merely withdraw or retire; a partnership agreement can provide for continuation after the dissociation of a member. If so, then specific partnership property stays within the continuing partnership. However, **continuation does not prevent dissolution**, and absent an appropriate statute, continuation may not preserve the original entity. Thus, while the property remains in the partnership, contracts associated with that property can still be substantially affected by the disassociation.

Partnership Dissolution

In its present form, the UPA applies the aggregate theory to partnership dissolution.[22] Therefore a partnership is dissolved upon a change in its aggregate membership. Reuschlein and Gregory conclude that: "The common law aggregate theory of partnership as a collection of individuals rather than an entity easily leads to this result."[23] They also note that: "The mystical union of partners is clearly changed by retirement or admission."[24]

There are many ways in which a partner may dissociate from a partnership. A change can occur as a result of the death or withdrawal of a partner.[25] A partner may withdraw simply by leaving the partnership, or retiring. A partner may sell or transfer all of his interest to the other partner(s) or to a third party. Absent a controlling statute, these withdrawals will cause a dissolution of the partnership.[26]

Withdrawal may even occur in contravention of the partnership agreement. It is a "central tenet" of partnership law in most jurisdictions that any partner may dissolve the partnership even in contravention of the partnership agreement.[27] Perhaps the greatest reason for allowing a partner to withdraw even in contravention of the agreement is to allow a partner to "terminate the heavy risks involved in being subject to another person's power to bind."[28] However, "the UPA escape route amounts to handing each partner a cache of dynamite," for any partner may at any time withdraw and dissolve the partnership.[29] And, because of its consequences, dissolution may be the least desirable result of a change in membership.

Dissolution and Liquidation

Ribstein notes that: "In general, the UPA approaches partner dissociation by blowing apart the partnership through mandatory dissolution and by giving each partner a right in most instances to compel liquidation, reserving the more limited buyout right to a few specific situations."[30] Bromberg concludes that: "While dissolution itself is a technical concept of little inherent interest, its consequences, if not properly anticipated and controlled, may be devastating . . . ."[31]

There are many reasons why liquidation upon dissolution is not always a prudent or cost effective result after a partner withdraws or otherwise disassociates from the partnership. Dissolution of a partnership, according to Fuller, generally causes a "sudden and enforced liquidation of the business which can rarely be consummated without substantial losses . . . ."[32] Fuller also notes that: "The toll is likely to be especially great, for example, where the venture is one having a valuable good will, or assets such as buildings, inventories, fixtures, and expensive mechanical equipment which are not ordinarily susceptible of advantageous sale on quick liquidation."[33] Reuschlein and Gregory conclude that: "A going business in operation for any length of time will have a value in excess of its individual assets valued separately."[34] And, according to a note in the *Harvard Law Review*, "Since the partnership thereby loses value as a going concern, an agreement preventing such a liquidation is desirable for the surviving partners."[35]

Therefore, for economic reasons, it may be best to have the UPA limit dissolution and termination to those instances where the partners expressly agree to such a result. And, for fairness to all the partners, it also may be best to have the UPA recognize continuity in the entity and avoid the otherwise detrimental effect on the continuing partnership's contractual relationships.

Dissolution and Partnership Contracts

Partnership contracts may be significantly affected by forced dissolution. Where one of the parties to the contract disappears, rights and duties under the contract may be substantially affected. "A contract might bind a particular entity and therefore terminate on dissolution of the entity, again even if the dissolution was only a technical one."[36] Alternatively, a contract might confer benefits on a particular entity and therefore terminate on dissolution of the entity, again even if the dissolution was only a technical one.

As Ribstein observed, "a partnership, like a corporation, should not dissolve merely as a result of changes in ownership because partners and third parties contracting with the partnership would not want or expect their agreements to change or terminate in this situation."[37] Again, adoption of the entity theory regarding disassociation would preserve privity of contract between the partnership and third parties, thus preserving the rights and duties under any contract.

Title Insurance

Title insurance is an area where the rights of the partnership under the contract may be substantially affected upon a change in membership. This is due to the nature of the title insurance policy. "A title insurance policy is a contract of indemnity against certain types of loss which may be sustained by the insured by reason of defects in the title to or liens or encumbrances upon realty in which the insured has an interest."[38] According to an American Bar Association committee report, "The owner policy is issued to the purchaser or owner of real property and protects him against financial loss from any defect affecting the marketability or merchantability of the title. This policy guarantees title **as long as the purchaser owns the property**, and, after selling it, continues to protect him on the warranties made in the deed."[39]

Taub notes that: "Generally, a title policy insures only the named insured and those who succeed him in interest by operation of law; title policies do not run with the land."[40] Given the typical fees charged for title insurance policies, it is economically necessary for title insurers to have such a limitation on their liability.[41] Thus, while the policy would continue to protect those who succeed to title through operation of law, including corporate successors, it does not protect assignees or grantees of the named insured.[42]

Thus, a partnership that is continued after dissolution brought on by dissociation of a member may not be in privity of contract with a title insurer.[43] Consequently, the continuing partnership could find itself uninsured against title defects, as in the **Fairway Development Company** case.[44]

Fairway Development Company

In **Fairway**, Messrs. Bernabei, Serra, and Wenger formed a partnership. Each contributed to the partnership's capital and shared in the partnership's profits and losses equally. The District Court of Ohio referred to this entity as Fairway I. Bernabei and Serra sold their entire interest to Wenger and a third party, Valentine. The court considered this a different entity, a new partnership, and referred to it as Fairway II. Later Fairway II discovered a defect in the title of some partnership real property and sued the original title insurer alleging a breach of contract under a title guarantee insurance policy. The trial court held that, after the change in membership, the original partnership was dissolved. Therefore, the new partnership was not the party insured under the policy and thus had no standing to sue upon discovery of a defect in the title.

This is a clear example of the application of the aggregate theory of partnerships, a result that would have been different if the entity approach had been applied. Though the property remained the property of the partnership owned by Wenger and Valentine and no deed was used to effect a transfer in ownership, the court concluded that Fairway II was not insured. It is precisely this result that suggests a need to revise the UPA.

While Michigan courts have not decided a case similar to Fairway, title insurance companies doing business in Michigan appear to interpret their policies and Michigan law in the same manner as the court in Fairway interpreted the Fairway policy and Ohio law. Most title insurers in Michigan have filed a "Fairway Endorsement" with the Michigan Insurance Bureau similar to that appearing in the Appendix to this article and charge additional fees for the issuance of such an endorsement. In light of these fees, the limited coverage and the hope that the Fairway decision will not be followed by Michigan courts, it appears that Michigan title insurers have not issued Fairway endorsements to many title insurance policies. Also, perhaps not all real estate practitioners are aware of the possible application of Fairway.

III. DISSOCIATION WITHOUT DISSOLUTION

Partnerships, like corporations, provide a means for pooling capital among enterprising individuals. A major objective in establishing a partnership instead of a corporation is to be taxed as a partnership but obtain as many of the advantages of incorporation as possible. Indeed tax considerations are an essential aspect of partnerships.[45] However, a significant advantage presently not possessed by the partnership is "immortality."[46] Unlike a partnership, stockholders in a corporation can change daily while the corporate entity remains the same.

Fuller wrote that "the utility of the partnership as a business device will be greatly increased if the unfortunate consequences of a partner's death can be overcome or substantially minimized."[47] It follows that the utility of a partnership will also be greatly increased if the consequences of a partner's dissociation can be overcome or substantially minimized. As Reuschlein notes, "[i]t is not necessary that the retirement or admission of partners cause a dissolution . . . ."[48]

It is well known that "as a practical matter, dissolution no longer occurs in many large partnerships. For example, the articles of professional partnerships engaged in the rendition of law, accounting, or stock brokerage services frequently provide that there will be no dissolution on the death or retirement of any individual partner."[49] Bromberg concurs on this point, concluding that, "no dissolution occurs in a large partnership whose articles specify that there is no dissolution on death, retirement, incapacity, etc."[50]

The UPA provides that dissolution of a partnership does not cause the liquidation of the firm if there is an agreement among the partners stating that it does not do so.[51] Ribstein concurs: "Dissolution and continuation provisions are standard elements of a partnership agreement."[52] "Continuation agreements can be made equally applicable to any kind of potential dissolution, and even to a partnership at will."[53] Bromberg also notes: "An agreement of this sort is the only reliable way of assuring the preservation of a partnership business."[54]

All the UPA requires is that continuation provisions agree to something other than liquidation.[55] This means that the partnership agreement must be drafted so as to preserve the going concern value of the business, and that the rights of the partners to compel liquidation and be paid in cash must be restricted to the same end.[56]

However, the court in **Fairway** interpreted the UPA as adopted in Ohio to provide that the continued partnership was in fact a new entity. It is this result, which is the antithesis of the entity concept of partnerships, that the UPA Revision Subcommittee of the ABA's Committee on Partnerships and Unincorporated Business Organizations proposed to change.[57] According to this committee:

> Because the "entity theory" avoids a number of technical problems, such as the authority of a general partnership to sue or be sued in its partnership name, the subcommittee determined that it should be incorporated into any revision of the UPA whenever possible and that the "aggregate theory" should be retained only where

it appears to be essential, e.g., because of tax considerations."[58]

The committee recommended that there be "specific authorization for a partnership agreement to contain a provision that prevents a technical dissolution if the remaining partners agree to buy out the interest of the withdrawing partner."[59]

Statutory and Case Law Attempts to Eliminate Automatic Dissolution and Liquidation

A few states have adopted modified versions of the UPA and allow a partnership to avoid dissolution upon the withdrawal of a partner. In Nebraska, the UPA was adopted "with modifications to make clear that the entity theory was to apply. The Nebraska version of the Act's definition section provides that a partnership is an association of persons organized as a separate entity to carry on a business for profit, and the Act's rules of construction were changed to provide that it must be interpreted and construed in harmony with the entity theory of partnership."[60] The California Corporations Code, section 15031, provides in part that while withdrawal of a partner may cause dissolution, the partners may agree in writing to continue the partnership without dissolution.[61]

Case law, too, has demonstrated that courts are willing to abide by a partnership agreement that allows for disassociation without dissolution. But if there is no agreement to the contrary, some courts have held that a partnership dissolves when a partner withdraws or dies.

In **Davidson v Tilden**[62] the California Court of Appeals stated that had the partners made an agreement pursuant to the California Code, dissolution would not have resulted after the withdrawal of a partner.[63] One of the partners withdrew from J. F. Davidson Associates and the partnership agreement did not state that the partnership would not dissolve upon the withdrawal of a partner. As a result, when the remaining partners decided to continue the partnership under the same name, a new entity came into existence.[64]

The New York Supreme Court in **Wagner v Etoll** also stated that because there was no agreement to the contrary, a dissolution resulted after the death of a partner.[65] Although the surviving partners continued the business, "a new partnership independent of the [original] partnership agreement came into existence . . . ."[66] A similar conclusion was reached by the New Jersey Supreme Court in **Burger v Kurzman,** where the court stated that the partnership was dissolved because "significantly, the [partnership] agreement contained absolutely no provision for the continuation of the partnership after the death of a partner."[67] The court stated that unless there was an agreement to the contrary, a partnership was dissolved upon the death of any partner.[68] Although the three surviving partners continued the business much as before, they created a new relationship among themselves that was different from the partnership agreement that also included the deceased.[69] The court reasoned:

> A partnership is a contractual relation dependent upon the personality of its members. The admission or withdrawal of a member so radically changes the contractual rights inter se as to produce essentially a new relation even though the parties contemplate no actual dissolution of the firm and continue to carry on business under the same name, under the original articles and with the same account books.[70]

Because there was no agreement to the contrary, the partners created a new partnership when they continued the business.[71]

The clear thrust of these cases is that the partnerships would not have been dissolved had there been a partnership agreement providing for a continuation without dissolution in the event of the death or withdrawal of one of the members.

In other cases the partnership agreements did address this issue, and provided that dissolution would not occur upon the death or withdrawal of a member.

In **Adams v Jarvis**, the Wisconsin Supreme Court held that a partnership "continued to exist under the terms of the agreement," and did not wholly dissolve after a partner withdrew.[72] This particular agreement specifically provided that the partnership would not terminate in the event that one of the partners withdrew.[73] The court found that "[t]he agreement contemplates [that the] partnership would continue to exist between the remaining partners even though the personnel constituting the partnership was changed."[74] The court qualified its holding by stating that "[i]f the partnership agreement provides for continuation, sets forth a method of paying the withdrawing partner his agreed share, [and] does not jeopardize the rights of creditors, the agreement is enforceable."[75] Lastly, the court stated that the "statute should not be construed to invalidate an otherwise enforceable contract entered into for a legitimate purpose."[76]

In **Osborne v Workman**, the Supreme Court of Arkansas stated that the issue was "whether under the

Uniform Partnership Act one partner can terminate a partnership created for an indefinite term where the partnership agreement provided for its continuation until 'dissolved mutually or by law.'"[77] Here the intent of the partnership agreement was that termination was to occur only "by mutual agreement and not by unilateral act of a single partner."[78] The court held that where the partnership agreement provided that the partnership would continue until both partners agreed or it was dissolved by law, one partner could not cause a dissolution by withdrawing and demanding a winding up.[79]

Perhaps one of the strongest statements in support of the validity of an agreement against automatic dissolution was that of the Nebraska Supreme Court in **Bailey v McCoy**. The court stated that "the [partnership] agreement in many respects is the law of the partnership."[80] The court reviewed works by Crane and Bromberg which stated that a partnership need not be dissolved upon the withdrawal or admission of a partner.[81] The court decided that "it [is] time [to] recognize in this respect [changes of membership and] . . . that the partnership is what the partners make it."[82] The court emphasized that " . . . no dissolution occurs in a large partnership whose articles specify that there is no dissolution on death, retirement, incapacity, etc. . . . There is no reason why legal theory should not accept this practical result, and it has done so. And there is no reason to limit it to larger firms."[83] The court concluded that a partnership may continue after admitting a partner or having one withdraw.[84]

These cases and underlying statutory provisions have strengthened the concept of the partnership as an entity. In permitting disassociation without dissolution, they have enabled partnerships to operate with more flexibility. They have enabled partnerships to avoid the economic disasters inherent in automatic dissolution. As such they provide a persuasive basis for adopting an entity approach toward partnerships.

Further support for revising the UPA to fully reflect the entity theory of partnerships comes from cases interpreting United States bankruptcy laws as they apply to partnerships. In **Meek v Centre County Banking Co, et al**, the United States Supreme Court stated that "there hence can be no doubt that a partnership may be adjudged a bankrupt as a distinct legal entity."[85] More recently the United States Court of Appeals, Fourth Circuit, reiterated that "a partnership may be adjudged a bankrupt as a distinct legal entity."[86] Furthermore, in **Liberty Nat. Bank of Roanoke, Va v Bear, et al**, the United States Supreme Court indicated that a "partnership, during the continuation of the partnership business, or after its dissolution and before the final settlement thereof, may be adjudged a bankrupt."[87] So within the bankruptcy code a partnership is viewed as a distinct legal entity, and it continues to be a distinct entity after dissolution and until final termination.

IV. CONCLUSION

The reasons for considering a partnership to be a distinct legal entity are many. As a distinct entity, the partnership could avoid the pitfalls of forced dissolution upon dissociation of one of its members. It could preserve the goodwill and value of the ongoing business that would be destroyed on liquidation. It could preserve the rights and duties of contracts between it and third parties. The underlying purpose would be to increase the utility of the partnership as a commercial entity, giving it flexibility and continuity in the face of inevitable changes in its aggregate membership. With these goals in mind, several scholars have suggested alternatives or revisions to the present UPA so that it would more fully reflect the entity theory.

Goldstein and Goode urge that "it should be stated forthrightly in the definition of a revised UPA or in an official Comment that, insofar as title to property is concerned, a partnership shall be deemed a legal entity capable of acquiring, holding, encumbering and conveying property."[88] Thus, disassociation would not affect the entity nor the entity's standing as an insured party under title insurance.

Bromberg has proposed an alternative to automatic dissolution upon dissociation. He recommends a clause where dissolution is caused only by a certain majority vote of the partners, and where each partner waives his right to dissolve or obtain dissolution in any other way.[89] Moreover, he suggests a clause specifically stating that there would be no dissolution upon admission or withdrawal of a partner.[90] He also suggests that upon withdrawal, goodwill and all other partnership property shall belong to and remain solely vested in the partnership.[91]

A similar approach was envisioned by Ribstein, who proposed the following provisions: "Subject to provisions of the partnership agreement limiting the circumstances under which the partnership entity dissolves, the partnership entity shall dissolve when, following dissociation of one or more partners pursuant to sec. 1.01 or sale of the assets of the business pursuant to section 1.04, the business of the partnership is either not carried on or is carried on solely by one or more persons not partners in the dissolved partnership."[92]

The UPA Revision Subcommittee of the Committee on Partnerships and Unincorporated Business Organizations recommended that there be "specific authorization for a partnership agreement to contain a provision that prevents a technical dissolution if the remaining partners agree to buy out the interest of the withdrawing partner."[93]

The wait for changes to the UPA hopefully will not be long. A proposed Revised Uniform Partnership Act (RUPA) was approved by the National Conference of Commissioners on Uniform State Laws in August of 1992. Since this approval, additional work has been completed to gain the support of various sections of the American Bar Association. It now appears that the proposed RUPA will be presented to the American Bar Association at its mid-year meeting in February, 1994.

Significantly, the proposed RUPA applies the entity theory to changes in partnership membership. Donald J. Weidner, Professor of Law at the Florida State University College of Law and the Reporter for the drafting committee, discussed the major changes at a seminar in Atlanta in 1991:

1. RUPA introduces a blanket provision that, with certain limited exceptions, partners may contract out of the rules in RUPA that govern their relations among themselves.

2. RUPA contains a number of provisions that adopt an entity theory to achieve simplicity.

3. RUPA rewrites the rules on partnership breakups but retains much of the substance of present law.

In allowing the partners to contractually govern their relations among themselves, the proposed RUPA allows for continuation by the same entity after a change in membership without dissolution. At the same time, the proposed RUPA retains provisions from the UPA that require dissolution if not changed by the partnership agreement.

The proposed RUPA appears to offer the best of both theories: a partnership may contract to preserve the entity or, if such preservation is undesirable, allow for dissolution according to the historical approach. However, until its adoption in some form in the State of Michigan, a lawyer in Michigan is still faced with the possibility of a technical dissolution and loss of title insurance coverage.

Therefore, when drafting a partnership agreement, a lawyer should advise prospective partners of the tenuous nature of their proposed partnership entity. A lawyer may draft the agreement to provide for changes in the aggregate membership and a manageable transition, but presently it is not certain that partnership agreements providing for continuation of the partnership without dissolution are effective.

What can be done to prevent another **Fairway**? The complexity of the solution varies with the complexity of the partnership. The simplest solution might be to have the first entity deed the property to the second "new" entity, which purchases a new title insurance policy or relies on warranties in the deed. The problem here is obvious; in an ever-changing aggregate, the cost of the title insurance and/or transfer taxes would be excessive. A more complex solution might be to have the partnership own real estate indirectly; the partnership could own stock in a corporation that owns real estate. This may cause tax problems for some partnerships. It will be the lawyer's responsibility to match the agreement with the circumstances.

ENDNOTES

1. Goldstein & Goode, **Entity and Aggregate Theories of Partnership: The Need for Clarification**, 1 Prob. and Prop. 14, 16 (1987) [hereafter "Goldstein"].
2. **Fairway Development Company v Title Insurance Company of Minnesota**, 621 F. Supp. 120 (D.C. Ohio 1985). This case will be discussed in greater detail at footnote 44.
3. **Id.** at 125.
4. **See also**, Ribstein, **A Statutory Approach to Partner Dissociation**, 65 Washington U. L. Q. 357 (1987). Ribstein's article is written for the same purpose [hereafter "Ribstein"].
5. UPA § 6(1). See also § 6 of the Michigan UPA, MCLA § 449.6.
6. 59A Am. Jur. 2d, Partnership § 2.
7. Goldstein, **supra** note 1, at 16.
8. **Id.**
9. Ribstein, **supra** note 4, at 400.
10. 59A Am. Jur. 2d, Partnership § 6.
11. Ribstein, **supra** note 4, at 400.
12. **Id.**
13. **Partnership Continuation Agreements**, 72 Harv. L. Rev. 1302 (1958-59) [hereafter "Harvard"].
14. Goldstein, **supra** note 1, at 16.
15. **Id.**

16. **Id**.

17. UPA § 25(2)(d). See also MCLA §449.25(2)(d).

18. UPA § 38(2). See also MCLA §449.38(2).

19. UPA § 25(1) states that a partner is co-owner with his partners of specific partnership property holding as a tenant in partnership. Section 25(2) defines tenant in partnership as an equal right with partners to possess the property for **partnership purposes**, and that it is not assignable unless all partners assign their rights in the same property. See also Section 25(1) and (2) of the Michigan Uniform Partnership Act, MCLA §449.25 (1) and (2).

20. UPA §§ 27 and 25(2)(b). See also Sections 27 and 25(2)(b) of the Michigan Uniform Partnership Act, MCLA 449.27 and 449.25(2)(b).

21. Harvard, **supra** note 13, at 1306.

22. Hillman, **Law Firms and Their Partners: The Law and Ethics of Grabbing and Leaving**, 67 Texas L. Rev. 1 (1988) [hereafter "Hillman"]. The Michigan version of the UPA is the same. Section 29, MCLA 449.29, provides the definition of dissolution, stating that "the dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business."

23. Reuschlein & Gregory, The Law of Agency and Partnership 355 (West Publishing 2d ed. 1989) [hereafter "Reuschlein"].

24. **Id**.

25. UPA § 29. See also Section 29 of the Michigan UPA (MCLA § 449.29).

26. 59A Am. Jur. 2d, Partnership § 835.

27. Hillman, **supra** note 22, at 35. See Section 31 of the Michigan Uniform Partnership Act, MCLA §449.31. See also **Atha v Atha** 303 Mich 611 (1942), where the court stated that the right of partners to dissolve is a right incident to every partnership, and there are no indissoluble partnerships.

28. Ribstein, **supra** note 4, at 378.

29. **Id**. at 360.

30. **Id**. at 377.

31. Bromberg, Crane and Bromberg, Partnership 631 (West Publishing 1968) [hereafter "Bromberg"].

32. Fuller, **Partnership Agreements for Continuation of an Enterprise After the Death of a Partner**, 50 Yale L.J. 202, 203 (1940) [hereafter "Fuller"].

33. **Id**.

34. Reuschlein, **supra** note 23, at 345.

35. Harvard, **supra** note 13, at 1302.

36. Reuschlein, **supra** note 23, at 345.

37. Ribstein, **supra** note 4, at 401.

38. Theodore Taub, **Rights and Remedies Under a Title Policy**, in American Bar Association Section on Real Property, Probate and Trust Law 1979 Fall Program, Title Insurance and You — What Every Lawyer Should Know! 69 (1979) [hereafter "Taub"].

39. American Bar Association Standing Committee on Lawyers' Title Guaranty Funds, How-To-Do-It: Bar-Related Title Assuring Organizations, 8 (1976).

40. Taub, **supra** note 41, at 70-71.

41. Werner, **The Basics of Title Insurance**, in American Bar Association Section of Real Property, Probate and Trust Law, Title Insurance: The Lawyer's Expanding Role 39 (1985) [hereafter "Werner"].

42. **Id**.

43. Werner, **supra** note 41, at 47.

44. **Fairway Development Company v Title Insurance Company of Minnesota**, 621 F. Supp. 120 (D.C. Ohio 1985).

45. See note 58.

46. Fuller, **supra** note 32, at 202.

47. **Id**. at 203.

48. Reuschlein, **supra** note 23, at 354.

49. 59A Am. Jur. 2d, Partnership § 892.

50. Bromberg, **supra** note 31, at 418. See Sec. 31(4) of the Michigan Uniform Partnership Act, MCLA Sec. 449.31(4), which states that dissolution is caused by the death of any partner. See also **Brewer v Stoddard** 309 Mich 119 (1944), where the court stated that the death of a partner dissolves a partnership.

51. 59A Am. Jur 2d, Partnership § 892.

52. Ribstein, **supra** note 4, at 360.

53. Bromberg, **supra** note 31, at 476.

54 . **Id**.

55 . **Id**.

56. Reuschlein, **supra** note 23, at 345.

57. The UPA Revision Subcommittee of the Committee on Partnerships and Unincorporated Business Organizations, **Should the Uniform Partnership Act Be Revised?**, 43 Bus. Law. 121, 124 (1987) [hereafter "Subcommittee"].

58 . **Id**.

59. **Id.**
60. 59A Am. Jur. 2d, Partnership § 6.
61. Cal. Corp. Code sec. 15031.
62. **Davidson v Tilden,** 86 Cal. App. 3d 283, 150 Cal. Rep. 194 (1978).
63. **Id.** at 196.
64. **Id.**
65. **Wagner v Etoll,** 46 A.D.2d 990, 362, N.Y.S.2d 278, 280 (1974).
66. **Id.** at 279.
67. Burger, Kurzman, Kaplan & Stuchin et al v Kurzman, 139 A.D.2d 422, 423, 527 N.Y.S.2d 15, 16 (1988).
68. **Id.** at 424, 527 N.Y.S.2d at 16.
69. **Id.** at 424, 527 N.Y.S.2d at 16-17.
70. **Id.** at 424, 527 N.Y.S.2d at 17.
71. **Id.**
72. **Adams v Jarvis,** 23 Wis.2d 453, 459, 127 N.W.2d 400, 404 (1964).
73. **Id.** at 458, 127 N.W.2d at 403.
74. **Id.**
75. **Id.** at 459, 127 N.W.2d at 403.
76. **Id.**
77. **Osborne v Workman,** 273 Ar. 538, 539, 621 S.W.2d 478, 479 (1981).
78. **Id.** at 542, 621 S.W.2d at 480.
79. **Id.**
80. **Bailey v McCoy,** 187 Neb. 618, 193 N.W.2d 270, 273 (1971).
81. **Id.**
82. **Id.**
83. **Id.**
84. **Id.**
85. **Meek v Centre County Banking Co et al,** 268 U.S. 426, 431 (1925).
86. **Grant v Bank of Virginia,** 580 F.2d 705, 707 (1978).
87. **Liberty Nat Bank of Roanoke, Va v Bear et al,** 276 U.S. 215, 221 (1928).
88. Goldstein, **supra** note 1, at 18.
89. Bromberg, **supra**, note 31, at 664.
90. **Id.** at 665.
91. **Id.** at 665-666.
92. Ribstein, **supra** note 4, at 425.
93. Subcommittee, **supra** note 57, at 124.

APPENDIX

FAIRWAY ENDORSEMENT

Attached to Policy No. ____________________

ISSUED BY

____________________ TITLE INSURANCE COMPANY

The Company hereby assures the insured partnership that this Policy and the coverage provided to the insured partnership hereunder shall not be deemed to have lapsed, or to have been forfeited, or to have terminated because of the occurrence, subsequent to the Date of the Policy, of either of the following events, provided that the insured partnership has not been dissolved or discontinued by reason of the following events pursuant to applicable state law,

(a) the admission or withdrawal of any individual or entity as a partner in the insured partnership, or

(b) a change in any partner's interest in capital or profits of, or as limited or general partner in, the insured partnership.

Nothing contained herein shall be deemed to be a waiver of any rights or defenses the Company may otherwise have under this Policy.

This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

Title Insurance Company

By:____
Authorized Signature

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA) AND HUD'S REGULATION X: WHAT HATH HUD WROUGHT?

by *Howard A. Lax**

The universe of residential transactions changed dramatically with the close of 1992 as Congress amended the Real Estate Settlement Procedures Act,[1] effective October 28, 1992. Four days later, the U.S. Department of Housing and Urban Development (HUD) published a final regulation revising Regulation X.[2] This regulation was the result of a published proposed rule,[3] and two leaked proposed regulations which were never published.[4] The new regulation was immediately challenged by two trade groups[5] as arbitrary and capricious. Nevertheless, as of December 2, 1992, the new regulation was implemented for all federally-related mortgage loans secured by a first lien on residential property.

With regard to federally-related mortgage loans secured by junior liens on residential property, HUD, the OCC and the FDIC have stated that no enforcement actions will be taken until HUD issues regulations to implement the amendment of RESPA.[6] Aside from junior lien loans, the only residential mortgage loans which are exempt from Regulation X are residential construction loans without end take-out financing,[7] true secondary market sales of federally-related residential mortgage loans,[8] and lot loans.[9] In all other respects, any transaction **related to** a federally-related mortgage loan must comply with the requirements set forth in Regulation X.

The "Yertle the Turtle" Method of Regulation: Higher and Higher, and Don't Spare the Paperwork

HUD has defined the scope of the regulations almost as broadly as it can under RESPA.[10] "Federally-related mortgage loans" are defined in the regulation as loans secured by structures designed principally as one-to-four family dwellings and the real estate supporting the dwelling (including cooperative housing and condominium units) which (1) can be sold to FNMA/FHLMC/GNMA, or (2) are made by an insured depository institution, or (3) are made by any lender subject to the Truth-in-Lending Act which makes or invests in an aggregate of $1,000,000.00 of residential loans in any year, or (4) are assisted by any federal program.[11]

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Disclosure requirements are triggered by eight events. First, the referral of a person to an affiliated entity or an entity under common control or 1% common ownership creates the need for a Controlled Business Arrangement (CBA) Disclosure.[12] The CBA Disclosure is the first prerequisite to create a "safe harbor" for the payment of bona fide dividends and for other benefits derived from legitimate transactions between entities under common ownership or control.[13] The regulation requires the use of a model disclosure[14] to notify the referred person of the range of fees that the affiliated entity may retain from the applicant.[15]

Second, a Computer Loan Origination (CLO) Fee Disclosure[16] is required if a CLO service operator (which could include a mortgage broker) will charge fees to applicants or borrowers for its computer-related services.[17] Implicit in this arrangement is the assumption that the CLO service will somehow make use of a cathode ray tube to obtain information for an applicant.[18]

Third, a Good Faith Estimate of Settlement Costs is required whenever written or computer-generated information is submitted to a lender or mortgage broker with the anticipation of a credit decision related to a mortgage loan.[19] In addition, a Special Information Booklet (the "Settlement Costs" booklet) must be given to each applicant, except when the application is denied within three business days of the date of application or when the applicants request a refinancing of a loan.[20] It is not clear why these exceptions exist for the Settlement Costs booklet, and not for the Good Faith Estimate of Settlement Costs.

Fourth, a Servicing Transfer Disclosure must be given to the applicants at the time of application. This disclosure provides a summary of the borrower's rights upon transfer of servicing of a loan, and it provides a three year history of the lender's transfers of servicing within the first year after origination of its loans, rounded to the nearest quartile.[21]

Fifth, a HUD-1 Settlement Statement must be used whenever documents which create an obligation **related to** a federally-related mortgage loan are executed.[22] If the lender escrows funds for taxes and/or insurance premiums, the borrower must also be given a disclosure of the initial escrow account, a statement of the various monthly escrow charges, and a summary of the borrower's rights with regard to the escrow account.[23]

Sixth, a yearly escrow analysis is required, and the lender cannot keep an escrow balance which exceeds two months of escrow payments for each "item" after the largest payment expected for each "item" is made.[24]

Seventh, a notice of the transfer of loan servicing must be provided to the borrowers from both the old and new loan servicers. The old servicer must provide its notice no later than fifteen days before the transfer occurs. The new servicer must provide its notice within fifteen days after the effective date of transfer of servicing. These notices may be combined.[25]

Eighth, the borrower may question or contest a loan account record. The servicer must acknowledge receipt of and promptly investigate any written borrower inquiry regarding a loan account.[26]

The instructions for completing the HUD-1 Settlement Statement are modified from prior regulations. The Controlled Business Arrangement Disclosure and the Computer Loan Origination Services Disclosures are new forms. The Good Faith Estimate Disclosure has a suggested model form for the first time, and additional information must be included on this form.[27] The HUD-1 Settlement Statement likewise must include additional information, and the placement of fees and charges which are paid outside of the closing, or which are absorbed by third parties must be presented in a different manner on the HUD-1.[28] Other instructions for completing the HUD-l have been modified as well.[29] Needless to say, the lender cannot charge directly for preparation of these disclosures and notices, or for preparation of Truth-in-Lending disclosures.[30]

Don't Let the Peas Touch the Corn

The most difficult provisions in the new regulation are the changes in the definition of a "kickback."[31] HUD has, in essence, created the impression that any benefit which can be derived from a federally-related transaction is presumed to be an illegal kickback.[32] The rules are simple to follow and apply to single entities which perform all of the functions necessary to process and originate federally-related mortgage loans. Entities which attempt to conduct business in a cooperative manner, and affiliated entities which conduct business as a cohesive entity will find, however, that their efforts are chilled by the new regulation rather than supported. HUD's original proposal would have created an express presumption that anything of value paid or received from a provider of settlement services or a lender was an illegal kickback if business opportunities were referred between the entities. The final regulation eliminates the word "presumption,"[33] but the effect is the same.

The regulation allows an entity to receive a return on an investment if (1) the CBA Disclosure is provided each time a person is referred to the affiliated entity, (2) the entity cannot require the use of an affiliated entity for settlement services,[34] and (3) no other benefits are received or paid by the entities to each other except fees paid for services rendered or value given. Fees paid to an entity for services rendered must be "commensurate" with fees paid to similar service providers. High fees may invite a HUD investigation to determine whether the excess is a hidden kickback.[35] HUD's prior opinions permitting percentage fees have been withdrawn.[36] Hence, it is not clear whether percentage fees in large loans will be investigated by HUD or circumscribed by later HUD interpretations.

Who Loves Ya Baby?

HUD has a new Enforcement Division to seek out and prosecute violators of Section 8 of RESPA. The principal sources of referrals to this Division are within the mortgage lending industry. HUD circulates a criminal referral form in each public forum to which it is invited, and competitors are turning each other in. HUD also cooperates with other federal and state agencies to find and prosecute violations.[37]

This Division will concentrate on lenders and providers of settlement services in states which have the highest incidence of reported violations. HUD has a special interest, however, in challenging a lending institution in Michigan, Ohio, Kentucky or Tennessee to reverse the opinion in **Graham Mortgage**.[38] After finding evidence of a criminal violation, HUD is likely to ask for a civil settlement in lieu of criminal prosecution. The threat of criminal prosecution will force many to settle, since loan applicants also have a private right of action for triple damages. Publication of the charges against a settlement service provider will invite civil litigation.[39] HUD has a three-year statute of limitations for prosecution, and the applicant has a one-year statute of limitations for pursuing a civil remedy.[40]

Beam Me Up Scotty

HUD recently published its proposed regulations for junior lien residential mortgage loans.[41] The proposed changes to Regulation X should be reviewed critically, and comments should be addressed to HUD regarding all of Regulation X, and not just the changes made to accommodate junior lien loans.

ENDNOTES

1. 12 USC §2061 **et. seq.**, as amended by the Housing and Community Development Act of 1992, 1992 P.L. 510 §§ 908 and 951.
2. 24 CFR Part 3500, 57 FR 49600, November 2, 1992, as amended in 57 FR 56856, December 1, 1992, and clarified in 58 FR 17156, April 1, 1993. Section 21 of the regulation was implemented as an interim rule on April 26, 1991. 56 FR 19506.
3. 53 FR 17424, May 16, 1988.
4. Versions dated December 7, 1988 and January 3, 1991.
5. **Mortgage Bankers Association of America v United States of America**; and **Coalition to Retain Independent Services and Settlements (CRISIS) v Jack Kemp**.
6. The amended Act requires HUD to promulgate regulations to implement the amendment on or before April 28, 1993. The Federal Deposit Insurance Corporation stated in FIL-93-92, dated December 28, 1992:

   > HUD's General Counsel Frank Keating has issued an interpretation regarding the effective date of provisions of the Housing and Community Development Act of 1992 that extend the coverage of RESPA to subordinate liens. Mr. Keating's interpretation states that the extension of RESPA to subordinate liens will not become effective until final rules on the 1992 amendments are issued by HUD. The FDIC supports this position and likewise agrees not to enforce the RESPA coverage on subordinate liens until final rules have been issued.

   HUD issued an Interpretive Ruling (58 FR 13705, March 15, 1993) stating that Section 908(c) of the Housing and Community Development Act of 1992 (requiring promulgation of regulations, a public comment period, and issuance of final regulations, to give effect to Section 908 within 180 days) conflicts with Section 908(d) (giving immediate effect to the enlarged scope of RESPA). Accordingly, implementation of Section 908 (application of RESPA to junior lien residential mortgage loans) was delayed by HUD until final regulations can be issued. HUD failed to state why it could not work within the 180 day deadline required by the Act for final implementation of the required regulations.

   OCC Banking Bulletin 92-65, dated November 23, 1992, states:

   > The Act requires HUD to issue final regulations covering section 908 within 180 days of enactment. However, since the Act became effective on October 28, 1992, banks should make every effort to comply with the above sections as soon as possible.

   This Banking Bulletin was reversed by Banking Bulletin 93-21 (April 15, 1993).
7. 24 CFR §3500.5(b)(2) actually exempts "temporary financing such as a construction loan." "Temporary financing" is not defined further, but the exemption for construction loans is discussed at some length.
8. 24 CFR §3500.5(b)(3).
9. The definition of a "federally-related mortgage loan" requires that at least some of the proceeds be used for the acquisition of a residence or that the loan be secured by both a residence and real estate. See 24 CFR §3500.2(a)(3)(i)(A) and (B). Lot loans are not used for acquisition of a residence. Similarly, most manufactured housing loans are secured by the home only, and do not meet the definition of a federally-related mortgage loan.

10. RESPA's definition of a "federally-related mortgage loan" does not mention the requirement that the loan be secured by a dwelling. Under the Act, the loan is a federally-related mortgage loan if it is secured by "residential property." HUD has never attempted to regulate loans secured by land zoned for residential use.

11. 24 CFR §3500.2(a)(3).

12. 24 CFR §3500.15(a) and (b).

13. 24 CFR §3500.15(b)(3)(i)(A) and (B).

14. Appendix D to 24 CFR Part 3500.

15. 24 CFR §3500.15(b)(1) requires the disclosure of the fee or range of fees retained by the entity to which a person is referred. Disclosing a loan percentage is presumptively inappropriate. Furthermore, the affiliated entity is not excused from providing this disclosure by reason of providing the Good Faith Estimate of Settlement Costs containing loan specific information. The regulation does not explain how to provide this disclosure in a telephone referral. Grant Mitchell of HUD's Office of General Counsel indicated recently that if the referral is made by a live person, the call should be followed up by a written disclosure. Nevertheless, there is no bright line distinguishing a promotional activity which is exempt from Section 8 of RESPA (24 CFR §3500.14(g)(2)(i)) from a referral.

16. See Appendix E to 24 CFR Part 3500.

17. 24 CFR §3500.14(g)(2)(iii).

18. The concept of allowing brokers to collect a fee for providing borrowers with loan product information is based on the Citicorp "Mortgage Power" program, which included a computerized loan origination system. HUD states, at 57 FR 49603, "...HUD policy staff concluded that there were potentially substantial consumer benefits in the utilization of new technology. Further, the technology was in flux and represented, at most, no more than one to two percent of mortgage originations annually. Considering all of these factors, HUD concluded that it would issue a CLO exemption under its authority in section 19(a) of RESPA which would have the effect of eliminating possible regulatory inhibitions on the development of this technology.... HUD has required that system operators provide the consumer with a written disclosure."

19. The mortgage broker (or the lender if there is no mortgage broker) must provide a Good Faith Estimate of Settlement Costs to the applicant within three business days of receipt of an application. 24 CFR S3500.7(a). "Applicant" is defined at 24 CFR §3500.2(a)(1).

20. The lender and/or the mortgage broker must provide the Settlement Costs booklet to one of the applicants within three business days of the application. See 24 CFR §3500.6(a) and §951 of the Housing and Community Development Act of 1992.

21. 24 CFR §3500.21 was published as an interim rule in 56 FR 19506 (April 26, 1991) to implement Section 6 of RESPA. This section of Regulation X is still in effect, although it was not republished on November 2, 1992.

22. 24 CFR §3500.8. The HUD-1 must be prepared a day in advance of the closing, unless the borrower waives the right to inspect the closing statement prior to closing. 24 CFR §3500.10(a) and (c).

23. 24 CFR §3500.17 was published as a proposed rule in 56 FR 64446 (December 9, 1991) to implement Sections 10(b), 10(c) and 10(d) of RESPA. Section 942 of the National Affordable Housing Act, Pub. L. 101-625 (November 28, 1990) required that HUD issue regulations to implement the provisions of the Act (amending RESPA) within 90 days. HUD issued proposed regulations, and an advisory (58 FR 5520, January 21, 1993), but has reserved publication of a final regulation. It is not clear whether the original §3500.17 (56 FR 13384, April 1, 1991) has been repealed. Most loan servicers agree that the provisions of the Act must be followed today.

24. See note 23.

25. 24 CFR §3500.21(e). Thirty days are allowed for the notice of transfer of servicing if the old servicer is terminated for cause, or the servicer or its parent are subject to proceedings under a petition for bankruptcy, or proceedings for receivership or conservatorship.

26. 24 CFR §3500.21(f). Receipt of a written inquiry must be acknowledged within twenty days. The servicer must investigate the inquiry and respond to the borrower within sixty days. The servicer cannot report a disputed payment to a credit reporting agency during the sixty-day investigation period. This section does not affect the enforceability of the loan documents.

27. The Good Faith Estimate must reveal the name, address, telephone number, and relationship to the lender of any provider of settlement services which the lender requires the borrower to use. 24 CFR §3500.7(e). Payments to settlement service providers must be listed even if the lender pays them. See Appendix A to Regulation X, Instructions for lines 808-811. In addition, service release fees and yield spread premiums paid to a mortgage broker must be disclosed. See Appendix B to Regulation X, fact example 12.

28. See the introductory instructions for completing the HUD-l Settlement Statement found in Appendix A of the Regulation.

29. Some of the changes to the instructions for the HUD-l Settlement Statement are discussed at 57 FR 49606. Please also note:

(a) in construction loans, the price of the land is listed on line 104, the costs of construction on line 105, and the loan amount on line 202,

(b) as noted in fact example 12 in Appendix B to the regulation, fees paid to or from the investor in "table funded" transactions are listed on lines 808 through 811 (e.g., yield premiums and service release fees), and

(c) an entire copy of Section L (fees paid by the borrower and the seller) must be given to both the borrower and the seller (the instructions permit the lender to withhold the borrower's information from Sections J and K from the seller and vice versa).

30. 24 CFR §3500.12.

31. HUD reorganized S3500.14 and clarified its definitions of payments and settlement services for purposes of Section 8.

32. 24 CFR §3500.14(b) and (d).

33. The preamble to the Regulation at 57 FR 49601 states:

> In the proposed rule, HUD stated its view that in order for the controlled business arrangement exemption in RESPA to make sense, the mere existence of a controlled business arrangement must raise a presumption of a Section 8 violation. Although relatively few comments stated a position on this matter, most of the individuals who expressed a view argued that language dealing with a presumption was difficult and inappropriate.
>
> The changes to the proposed §3500.15 that appear in the rule respond to the concerns raised in the comments about the "presumption" in the proposed rule. Based on these comments, the concept of a presumption, a legal term relating to the burden of proof in a criminal proceeding, has been deleted from the rule. Rather, the rule simply states that controlled business arrangements do not violate Section 8 of RESPA if the conditions provided in §3500.15(b) are met. The Department believes these modifications more clearly reflect the Congressional intent and provide businesses subject to RESPA with clear rules for complying with Section 8.

34. When a Controlled Business Arrangement exists, a lender may only require the use of particular appraisers, credit reporting agencies and attorneys to represent the lender's interests. Note that a mortgage broker cannot require the use of an affiliated lender for a loan. In effect, a mortgage broker cannot limit its representation to affiliated lenders. 24 CFR §3500.15(b)(2).

35. 24 CFR §3500.14(g). According to David Williamson, Director, RESPA Enforcement, payments for settlement services should be "commensurate" to payments for similar services in the mortgage banking industry and in other industries. §3500.14(g)(3) states:

> The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of Section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. The fact that the transfer of the thing of value does not result in an increase in any charge made by the person giving the thing of value is irrelevant in determining whether the act is prohibited.

36. 24 CFR §3500.4(d).

37. 24 CFR §3500.19(a).

38. **US v Graham Mortgage Corp**, 740 F2d 414 (6th Cir. 1984). HUD's repudiation of the holding in this case is found at 57 FR 49601.

39. David Williamson, the Director of the Enforcement Division, states that it is the position of his Division to seek four times the amount of any illegal payments in settlement of HUD's charges. 24 CFR §3500.19(b)(1) provides criminal penalties of one year imprisonment and/or a $10,000.00 fine for each violation of 24 CFR §§3500.14 or 3500.15. 24 CFR §3500.19(b)(2) provides a right of action to anyone paying fees to the offending service provider for three times the charge for the settlement service, plus costs and attorneys fees. The lender's charge for a loan is its points (origination and discount fees).

40. 24 CFR §3500.19(d). Please note that HUD finds it necessary to require record keeping for five years, based upon a three year limitations period. 57 FR 49605. It is not clear whether records must be kept in their original state or whether copies or electronic storage of information will be sufficient.

41. 58 FR 28478 (May 13, 1993). HUD invited comments not only on the proposed changes to Regulation X regarding junior liens loans, but also comments regarding "other technical clarifications and corrections that may be desirable for inclusion in a revised final rule." 58 FR 28479. Comments must be received by HUD by July 12, 1993.

LEGISLATIVE STATUS REPORT
ACTION ON LEGISLATION OVER THE LAST THREE MONTHS

by *Gregory L. McClelland* and *Gail A. Anderson**

HB 4001 — Amends general property tax act to prohibit property tax sale of homestead property of certain low-income senior citizens — introduced by Rep. Varga on 2/2/93 and referred to Committee on Taxation; 4/21/93, second reading with substitute; 4/29/93, third reading with substitute, passed; 5/4/93, Committee on Finance.

HB 4023 — Allows for the establishment of limited liability companies — introduced by Rep. Profit on 2/2/93 and referred to Committee on Business & Finance; 2/11/93, second reading with substitute; 2/17/93, third reading with substitute; 2/18/93, amended; 2/23/93, passed; 2/23/93, vote reconsidered, passed; 2/24/93, Committee on Corporations & Economic Development; 3/30/93, general orders with substitute; 3/31/93, third reading with substitute; 4/1/93, passed; 4/1/93, Senate substitute concurred in, ordered enrolled; 4/5/93, presented to Governor; 4/14/93, approved by Governor as Public Act No. 23.

HB 4057 — Amends occupational code to require licensees to provide agency disclosure statements — introduced by Rep. J. Young, Jr., on 2/2/93 and referred to Committee on State Affairs; 4/1/93, second reading with substitute; 5/4/93, substitute adopted; 5/5/93, third reading; 5/6/93, passed; 5/11/93, Committee on State Affairs & Military/Veteran Affairs.

HB 4109 — Creates the home inspection services act to define and prescribe certain disclosures and standards in contracts involving home inspection services — introduced by Rep. DeLange on 2/2/93 and referred to Committee on Consumers; 4/27/93, second reading with substitute; 5/4/93, third reading with substitute; 5/5/93, amended, passed; 5/6/93, Committee on State Affairs & Military/Veteran Affairs.

HB 4269 — Amends occupational code to prohibit the payment of referral fees, to provide that certain types of disclosures concerning occurrences on real property are not required, and to provide clarification regarding the employment relationships between brokers and salespersons — introduced by Rep. J. Young, Jr., on 2/17/93 and referred to Committee on State Affairs; 4/1/93, second reading; 5/4/93, third reading; 5/5/93, passed; 5/5/93, vote reconsidered, passed; 5/6/93, Committee on Commerce.

HB 4283 — Provides for limitation on minimum mills allocated by county to local school districts — introduced by Rep. Dalman on 2/17/93 and referred to Committee on Taxation; 3/11/93, second reading with substitute.

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.

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.

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.

HB 4334 — Amends tax tribunal act to allow continuation of certain appeal processes for appeals based on change in final equalization multiplier, provides for automatic appeal of subsequent years, allows certain rehearings for good cause shown — introduced by Rep. Bullard on 2/23/93 and referred to Committee on Taxation; 2/24/93, second reading with substitute; 3/10/93, third reading with substitute; 3/11/93, passed; 3/11/93, vote reconsidered, passed; 3/16/93, committee on finance; 3/18/93, general orders; 3/25/93, third reading; 3/30/93, passed; 3/30/93, ordered enrolled; 4/1/93, presented to Governor; 4/14/93, approved by Governor as Public Act No. 21.

HB 4346 — Amends general property tax act to accelerate foreclosure process for certain abandoned residential property — introduced by Rep. DeLange on 2/24/93 and referred to Committee on Taxation; 3/17/93, second reading with amendment(s); 3/24/93, third reading with amendment(s); 3/25/93, passed; 3/30/93, Committee on Finance.

HB 4392 — Amends the income tax act to eliminate $1200 cap on property tax credits — introduced by Rep. McManus on 3/2/93 and referred to Committee on Taxation.

HB 4396 — Amends mobile home commission act to require mobile home owners to allow antennae or to make available a reception tower for hook-up by tenants — introduced by Rep. Middleton on 3/2/93 and referred to Committee on Housing & Urban Affairs; 4/21/93, second reading with substitute; 5/5/93, third reading with substitute as amended; 5/1/93, passed; 5/11/93, Committee on Local Government and Urban Affairs.

HB 4415 — Amends hazardous waste management act to require applicants for construction permits who seek to use salt dome or salt bed formations or mines to obtain consent of all surface owners — introduced by Rep. Varga on 3/3/93 and referred to Committee on Conservation, Environment & Great Lakes.

HB 4416 — Amends general property tax act to prohibit close relative of local assessor from serving on board of review — introduced by Rep. Middaugh on 3/3/93 and referred to Committee on Taxation; 4/21/93, second reading; 5/4/93, third reading; 5/5/93, passed; 5/6/93, Committee on Finance.

HB 4423 — Requires credit granting institutions to file affidavit with the commissioner attesting to compliance with or exemption from the federal home mortgage disclosure act — introduced by Rep. Murphy on 3/3/93 and referred to Committee on Business & Finance; 3/11/93, second reading with amendment; 3/23/93, third reading with amendment(s); 3/30/93, amended, passed; 3/31/93, Committee on Corporations & Economic Development; 5/4/93, general orders; 5/6/93, third reading with amendment(s); 5/11/93, amended, passed; 5/18/93, Senate amendment(s) concurred in, ordered enrolled; 5/20/93, presented to Governor.

HB 4424 — Requires financial institutions to comply with requirements of federal home mortgage disclosure act — introduced by Rep. Murphy on 3/3/93 and referred to Committee on Business & Finance; 3/11/93, second reading; 3/23/93, third reading; 3/30/93, passed; 3/31/93, Committee on Corporations & Economic Development; 5/4/93, general orders; 5/6/93, third reading; 5/11/93, passed; 5/11/93, ordered enrolled; 5/13/93, presented to Governor.

HB 4442 — Amends hazardous waste management act to prohibit issuance of construction permit to any applicant convicted of violation of any environmental statute — introduced by Rep. Walberg 3/4/93 and referred to Committee on Conservation, Environment & Great Lakes.

HB 4452 — Amends highway advertising act of 1972 to allow counties to regulate location of billboards and provides other general amendments — introduced by Rep. Gagliardi on 3/9/93 and referred to Committee on Transportation.

HB 4456 — Amends general property tax act to shorten redemption periods for certain abandoned residential property — introduced by Rep. Murphy on 3/9/93 and referred to Committee on Taxation; 3/17/93, second reading with amendment(s); 3/24/93, third reading with amendment(s); 3/25/93, passed; 3/30/93, Committee on Finance.

HB 4501 — Amends solid waste management act to give local unit of government final authority over permits to build or expand landfill or incinerator, or to charge compact fee — introduced by Rep. Kukuk on 3/16/93 and referred to Committee on Conservation, Environment & Great Lakes.

HB 4503 — Amends drain code of 1956 to allow chief executive officer of each public corporation that is assessed for costs of drain to be a member of intercounty drainage board — introduced by Rep. Bryant on 3/17/93 and referred to Committee on Agriculture & Forestry.

HB 4504 — Permits reinstatement of certain dissolved downtown development authorities — introduced by Rep. Hoffman on 3/17/93 and referred to Committee on Economic Development; 3/23/93, second reading with substitute; 3/30/93, third reading with substitute; 4/1/93, amended, passed; 4/20/93, Committee on Local Government & Urban Development; 4/29/93, general orders; 5/6/93, third reading; 5/11/93, passed; 5/11/93, ordered enrolled; 5/13/93, presented to Governor.

HB 4565 — Amends general property tax act to extend property tax assessment freeze through 1993 — introduced by Rep. Bullard on 3/30/93 and referred to Committee on Taxation.

HB 4567 — Prohibits certain new exemptions under plant rehabilitation act — introduced by Rep. Bankes on 3/31/93 and referred to Committee on Taxation.

HB 4568 — Amends hazardous waste management act to prohibit location of hazardous waste incinerators within 5 miles of schools, hospitals or correctional facilities — introduced by Rep. Hammerstrom on 3/31/93 and referred to Committee on Conservation, Environment & Great Lakes.

HB 4580 — Amends property tax act to require property tax assessment freeze for 1992 and 1993 and to provide for reevaluation under certain circumstances — introduced by Rep. Willard on 4/1/93 and referred to Committee on Taxation.

HB 4585 — Allows use of funds from tax increment finance authority for cleanup of contaminated sites — introduced by Rep. Llewellyn on 4/1/93 and referred to Committee on Conservation, Environment & Great Lakes.

HB 4597 — Provides for inheritance pickup tax, which allows a state to "pickup" in revenue the amount federal death tax laws allow to taxpayer as a credit for death taxes paid to states; provides for a lien upon the estate of the decedent (including real estate) and permits transfers of property of the estate to bona fide purchasers under certain circumstances — introduced by Rep. Bullard on 4/1/93 and referred to Committee on Business & Finance; 5/4/93, second reading with substitute; 5/5/93, third reading with substitute as amended, passed; 5/5/93, vote reconsidered, passed; 5/5/93, vote reconsidered, passed; 5/6/93, Committee on Finance; 5/18/93, general orders; 5/19/93, third reading; 5/20/93, passed; 5/20/93, ordered enrolled; 5/24/93, presented to Governor.

HB 4604 — Eliminates sunset on asbestos abatement contractors licensing act and requires a post-abatement air monitoring check-introduced by Rep. Shugars on 4/1/93 and referred to Committee on Public Health; 4/29/93, second reading with substitute; 5/6/93, third reading with substitute as amended; 5/11/93, passed; 5/12/93, Committee on Local Government & Urban Development; 5/13/93, referred to Committee on Health Policy; 5/26/93, general orders; 5/27/93, rules suspended, immediate passage; 5/27/93, substitute adopted as amended, passed; 5/27/93, rules suspended, Senate substitute concurred in, ordered enrolled.

HB 4609 — Amends subdivision control act to extend sunset on plat review fees to October 1, 1998 — introduced by Rep. Brackenridge on 4/20/93 and referred to Committee on Local Government; 4/27/93, second reading; 5/4/93, third reading; 5/5/93, passed; 5/6/93, Committee on Local Government & Urban Development.

HB 4611 — Amends general property tax act to provide that true cash value of land subject to farmland and open space preservation act shall be the same whether it is classified as agricultural or developmental — introduced by Rep. Gustafson on 4/20/93 and referred to Committee on Taxation.

HB 4612 — Amends income tax act to increase maximum property tax credit after 1993 to $1,500 per year — introduced by Senator Whyman on 4/20/93 and referred to Committee on Taxation.

HB 4613 — Amends income tax act to provide for deduction of property tax credits from taxable income — introduced by Rep. Gustafson on 4/20/93 and referred to Committee on Taxation.

HB 4620 — Provides for tax sale deferrals for senior citizens — introduced by Rep. Profit on 4/20/93 and referred to Committee on Taxation.

HB 4642 — Amends worker's compensation act to revise amount of total construction cost in connection with certain separate insurance policies at construction sites from $100,000,000 to $35,000,000 — introduced by Rep. DeLange on 4/22/93 and referred to Committee on Labor.

HB 4654 — Amends Michigan natural resources trust fund act to require payment to local units of government for taxes lost due to the purchase of land by the State — introduced by Rep. Randall on 4/22/93 and referred to Committee on Conservation, Environment & Great Lakes.

HB 4666 — Amends general property tax act to exempt designated wetlands and wetlands for which a permit has been denied under the Goemaere-Anderson wetland protection act — introduced by Rep. Goschka on 4/27/93 and referred to Committee on Taxation.

HB 4676 — Amends general property tax act to prohibit assessors from including the value of a new residential dwelling for assessment purposes until the dwelling is occupied — introduced by Rep. Griffin on 4/28/93 and referred to Committee on Taxation.

HB 4678 — Amends the Goemaere-Anderson wetland protection act to require notice to municipalities when wetland permit is issued — introduced by Rep. Bullard on 4/29/93 and referred to Committee on Conservation, Environment & Great Lakes.

HB 4680 — Provides for development agreements between local units of government and property owners and sets forth procedures for reviewing such agreements — introduced by Rep. Bullard on 4/29/93 and referred to Committee on Local Government.

HB 4681 — Returns zoning control of oil and gas well drilling to townships — introduced by Rep. Bullard on 4/29/93 and referred to Committee on Local Government.

HB 4706 — Amends general property tax act to exempt low-income senior citizens from property taxes assessed on homestead for school operating purposes and provides for state reimbursement-introduced by Rep. Dobronski on 5/4/93 and referred to Committee on Taxation.

HB 4707 — Amends general property tax act to provide that title taken by tax deed is subject to special assessments and unpaid installments of special assessments—introduced by Rep. Bullard on 5/5/93 and referred to Committee on Taxation.

HB 4770 — Amends the environmental response act to add an exemption for property designated as part of a Michigan enterprise zone — introduced by Rep. Shugars on 5/11/93 and referred to Committee on Conservation, Environment & Great Lakes.

HB 4772 — Repeals requirement of certain post-abatement air monitoring checks and of certain training and accreditation required of persons responsible for asbestos abatement — introduced by Rep. Shugars on 5/12/93 and referred to Committee on Labor.

HB 4783 — Amends the underground storage tank regulatory act to provide that the Department shall not enforce the requirements of the act or the rules promulgated under the act relating to financial responsibility until September 30, 1993—introduced by Rep. Alley on 5/13/93 and referred to Committee on Conservation, Environment & Great Lakes; 5/18/93, second reading with substitute; 5/25/93, third reading with substitute, as amended, passed; 5/27/93, Committee on Natural Resources & Environmental Affairs.

HB 4784 — Amends the leaking underground storage tank act to provide that the Department shall not enforce the act against persons in compliance with the reporting requirements until September 30, 1993 — introduced by Rep. Middaugh on 5/13/93 and referred to Committee on Conservation, Environment & Great Lakes; 5/18/93, second reading with substitute.

HB 4785 — Amends the Michigan underground storage tank financial assurance act to provide that the administrator shall not accept claims under the act after May 20, 1993, to create the Michigan Underground Storage Tank Financial Assurance Authority and to authorize the use of bonds, notes, obligations or other evidences of indebtedness — introduced by Rep. Alley on 5/13/93 and referred to Committee on Conservation, Environment & Great Lakes; 5/18/93, second reading with substitute; 5/25/93, third reading with substitute, as amended, passed; 5/27/93, Committee on Natural Resources & Environmental Affairs.

HB 4787 — Revises provisions of occupational code for architects, professional engineers and professional surveyors ("design professionals") and provides for disciplinary procedures for licensed and unlicensed practitioners — introduced by Rep. J. Young, Jr., on 5/13/93 and referred to Committee on State Affairs.

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.

HB 4805 — Requires title insurance rates to be negotiable — introduced by Rep. McBryde on 5/20/93 and referred to Committee on Insurance.

SB 1 — Amends property tax act to phase in reduction in percentage of true cash value — introduced by Sen. DiNello on 1/13/93 and referred to Committee on Finance; 5/13/93, general orders with substitute; 5/13/93, third reading with substitute; 5/13/93, passed; 5/18/93, Committee on Taxation; 5/20/93, second reading with substitute; 5/27/93, third reading with substitute, passed.

SB 4 — Amends liquor control act to provide that approval by local legislative bodies shall be presumed if not received within 30 days — introduced by Sen. DiNello on 1/13/93 and referred to Committee on State Affairs & Military/Veteran Affairs; 3/23/93, general orders with substitute; 3/31/93, referred to Committee on State Affairs & Military/Veteran Affairs.

SB 8 — Amends liquor control act to provide size requirements for certain advertising signs located inside licensed premises — introduced by Sen. DiNello on 1/13/93 and referred to Committee on State Affairs & Military/Veteran Affairs; 3/9/93, general orders with amendment(s); 3/11/93, third reading with amendment(s); 3/16/93, passed; 3/16/93, Committee on Liquor Control; 4/21/93, second reading; 4/29/93, amended.

SB 146 — Amends general property tax act to gradually reduce assessment as percentage of true cash value — introduced by Sen. Carl on 1/26/93 and referred to Committee on Finance; 2/9/93, general orders with substitute; 2/10/93, third reading with substitute as amended, passed; 2/11/93, Committee on Taxation; 3/11/93, second reading with substitute; 3/30/93, substitute adopted as amended; 3/30/93, third reading with amendment(s), amended, passed; 3/31/93, vote reconsidered, substituted, passed.

SB 203 — Extends property owner liability immunity to Michigan trailways and public trails that are located in urban, suburban or rural areas — introduced by Sen. Ehlers on 1/26/93 and referred to Committee on Natural Resources & Environmental Affairs; 2/9/93, general orders with amendment(s); 2/16/93, third reading with amendment(s); 2/17/93, passed; 2/17/93, Committee on Tourism & Recreation; 3/23/93, second reading; 3/25/93, third reading; 3/30/93, passed; 4/1/93, given, ordered enrolled; 4/12/93, presented to Governor; 4/20/93, approved by Governor as Public Act No. 26.

SB 225 (same as HB 4351) — Allows abandoned railroads to be used for statewide trail system — introduced by Sen. Pridnia on 1/26/93 and referred to Committee on Natural Resources & Environmental Affairs; 2/9/93, general orders; 2/16/93, third reading; 2/17/93, passed; 2/17/93, Committee on Tourism and Recreation; 3/23/93, second reading; 3/25/93, third reading; 3/30/93, passed; 4/1/93, given, ordered enrolled.

SB 480 — Amends occupational code to require real estate salespersons and brokers to provide agency disclosure statements — introduced by Rep. Sen. Hart on 3/9/93 and referred to Committee on State Affairs & Military/Veteran Affairs.

SB 481 — Amends property tax act to provide for property tax credit based on actual taxes paid after sale or transfer of homestead property in the taxable year — introduced by Sen. Cherry on 3/9/93 and referred to Committee on Finance.

SB 504 — Amends recreational trespass act to regulate entry onto property of another person for purposes of recreational activity, to provide limitations on civil actions and certain criminal prosecutions, to provide forfeiture of certain property under certain circumstances, and to provide for the payment or restitution — introduced by Sen. Faust on 3/17/93 and referred to Committee on Natural Resources & Environmental Affairs; 5/18/93, general orders; 5/19/93, third reading; 5/20/93, passed; 5/20/93, Committee on Conservation, Environment & Great Lakes.

SB 505 — Provides for forfeiture of certain property for violation of recreational trespass act under certain circumstances-introduced by Sen. Gast on 3/17/93 and referred to Committee on Natural Resources & Environmental Affairs; 5/18/93, general orders; 5/19/93, third reading; 5/20/93, passed; 5/20/93, Committee on Tourism & Recreation.

SB 507 — Prohibits city zoning ordinances preventing residents from giving or receiving music lessons in own home — introduced by Sen. Faxon on 3/17/93 and referred to Committee on Local Government & Urban Development; 4/29/93, general orders with substitute; 5/4/93, third reading with substitute; 5/6/93, passed; 5/6/93, Committee on Local Government.

SB 509 — Amends township rural zoning act to prohibit zoning ordinances preventing residents from giving or receiving music lessons in own home — introduced by Sen. Honigman on 3/17/93 and referred to Committee on Local Government & Urban Development; 4/29/93, general orders with substitute; 5/4/93, third reading with substitute; 5/6/93, passed; 5/6/93, Committee on Local Government.

SB 510 — Amends county rural zoning enabling act to prohibit zoning ordinances preventing residents from giving or receiving music lessons in own home — introduced by Sen. Honigman on 3/17/93 and referred to Committee on Local Government & Urban Development; 4/29/93, general orders with substitute; 5/4/93, third reading with substitute; 5/6/93, passed; 5/6/93, Committee on Local Government.

SB 512 — Amends solid waste management act to revise deadline date for compostable materials in solid waste landfill — introduced by Sen. Pollack on 3/18/93 and referred to Committee on Natural Resources & Environmental Affairs; 3/23/93, General Orders; 4/1/93, referred to Committee on Natural Resources & Environmental Affairs.

SB 564 — Amends liquor control act to allow transfer of location of SDD or SDM licenses with drive-through services — introduced by Sen. Schwarz on 4/1/93 and referred to Committee on State Affairs & Military/Veteran Affairs; 5/27/93, general orders.

SB 573 — Amends subdivision control act to revise sunset provisions — introduced by Sen. Gast on 4/21/93 and referred to Committee on Local Government & Urban Development.

SB 589 — Amends the real estate section of the occupational code to revise certain continuing education requirements, to impose prohibitions on certain fee arrangements and to provide in certain instances for the creation of a lien on commercial property for commissions owed — introduced by Sen. DiNello on 4/28/93 and referred to Committee on State Affairs & Military/Veteran Affairs.

SB 596, 598-601 — Amends various statutes to provide for Proposal "A" implementation — introduced by Sen. DeGrow and Sen. Emmons on 5/4/93 and referred to Committee on Finance.

SB 603 — Amends the real estate section of the occupational code to preclude liability for failing to make certain disclosures concerning occurrences on real property and to provide for clarification regarding employment relationship between brokers and salespersons — introduced by Sen. Pridnia on 5/4/93 and referred to Committee on State Affairs.

SB 644 — Provides general amendments to Michigan underground storage tank financial assurance act, provides for a gradual decrease in the amounts available per claim, and provides that no funds will be available after December 23, 1998—introduced by Sen. Ehlers on 5/13/93 and referred to Committee on Natural Resources & Environmental Affairs.

SB 645 — Provides general amendments to leaking underground storage tank act — introduced by Sen. Ehlers on 5/13/93 and referred to Committee on Natural Resources & Environmental Affairs.

SB 651 — Provides for storm water discharge permits authorizing the discharge of waste water to the surface waters of the state, and provides for the collection of fees for such permits — introduced by Sen. Ehlers on 5/19/93 and referred to Committee on Natural Resources & Environmental Affairs.

SB 662 — Amends income tax act to increase property tax credit limit, and to provide for an annual adjustment to that limit based upon the consumer price index—introduced by Sen. Dunaskiss on 5/27/93 and referred to Committee on Finance.

RECENT DECISIONS

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

Kratze v Independent Order of Odd Fellows, ___ Mich ___; NW2d ___ (No. 919558, April 28, 1993)

Remedies — Encroachment

The question before the court was the proper remedy for dealing with a 1.2 foot encroachment of a building onto real property. The trial court had ordered the encroachment removed and ordered substantial damages. The Court of Appeals had affirmed the order to remove the encroachment, but had substantially decreased the damages. The Supreme Court reversed the injunction and reduced further yet the damages to which the Plaintiff would be entitled.

In fashioning a remedy where a structure encroaches onto the property of another, the Supreme Court held that the trial court should balance the relative hardship to the parties and the equities between them. If the relief sought is disproportionate to the nature and extent of the injury sustained, the court should not interfere, but rather leave the parties to some other remedy. The court noted that it had an interest in avoiding judicial approval of private eminent domain by the encroacher, but also an interest in preventing extortion by the encroachee. In the case at bar, an encroachment of 1.2 feet was found to be slight, and it was found that because of the age of the structure, removal of the encroachment could cause the building to collapse. The court therefore held that the order to remove the encroachment should be vacated.

In assessing damages for trespass, the court first looked to the question of whether the injury was permanent or temporary. Physical permanence was not the sole test. The trespass must also be "legally permanent" in the sense that the court would not require its removal. Once it was determined that the injury was permanent, the proper measure of damages was the diminution in value of the property, its value without the encroachment less its value with that burden. Where the purchase price of the land was not changed once the encroachment was discovered, the difference in value was zero. The only recovery that could be had, therefore, was the actual value of a 1.2 foot strip.

Energetics, Inc v Whitmill, 422 Mich 38; ___ NW2d ___ (1993)

Dormant Minerals Act —
Reversion of Leasehold Interest

The question before the Michigan Supreme Court was whether certain severed oil and gas interests were properly "deemed abandoned" under the Dormant Minerals Act, MCLA 554.291 **et seq**; MSA 26.1163(1) **et seq**. The disputed interests were leased in 1951 to the Sun Oil Company for a primary term of 10 years. The primary terms expired and in 1978 similar leases were entered into with the defendants in this case. Oil production on the disputed parcels began in 1985 and an interpleader action was thereafter begun to determine the proper payment of the royalties. The trial court ruled that when each of the leases expired in 1961 the oil and gas interest was "transferred" back to the owners and a new 20 year period began. The Court of Appeals reversed. The Supreme Court reversed the Court of Appeals, reinstating the holding of the trial court. The Supreme Court declined to adopt the reasoning suggested by the Plaintiffs that the existence of a lease of mineral rights would itself prevent the running of the 20 year period during the term of the lease. In such case, speculators could circumvent the act simply by recording long terms leases on the property. The court rather reasoned that the reversion was itself a conveyance, and so long as the reversion occurred in the 20 year period, that was a sufficient transfer to reinitiate the Act's 20 year clock.

Price v Long Realty, Inc ___ Mich App ___; ___ NW2d ___ (No. 120698, February 10, 1993)

Real Estate Brokers — Consumer Protection Act

In this case the Court of Appeals settled questions as to the scope of **Attorney General v Diamond Mortgage Co** 414 Mich 603; 327 NW2d 805 (1982). In that case the Supreme Court had held the Consumer Protection Act applicable to a mortgage broker. In **Kekel v Allstate Ins Co** 144 Mich App 379, 374 NW2d 455 (1985) the Court had held that the **Diamond** holding did not apply to a no fault insurer whose conduct was subject to regulation as a licensee. It has been argued in subsequent cases that real estate brokers fall within the **Kekel** exception rather than the **Diamond** rule. In the instant action, the Court rejected that argument and held that the conduct of the broker was not protected under the Act. The test was whether the specific actions that were the subject of the complaint were regulated by the act. Since the act did not authorize non-disclosure, the Brokers were not protected.

Feister v Bosack, 198 Mich App 19; ____ NW2d ____ (1993)

Landlord/Tenant — Duty to control tenant's dog

An action for dog bite was brought against the owner of property for the indiscretion of his tenant's dog. The injury did not occur on the rented premises. The landlord had long known about the existence of the dog, without expressly permitting or forbidding it. The landlord's only knowledge of any actual danger from the dog was obtained two days before the incident which gave rise to this action. The Plaintiff sued both the landlord and the tenant under the dog bite statute, MCL 287.351, MSA 12.544, arguing that it created strict liability for the actions of the dog. The trial court granted summary disposition for the landlord.

On appeal, the Court of Appeals affirmed the trial court, distinguishing the holding of the court in **Szdodzinski v Griffin** 171 Mich App 711; 431 NW2d 51 (1988), because in that case the landlord was held liable for the actions of the dog which occurred on the leased premises. Two members of the court framed the court's holding in quite broad terms, arguing that the landlord has no duty to inspect the premises to discover the existence of the tenant's dangerous animal. The third member of the panel would base his holding on the more limited premises that, with two days notice of a potential problem with the dog, there was not sufficient time on a month-to-month lease to take any action to remove the dog.

Arco Industries Corporation v American Motorists Insurance Co, 198 Mich App 335; ____ NW2d ____ (1993)

Insurance Coverage for chemical spill

The MDNR brought an action for remediation of a chemical contamination of a site owned by Plaintiff. Plaintiff brought this action for declaratory judgment against its liability insurance carrier, arguing that it had a duty to defend the suit brought by the MDNR. The trial court granted summary disposition in favor of the Plaintiffs, holding that the carrier owned a duty to defend. The Court of Appeals reversed.

The insurance policy defined an "occurrence" an accident where the property damage was "neither expected nor intended from the standpoint of the insured." The evidence clearly showed that the Plaintiff's employees had intentionally deposited toxic matter into a lagoon in the rear of the property. The court rejected the argument that it was not foreseeable that the some part of that toxic matter could seep into the ground water. The Court found, therefore, no duty to defend.

Kipka v Fountain, ____ Mich App ____; ____ NW2d (No. 148957, March 1, 1993)

Adverse possession — retaining wall

The dispute before the court concerned a five foot strip of land about a hundred feet long. Claim was made against the record title holder based on adverse possession and acquiescence. The Court noted that at the root of both claims of adverse possession and acquiescence is the statute of limitations for recovery of real property. The question before the court was when the 15 year period began to run and which party had the duty to prove the exact date of commencement. On the facts of the case, the court held that simply knowing of a dispute over ownership and intending that the property be one's own does not begin the running of the fifteen year period. It requires, rather, some overt act of ownership and possession, putting the actual owner on notice of the claim. In the case at bar, the action was brought within a very short time of the arguable end of the 15 year period. Where the claimant could not prove the exact date, it was held that he had failed in his burden of proof and adverse possession was denied.

Charter Township of Plymouth v Department of Social Services, ____ Mich App ____; ____ NW2d ____ (No. 136270, March 1, 1993)

Zoning — Adult Foster Care — Preemption of local regulation

The question before the Court of Appeals was whether the Federal Fair Housing Act Amendment of 1988 to Title VIII of the Civil Rights Act of 1968, 42 US 3601, **et seq** preempted the operation of the Michigan Zoning Enabling Acts and the Adult Foster Care Licensing Act, MCL 400.701 **et seq**, MSA 16.610 **et seq**.

In 1989, DSS had issued a license to operate an adult foster care facility within the borders of the Plaintiff Township. In doing so, it did not comply with the notice requirements of the statute. It claimed that it was not required to do so because the local acts had been preempted by the Fair Housing Act. The Court of Appeals affirmed the trial court in enjoining DSS from licensing without following the acts. It held that the FHA did not preempt local rules, notwithstanding its broad remedial purposes.

CONTINUING LEGAL EDUCATION

by
Lawrence D. McLaughlin, Chairperson
and
Arlene R. Rubinstein, Administrative Assistant

EIGHTEENTH ANNUAL SUMMER CONFERENCE
Grand Traverse Resort • July 21-24, 1993

Limited accommodations are still available for registrants to attend the Eighteenth Annual Summer Conference at the Grand Traverse Resort. The conference entitled "Current Developments and Practice Tips 1993", will open with our Welcoming Cocktail Party Wednesday, July 21 and end Saturday, July 24 after the "Hot Tips" portion of our seminar.

Rates at the Grand Traverse Resort:	Hotel (single/double) $145	One Bedroom Condo (sleeps 4) $185
	Tower (single/double) $175	Two Bedroom Condo (sleeps 6) $260

Rates quoted do not include state and local taxes, which are 6%. No charge for children occupying the same room.

Cancellation Policy: Your deposit will be refunded if cancellation is made more than 72 hours prior to your arrival date.

Nyal D. Deems of Varnum, Riddering, Schmidt and Howlett has chosen a distinguished group of speakers to discuss these timely and informative topics of interest to all real estate attorneys. Thursday morning Patrick E. Mears of Dykema Gossett will focus on recent decisions rendered by federal and state courts dealing with important issues of bankruptcy and creditor's rights law. David W. Berry will follow with a discussion on recent developments in regulatory takings law and inverse condemnation. Closing the morning's session will be Michael Moore, Deputy Director of the Michigan Department of Natural Resources who will speak on the Past, Present and Future of the Department of Natural Resources.

Friday morning will begin with Jon F. DeWitt of Varnum, Riddering, Schmidt & Howlett speaking on developments in the area of lender liability. Philip Grashoff with Honigman Miller Schwartz and Cohn will provide an update of developments under Act. 307. Robert R. Nix of Kerr, Russell and Weber will conclude Friday morning's lectures with State of the Law.

The popular "Hot Tips" portion of the conference will begin Saturday morning, with the following:

The Amendment to the Statue of Frauds — Promises to Loan from Institutions
Gary A. Taback of Sommers, Schwartz, Silver & Schwartz

Prepackaged Chapter 11 Workouts
Robert A. Hendricks — Varnum, Riddering, Schmidt & Howlett

Status of Leases in Foreclosure: Vicki R. Harding of Pepper, Hamilton & Scheetz

Market Rate Renewal Options In Leases
Dennis M. Gannan of Dykema Gossett

ADA Developments and Lease Provisions with Respect to ADA Requirements
Philip A. Erickson of Thrun, Maatch and Nordberg

Limited Liability Companies: Steven R. Heacock of Warner, Norcross & Judd

Water Law Update: Nyal D. Deems of Varnum, Riddering, Schmidt & Howlett

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

HOMEWARD BOUND

The 1993-94 Homeward Bound series will begin in Grand Rapids on Tuesday, October 26, 1993 at the L. V. Eberhard Center, 301 W. Fulton, Grand Rapids and Thursday, October 28, 1993 in Troy at the MSU Management Education Center, 811 W. Square Lake Road. Dennis M. Gannan of Dykema Gossett has planned an exciting program! The October seminar is entitled "A Real Estate Lawyer's Guide Through the Maze of Non-Consensual Liens." Other topics to be discussed include: Understanding what is possible in Restructuring Real Estate Loans in Chapter 11; Regulation of Residential Transactions, Subdivision Control Act/Site Condominiums; Real Estate Tax Appeals/Primer on Valuation of Commercial Property; How to get what you need from a Title Company; Inverse Condemnation and Zoning Litigation and Resolving Residential Construction Disputes. A listing of dates, speakers and topics can be found elsewhere in this issue.

1994 WINTER CONFERENCE DISNEY WORLD

Peter Nathan of Jacob and Winegarden is planning a great conference to be held at the Grand Floridian March 9-12, 1994. At this time we are working with Kathie Morinelli at Pointe Travel in securing airline reservations. Please call Kathie at Pointe Travel 313-884-3172 or write Pointe Travel, 20311 Mack Ave., Grosse Pointe, MI 48236.

Rooms have been reserved at the Grand Floridian in the Disney Complex at $210 per night plus 10 percent tax. The Grand Floridian will be the Conference headquarters. All seminars and meal functions will be held at this location.

For more information on any Section activity please call, Arlene Rubinstein, Administrative Assistant at 313-644-7378.

COURSE CALENDAR

Set forth below is a schedule of continuing legal education courses sponsored or co-sponsored by the Real Property Law Section through September 1993.

Key: HB = Homeward Bound
ICLE = Courses co-sponsored by the Institute of Continuing Legal Education

DATE	LOCATION	PROGRAM	TOPIC
July 21-24	Grand Traverse Resort	Summer Conference	Current Developments and Practice Tips 1993
Sept. 29	Grand Rapids	Annual State Bar Meeting	Real Property Updates

STATE BAR OF MICHIGAN REAL PROPERTY LAW SECTION

EIGHTEENTH ANNUAL SUMMER CONFERENCE

CURRENT DEVELOPMENTS AND PRACTICE TIPS 1993
GRAND TRAVERSE RESORT • ACME, MICHIGAN

THURSDAY, JULY 22, 1993

9:00 A.M. - Noon

Introductions:	Lawrence D. McLaughlin, Esq. CLE Chairperson Honigman Miller Schwartz and Cohn
General Information:	Nyal D. Deems, Esq. Program Coordinator Varnum, Riddering, Schmidt & Howlett
Bankruptcy/Debtor-Creditor Update	Patrick E. Mears, Esq. Dykema Gossett
Regulatory Takings	David W. Berry, Esq. Butzel Long
The Department of Natural Resources — Past, Present and Future	Michael D. Moore Deputy Director of the Department of Natural Resources

FRIDAY, JULY 23, 1993

9:00 A.M. - Noon

Update of Environmental Issues With Respect to Lender Liability	Jon F. DeWitt, Esq. Varnum, Riddering, Schmidt & Howlett
Update of Environmental Issues with Respect to Act 307	Philip A. Grashoff, Jr., Esq. Honigman Miller Schwartz and Cohn
State of the Law	Robert R. Nix, II, Esq. Kerr, Russell & Weber

EIGHTEENTH ANNUAL SUMMER CONFERENCE

CURRENT DEVELOPMENTS AND PRACTICE TIPS 1993

(Continued)

SATURDAY, JULY 24, 1993

8:30 A.M. - 11:30 A.M.

"HOT TIPS"

The Amendment to the Statue of Frauds – Promises to Loan from Institutions
Gary A. Taback, Esq. – Sommers, Schwartz, Silver & Schwartz

Prepackaged Chapter 11 Workouts
Robert A. Hendricks, Esq. – Varnum, Riddering, Schmidt & Howlett

Status of Leases in Foreclosure
Vicki R. Harding, Esq. – Pepper, Hamilton & Scheetz

Market Rate Renewal Options in Leases
Dennis M. Gannan, Esq. – Dykema Gossett

ADA Developments and Lease Provisions with Respect to ADA Requirements
Philip A. Erickson, Esq. –Thrun, Maatch and Nordberg, PC

Limited Liability Companies
Steven R. Heacock, Esq. – Warner, Norcross & Judd

Water Law Update
Nyal D. Deems – Varnum, Riddering, Schmidt & Howlett

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EIGHTEENTH ANNUAL SUMMER CONFERENCE
REGISTRATION FORM

Name ______________________________

Address ______________________________

City ______________ State ______ Zip ________ Phone __________

FEES: Section members $200   Non-Section members $225

Make checks payable to: Real Property Law Section and Mail to: P.O. Box 473, Birmingham, MI 48012.

For further information, call Arlene Rubinstein at 313-644-7378.

STATE BAR OF MICHIGAN
REAL PROPERTY LAW SECTION
CONTINUING LEGAL EDUCATION

1993-1994 HOMEWARD BOUND SERIES

Grand Rapids (GR)	Troy (T)
L.V. Eberhard 301 W. Fulton Grand Rapids 3:00-6:00 p.m.	Management Education Ctr. Michigan State University 811 W. Square Lake Road Troy 3:30-6:30 p.m.

October 26, 1993 (GR) October 28, 1993 (T)
A REAL ESTATE LAWYER'S GUIDE THROUGH THE MAZE OF NON-CONSENSUAL LIENS
Timothy J. Curtin of Varnum, Riddering, Schmidt & Howlett
Lawrence M. Dudek of Miller Canfield

November 16, 1993 (GR) November 18, 1993 (T)
UNDERSTANDING WHAT IS POSSIBLE IN RESTRUCTURING REAL ESTATE LOANS IN CHAPTER 11 - A CASE APPROACH
Patrick E. Mears of Dykema Gossett
Edgar C. Howbert of Dickinson, Wright, Moon, VanDusen & Freeman

December 7, 1993 (GR) December 9, 1933 (T)
REGULATION OF RESIDENTIAL TRANSACTIONS
Howard A. Lax of NBD Bank, N.A.
James C. Conboy, Jr. of Bodman, Longley & Dahling

January 18, 1994 (GR) January 20, 1994 (T)
SUBDIVISION CONTROL ACT/SITE CONDOMINIUM
Kevin M. Kohls of Honigman Miller Schwartz and Cohn
C. Kim Shierk of Dykema Gossett

February 22, 1994 (GR) February 24, 1994 (T)
REAL ESTATE TAX APPEALS/PRIMER ON VALUATION OF COMMERCIAL PROPERTY
Carl Rashid, Jr. of Butzel Long

1993-1994 HOMEWARD BOUND SERIES

(Continued)

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