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Don't Disrespect the Receivership

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A recent decision by the North Carolina Business Court highlights the risks of interfering with property that is part of a receivership estate.

The North Carolina Commercial Receivership Act celebrated its three-year anniversary in January, and we are beginning to see how it can be a powerful weapon for creditors who need to take control of an uncooperative corporate borrower but don't want to pursue an involuntary bankruptcy. In a receivership, the court, upon request from a creditor, appoints an independent party, the receiver, to take control of and responsibility for the assets of a business. Think of it as bankruptcy in state court.

There are two types of receiverships: general and limited. In a general receivership, the receiver is like a trustee in bankruptcy, acting to preserve assets, operate the business for a period of time, or oversee liquidation and distribute proceeds to creditors. In a limited receivership, the receiver controls a portion of the debtor's property to assist a secured creditor with its remedies against the collateral.

The Receivership Act grants broad powers to a general receiver, including:

- managing and operating a business in the ordinary course;
- taking possession of, collecting, managing, controlling, conserving, or otherwise protecting receivership property;
- entering into contracts;
- demanding and filing lawsuits for the collection of debts and rents; and
- selling, leasing, licensing, exchanging, or otherwise disposing of receivership property with court approval.

Crucially, like a bankruptcy trustee, a receiver is endowed with the power to exercise his or her duties without outside interference. A recent case from the North Carolina Business Court demonstrates the price one can pay for disrespecting the receivership.

In 2019, 10 Academy Street QOZB I, LLC (the "QOZB") was created to purchase and develop commercial real estate in South Carolina. Another limited liability company, CitiSculpt Fund Services, LLC, was formed to serve as manager of QOZB.   CitiScupt solicited investments in QOZB. Two of these investors were Blueprint 2020 Opportunity Zone Fund, LLLP, and Woodforest CEI-Boulos Opportunity Fund, LLC, who each invested $2.5 million. QOZB later took action related to the real estate and connected investments without required disclosure to Blueprint and Woodforest. As a result, Blueprint and Woodforest sued to appoint a receiver for

QOZB.

In March 2023, the Business Court appointed a general receiver. The order appointing the receiver empowered him to market the commercial real property for sale. It also provided that only the receiver had the authority to act on behalf of QOZB and required CitiSculpt, as the company's existing management, to comply with the order, which included allowing only the receiver to take action on behalf of the receivership estate. Lastly, the order stated that the court retained jurisdiction and supervision of all matters concerning the receiver and the receivership. This means that all actions related to the receivership needed to be approved by the Business Court.

CitiSculpt ignored the court. When the receiver found a buyer for the real property in the summer of 2023, CitiSculpt rejected the proposed sale and, to keep it from closing, filed a lawsuit and lis pendens against the property in a South Carolina state court. They did so without court permission and without notice to the receiver, directly violating the receivership order.

When the receiver found out, he moved the court to enforce the receivership and sanction management and their lawyers for violating the receivership order. The court wasted no time in granting the receiver's motion and sanctioning all the "active participants in the misconduct."   The order also required the parties to pay actual damages associated with their violation of the order and the receiver's attorneys' fees in defending the South Carolina lawsuit and bringing the motion for sanctions. They were also required to dismiss the South Carolina lawsuit.

Whatever the motivation of management to stall or complicate the sale of the property by filing the South Carolina lawsuit, it came at a price. Their strategy backfired, and they found themselves on the hook for the receiver's legal fees. This decision is a reminder of the broad powers of a court-appointed receiver and the costly consequences of disregarding them.

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 For further information regarding the issues described above, please contact Lilian L. Faulconer or Lance P. Martin.