Case Evaluation and Judicial Foreclosure Do Not Mix: Proceed with Caution

June 27, 2014

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LACHES, June 2014

In commercial collection lawsuits, secured creditors and debtors are regularly ordered to go through the case evaluation process, even when claims for both money damages and equitable relief – such as foreclosure or claim and delivery – are pending.

However, case evaluation in lawsuits between creditor plaintiffs and debtor defendants raises several distinct concerns. First, it complicates the foreclosure of the liens and the creditor's ability to enforce the terms of the loan documents. Second, it distorts the risks for the parties because the threat of case evaluation sanctions is one-sided, as the loan documents usually provide for fee-shifting in favor of the creditor. Finally, and most important, it is an ineffective tool for resolving such disputes and therefore a waste of the parties' and evaluators' resources.

Accordingly, creditor litigants should approach case evaluation cautiously. In the long term, consideration should be given to amending the Michigan Court Rules to pre-emptively exclude from case evaluation lawsuits with mortgage foreclosure claims, and those with contract claims that have attorney fee-shifting provisions that only flow in one direction.

Case Evaluation: History and Practice in Michigan

As Michigan litigators are intimately familiar, case evaluation is an alternative dispute resolution process in which a panel of three attorneys provides a *monetary* evaluation of the case after hearing from counsel for the parties. The evaluation award is intended to approximate the present settlement value of the case.

The goal of case evaluation is to "encourage settlement" and deter "protracted litigation." After being advised of the award, the parties have the opportunity to accept or reject the award. If both parties accept the award, the case is resolved, and after a window for the liable party to pay the sum, a monetary judgment is entered in the amount of the award. If a party rejects the award, the rejecting party risks being penalized if it does not improve upon the award at trial or via judgment.

The threat of this penalty is significant, as it can include costs from the time of case evaluation through final judgment, including attorney fees. As you would expect, this penalty can amount to hundreds of thousands of dollars or more in instances where the case proceeds to trial.

The case evaluation panel gives one award for each party's collective claims. As set forth in the court rule, "[t]he evaluation may **not** include a separate award on any claim for equitable relief, but the panel may consider such claims in determining the amount of an award." Indeed, it is beyond the scope of the case evaluation panel to award equitable relief. Accordingly, in collection cases with foreclosure claims, the case evaluation panel award is expected to take into account both the money damages claims (*e.g.*, breach of note) and equitable claims (*e.g.*, foreclosure) in issuing an award.

Case evaluation originated in the early 1970s and was initially applied only to auto negligence cases. It was embraced by the courts and expanded to include other kinds of civil claims – including breach of contract and equitable claims. It was known as "mediation" until the year 2000, at which time it became known as "case evaluation" in an attempt to eliminate confusion with the term "mediation" in common parlance.

Tort and medical malpractice cases are required to be referred to case evaluation. The referral of "any civil action in which the relief sought is primarily money damages or a division of property," is permissive.

The case evaluation process is unique to Michigan. It has been observed that "[n]o state appears to have as sweeping a sanction-based ADR process, both in terms of scope of cases arbitrated, and a limitless award amount."In Oakland County, all cases noted "N" for tort and "C" for contract are ordered into case evaluation. In Wayne County, all cases with a request for a monetary award are ordered to case evaluation.

According to a statewide judge's survey, more than 90 percent of tort claims are ordered to case evaluation, but only 70 percent of civil non-tort cases are so referred. So, while non-tort claims are not mandated to be case evaluated by statute, judges nonetheless use their discretionary power to refer most lawsuits to case evaluation.

The case evaluation fee-shifting sanctions reflect a notable exception to the American standard where every party to litigation pays its own costs. It reflects an embrace of a more European-style litigation, where litigation costs are borne by losers and on an equitable basis.

Commercial Collection and Mortgage Foreclosure

When a business obtains a loan and pledges real property as collateral, the terms of the loan typically require that the debtor grant the creditor a mortgage lien on the real property. The mortgage includes a provision known as a "power of sale," that expressly enables the creditor to pursue non-judicial foreclosure (foreclosure by advertisement) or judicial foreclosure upon the debtor's default. The mortgage authorizes the use of the foreclosure process so that the secured creditor can easily sell a pledged property and apply the proceeds of such sale to the outstanding debt. Similar provisions in loan documents are regularly included where personal property collateral is pledged.

Judicial foreclosures of mortgages securing commercial properties are less common than foreclosures by advertisement. Non-judicial foreclosure is generally the preferred route for a foreclosing creditor because of its expediency and efficiency. Prior to the Great Recession, foreclosure by advertisement was typically adequate to make the creditor whole because the collateral's value was equal to or greater than the debt. However, in a time of depressed property values, judicial foreclosures are more common as creditors seek to liquidate their collateral and collect on the debt owed in one proceeding.

Case Evaluation and Foreclosure

Orders for case evaluation are issued early in most lawsuits. Once a case is ordered to be evaluated, a party has only 14 days to file a motion with the court seeking to remove it from evaluation. At this stage of most commercial collection cases, the parties are discussing loan resolution and the creditor's priority is not in moving the lawsuit forward, but in settling it.

As such, it may be difficult to convince creditor clients that the cost of trying to avoid case evaluation is worthwhile. However, given this short window of opportunity, creditors and their counsel must act promptly if they seek to avoid the potential pitfalls of case evaluation. Notably, debtor litigants may actually be receptive to agreeing to opt out of case evaluation given its ineffectiveness and cost.

The courts have broad discretion in evaluating a motion to remove a case or exempt specific claims from case evaluation. While the court rules provide the ability to opt out of case evaluation entirely if equitable claims predominate, or exempt the equitable claims only, many judges view these motions as attempts to skirt settlement discussions and are reluctant to give the parties a pass. Certain judges seem to deny these motions as a matter of course – even when they are unopposed.

In the current environment, case evaluation of lawsuits with both judicial foreclosure and money damage claims is inevitable. There is no standard for when case evaluation takes place, but it is typically set near the end or close of discovery and before the court hears final motions for summary disposition. Once the panel hears the case, it is required to issue an award within 14 days, but it is customary for the panel to present the award to counsel for the parties at the time of the evaluation.

If Both Parties Accept the Case Evaluation Award

If both the creditor plaintiff and debtor defendant accept the case evaluation award, the debtor has 28 days to pay the amount of the award to the creditor. Since the debtor is likely not able to make the payment, the court will enter a money judgment based upon the amount of the award, thereby resolving the lawsuit. Mutual acceptance of a case evaluation award resolves and disposes of the entire case. Accordingly, the creditor cannot continue the foreclosure claim to judgment in the existing lawsuit, and *res judicata* prevents the creditor from initiating another lawsuit on the foreclosure claim.

However, the mortgage remains of record and there is no authority to suggest it is extinguished. This leaves a secured creditor in a conundrum – while the creditor has expeditiously obtained a monetary judgment, if the debtor does not have readily accessible assets, how can a secured creditor realize the proceeds from mortgaged property?

The foreclosure by advertisement and judicial foreclosure statutes both contemplate that a mortgage lien can be enforced in post-judgment proceedings, providing:

> A party may foreclose a mortgage by advertisement if all the following circumstances exist: … (b)… if, an action or proceeding has been instituted (to recover the debt), the action or proceeding has been discontinued; or an execution on a judgment rendered in an action or proceeding has been returned unsatisfied, in whole or in part. MCL 600.3204(1)(b)

If a judgment has been obtained in any other civil action for the money … demanded in the complaint in an a action to foreclose a mortgage on real estate … no proceeding shall be had in the action to foreclose unless the sheriff … has returned an execution unsatisfied … and certified that he can find no property of the defendant out of which to satisfy the execution except the mortgaged promises.

Therefore, in post-judgment proceedings, a creditor must attempt to liquidate the personal property and other assets first. Only after it is determined that the personal property is inadequate to satisfy the judgment can the creditor start attempting to liquidate the real property, again. This may significantly delay the process. And, where real property is concerned, this delay may have significant negative consequences.

If there are junior liens or other title issues relating to the mortgaged property, the creditor may need a judicial foreclosure to resolve those issues. While it seems that *res judicata* or collateral estoppel should not prevent a creditor from foreclosing its lien as part of a lawsuit filed in post-judgment proceedings, to the extent the lien was part of the initial lawsuit, it may.

Assuming that a creditor can overcome this hurdle, the judicial foreclosure statute is clear that the foreclosure sale cannot occur until six months after the complaint is filed, thereby resulting in further delays. In the alternative, upon exhausting attempts to liquidate personal property, the creditor may seek to sell the property via sheriff's levy. However, this process requires the creditor to bear costs it should not be forced to incur given its contracted-for remedies in the loan documents, essentially rewriting the contract. In addition, like foreclosure by advertisement, sale via sheriff's levy does not resolve any lingering title issues or junior liens.

Each alternative approach for foreclosing a mortgage lien impairs the creditor's ability to sell the property quickly and thus shifting property values may further prejudice the creditor's position. Indeed, all outcomes dilute the terms of the loan documents to which the creditor and debtor agreed.

If the Creditor Accepts and the Debtor Rejects

If the creditor accepts the case evaluation award and the debtor rejects the award, this has little practical effect on the case. Since the vast majority of loan documents have attorney fee-shifting provisions that require the debtor to pay the creditor's attorney fees incurred while collecting the indebtedness, the threat of case evaluation sanctions is simply redundant. With the debtor's rejection, the creditor can continue to seek both a monetary award and a judgment of foreclosure.

However, even if the ultimate judgment is significantly better than the case evaluation award and sanctions should be available, the threat is weak given that the operative contracts already shift fees. In sum, there is little risk, if any, for a debtor who decides to reject a case evaluation award.

If the Debtor Accepts and the Creditor Rejects, or If Both Parties Reject

If the creditor rejects the case evaluation award to preserve its foreclosure remedy, it increases the risk for the creditor – irrespective of what the debtor does. Case evaluation sanctions may be awarded even where both parties reject the award.

In a scenario where the case evaluation panel enters an award in the sum approximating the amount the creditor asks for in the complaint, the creditor's options are difficult. First, the creditor may not want to delay its right to judicial foreclosure. Second, despite receiving a "favorable" award, the creditor is now required to improve its position by 10 percent to avoid sanctions. Thus, if the case evaluators fail to discount their award by at least 10 percent, the creditor faces sanctions including attorney fees where the parties previously contracted that debtor would bear these fees and costs. It is doubtful that such a result was intended by this court rule.

If the ultimate verdict awards equitable relief, the imposition of costs is permissive, and the court must take into account both the monetary relief and the equitable relief to determine whether the "verdict is not more favorable to the rejecting party than the evaluation." Notably, in the unpublished case of *MacLeod v. Bay Haven Marina, Inc.*, the Michigan Court of Appeals agreed that the trial court's decision not to award case evaluation sanctions was appropriate, where the monetary award after a bench trial was less than the case evaluation award but where the court also entered a judgment of foreclosure and ordered the sale of the property.

The *MacLeod* court explained while the monetary relief favored one party, the equitable relief favored the other party. In making its decision, the court explained that "[b]ecause the trial court's subsequent entry of judgment on the mediation award would have disposed of all claims, including equitable ones, defendant would have been precluded from pursuing foreclosure." However, given that this case has persuasive value only and practically nullifies the possibility of case evaluation sanctions in these cases, it should provide little comfort to creditors that circuit courts will uniformly agree with this reasoning.

Strategies and Suggestions

Given these considerations, counsel for secured creditors should pay careful attention to case evaluation from the beginning of the lawsuit. If it is not a near-certainty that the dispute will be resolved from the outset of a case, litigants should consider filing a motion to remove either the entire case or the equitable claims only from case evaluation.

Creditors should not hesitate to seek to persuade the debtor to join the motion on the basis that the process is not likely to result in a resolution and will cause both parties to incur wasteful legal fees – all of which may be ultimately borne by the debtor. At minimum, creditor clients should be advised early on that they may find themselves in a position where they are forced to reject case evaluation – and risk sanctions – simply to preserve contractual rights bargained for at the time of loan origination.

Ultimately, consideration should be given to modifying the rules to provide for uniformity in case evaluation with foreclosure and other equitable counts and attorney fee-shifting provisions.

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Original Printing: LACHES, June 2014