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Finance, Real Estate & Bankruptcy News

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CFPB CONTINUES CRACKDOWN ON REAL ESTATE KICKBACKS

-Steve Owen

Referrals are common in the real estate industry. Brokers and builders refer clients to mortgage lenders. Lenders refer clients to title companies. And so on. The real estate referral ecosystem is critical to moving real estate transactions along efficiently and effectively. Most clients need introductions to qualified professionals to assist them in what is often the most complicated financial transaction they will ever be involved in.

But referrer beware. Demanding something in return can cost you.

On September 30, 2014, the Consumer Financial Protection Bureau ("CFPB") ordered Lighthouse Title ("Lighthouse"), a Michigan title insurance agency, to pay $200,000 for illegal quid pro quo referral agreements. According to a press release issued by the CFPB, Lighthouse violated the Real Estate Settlement Procedures Act, which prohibits, among other things, providing something of value to any person with an agreement or understanding that the person will refer real estate settlement services.

The "kickback" agreement at issue involved Lighthouse entering into marketing services agreements ("MSAs") with companies such as real estate brokers with the expectation that mortgage closing and title insurance business would be referred to Lighthouse. The CFPB determined that fees paid by Lighthouse under the MSAs - ostensibly for marketing services - were actually set by determining the number of referrals Lighthouse received from the companies, and that companies on average referred much more business to Lighthouse if they had an MSA in place.

In addition to the $200,000 fine, Lighthouse is required to terminate MSAs with companies in a position to refer business to it, and is prohibited from entering into new MSAs with such companies.

This action is part of a continuing effort by the CFPB to crack down on illegal kickback agreements. Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 created and authorized the CFPB to implement, examine for compliance with, and enforce federal consumer financial law.

Under Dodd Frank, the CFPB has regulatory, supervisory, and enforcement authority of depository institutions and credit unions with total assets of more than $10 billion, as well as certain non-banks, regardless of size, including mortgage companies, originators, brokers, and servicers. If the CFPB detects a possible violation by a smaller financial institution, it will refer that violation to the institution's prudential regulator for enforcement.

The CFPB has recently stepped up enforcement actions to prevent real estate kickbacks. Just a few examples include:

- A New Jersey title services company that was fined $30,000: http://files.consumerfinance.gov/f/201406_cfpb_consent-order_stonebridge-title-services.pdf
- An Alabama real estate firm that was fined $500,000: http://files.consumerfinance.gov/f/201405_cfpb_consent-order_realty-south-and-title-south.pdf

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- A Missouri lender that was fined $81,076: http://files.consumerfinance.gov/f/201401_cfpb_consent-order_fidelity.pdf
- A Connecticut company that self-reported a violation and was ordered to pay $83,000: http://files.consumerfinance.gov/f/201402_cfpb_consent-order_first-alliance.pdf

So what can companies in the real estate industry do to remain in compliance and avoid penalties and liability? For starters, have any fee (or other consideration) paying agreements that your company has in place reviewed by an attorney to make sure it doesn't violate the law. Some arrangements may be permissible if proper disclosures are made to the consumer. Also, have written policies and procedures in place and train employees at all levels on these issues. Periodically audit - either by an internal team or an outsourced expert - your practices to ensure continued compliance.

The CFPB is actively investigating illegal kickback schemes. If you have any questions about these and other compliance issues, please contact your Foster Swift lawyer.

COLLECTION ACTIONS GONE AWRY: MICHIGAN COURT OF APPEALS UPHOLDS ATTORNEY'S FEE AWARD AGAINST PLAINTIFF FOR "FRIVOLOUS" COLLECTION EFFORTS

- Patricia Scott

A lesson that many plaintiffs learn - the hard way - is that winning a judgment in a lawsuit is not the end of the battle. In many ways it's just the beginning. The judgment simply gives license to pursue recovery of damages. And obtaining recovery can often be as, if not more, difficult than obtaining the judgment itself. Sometimes, as in a decision that was recently upheld by the Michigan Court of Appeals, judgment creditors can find themselves on the wrong side of collection efforts by adopting an overzealous approach to collect their judgment.[1]

THE TRIAL COURT

The underlying case involved a lawsuit brought by an individual ("Plaintiff") against his uncle ("Defendant") in which the Plaintiff obtained a judgment in the amount of $100,000. In his efforts to collect the judgment, Plaintiff attempted to garnish the $100,000 from a limited liability company called Total G Services, LLC ("TGS"). Plaintiff's cousin owns TGS and is also its resident agent. TGS filed garnishee disclosures stating that it was not indebted to Defendant, did not possess or control Defendant's property, and Defendant was not an employee. After some discovery and motion practice in connection with the garnishment action, Plaintiff took no further action in the proceeding.

Over a year later, Plaintiff again attempted to garnish the $100,000 plus interest and costs, from TGS. TGS's resident agent refused service because the writs of garnishment misspelled his name. Plaintiff then obtained a default judgment against TGS after it failed to file its garnishee disclosures.

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TGS then filed its garnishee disclosures (stating facts consistent with those asserted in the initial action) and filed a motion to set aside the default and default judgment. It argued that the resident agent believed that service of the writs of garnishment was not proper because his name was misspelled and that corrected papers would subsequently be served. TGS also asserted two meritorious defenses to the underlying garnishment action - namely that it was not indebted to Defendant because he was neither an owner nor employee of TGS. TGS also argued that setting aside the default and default judgment was appropriate because:

> (1) plaintiff was not prejudiced by the short delay, (2) this case was the result of a family feud and personal vendetta which had existed for years, (3) plaintiff and the underlying defendant, his uncle, were in collusion against garnishee defendant, and (4) it would be manifestly unjust to hold garnishee defendant liable on defendant's judgment debt considering the strength of its meritorious defenses and its showing of good cause.

Plaintiff opposed the motion, and submitted affidavits from Defendant, as well as other family members, asserting that Defendant was, in fact, an owner of TGS.

The trial court granted TGS's motion to set aside the default and default judgment. Thereafter, following discovery, TGS filed a motion for summary disposition, arguing that there was no genuine issue of material fact that Defendant was neither a member nor employee of TGS and, thus, it was not required to make any garnishment payments to Plaintiff on behalf of the Defendant. TGS also requested that the trial court impose sanctions against Plaintiff, arguing that Plaintiff's action was frivolous, as its primary purpose was to perpetuate a family feud and there was no basis to believe that Defendant was an owner or employee of TGS. The trial court granted the motion for summary disposition, and concluded that the action was frivolous and took the issue of sanctions under advisement. It subsequently granted TGS's request for $10,800 in attorney fees.

THE APPEAL

Plaintiff appealed all aspects of the lower court's decision to: (1) set aside the default and default judgment, (2) grant the motion for summary disposition, and (3) award attorney fees. The Michigan Court of Appeals upheld the lower court's ruling.

It found that TGS established "good cause" for setting aside the default and default judgment, stating that TGS's resident agent's belief that service was improper constituted sufficient good cause, in that it was a substantial defect or irregularity in the proceeding, or a reasonable excuse, in accordance with applicable standards established by case law. The fact that TGS had timely complied with its obligation to file garnishee disclosures when a writ of garnishment was first served in the case also weighed in favor of setting aside the default and default judgment. Finally, the defenses asserted by TGS in its motion to set aside, namely that Defendant was neither an owner nor employee, would be absolute if proven.

Next, the Court of Appeals reviewed, and upheld, the trial court's decision to grant TGS's motion for summary disposition. The Court of Appeals analyzed the Michigan Limited Liability Company Act, in particular the requirements related to the manner in which a person may be admitted as a "member" of an LLC. It found, in accordance with TGS's arguments, that Defendant never became a member of TGS. No corporate formation or other documents, tax returns, or bank statements ever identified Defendant as a member.

Moreover, the fact that TGS's sole member had made payments to Defendant in the past - payments which Plaintiff characterized as "distributions" from the LLC - had

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no relevance because there was no evidence that Defendant was ever a member and, as a result, could not have received "distributions." Testimony and affidavits offered by Plaintiff as to Defendant's membership interest were found to be unsupported by any legal documents and were inconsistent with applicable LLC statutory law. The Court of Appeals also found that there was no evidence presented by Plaintiff that Defendant was an employee of TGS.

The Court of Appeals then considered and rejected Plaintiff's argument that Michigan's Traxler-McCauley-Law-Bowman Bingo Act (Bingo Act), MCL 432.118, did not prohibit "a person with a gambling-related conviction from owning an equitable membership interest in a licensed charitable gaming entity." Because Defendant was not a "member" of the LLC, the Court of Appeals held that the Bingo Act's dictates were irrelevant.

Plaintiff's final argument on appeal was that his garnishment action was not "frivolous" and, thus, the award of attorney's fees was not warranted. MCL 600.2591 defines an action as frivolous - giving rise to costs and fees - as one where at least one of the following conditions is met:

i. The party's primary purpose in initiating the action or asserting the defense was to harass, embarrass, or injure the prevailing party.
ii. The party had no reasonable basis to believe that the facts underlying that party's legal position were in fact true.
iii. The party's legal position was devoid of arguable legal merit.

The trial court concluded that Plaintiff's primary purpose in the action was to harass TGS, and also that Plaintiff had no reasonable basis to believe that TGS was indebted to Defendant. The Court of Appeals agreed and held that the trial court did not abuse its discretion by concluding that Plaintiff's garnishment action was frivolous. Finally, the Court of Appeals upheld the trial court's award of $10,800 to TGS.

THE LESSONS

There are a few lessons that litigants, or potential litigants, can learn from this case:

1. **Obtaining a judgment is just the first step to recovery.** Once a party obtains a judgment, it becomes a judgment creditor - but the judgment is simply a piece of paper (albeit an important one) that orders the defendant to pay a sum of money. Smart, strategic collection activity must then follow.

2. **There are risks that judgment creditors face during collection.** Indeed, there can be serious consequences for violating bankruptcy and debtor-protection laws. As we learned in this case, even taking an action as routine as garnishment must be done carefully.

3. **It's important to work with experienced counsel.** Beyond mitigating the risks of collection, increasing the likelihood of collection success often hinges on choosing the right creditor's attorney. Engaging an attorney who knows how to assess a case, conduct appropriate discovery, and implement a strategy that may involve negotiation and proceedings supplemental to judgment, such as garnishment, is critical to turning a judgment into recovery.

If you have any questions about this case, or creditor's rights issues in general, please contact a Foster Swift collection attorney.

[1]*Haddad v Haddad and Total G Services, LLC, unpublished opinion per curium of the Court of Appeals, decided Sept 23, 2014 (Docket Nos 315686 and 316492).*

NEW LAW EXPANDS PROPERTY TAX "UNCAPPING" EXEMPTIONS FOR FAMILY COTTAGE TRANSFERS

-Ben Price

The cottage - it's a place where memories are made, special events are hosted, and traditions are sustained for many Michigan families. One of the challenges families often face, however, is keeping the family cottage in the family, as it is not always feasible to do so from a financial standpoint.

Michigan has recently taken action to make cottage succession planning a bit easier, and less expensive. Public Act 310 of 2014 was signed into law by Governor Snyder on October 9, 2014. The bill expands current law (Public Act 497 of 2012), which prevents the uncapping of property taxes on certain transfers of residential property between family members.

The new law features a few important changes. The first relates to the definition of which family members can participate. The prior law - which remains in effect for transfers made before December 31, 2014 - exempted transfers between individuals related by "blood or affinity to the first degree." One of the new law's major changes (and improvements) is clarifying what that ambiguous phrase means.

The new law - for transfers taking place on or after December 31, 2014 - defines an eligible transferee as a person related to the owner or the owner's spouse's mother, father, sister, brother, daughter, adopted daughter, son, adopted son, or grandchild.

The definition of transferor has also been expanded in the new law to include properties transferred by a trust or will. This will allow property to transfer upon the death of the current owner without uncapping the property taxes. The following types of transfers will not result in uncapping:

- A transfer of property into a trust by the trust settlor or the settlor's spouse, as long as the only present beneficiary or beneficiaries are eligible relative transferees as identified above (i.e., mother, father, daughter, son, etc.).
- A distribution of property from a trust, as long as the recipients of the property are all eligible relatives.
- A change in the sole present beneficiary of a trust that owns property, as long as the new beneficiaries are eligible relatives.
- A distribution of property pursuant to a will or by intestate succession to an eligible relative.

Finally, while transfers as described above will prevent the uncapping of property taxes, the exemption only applies if the property is not used for any commercial uses following the transfer. A question that arises, however, is what constitutes "commercial use"? The statute does not define the term. Some activity - opening a bed and breakfast, for example - is almost certainly commercial. Less clear is whether renting will be considered commercial. It's impossible to know at this point, but it may depend on the extent of rental activity. If the cottage is being used primarily as a rental and substantial income is being generated, then that may be considered commercial, whereas occasional rental activity may not be.

There's a verification mechanism in the new law that will help the Michigan Department of Treasury enforce the rules regarding commercial use. A local assessor can request verification of compliance with the non-commercial use requirements, and failure to comply with such a request within 30 days will result in a $200 fine.

There is some ambiguity in the law, and more questions will certainly arise, but by and large this law is good news for cottage owners in Michigan. If you have questions about the law, or need help with cottage succession planning, please contact a Foster Swift real estate attorney.

FOSTER SWIFT NAMED TO BEST LAW FIRMS 2015

Foster Swift has been included in the U.S. News Media Group and *Best Lawyers*® 2015 "Best Law Firm" rankings. Foster Swift was rated a Tier 1 law firm in 24 practice areas including Banking Finance in Lansing.

The U.S. News – *Best Lawyers*® "Best Law Firms" rankings are based on a rigorous evaluation process that includes the collection of client and lawyer evaluations, peer review from leading attorneys in their field, and review of additional information provided by law firms as part of the formal submission process. To be eligible for a ranking, a law firm must have at least one lawyer who is included in *Best Lawyers*® as part of the annual peer review assessment. For more information on *Best Lawyers*® and "Best Law Firms", please visit http://bestlawfirms.usnews.com.

To see the entire list of Foster Swift's rankings, visit http://bestlawfirms.usnews.com/profile/foster-swift-collins-smith-pc/rankings/4331

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The Michigan Bankruptcy Blog provides case law updates from the Bankruptcy Courts for the Western and Eastern Districts of Michigan.

The decisions of these courts have a big impact on debtors, creditors, and the trustees who represent bankruptcy estates, and the case law is constantly evolving. We've created this blog to discuss new cases that may be helpful to parties and bankruptcy practitioners. If you have questions or would like more information about any of the cases on the blog, please feel free to contact Patricia Scott at pscott@fosterswift.com or Laura Genovich at lgenovich@fosterswift.com.

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