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## **MORTGAGE BULLETIN 1998-02**

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### **Subject: Rights of First Refusal to Provide Additional Financing**

The Bureau has been presented with several queries regarding the use of a document referred to as a "right of first refusal to provide additional financing." These queries have centered on the question of whether the Bureau views the use of such documents in conducting licensable business activity as a violation of the Mortgage Brokers, Lenders, and Servicers Licensing Act, Act No. 173, P.A. 1987, as amended ("Act").

#### **Bureau Position**

- It is unlawful in the State of Michigan for an entity licensed or registered under the Act to use a document in conducting licensable business activity that purports to grant to the licensee or registrant a "right of first refusal to provide additional financing."
- The "right of first refusal to provide additional financing" document requires consumers to deal exclusively with a particular licensee or registrant in obtaining financial services secured by real property.
- The representation by a licensee or registrant that a "right of first refusal to provide additional financing" document is a recordable contract, is an act that deceives consumers, leading them to believe that they have entered into a valid agreement.
- A licensee or registrant that uses an exclusive business agreement will be subject to an administrative action against its license or registration for engaging in conduct prohibited by Section 22 of the Act.

Generally, a "right of first refusal" is a contractual right to preempt a third party from doing an act (i.e. purchasing property or lending money) before the person holding the right has the opportunity to do the same act on substantially similar terms and conditions.

The "right of first refusal to provide additional financing" document or other similar document, is a contractual device designed to require a consumer to deal exclusively with one licensee or registrant in obtaining financial services secured by residential real property. The exclusivity is created by a clause in the document. This clause requires that, upon the decision of the licensee or registrant to exercise its option under the right of first refusal, the consumer must

reject the third party offer triggering the right of first refusal and borrow the desired money from the licensee or registrant. This exclusivity requirement, although a lawful contract term in other situations, is unlawful when used in connection with a transaction subject to the Act.

Section 22(l) of the Act, MCL 445.1672(l); MSA 23.1125(72)(l), provides in pertinent part that:

“It shall be a violation of this act if a licensee or registrant:

...

- (l) Requires a prospective borrower to deal exclusively with the licensee or registrant in regard to a mortgage loan application.”

It is apparent to the Bureau that these documents unfairly and unlawfully restrict consumers from obtaining, and other licensees and registrants from making, mortgage loans. Licensees and registrants who utilize a “right of first refusal to provide additional financing” document or similar device in conducting business activity subject to the Act may be found to have entered into exclusive business agreements in violation of Section 22(l) of the Act.

Licensees and registrants that record documents purporting to grant a “right of first refusal to provide additional financing” with the register of deeds may be found to have unlawfully impeded the ability of consumers to obtain mortgage-based financing from other lenders. The representation by a licensee or registrant that a “right of first refusal to provide additional financing” document is a contract recordable with the register of deeds is an act that deceptively leads consumers to believe that they have entered into valid contracts and which has a high probability of confusing consumers as to their legal rights, obligations, and remedies. This deception and confusion of the consumer caused by the recordation of an exclusive business agreement is prohibited by the Act and the Michigan Consumer Protection Act (“MCPA”).

The Act states in Section 22(a), MCL 445.1672(a); MSA 23.1125(72)(a), that:

“It shall be a violation of this act if a licensee or registrant:

- (a) Does not conduct the business in accordance with law . . .”

The MCPA states in Section 3(1)(n), MCL 445.903(1)(n); MSA 19.418(3)(1)(n), that:

“Unfair, unconscionable, or deceptive methods, acts, or practices in the conduct of trade or commerce are unlawful and are defined as follows:

...

- (n) Causing a probability of confusion or of misunderstanding as to the legal rights, obligations, or remedies of a party to a transaction.”

If a violation of the MCPA exists, such a violation will also be considered a violation of Section 22(a) of the Act. Licensees and registrants that deceive consumers and cause confusion through the recordation of a “right of first refusal to provide additional financing” may be found to have violated Section 22(a) of the Act.

Although it is unlawful to use a “right of first refusal to provide additional financing” document in conducting business activity subject to the Act, it may be permissible for licensees and registrants to enter into other types of agreements with consumers. These agreements may require that consumers inform the licensee or registrant of the consumer’s decision to seek additional financing, provided that such agreements do not require consumers to deal exclusively with the licensee or registrant in obtaining financing. As long as such agreements are formed as valid contracts and do not violate any provision of the Act or other applicable law, the use of such agreements by licensees and registrants will not be considered violations of the Act.

It is the responsibility of each licensee and registrant under the Act to ensure that business activity subject to the Act and the forms and contracts used in conducting such activity comply with all applicable law.

Further questions regarding this bulletin should be directed to the Examination Division of the Financial Institutions Bureau at (517) 373-3470.

/s/

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Patrick M. McQueen, Commissioner

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November 12, 1998  
Date

/s/

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Ann Gaultney, Director  
Examination Division

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November 12, 1998  
Date

/s/

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Barbara J. Strefling, Director  
Licensing and Enforcement Division

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November 12, 1998  
Date