Rhode Island Modernizes its Receivership Law By Enacting the Commercial Receivership Act

Description

By Daniel E. Burgoyne

On June 20, 2022, Rhode Island Governor Daniel J. McKee signed into law the Rhode Island Commercial Receivership Act ("CRA"), which updates and modernizes Rhode Island receivership practice. Pub. L. 2002, ch. 107 and 108. The CRA is based upon the Uniform Law Commission's 2015 Commercial Real Estate Receivership Act. The uniform act is now adopted in twelve states including Rhode Island. However, the Rhode Island enactment is broader and applies to receiverships not only of real estate, but of entire business entities. The CRA will not affect existing receiverships but will apply to cases in which a receiver is appointed on or after June 20, 2022.

Existing Rhode Island law governing commercial receiverships had been spread out across the organic statutes for each type of business entity. These statutes are often inconsistent or leave important questions unanswered, such as the circumstances which justify appointment of a receiver in the first place. *See e.g.* G.L. 1956 § 7-1.2-1314 (business corporation receiverships); § 7-6-61 (nonprofit corporation receiverships); § 7-16-45(b) (winding up of limited liability companies); § 7-12-48 (winding up of partnership). While court rules such as Super. R. Civ. P. 66 and judicial opinions filled in some of these gaps, they frequently resulted in expensive disputes and uncertain outcomes.

The CRA addresses many of these shortcomings. In particular, Section 6(a)(c) makes clear that for any business entity—i.e. a "non-individual"—receivership is always available in the event of dissolution or revocation of the entity charter, deadlock in management, oppressive or fraudulent conduct, and insolvency. The CRA also makes explicit many of the rules and procedures that already implicitly govern Rhode Island receivership practice. It codifies existing procedures addressing notice to interested parties, bond requirements for receivers, claim-filing procedures, engagement of professionals, stay of creditor actions, distribution of assets, multi-jurisdictional receiverships, treatment of executory contracts, and periodic reporting requirements.

The CRA also codifies the existing concept of a temporary, non-liquidating receiver appointed to assist Rhode Island businesses adversely affected by a public emergency. This concept has its origins in a March 31, 2020 order of the Rhode Island Judiciary which was issued in response to the COVID-19 pandemic. *See* Rhode Island Superior Court Administrative Order No. 2020-04. The CRA permanently codifies this concept in the Rhode Island General Laws so that it is available in the future. Whenever the Governor declares a public emergency, and that emergency results in business closures or substantial revenue losses to businesses that were not insolvent prior to the emergency, those businesses can seek relief under the CRA. Such businesses receive protection from creditors while developing a business plan to repay debts that arose during the public emergency.

The scope of the CRA set forth in Section 4(a) is broad and covers receiverships of virtually any type of property. However, two exceptions limit this otherwise broad scope. First, Section 4(b) generally excludes real property containing four or fewer dwelling units from the scope of the CRA unless certain specific criteria are met relating to use of that property for commercial, agricultural, industrial, or mineral-extraction purposes. Second, under Section 4(c), the CRA does not apply to a receivership "in which the receiver is a governmental unit or an individual acting in an official capacity on behalf of the unit." This has the effect of excluding receiverships of insurers and financial institutions from the CRA's scope, as the Director of the Department of Business Regulation has statutory responsibility to serve as receiver for these organizations. *See* G.L. 1956 § 27-14.4-3 (insurers) and § 19-12-1 (financial institutions).

While much of the CRA simply codifies existing practice, several provisions represent a substantive change to existing law. First, the CRA solves a significant problem that was the subject of a recent PS&H article. *See* How to Prevent Frivolous Appeals from Derailing Receivership Sales of Rhode Island Real Estate, Daniel E. Burgoyne and Christian R. Jenner, June 15, 2022. Until recently, it was easy for an aggrieved party to thwart a receiver's sale of real estate simply by filing a notice of appeal and paying a $150 filing fee. Unless the receiver or creditor responds, the mere filing of a notice of appeal could prevent a title insurer from issuing a clean title policy, and delay or thwart the sale, regardless of whether the appeal had any merit. The CRA now provides in Section 16 that [a] reversal or modification of an order approving a transfer … does not affect the validity of the transfer to a person that acquired the property in good faith or revive against the person any lien extinguished by the transfer, whether or not the person knew before the transfer of the request for reversal or modification, unless the court stayed the order before the transfer.

This new statute operates similarly to 11 U.S.C. § 363(m) of the United States Bankruptcy Code. As a result, for sales governed by the CRA, title insurers should now have sufficient assurance that they can issue a clean title policy for a receivership sale of real estate, even if a notice of appeal is filed. Unless the appellant persuades a court to stay the sale pending appeal, a sale to a good-faith purchaser will not be invalidated even if the appeal is ultimately successful. The CRA appropriately places the burden upon the objector to demonstrate that an appeal has merit before a sale will be delayed by an appeal.

Finally, in a new and potentially controversial addition to Rhode Island receivership practice, the CRA confers upon secured creditors greater control over collateral in cases where they did not request the receivership. Section 16(c) of the CRA provides that when a receiver sells property, it is generally sold free and clear of the liens of any creditor "that obtained appointment of the receiver," any subordinate lien, and the owner's right of redemption. However, the sale is not free and clear of the senior creditor's lien unless the senior creditor consents. Without consent, the senior creditor's lien will remain attached to the collateral, and the senior creditor's obligation would be unaffected by the receiver's sale. This feature has drawbacks for a borrower or junior creditor that wants to see collateral liquidated by the receiver. However, it is useful for a senior creditor which opposes having its assets sold in receivership. Sometimes a senior secured creditor reasonably believes that it can more efficiently liquidate its collateral outside of the receivership process. Under the CRA, it now has greater power to require that result instead of acquiescing to a receivership sale.

Partridge Snow & Hahn's Commercial Restructuring, Workouts & Asset Recovery Team is ready to answer questions regarding the implications of this legislation. For more information, contact Attorney Daniel E. Burgoyne.

The Author also thanks Thomas S. Hemmendinger, Esq., whose June 24, 2022 presentation to the Rhode Island Bar Association informed this Client Alert.

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