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BANKRUPTCY AND THE NORTH CAROLINA COMMERCIAL RECEIVERSHIP ACT: CONSIDERATIONS WHEN TRANSFERRING REAL ESTATE



Presenters

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BANKRUPTCY AND REAL ESTATE



Bankruptcy – What is it?

- “A system designed to give honest debtors an opportunity to start over by discharging their debts...while providing for the orderly liquidation or reorganization of the debtor’s estate.”
Local Loan v. Hunt, 292 U.S. 234
- Its own Code, Rules, Courts. In NC, Eastern, Middle and Western Districts with Divisions within each District, geographically.
- Insolvency is a condition that may drive debtors into bankruptcy. Symptom v. Cure.



The Bankruptcy Estate

- When a debtor, whether an individual, spouses or a business entity, files for protection under the bankruptcy court, the court prescribes which assets are to be used in order to pay creditors all or some of what they are owed.
- In some instances, there may be disagreement over which assets are included. In such cases, the bankruptcy court will hear arguments and issue a court order detailing its decision(s).

- All legal and equitable interests the debtor has in property/assets on the day the petition of bankruptcy is filed, with some specific post petition interests included.
- LESS interests in property **exempted** by the individual debtor. **11 U.S.C. §522** and **NCGS 1C-16**
- Retirement Accounts
- ITEMS REMOVED FROM ESTATE:
 - Sold in accordance with Bankruptcy Code
 - Abandoned by Trustee under court order or confirmed plan
 - Foreclosed upon under Order to Lift Stay
 - ALL property remaining in estate if Court DISMISSES case.



Core Concepts for the Real Estate Practitioner



- **Avoidable Transfers:** These can increase the size of the estate by either bringing assets back into the estate or avoiding a secured interest on assets. For the real estate practitioner, this means voidable transfers as well as security interests.
 - **Preferential Transfer:** A transfer by debtor (1) to or for a creditor; (2) for debt owed prior to filing; (3) while debtor was insolvent; (4) made within 90 days of filing, or one year if to an insider; AND (5) so that creditor got more than a Chapter 7 payment.
 - **Fraudulent Transfer:** A transfer by debtor within 2 years if the court determines that there is actual intent to hinder, delay or defraud; OR, that the asset was sold for less than reasonable value; AND, Debtor was insolvent or became insolvent because of transfer.
 - **Self Settled Trust:** Within 10 years IF made by Debtor, who is a beneficiary, with intent to defraud.



- **Exemptions** – Statutorily defined amounts of equity that the debtor may claim against property in the estate. Federal code allows the use of state exemptions. North Carolina exemptions are found in NCGS 1C-16. For real estate, each debtor is allowed up to \$35k against their residence. A married couple would have \$70k total. A surviving tenant by the entirety has a \$60k exemption against equity in the property.
- **Plan** – Under chapters 11 and 13, the debtor, as Debtor in Possession, create a feasible plan that will provide payments to creditors of at least what they would receive under a Chapter 7 liquidation. The plan must be confirmed by court order. The plan should be specific about how real estate will be handled.



- **Automatic Stay** – Under 11 U.S.C. §362(a), the filing of a petition triggers an automatic stay as to any collections, including legal action, by the creditors. There are limited exceptions, notably the perfecting of mechanics liens. Creditors may not move forward until the stay is lifted by court order, dismissal of the case or discharge of the case (for liens that attach to property).
- **Discharge Order** – The release of debtor from personal liability for pre-petition debts. It does not conclude the case and it does not release liens that attach to property, without specifically stating the same.
 - Chapter 7 – Discharge order after all assets distributed.
 - Chapter 11 – Upon confirmation of plan. Confirmed plan acts as substitute contracts with creditors.
 - Chapter 13 – Discharge after successful completion of plan, which must contain a release of liens if appropriate.



- **Dismissal Order** – Dismissal of a bankruptcy case means that the debtor’s case has come to an end without successful completion of the bankruptcy, either because of the failure of the debtor to fulfill requirements or by request of debtor. An order is necessary to dismiss. Issues may arise in Chapter 13 cases if property has been sold “free and clear of liens” prior to the dismissal of the case. Often, instead of dismissal, a Chapter 11 or 13 debtor will convert the bankruptcy to a Chapter 7 liquidation.
- **Chapter 11 “In the Ordinary Course of Business”** - Under Chapter 11, the debtor carries on the business as a “Debtor in Possession”. As DIP, the debtor has statutory authority to sell assets, including real estate, “in the ordinary course of business” if it is part of how the business is conducted. The classic example is a home builder, who may sell homes that are being completed. Most times, it is not so straight forward. A court order confirming that a sale is “in the ordinary course of business” is always preferable.



Types of Bankruptcy

Bankruptcy types are defined by the chapter of the Code in which their relevant and unique provisions are found.

In order addressed herein:

- Chapter 7
- Chapter 11
- Chapter 13



Chapter 7 Liquidation of Debtor's Assets 11 U.S.C. §§ 701 – 784

Trustee Signs Deed

“Tom Trustee, Trustee of the
Bankruptcy Estate of Danny Debtor,
Case No. _____, U.S. Bankruptcy Court
for the Western District of North
Carolina”

- Individuals and Entities may file
- Trustee owns assets
- Trustee signs deed out of bankruptcy
- Stay automatic
- Secured Creditors can get stay lifted, especially if little or no equity
- Trustee may abandon property and/or “sell” equity to debtor or lender
- Discharge Order after all assets disposed of
- Dismissal Order if debtor fails to fulfill requirements/obligations
- “No Asset” Chapter 7 case means no assets to distribute to unsecured creditors. Secured Lenders can still foreclose after Lift Stay Order
- ALL ORDERS MUST BE SPECIFIC



Chapter 11 Reorganization of Business Debts 11 U.S.C. §§ 1101 - 1195

Debtor in Possession Signs Deed (Unless Court Order appointing Trustee)

“Penny President, president of Debtor Co., Debtor in Possession under Bankruptcy Case No. ____, U.S. Bankruptcy Court for the Eastern District of North Carolina”

- Most complex – counsel should be involved
- Business – entities or individuals with more than 50% of debt related to business
- Debtor in Possession (DIP)
- DIP can be removed for incompetence, fraud, dishonesty, etc.
- Plan must be confirmed
- Confirmed plan acts as substitute contract with creditors
- Discharge upon confirmation of plan
- DIP can sell property “in ordinary course of business”
- Secured creditors may seek Lift Stay if plan not followed
- DIP has authority of trustee to avoid liens, abandon property, sell property – in confirmed plan OR court order.
- ALL ORDERS MUST BE SPECIFIC



Chapter 11

Subchapter V

Small Business Debtors

11 U.S.C. §§ 1181 - 1195

Enacted in 2019. Effective 2/19/2020

For business debtors with up to \$2.7mm+ in secured and unsecured debt. Raised to \$7.5mm under CARES Act temporarily. (The CARES Act expires in March of 2021, unless extended.)

- Debtor required to file plan within 90 days.
- Debtor is Debtor in Possession, but if plan is confirmed without approval of creditors, Trustee collects and distributes all payments.
- Creditors must get at least as much as they would in a Chapter 7 liquidation.
- **Secured Creditors:** (1) Retain full security in property even while getting paid under plan; and, (2) Retain right to obtain Lift Stay upon failure of payments. These allow a secured creditor to capitalize on any deficiencies in security especially if increase in value of property.



Chapter 11

Single Asset Real Estate Debtors

Single Asset Real Estate: A single property or project that generates all of the gross income of the debtor and which no substantial business is being conducted by debtor other than the business of operating the real property and activities incidental. 11 U.S.C. §101(51B).

- Secured Lender friendly.
- Debtor's plan must show a reasonable certainty that it can begin making payments to creditor within 90 days, at least equal to the non-default interest rate on the secured interest.
- Court will grant Lift Stay orders routinely if and when debtor fails to make the payments.



Chapter 13
Wage Earner's
Debt Adjustment
11 U.S.C. §§ 1301 - 1330

Requires Court Order to Sell

DIP signs deed: "Danny Debtor, Debtor in Possession in Bankruptcy Case No. _____, U.S. Bankruptcy Court for the Middle District of North Carolina"



Chapter 13

Wage Earner's Debt Adjustment

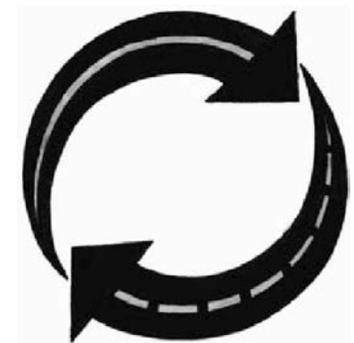
- Wage earning individuals only.
- Designed to allow individuals and spouses to readjust and retain assets.
- Most often filed to prevent or forestall foreclosure on residence.
- Automatic Stay in effect for duration of plan.
- Not true Debtor in Possession – Trustee receives and disburses all payments.
- Debtor makes up delinquent payment through plan while making regular payments to secured creditors.
- Debtor required to obtain confirmation of feasible plan.
- Must obtain court order to sell property.
- Discharge upon successful completion of Plan, not at confirmation of plan. Requires “Final Discharge/Release of Liens” upon successful completion of plan for Lien Avoidance of judgment liens on property. TITLE TRAP...address with counsel.
- Very high failure rate – often converted to Chapter 7 Liquidation.
- Can be complex. Counsel should be involved.



Recurring Issues in the Transfer of Real Estate

Any number of issues may arise.

The ones seen most frequently . . .



Bankruptcy in the Chain of Title



- Liens:
 - Debtor is generally released from personal liability for debts, including liens that attach to real estate.
 - Unless there is an Order directing otherwise, the liens – mortgages, judgment liens, taxes, etc. – remain against the real estate and must be paid off or otherwise released upon sale of the real estate.
- Proper party signing deed:
 - Was there a Court Certified Order recorded with the transaction directing the Trustee or the Debtor in Possession to sell the property?
 - Was the deed signed by that party in the appropriate manner (see above under each Chapter)?
- Foreclosure:
 - Was a Lift Stay Order obtained by lender?
 - Did lender take any actions to collect debt or foreclose during pendency of bankruptcy?



Notice of Bankruptcy

- How do you know if a seller is in bankruptcy?
 - Could be filed in any state in the country.
 - Most attorneys do not check PACER as part of their preliminary title search.
 - Seller or seller's attorney should provide the information with the contract.
 - Contract should be signed by Trustee or by Debtor in Possession (and acknowledged as such).
 - PACER is the federal government's case tracking system and can be invaluable. There is no cost to establish an account and very reasonable terms, most often free for occasional use.
- NCGS 47-29: A copy of the bankruptcy petition...**shall** be recorded with the register of deeds. By who? Statute doesn't say. IF notice is filed, it is almost exclusively filed by the Trustee. It gives notice to anyone with an interest or potential interest in the property.



Chapter 13 Plan Issues



- Very high failure rate – leads to dismissal or conversion to Chapter 7.
- Plans often state that upon completion, liens upon property are released. **MUST** have final discharge and final decree upon completion of plan in order to accomplish this.
- Insuring a sale with a plan in process is very difficult.



Liens NOT made part of the estate

- Liens not listed by debtor or noticed by trustee/Debtor in Possession before Discharge Order.
- Deeds of trust, judgment, taxes.
- In most cases, personal obligation released, but lien still attaches. Even though not noticed, creditor may not move forward with collection without an order lifting the automatic stay. Failure to do so – during the pendency of the bankruptcy – violates the automatic stay even without notice.



Real Estate NOT brought into estate

- It happens – sometimes inadvertently, other times on purpose.
- To sell, property will need to be brought into estate, even if the case has to be re-opened.
- Trustee/Debtor in Possession can then obtain order to sell, abandon or otherwise dispose of it.
- Otherwise, trustee may treat as an avoidable transfer and move the court for an order finding the same and, in some cases, to invalidate the transfer.



MECHANICS' LIENS vs. AUTOMATIC STAY

- While Section 362(a) imposes the Automatic Stay, Section 362(b)(3) DOES allow perfection of liens if state law imposes such a lien prior to perfection.
- In NC, a mechanics' lien attaches at the date of first furnishing of work, even though not perfected until a claim of lien is filed. NCGS Sections 44A-10 and 44A-18.
- If the first furnishing is prior to the filing of bankruptcy, the mechanic/creditor may continue to perfect its lien by filing claim of lien so that the lien attaches to the real property.

NCGS §44A-18 Subsection (f) was added to counter court holding that exemption from automatic stay does not extend to **claim of lien upon funds**, as held in *In re: Shearin Family Investments, US Bank. Ct., Eastern Dist. NC, 08-07082-8-JRL.*

- *Branch Banking and Trust Co. v. Hanson Aggregates Southeast, LLC, U.S. Court of Appeals for the Fourth District, No. 13-1560*

Confirms decision of U.S. Bankruptcy Court for the Eastern District of North Carolina.

A mechanic's lien interest in the property arises at the time the first work or materials are furnished, not when the notice of the lien is served. Therefore, the Bankruptcy Code's automatic stay does not prevent subcontractors and suppliers from perfecting their lien post-petition for material or labor supplied pre-petition.



Bankruptcy Appeals Periods

- Any party may file an appeal within 14 days of the entry of a judgment, order or decree of the Bankruptcy Court.
- If filed prior to entry (after announcement of finding but not yet entered), deemed to have been filed on day of entry.
- Any other party may file within 14 days of initial appeal – must be checked.
- If there are any questions about appeals in your transaction, consult with title counsel.

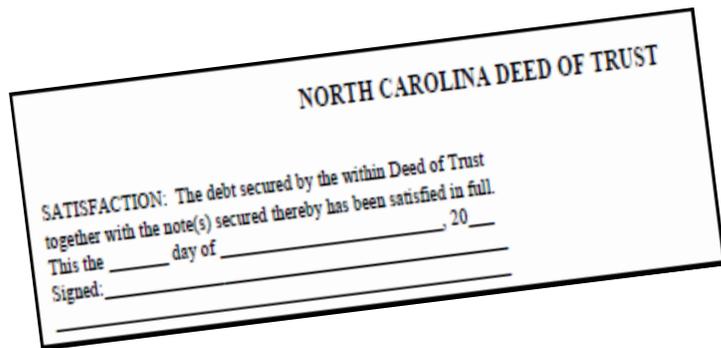


- General Rule in Bankruptcy – deeds out of bankruptcy are exempt from excise taxes.
- Specific Rule in Chapter 11 – Debtor must have a “confirmed plan” prior to transfer of property for excise taxes to be exempt.
- Definitive Supreme Court case – ***Florida Department of Revenue v. Piccadilly Cafeterias, Inc. (2008)***.
- The case centers around the fact that the government (i.e. Trustee in Bankruptcy) would be exempt. While a Debtor in Possession takes on Trustee responsibilities, a DIP is nonetheless not an instrumentality of the U.S.
- SO, Plan MUST be confirmed by court prior to transfer of property for excise taxes to be exempt in Chapter 11 cases.

Excise Taxes in Chapter 11 Cases



Uncancelled Deeds of Trust when Bankruptcy Order or Confirmed Plan Requires Release



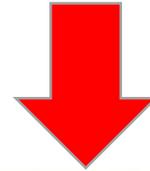
- If Bankruptcy is still open – petition the court to compel the Secured Creditor to comply with terms of the Order or Plan.
- If Post-Bankruptcy/sold by Trustee or Debtor in Possession – it may be necessary to re-open Bankruptcy to compel compliance by Secured Lender.
- If Debtor/Bankruptcy in chain of title, it may not be feasible to re-open case. Some alternatives:
 - Provide evidence of compliance with Order/Plan re: payment to Secured Creditor.
 - Contact Secured Creditor with Order/Plan and obtain release.
 - Follow procedures set forth in NCGS §45-36.13 et seq. for release by Satisfaction Agent.



Avoidable Interests in Real Property – Lender Beware!

- It is a responsibility of the Trustee, or the DIP, to maximize the value of the assets in the estate.
- Trustees and DIPs (should) examine all security interests encumbering real estate to ascertain their validity as a secured asset.
- If a Trustee or DIP concludes that a security interest should be avoided – and the court agrees – the lender becomes, at best, an unsecured creditor.
- Any court order to this effect must be very clear and specific so that there is no question when recorded in the land records.
- NOTE AS TO DIP: Avoiding a secured interest will never be “in the ordinary course of business.”

LENDERS



*In re: Harper 10-07510-8-JRL U.S. Bankr. Ct.,
Eastern District of North Carolina, January 25, 2012.*

- QUICK FACTS:
 - T/E property; Only husband on note and deed of trust
 - Lender foreclosed, sold and recorded trustee's deed into Wells Fargo
 - After recording deed, Clerk notified trustee of noticing issues
 - Trustee rescinded sale and conveyed property back to noteholder (husband only) purporting therein to reinstate deed of trust
 - Husband thereafter files for Chapter 7 bankruptcy protection

- HOLDING: BK Trustee instituted adversarial proceedings against Wells Fargo to 1. Quiet Title and 2. avoid lien on basis of Fraudulent Transfer

The court found that the Clerk of the Court was rightful to set aside the foreclosure under Rule 60 of the NC Rules of Civil Procedure; however, the clerk did not have the authority to rescind the trustee's deed or to reinstate the deed of trust. Instead of seeking relief from the Superior Court, Wells Fargo conveyed the property to the husband/debtor. The act of reconveyance, without the debtor's knowledge or consent, is not enough to reinstate the deed of trust. Wells Fargo lost their secured lien on the property.



*In re: Mercer, Case No. 09-04088-8-JRL, U.S. Bankr. Ct. for
the Eastern District of NC, July 23, 2010*

- QUICK FACTS:

- Mercer purchased real estate in own name
- Lender gave loan to Sea Horse Realty – wholly owned by Mercer
- Note, Deed of Trust and modifications signed by Mercer as principal of Sea Horse
- Deed of Trust recorded but not in chain of title because given by Sea Horse
- Mercer files for Chapter 13 bankruptcy protection
- Mercer files adversarial proceeding to invalidate security interest on property

HOLDING:

- NCGS §47-20 provides that a deed of trust is invalid as against lien creditors or bona fide purchasers for value until such time as it is properly recorded with the Register of Deeds.
- North Carolina is a pure race state and no notice replaces the recording of the instrument.
- 11 U.S.C. §544(a) in conjunction with 11 U.S.C. §1107(a) provides that the DIP steps into a position of a lien creditor and bona fide purchaser for value.
- THEREFORE, in the role of DIP, Mercer is victorious and the lien of the deed of trust was invalidated.



Angell v. Echols (In re Williams), Case No. 08-02284-8-JRL, U.S. Bankr. Ct. for the Eastern District of North Carolina, April 1, 2009.

QUICK FACTS:

- Husband and wife own property as tenants by the entirety
- Wells Fargo gives a loan and records a deed of trust in the land records
- Husband signs note and deed of trust as a “married man”
- Wife does not sign note and deed of trust but may have signed settlement statement and other closing documents (ct. did not allow this evidence on procedural grounds but found it wouldn’t matter in any case)
- Husband and wife file Chapter 7 three years after loan is made
- Court granted Trustee’s motion for summary judgment. Wells Fargo appealed.

HOLDING:

- All material facts were presented in motion for summary judgment. Evidence that wife signed “other” closing documents was not considered material by the court.
- An encumbrance of entireties property without joinder of one of the spouses is void as against the rights of a bona fide purchaser. The bankruptcy trustee is positioned as a bona fide purchaser in relation to the assets of a bankrupt’s estate per **11 U.S.C. §544(a)(3)**.



THE LENDER WINS!

In re Harris, Case No. 15-81295, U.S. Bankr. Ct. for the Middle District of North Carolina, April 12, 2016

QUICK FACTS:

- Chapter 13 filed first Chp. 13 2014, which was dismissed. Lender, who was under Automatic Stay during pendency of first bankruptcy.
- After dismissal, Lender assigned note to Bayview and foreclosure trustee moved forward with foreclosure.
- Debtor filed second Chp. 13 in 2015 and sought to have foreclosure voided on the basis of fraudulent transfer because of an irregularity in the foreclosure process – trustee did not obtain an order by clerk authorizing the “new lender” to foreclose. Theory was one of assumed lack of reasonable value because of procedural irregularity by foreclosure trustee. (“**Reasonable value**” is an element of fraudulent transfer under the bankruptcy code).

HOLDING:

- The foreclosing trustee followed NC foreclosure statute and was not required to obtain a second order from the clerk authorizing the sale and did properly move forward with a simple re-noticing of the sale.
- The court established that so long as state foreclosure law is followed, it would not engage in an independent analysis of whether the highest bid at foreclosure was “reasonable value” for the property.
- The court found for the lender and the foreclosed property was not brought back in the estate.



Liens Addressed in Prior Bankruptcy

- You may find a bankruptcy in the chain of title in conjunction with judgments and other liens that attached prior to the filing of the bankruptcy petition.
- The default position is that they attach to the property even though the debtor's personal liability may have been relieved.
- Either the trustee or the Debtor in Possession may move the court to sell "free and clear" of such judgments and liens, but there must be an Order specifically relieving the property of such judgments and liens – and the Order MUST be recorded.



Single Member LLC as Asset in Personal Bankruptcy - Prior Bankruptcy

- Debtor files for bankruptcy. Debtor has one or more LLCs set up to hold title to real estate.
- Debtor is sole member of LLC(s).
- The LLC may be a single asset entity or hold multiple parcels of real estate and/or other assets.
- The LLC itself is an asset of the bankruptcy estate and Trustee or Debtor in Possession is the “owner” of the LLC.
- There MUST be an order allowing the sole member LLC to sell the real estate, as the Trustee or Debtor in Possession has control over the LLC itself.
- ISSUE: How do you know that the sole member is in bankruptcy?



ORDERS, ORDERS, ORDERS

- Every action taken by the bankruptcy court must be done by Order, with the possible exception of being done within a Chapter 11 or 13 Plan – which still needs to be confirmed by Order.
- Orders recorded in the land records are essential to the integrity of the chain of title.
- Orders must be read carefully for proper notice and the exact, specific findings of the court – which are often at odds with what the seller believes.
- Orders to be recorded must be Bankruptcy Clerk Certified Copies, recorded as separate documents.
- **ORDERS ARE YOUR BEST FRIEND.**



Insuring Out of Bankruptcy

- When insuring out of bankruptcy, there are several factors to consider:
 - Is there an Order authorizing the sale?
 - Is there an Order stripping judgments or otherwise directing a “free and clear” sale?
 - If there is a “free and clear” order, which liens specifically are being removed?
 - If a Chapter 11 “ordinary course of business” sale:
 - Has the Plan been confirmed by the Court? (Order)
 - Has the Sale been approved by the Court? (Order)
 - Is the transfer a very crystal-clear “ordinary course of business” transaction?
- If out of foreclosure, has a lift stay order been entered with the Court?
- For all Orders, do they sufficiently describe who was served with notice, how they were served, and if it was sufficient notice?



Brief Checklists for Chapters 7 and 11

- CHAPTER 7:
 - Record Order directing Trustee to sell property, abandon property or exempting property.
 - Record Deed executed properly by Trustee.
 - Order to sell free and clear of liens (if appropriate), being specific as to notices and which exact liens shall not apply to the property.
 - Final Discharge of Debtor and closing of case (if sold post-bankruptcy).
- Chapter 11:
 - Confirmed Plan.
 - Record Order for Debtor in Possession to sell Property.
 - Record Order for selling free and clear of liens, if appropriate.
 - Record Plan if no Orders – usually prompts an order because debtors do not want plan recorded.
 - Order of Discharge.
 - Record Deed properly executed by Debtor in Possession.



Brief Checklists for Chapters 13 and Post-Bankruptcy Transfers

- CHAPTER 13:
 - Confirmed Plan.
 - Record Order to sell property by Debtor in Possession.
 - First Order of Discharge AND Final Decree of Discharge at successful conclusion of Plan.
 - Record Order to sell free and clear of liens (if appropriate).
 - Record Deed properly executed by Debtor in Possession.
- Sale After Bankruptcy:
 - Record Order of Discharge/Final Decree.
 - Record Order for Abandonment, Exemption, etc., showing a return of the property to Debtor, if appropriate.
 - Record Order for selling free and clear of liens, if appropriate.
 - Pay off/release of liens not extinguished as against the property by bankruptcy.



Brief Checklist for Foreclosures During Bankruptcy

- FORECLOSURE:
 - Order to Lift Stay allowing lender to foreclose, verifying full authority to foreclose and not just to obtain judgment to foreclose (which could be the case for partial exemptions or significant equity in the property).
 - Determine that foreclosure notices and actions were in accord with bankruptcy law and state statutes in terms of reconstituting a foreclosure instituted prior to the filing of bankruptcy petition by debtor.
 - Proper service/notice of foreclosure under state statutes.
 - Adherence to foreclosure requirements for title insurance.



RECEIVERSHIP AND REAL ESTATE



What it is...Why it is used

- Alternative to Bankruptcy
- Preserve assets involved in litigation
- State Process – statute, equity, common law
- Allows for flexibility in the use and sale of real estate assets by Receiver
- Court oversight
- Creditor may seek appointment
- Avoids lender liabilities in cases of real estate with environmental issues that would arise if property foreclosed upon and lender takes title
- Receiver may be appointed for entire business or for a particular asset or group of assets
- Often used to preserve assets pending outcome of litigation



RECEIVERSHIP IN NORTH CAROLINA

- Existing Receivership in North Carolina in Brief
 - Procedural process for the protection of creditors.
 - N.C.G.S. Chapter 1, Article 38 – considered Civil Procedure.
 - Courts also have the authority to appoint receivers in equity.
 - Special needs for real estate and related matters in business.
- New - North Carolina Commercial Receivership Act – N.C.G.S. Chapter 1, Article 38A
 - Effective January 1, 2021.
 - Addresses the needs of business creditors, particularly as related to real estate.
 - Supplemental to NC Court’s already existing statutory and equitable receivership authority
 - Based, at least in part, off the Uniform Commercial Real Estate Receivership Act.



COMMERCIAL RECEIVERSHIP IN NORTH CAROLINA - APPLICABILITY

- **Supplemental to current receivership law**
 - Unless modified by NCGS 1-38A, current statutory, common law and equitable principals apply and are the foundation on which the new act stands.
 - NCGS §1-507.21(c).
- **Applies to...**
 - Any receivership pursuant to any statute, common law or equitable order relating to the same, where the debtor is a business entity or an individual business debtor. SEE NCGS §1-507.21(a).
- **Does NOT apply to...**
 - State agencies
 - Wards/Wards' Estates
 - Estates/Trusts (other than business trusts)
 - No individuals other than individual business debtors



Individual Business Debtor NCGS § 1-507.20(12b)

“An individual owing consumer debt, on the date of the filing of the pleading seeking the appointment of a receiver under this Article for such individual, in an amount that is less than fifty percent (50%) of the individual’s total debt.”

- Roughly the same definition as under the Chapter 11 U.S. Bankruptcy Code – Individuals with more than 50% of debt related to business.
- “Small” individual real estate investors could easily fit under this definition.
- Could be spouses.
- Availability of North Carolina exemptions under 1C-1603; however, the court, not the clerk, shall determine the allowances.
- Similarities to the U.S. Bankruptcy Code are beneficial in case the debtor files for bankruptcy protection during the period of receivership – more seamless transition for both debtor and creditors.



Appointment of Receiver

- **Individual Business Debtor:**

- Upon motion by creditor or by court in equity
- District Court Judge
- Superior Court Judge
- Presiding Judge retains jurisdiction and supervision for the duration of the receivership



- **Entity Debtor:**

- Upon motion by creditor or by court in equity
- ONLY Superior Court
- Presiding Judge retains jurisdiction and supervision for duration of the receivership

- **NCGS § 1-507.24**



Types of Receiverships NCGS § 1-507.23

Limited Receivership

- Presumed if order fails to state
- Most likely type in relation to real estate

General Receivership

- Receiver takes control of all business assets
- “Running of Company”

Limited Receivership

- “...Any receivership which is based upon the foreclosure or enforcement of a security agreement, judgment lien, mechanic’s lien, or other lien pursuant to which the debtor or any holder of a lien would have a statutory right of redemption **shall** be a limited receivership...” NCGS §1-507.23
- Limited receiverships shall not act as a bar to debtor filing bankruptcy petition. NCGS § 1-507.21(d)



Specific to Foreclosure or Enforcement of Security Agreement

NCGS § 1-507.24(f)

A limited receiver may be appointed under any of the following circumstances:

1. Necessary to protect the property from waste, loss, spoilage, transfer, concealment, dissipation or impairment.
2. Debtor agreed to the appointment of a receiver in a signed record on default.
3. Debtor agreed to the appointment of a receiver in a signed record after default.
4. The property and any other collateral securing the debt are not sufficient to satisfy obligation.
5. Debtor fails to turn over collateral or proceeds of collateral (including rents) to the secured party properly entitled to receive them.
6. A subordinate lien holder has obtained the appointment of a receiver.



Stays – NCGS § 1-507.41

- Automatic Stay:
 - 60 days from Order of Appointment.
 - Includes a stay against “any act to create *or perfect* any lien against receivership property...”
Conflict with NCGS Sections 44A-10 and 44A-18 in regards to perfecting Mechanics’ Liens during pendency of stay? *MAYBE*... NCGS § 1-507.41(f)(7) may provide relief to Potential Lien Claimants, but it is a little ambiguous and does not reference §§ 44A-10 and 18.
- By Order of Court:
 - As necessary to protect receivership property or administration.
- Many exceptions, mainly as to governmental creditors, taxes, child support and rights of setoff. See § 1-507.41(f) for full recitation of exceptions.



Powers of Receiver – NCGS § 1-507.28

- **Limited Receivership:**

- Powers are limited and require court approval for sale of real estate
- Qualified by § 1-507.45 – Use or Transfer NOT in the ordinary course of business (SEE BELOW)
- Qualified by § 1-507.29 – Receiver as lien creditor; real estate recording; subsequent sales of real estate (SEE BELOW)



- **General Receivership:**

- Broader powers related to running the affairs of a business
- Includes lease, use and sale of property in the ordinary course of business
- Qualified by § 1-507.29 – Receiver as lien creditor; real estate recording; subsequent sales of real estate (SEE BELOW)



Use or Transfer of Receivership Property Not in the Ordinary Course of Business

NCGS § 1-507.45

- Use of property – with court order
- Transfer – On motion; after notice and hearing; Court may authorize the transfer of property by sale, lease, license, exchange or other disposition
- Sale of Receivership Property – With a court order, the receiver may sell receivership property “...*free and clear of all liens and all rights of redemption and claims of exemption of debtor...*” subject to various exceptions.
 - The Court’s order should address with specificity any liens and/or rights affected.



Receiver as Lien Creditor; Real Estate Recording; Subsequent Sales of Real Estate NCGS § 1-507.29

- Receiver has the powers and priorities of a lien creditor from the time of appointment, subject to recording requirements in the case of real estate.
- Real Estate Recording – the receiver shall record a Lis Pendens with the Register of Deeds “as soon as practicable” after appointment. The receiver has priority as a lien creditor from the date and time of recording.
- Subsequent Sales of Real Estate – Recording, with the Register of Deeds, of the Lis Pendens, the court order authorizing the receiver to sell the property, and the properly executed deed, shall be conclusive evidence of the receivers authority to sell/convey the property.
 - It is presumed that the Order will authorize the particular sale being contemplated in order to give adequate notice and hearing, and not a “general authority” to sell the property; however, the statute does not specifically state.



TAKE-AWAYS AND THOUGHTS FOR REAL ESTATE TRANSACTIONS RELATED TO THE NORTH CAROLINA COMMERCIAL RECEIVERSHIP ACT

- The Act is supplemental to existing receivership law – statute, common law and equity.
- Any transfer of real estate by the receiver must be evidenced by a Lis Pendens, specific and proper court order, and the properly executed deed, all recorded with the Register of Deeds.
- Property may be sold “free and clear” with specific and proper court order.
- Automatic Stay in effect for 60 days.
- Court ordered stays according to said order.
- Receiver has position as Lien Creditor from time of recording Lis Pendens. Compare to bankruptcy trustee – Lien Creditor *and* bona fide purchaser for value.
- Limited Receiverships cannot bar debtor from filing for protection under federal bankruptcy code.
- General Receivership has no automatic ability to file for bankruptcy – more of a court ordered alternative. Presumably, the court could order otherwise in any particular case.
- NEW STATUTE – Effective January 1, 2021.
- No case law interpreting provisions at this time.
- **Can be complex. Underwriter should be consulted.**



Thanks for joining us.

Please submit questions or comments to:

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