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From the desk of:

The Real e-ditor

We all know our local economy has been soft, and seems to be getting softer. With the exception of our Tigers (my Tiger is Curtis Granderson!), good news has been in short supply here in southeast Michigan. So we'll take good news where we can find it.

In this issue of *Real e-State*, we explore several good news legal cases for the real estate industry. First, real estate brokers whose right to a commission is stated only in a third-party agreement (a lease or purchase agreement) may be entitled to enforce their right to a commission as a third-party beneficiary. Next, builders can avoid paying a transfer tax on the value of completed construction, even where a purchase agreement includes terms for both the land purchase and the cost of construction, provided it separately states the consideration for each. Finally, the Army Corp of Engineers has its wings clipped by the U.S. Supreme Court, limiting its reach to regulate wetlands by redefining the nexus required for coverage under the Clean Water Act.

In addition to these developments, a case decided less than two weeks ago by the Michigan Court of Appeals tackled an issue with important ramifications for real estate developers: whether the installation of public services, including roads, sidewalks, streetlights and utilities, falls within the scope of "new construction" or "physical additions" to real estate such that the taxable value of real estate can be increased on account of these improvements. The Court of Appeals said "no", and held that the section of the property tax act authorizing such public service improvements to be assessed for taxation is unconstitutional. This case will be a major benefit to developers with unsold and slow moving lots. We will explore this case and its likely effects in greater detail in our January issue.

I can't give you a sure-fire formula for success, but I can give you a formula for failure: try to please everybody all the time."
-Herbert Bayard Swope

Transfer Tax Ruling: A Win for Taxpayers

BY: LINDSAY M. ADAMS

Attention Michigan builders! The Michigan Court of Appeals recently issued an important decision impacting the tax consequences of selling newly constructed buildings and homes. In reversing a tax tribunal ruling, the court has given builders an opportunity to pay less in real estate transfer taxes.

Under the State Real Estate Transfer Tax Act (SRETTA), MCL § 207.521, *et seq.*, builders have been obligated to pay a transfer tax based on the value of the unimproved lot *plus* the value of any improvements constructed.

In June 2006, the timing of this assessment was called into question in *Lake Forest Partners 2, Inc. v. Department of Treasury*. In that case, the parties used a single purchase agreement to set forth the terms of sale of an unimproved lot, as well as the terms of agreement to construct a new home on the lot. The purchase agreement separately stated the purchase price for the lot and the cost of construction.

The issue before the court was whether the transfer tax should be assessed upon execution of the purchase agreement or upon later execution of the deed. This distinction is critical. If an assessment is made at the time the purchase agreement is executed, only the value of the unimproved lot is considered. In contrast, an assessment made at the time of deed execution will take into account the value of the lot *plus* the value of the newly constructed home, thereby substantially increasing the transfer tax burden on the builder.

Noting that SRETTA directs the tax to be calculated on the value of the property

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Michigan Case Preserves Broker's Commission

BY: STEVEN D. SALLEN

In a recent case decided by the Michigan Court of Appeals, a broker's commission was preserved by a clause in a lease which provided that the landlord would pay a commission of six percent in the event of a future sale to the tenant.

After *Real Estate One v. Heller*, brokers may be entitled to enforce promises to pay a commission as third-party beneficiaries.

In *Real Estate One v. Heller*, the broker listed the owners' home for sale or lease. Real Estate One procured a tenant and a lease was entered into in 1997. A commission was paid for the lease transaction. The lease included the following clause:

> "Landlord agrees to pay Broker a commission of ___ for lease. Further, in the event this property is offered for sale, Tenant(s) has first right of refusal to purchase it at a price to be determined at that time and the Landlord/Seller will pay a commission of six percent."

In the Spring of 1999, the owner was contacted by the tenant and a telephone conversation led to the parties entering into an agreement to sell the home on land contract. In 2001, the tenant/buyer fulfilled the terms of the land contract and took title to the property. However, no commission was paid to the broker. No other agreement between the broker and the owner existed.

In 2005, Real Estate One filed suit against the owner for its six percent commission. The trial court entered a judgment against the broker, and the broker appealed the case to the Michigan Court of Appeals. In reversing the

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U.S. SUPREME COURT "PAVES" WAY TO FILL WETLANDS FOR DEVELOPMENT

BY: GEORGE A. CONTIS

The Clean Water Act of 1972 ("CWA") was enacted to rid the country's waterways of pollutants and to impose significant restrictions on landowners seeking to develop properties containing wetlands. Enforcement of the CWA is delegated to the U.S. Army Corps of Engineers ("Corps"). Previously, the Corps took an expansive approach in interpreting the scope of the CWA, however, a recent United States Supreme Court opinion[1] has disagreed with the approach of the Corps and restricted the CWA's applicability. This ruling means that the restrictions of the CWA will not apply unless the land satisfies the new definition of "waters of the United States" adopted by the Supreme Court.

In Michigan, developers have to first wade through the permitting process of the Michigan Department of Environmental Quality ("MDEQ") to fill wetlands as part of a development. Once MDEQ issues a permit, a developer may still be subjected to having the federal government assert jurisdiction under the CWA and pre-empt the permit issued by the MDEQ[2].

It is unlawful to discharge any pollutants into navigable waters or into tributaries adjacent to *navigable waters of the United States*. If the Corps asserts that a potential development would result in the discharge of pollution into the country's waterways, the developer is prohibited from developing its property. Developers can face millions of dollars in fines and even prison time should it disregard an edict of the Corps.

"...the Court opined that only those wetlands that have a continuous surface connection to bodies of water of the United States and in their own right are adjacent to such waters are covered by the CWA."

Historically, the Corps has taken a very expansive approach in enforcing the CWA and the definition of "waters of the United States." Not only did the Corps apply the CWA to traditionally navigable waters, tributaries of such waters, and adjacent wetlands (water that neighbored waters of the United States, even if totally physically separated from such waters), the Corps extended the coverage of the CWA by liberally interpreting the definition of "waters of the United States." This phrase was interpreted to include any land over which rainwater or drainage passes and leaves a visible mark. Given such an expansive interpretation of the definition of navigatable waters, many property owners were denied the opportunity to develop their properties, even in circumstances where a parcel of property which contained wetlands was physically separated by miles from the nearest navigable waterway.

"...the Court's decision...opens the door for developers who originally faced considerable federal opposition to the development and fill-in of "wetlands" that seemed to have little or no connection to the waters of the United States."

Earlier this year, the U.S. Supreme Court issued an opinion in a consolidated case involving two Michigan developers who challenged the Corps' interpretation of the applicability of the CWA. In *Rapanos v. United States*, the developer desired to build a shopping center and backfilled wetlands (in violation of a cease and desist order issued by the Corps). Even though Mr. Rapanos' property was more than 20 miles away from the nearest navigable waterway, the Corps determined that he violated the CWA. Specifically, the Corps found that there was a hydrological connection between the wetlands that Mr. Rapanos filled and the navigable waters of the United States since the wetlands were near man-made drainage ditches that eventually drained into the waters of the United States. In *Carabell v. United States Army Corps of Engineers, et al.*, the developer wanted to build a residential condominium project about one mile from Lake St. Clair and received a permit from the MDEQ. However, the Corps asserted that the development could not proceed because filling in the wetlands would violate the CWA.

In a plurality opinion[3], the U.S. Supreme Court determined that the Corps' interpretation of a "wetland" and "waters of the United States" within the context of the CWA was too broad. The Court held that "the waters of the United States" include only those relatively permanent, standing or continuously flowing bodies of water forming geographic features that are ordinarily described as streams oceans, rivers, and lakes, and that it does not extend to intermittent or ephemeral flows of water. In the case of wetlands, the Court opined that only those wetlands that have a continuous surface connection to bodies of water of the United States and in their own right are adjacent to such waters are covered by the CWA[4]. The result of this opinion was to undo years of expansive interpretation and enforcement by the Corps.

While every situation must be analyzed on its specific facts, the Court's decision on the applicability of the CWA opens the door for developers who originally faced considerable federal opposition to the development and fill-in of "wetlands" that seemed to have little or no connection to the waters of the United States.

[1] *Rapanos v. United States; Carabell v. United States Army Corps of Engineers, et al:* 126 S. Ct. 2208, 74 USLW 4365 (2006)

[2] The Department of Natural Resources had jurisdiction during the *Rapanos* case, but jurisdiction was eventually transferred to the MDEQ, which dealt with the state permitting in *Carabell*.

[3] Justice Scalia announced the judgment of the Court and three other Justices joined in the opinion. Two Justices issued concurring opinions and three Justices dissented.

[4] Since the 6th Circuit Court of Appeals applied the wrong standard to determine whether these wetlands were covered by the CWA, the Supreme Court remanded both cases for further proceedings.

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"at the time of transfer," the *Lake Forest Partners* court ruled that the assessment should be calculated when the purchase agreement is executed. Although legal title does not pass to the buyer until a deed is executed, a properly executed purchase agreement gives the buyer an equitable interest in the property, which is a sufficient transfer of "any interest in property" under SRETTA.

Going forward, what does this mean for Michigan builders? At first glance, it appears to be cause for celebration. Under this latest ruling, builders who use a single purchase agreement for the sale of new homes and buildings can avoid paying taxes on the finished product. Some builders may also be eligible for a tax refund on past transactions. However, as the appeal process has not been exhausted for *Lake Forest Partners*, it is unclear whether the ruling will stand, and whether it can be applied retroactively or whether the Michigan Supreme Court will tackle the issue. Pending appeal, proceed with caution and contact your Maddin Hauser attorney for more information.

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decision of the trial court, the Court of Appeals relied on Michigan's third-party beneficiary statute, MCL § 600.1405(1), which states that "[a]ny person for whose benefit a promise is made by way of contract . . . has the same right to enforce said promise that he would have had if the said promise had been made *directly* to him as the promisee." (emphasis added). The Court of Appeals reasoned that by the plain language in the lease, the owner had agreed to undertake a promise *directly* for the benefit of the broker. Therefore, by law, the broker was a third-party beneficiary of that section of the lease which obligated the owner to pay a commission.

This case is very significant to real estate brokers in Michigan. Where the broker has no listing or other agreement for payment of a commission, the broker may be a third-party beneficiary if a direct obligation to pay a commission is specified by the parties in their transaction agreement. For their protection, brokers should look to have the obligation of their client to pay their commission clearly stated in the purchase agreement, lease, option or other substantive agreement between the transaction parties. And now, after *Real Estate One v. Heller*, we know that brokers may be entitled to enforce such promises as third-party beneficiaries.

Thanks to James M. Reid IV, Esq., for his contributions to this article.

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WITH THIS PRE-NUP, I THEE WED

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