
July 2, 2020

North Carolina Commercial Receivership Act Recently Enacted

By **Kenneth M. Greene**

On July 1, 2020 Governor Cooper signed into law the North Carolina Commercial Receivership Act (the “Act”), Session Law 2020-75, which creates a new Chapter 38A of the General Statutes. The Act becomes effective January 1, 2021 and applies to receiverships commenced under the Act on or after that date. The Act creates a new statutory remedy for those persons that are eligible to be debtors under the Act and does not replace any other provisions of statutory law or principles of common law and equity which continue in effect.

The Act was recommended for enactment by the Bankruptcy Section of the North Carolina Bar Association which had formed a committee of attorneys who regularly appear in receivership and insolvency related proceedings in North Carolina’s federal and state courts to study North Carolina’s current receivership statutes and draft a new one. Kenny Greene of Carruthers & Roth, P.A., was one of the committee members and one of the principal drafters of the bill.

Here are a few of the highlights of the Act:

Eligible Debtors - The Act applies only to individual business debtors and entities. Individuals that are not business debtors are excluded. Individual business debtors are those individuals whose debts incurred primarily for personal, family or household purposes constitute more than 50% of the individual’s total debt as determined on the date of the filing of the pleading seeking the appointment of a receiver. Also excluded from the coverage of the Act are receiverships in which an agency of the State is the receiver or in which the receiver is appointed, controlled or regulated by an agency of the State, receiverships for a ward or ward’s estate, trusts other than a business trust, estates of deceased individuals, missing persons or absentees in military service.

Types of Receivership - The Act creates two kinds of receiverships. One is a general receivership over all or substantially all of the nonexempt property of a debtor for the purpose of liquidation and distribution to creditors. The other is a limited receivership which applies only to that part of the debtor’s nonexempt property that is identified in the order appointing the limited receiver. Limited receiverships most commonly apply in the case of a secured creditor, such as a holder of a deed of trust encumbering real property, exercising its contractual remedies by seeking to have its collateral controlled, managed, used and perhaps sold by a limited receivership. A receiver in a general receivership is known as a general receiver and a receiver in a limited receivership is known as a limited receiver. The scope of each kind of receiver’s powers under the Act are substantially different. If the order appointing the receiver does not specify the kind of receivership, the receivership is a limited receivership until the court orders otherwise.

Who Can File Action to Appoint Receiver – A receiver may be appointed by the filing of a civil action in which the sole relief requested is the appointment of a receiver or is combined with or ancillary to a civil action in which other relief is requested. A creditor to whom only consumer debt is owing may not file an action to have a receiver appointed for an individual business debtor under this statute. For the first time, an individual business debtor or an entity may file a voluntary receivership.

Single Judge to Supervise Receivership – One of the biggest accomplishments of the Act is to provide a statutory procedure for the receivership and the receiver to be supervised by a single judge. Either a judge of the Superior Court Division or the District Court Division may appoint a limited or general receiver for an individual business debtor. Only a judge of the Superior Court Division may appoint a limited or general receiver for an entity. That continues current practice in this State. Once a general or limited receiver is appointed for an individual business debtor or a limited receiver is appointed for an entity, the senior resident superior court judge or the chief district court judge for the court in which the receivership is pending shall appoint a judge to be the presiding judge over the receiver and the receivership. That presiding judge shall retain jurisdiction and supervision of the receiver and the receivership until the receivership is terminated and the receiver discharged.

If a general receiver is appointed for an entity, then unless the case as a mandatory complex business case, the senior resident superior court shall send a copy of the receivership order through the Administrative Office of the Courts, and the Chief Justice shall designate the receivership as an exceptional civil case pursuant to Rule 2.1 of the General Rules of Practice of the Superior and District Courts and, pursuant to that Rule, appoint a single superior court judge to be the presiding judge over the receiver and the receivership. If action is filed in which a general receiver is sought to be appointed for an entity having not less than \$5 million of assets, either the entity or one or more creditors to whom the entity owes more than \$25,000 in the aggregate may designate the case as a mandatory complex business case, in which case the case shall be assigned to the North Carolina Business Court.

Grounds for Appointment of a Receiver – Limited receivers under the Act may be appointed before judgment to protect a party that has an apparent right, title or interest in property that is the subject of the action, if the property is in danger of waste, loss, dissipation or impairment, or is about to be transferred in a transaction that is voidable under applicable law. Either a limited or general receiver may be appointed after judgment when an individual business debtor or an entity is insolvent (defined in the Act to mean having total debts greater than the aggregate fair market value of all of the debtor's nonexempt assets), is unable to pay or is not paying its debts as they become due, is in imminent danger of insolvency, suspends its business for want of funds, loses its legal existence, or is the subject of a dissolution proceeding. The court may also appoint a limited receiver in connection with a power of sale or judicial proceeding or other enforcement of a security agreement if the appointment is necessary to protect the property, if the debtor agreed to the appointment on default, if the property and other collateral is insufficient to pay the secured debt, if the debtor has failed to turn over the collateral to the secured party, or the holder of a subordinate lienholder obtains a receiver for the same property.

Bad Faith Filing – If the court denies the request for the appointment of a receiver, the court may grant judgment against the party seeking the appointment for any damages proximately caused by such filing, including costs and reasonable attorneys' fees, and punitive damages, if the court determines that the motion was filed in bad faith. Additionally, even after the receiver's appointment, the court may later assess damages against the person that sought the receiver's appointment, including the fees and expenses of the receivership, if the court finds the appointment was sought wrongfully or in bad faith.

Automatic Stay – In all receiverships, the entry of an order appointing a receiver operates as an automatic stay of any action to exercise control or obtain possession or enforce a judgment against receivership property, or to perfect a lien in receivership property. The stay does not apply to the enforcement of a lien in receivership property and also has numerous exceptions that are similar in nature to the exceptions set forth in Section 362 of the Bankruptcy Code. In addition, the order appointing a general receiver operates as an automatic stay to institute or continue the prosecution of any action against the debtor or the receiver that could have been commenced before the time of appointment to recover any claim against the debtor that arose before the time of appointment or to enforce any lien in receivership property. However, that expanded stay in general receiverships expire 60 days after the receiver’s appointment unless, before the expiration of that 60 day period, the receiver or party in interest files a motion to extend the stay and before the expiration of 30 days following the end of the 60 day period, the court orders the stay extended. The court may modify any stay at any time for cause. The court may void any act taken in violation of the stay and award damages caused by a knowing violation of the stay, including reasonable attorneys’ fees and costs, and may sanction the violation as civil contempt.

Sales of Receivership Property – With court approval, the receiver may sell, lease, license, exchange or otherwise dispose of receivership property other than in the ordinary course of business. Any sale may be free and clear of all liens and rights of redemption and claims of exemption of the debtor, regardless of whether the sale will generate sufficient proceeds to satisfy all liens and claims of exemption, unless (i) the proceeds are insufficient to pay all liens and claims of exemption, (ii) the debtor or the secured party holding the lien files a timely objection to the receiver’s sale, and (iii) the court after a hearing determines that the amount to be received by the objecting party from the proceeds is less than the amount the objecting party would likely receive within a reasonable time in the absence of the receiver’s sale. Liens attach to proceeds with the same validity, perfection and priority the lien had on receivership property before the sale. Any sale may be by public or private and may or may not be subject to confirmation by the court. If the sale proceeds are insufficient to pay in full all of the receiver’s costs and expenses of preserving, protecting or selling the property, including the fees and expenses of the receiver and its professionals that are directly attributable to the preservation, protection or disposition of the collateral, then the court upon the receiver’s motion may order that the receiver recover such costs and expenses from the collateral or its proceeds, but only to the extent that the lienholder receives a direct and quantifiable benefit from the receiver’s actions.

Executory Contracts – With court approval, a receiver may adopt or reject an executory contract that is part of receivership property. If the receiver does not request adoption or rejection of an executory contract within 90 days after the time of appointment, or such longer or shorter period as the court may order, the executory contract is deemed rejected. Any provision of an executory contract that requires or permits forfeiture, modification or termination because of the appointment of the receiver or the financial condition of the debtor shall not affect the receiver’s power to adopt the executory contract. If, at the time the receiver is appointed, the debtor has the right to assign the executory contract under applicable laws, the receiver may assign the executory contract with court approval.

Receivership Financing – Without court approval, the receiver may incur unsecured credit on behalf of the receivership. With court approval, the receiver may incur secured credit and encumber receivership property. Any financing incurred by the receiver is an administrative expense of the receivership and entitled to be paid with the same priority as all other administrative expenses of the receivership.

Channeling of Actions and Proceedings – Unless the court orders otherwise, all actions by or against the receiver or relating to the receivership or receivership property must be commenced in the court in which the receivership is pending. Actions or proceedings pending at the time of the receiver’s appointment in which the debtor is a party may be transferred to the court in which the receivership is pending upon the receiver’s or any party’s motion for change of venue made in the court in which the action or proceeding is pending, provided that the transfer motion is filed no later than 90 days after the time of appointment.

Procedures for Determining Individual Business Debtor’s Exemptions – The Act makes no changes in an individual business debtor’s exemptions. The Act maintains the current procedures for an individual business debtor in a receivership under the Act to claim his or her exemptions under G.S. 1C-1603, except that all claims of exemption, objections to claims of exemption, and allowances of exemptions, shall be made by the court in which the receivership is pending and not by the Clerk of Superior Court.

*If you have any questions regarding this client alert, please feel free to contact **June Basden** (336-478-1122, jlbasden@crlaw.com); **Kenny Greene** (336-478-1124, kmg@crlaw.com); **Britton Lewis** (336-478-1137, bcl@crlaw.com); or any member of our **Banking and Finance** and **Real Estate** Teams.*