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10 THINGS YOU DIDN'T KNOW ABOUT COLLECTIONS LAW IN NORTH CAROLINA

For many small businesses, handling situations where customers or others fail to pay their debts has become a significant issue. Friendly reminders and even stern notices are often insufficient to compel debtors to pay amounts they owe. As a result, business owners often find themselves forced to consider more aggressive tactics. Listed below are ten strategies and mechanisms available to creditors in North Carolina that can help maximize their likelihood of recovery.

1. **Collect Information First.** Collecting information from a debtor in the beginning of a business relationship (and maintaining and updating such information when needed) can significantly improve a creditor's likelihood of collecting any past-due debts in the future. Basic information such as the customer's accurate legal name and, if the customer is a partnership or proprietorship, the names and addresses of its owners, may be essential to collecting certain debts. Other information such as bank account numbers and social security numbers can also prove to be helpful in collections. Asking customers to fill out a simple form or "credit application" prior to a business transaction is an effective way of obtaining this helpful information.

2. **Statute of Limitations.** The statute of limitations for collections matters in North Carolina is three (3) years from the date of the breach of contract, or four (4) years from the date of breach if the debt arises from a sale of goods. However, when a debtor makes a partial payment on a current account, the statute of limitations will generally start again from that date.

3. **Judgments.** A judgment entered in North Carolina is good for ten (10) years and may be renewed for another ten (10) years after that.

4. **Supplemental Proceedings.** After a judgment is entered, the creditor will first attempt to collect the judgment through "execution," a process in which the sheriff demands payment from the debtor and looks for available property to satisfy the judgment such as vehicles and real property. In many cases, the sheriff is unable to locate any property sufficient to satisfy the judgment, and the execution is returned unsatisfied. However, the creditor may then use "supplemental proceedings" to attempt to discover assets or other information the debtor may be concealing, which can be used to collect the judgment. Supplemental

proceedings allow a creditor to force the debtor to answer written questions concerning the debtor's assets and finances. They also allow a creditor to examine the debtor in person, before a clerk of court. In the event the debtor fails to comply with the creditor's requests, the debtor can be held in contempt of court (*i.e.*, jail). Therefore, supplemental proceedings can be a powerful collection tool.

5. **Garnishment.** In most cases in North Carolina, wage garnishment is not permitted by law. However, if a judgment creditor learns, through supplemental proceedings or otherwise, of third parties who owe the debtor money (other than wages or other exemptions such as child support), the creditor may have such money taken directly from the third parties and applied to the judgment. Judgment creditors may also examine such third parties through supplemental proceedings. If, during a supplemental proceeding, the third party discloses that it has property or money owed to the judgment debtor, the court may order the third party to pay or transfer the property directly to the court for application to the judgment.

6. **Bank Accounts.** Similarly, funds in a judgment debtor's bank account may be available to the creditor for application to the judgment. Obtaining bank account information from a debtor at the onset of the business relationship can make it much easier to collect funds in the bank account later.

7. **Charging Orders.** When a debtor owns an interest in a limited liability company, a judgment creditor can obtain a court order directing the LLC to pay the judgment creditor any distributions that would otherwise be payable to the debtor, until the judgment is satisfied. This is called a "charging order," and it effectively assigns the debtor's interest in the LLC to the creditor. Although creditors should consider possible tax implications before seeking a charging order, this can often be an effective mechanism for aiding in the collection of a judgment.

8. **Fraudulent Conveyances.** Through supplemental proceedings, a creditor may learn that the debtor previously transferred property or funds in a manner deemed fraudulent under the law. For example, if the debtor transferred assets for the purpose of hiding them from his creditors, or if he sold property for less than its reasonable value at a time when he was unable to pay his debts, an affected creditor may be entitled to have the transfer reversed and the property (or its value) applied to the judgment.

9. **Liens.** A judgment creates an automatic lien on all real property owned by the debtor in the county in which the judgment is entered. Additionally, North Carolina law creates various types of liens on real and personal property when creditors have provided certain services to the debtors, such as healthcare services, repair work to cars and other personal

property, and construction work. Even when a debtor's equity in the property subject to a lien is too insignificant to justify a creditor's seizure or sale of the property (for example, when several other creditors have higher priority liens on the property), a lien may prove to be a valuable tool in forcing the debtor to pay a judgment because it may make it harder for the debtor to sell the property or obtain credit. Therefore, it may be important for a creditor to take the necessary steps to create and perfect its lien, even if the creditor does not intend to act on the lien.

10. **Exceptions to Discharge in Bankruptcy.** Creditors typically view bankruptcy filings by debtors as the end of the road for their collections efforts. This is because most bankruptcy cases result in a "discharge" of all of the debtor's debts incurred prior to filing bankruptcy. The discharge dissolves all of the creditors' rights to collect from the debtor at the close of the bankruptcy action. However, in some circumstances, a creditor may challenge the debtor's right to a discharge of certain debts, such as those debts incurred because of fraud or false pretenses on the part of the debtor. Additionally, a debtor may be unable to obtain a discharge if the debtor fraudulently transferred property within one year prior to filing bankruptcy.

If you have questions about this article or other collections-related issues, please contact Nathan Duggins, nduggins@tuggleduggins.com or Emma Merritt Baggett, ebaggett@tuggleduggins.com