STATE OF NORTH CAROLINA

IREDELL COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
16 CVS 2877

W. AVALON POTTS, individually and derivatively on behalf of Steel Tube, Inc.,

Plaintiff,

v.

LEON L. RIVES, II; KEL, LLC; RIVES & ASSOCIATES, LLP; ELITE TUBE & FAB, LLC;

Defendants,

and

STEEL TUBE, INC.,

Nominal Defendant.

ORDER ON MOTION TO AMEND

1. This action arises out of a dispute between Plaintiff W. Avalon Potts and Defendant Leon L. Rives, II regarding the ownership and management of Steel Tube, Inc. On August 4, 2017, Rives moved to amend his answer pursuant to North Carolina Rule of Civil Procedure 15. Rives seeks to add five counterclaims and to name Avalon1, LLC as a counterclaim-defendant. Potts opposes the motion in part on the ground that Rives lacks standing to pursue certain claims because he no longer holds an ownership interest in Steel Tube.

BACKGROUND

2. Potts and Walter Lazenby co-founded Steel Tube in 1990. (V. Am. Compl. ¶ 14, ECF No. 17 ["Compl."]; Answer to Am. Compl. ¶ 14, ECF No. 31 ["Answer"].) At that time, each took a 50% interest in the company in the form of 15,000 shares.

(Compl. ¶¶ 14–15; Answer ¶¶ 14–15.) Lazenby later transferred half of his shares to his wife. (Compl. ¶ 15; Answer ¶ 15.)

3. On January 15, 2015, Rives purchased the Lazenbys' 15,000 shares. (Compl., Ex. 3 ["Purchase Agreement"].) As part of the purchase agreement, Rives promised to pay $600,000 "in $6,000 monthly payments until paid in full." (Purchase Agreement at 1.) Lazenby received "a security interest in the stock" of Steel Tube, including the right to "repossess his stock" from Rives "upon default." (Purchase Agreement at 2.)

4. The purchase made Rives a 50% owner of Steel Tube. He was elected as an officer and director in February 2015, and his ownership interest was "reflected in stock certificate number 5" in the company's books and records. (Mot. for Leave to Am. Answer and Add Countercl. ["Mot."], Ex. 1, Countercl. ¶¶ 7, 9 ["Countercl."], ECF No. 46.) The certificate "provides that the stock is 'transferable only on the books of the corporation by the holder hereof in person or by attorney upon surrender of this certificate properly endorsed.'" (Countercl. ¶ 11.) Rives alleges that he has never "surrendered the certificate, nor has he at any time endorsed the certificate for surrender or transfer." (Countercl. ¶ 12.)

5. Potts and Rives have not enjoyed good relations as co-owners and officers of Steel Tube. Potts initiated this action on November 29, 2016, seeking to dissolve the company on the ground that Rives had misappropriated its assets for his own benefit. (*See* V. Compl. ¶ 41, ECF No. 1.)

6. Two months later, Potts triggered a series of events that resulted in the present dispute. On January 26, 2017, Potts and the Lazenbys executed an agreement purporting to assign the Lazenbys' security interest to Avalon, LLC ("Assignment"). (Countercl. ¶ 15; Mot., Ex. A.) Potts states, and Rives does not dispute, that Rives had defaulted by failing to make any payments to the Lazenbys after August 2016. (*See* Mem. in Opp'n to Mot. to Am. Answer 2, ECF No. 49 ["Opp'n Br."].) As a result, upon executing the Assignment, Potts directed the repossession of the shares from Steel Tube's books and records. (*See* Countercl. ¶¶ 14, 17, 39(d), 43(d).)

7. In a letter dated January 30, 2017, counsel for Potts notified counsel for Rives of the Assignment and the fact that "Avalon, LLC has exercised its rights to repossess all" of Rives's shares. (Reply Br. in Supp. of Mot. for Leave to Am. Answer to Add a Countercl. and Join an Additional Party ["Reply"], Ex. A at 1, ECF No. 53.1 ["Repossession Notice"].) The letter asserts that Rives "no longer ha[s] any ownership interest in" Steel Tube and that "Potts and Avalon, LLC have decided to remove [Rives] as an officer and director of [Steel Tube], effective immediately." (Repossession Notice at 1.) It further states that "Avalon, LLC is willing to accept" the shares in satisfaction of any obligations owed by Rives under the purchase agreement but that "Avalon, LLC will move forward with a sale" of the shares under N.C. Gen. Stat. § 25-9-610 if Rives refused. (Repossession Notice at 2.)

8. Shortly after repossessing the shares, Potts moved to amend his complaint. The amended complaint states that, "[a]s the sole shareholder of [Steel Tube], Potts

will fairly and adequately represent the interest of [Steel Tube] in enforcing and prosecuting its rights against Rives." (Compl. ¶ 4.) Potts removed his dissolution claim and replaced it with seventeen claims for breach of fiduciary duty, fraud, and numerous other causes of action. Rives consented to the amendment, and the Court granted the motion.

9. On February 20, 2017, counsel for Rives responded to the repossession notice. In that correspondence, counsel objected only "to acceptance of the collateral as satisfaction of the debt." (Opp'n Br., Ex. 1 at 1.)

10. Two days later, counsel for Potts sought clarification. Observing that Rives had not expressly disputed the repossession of the shares and the loss of Rives's ownership interest, counsel stated that "I can only assume that neither you nor Rives have any legitimate basis to dispute these issues." (Opp'n Br., Ex. 3 at 1.) After noting that Potts intended to make a substantial loan to Steel Tube on February 24, his counsel stated "[i]f I do not hear otherwise from you before then, I will inform my client that there is no dispute regarding" Avalon, LLC's ownership of the shares. (Opp'n Br., Ex. 3 at 1–2.)

11. Counsel for Rives responded by disputing Potts's valuation of the shares and stating that the secured party would be "obligated to pay Mr. Rives any funds received in disposition beyond the balance of the outstanding debt." (Opp'n Br., Ex. 4 at 1.) The letter does not expressly object to the repossession of the shares but generally "reserves all other rights, claims and defenses at this time." (Opp'n Br., Ex. 4 at 2.)

12. Around this time, counsel for Potts learned that Avalon, LLC—the purported assignee of the Lazenbys' security interest—had never been formed and was therefore a non-existent entity. (*See* Opp'n Br. 3 n.12.) Potts then formed Avalon1, LLC, and Avalon1 and the Lazenbys executed an Amended and Restated Assignment Agreement on February 27, 2017. (Countercl. ¶¶ 17–18; Mot. Exs. B, C.)

13. On April 24, 2017, approximately three months after receiving notice that his shares had been repossessed, Rives filed his answer to the amended complaint. Rives did not assert any counterclaims.

14. In the meantime, Potts made preparations to dispose of the 15,000 shares. Avalon1 sent notice to Rives's last known address on May 23, 2017 that a public sale of the collateral was to take place at the Iredell County Courthouse on June 5, 2017. (Countercl. ¶ 20; Mot., Ex. D.) Rives did not receive the notice, having moved from that address in 2016—a fact he contends Potts was fully aware of. No notice was sent to Rives's counsel. (*See* Countercl. ¶ 20.) From May 25, 2017 to June 4, 2017, Potts advertised the sale in the *Statesville Record & Landmark*. (*See* Mot., Ex. D at 7–8.) He also placed ads in the *Charlotte Observer* on May 28, 2017 and June 4, 2017. (*See* Mot., Ex. D at 6.)

15. The public sale was held on June 5. As the only bidder, Avalon1 purchased "all right, title and interest, if any, of Leon L. Rives, II (the 'Debtor') in and to . . . 15,000 shares of the capital stock of [Steel Tube]." (Mot., Ex. D at 9.) Notice of disposition of the collateral was sent to Rives's counsel on June 7, 2017. (Mot. for T.R.O. ¶ 10, ECF No. 42; *see also* Mot. for T.R.O., Ex. C at 2–3.)

16. The notice prompted Rives to move for a temporary restraining order on June 8, 2017, seeking to enjoin the disposition of the shares under N.C. Gen. Stat. § 25-9-625(a). (*See* Mot. for T.R.O. 3–4.) The public sale had already occurred, however, and Potts stipulated at a hearing on the same day that Avalon1 would not further dispose of the shares. Rives indicated his intention to move to amend the answer and add counterclaims, and the parties agreed to confer regarding a schedule for anticipated motions practice.

17. Rives filed his motion to amend and a supporting brief on August 4, 2017. According to Rives, the sale of the repossessed shares was commercially unreasonable and invalid, and he remains a shareholder of Steel Tube. In addition, he contends that actions taken by Steel Tube without shareholder approval in the interim are invalid. He seeks to add Avalon1 as a counterclaim-defendant and to add five counterclaims: (i) a claim for breach of fiduciary duty; (ii) a claim for sale of stock in violation of Article 9 of the Uniform Commercial Code; (iii) a claim for a declaratory judgment that Rives remains an officer, shareholder, and director of Steel Tube; (iv) a request to enjoin corporate actions taken without Rives's consent; and (v) a claim for judicial dissolution of Steel Tube. (*See* Countercl. ¶¶ 37–55.)

18. Potts opposed the motion on August 10, 2017. The motion is fully briefed, and the Court held a hearing on September 1, 2017. The motion is ripe for determination.

DISCUSSION

19. Precedent and the Rules of Civil Procedure dictate that "leave to amend pleadings 'shall be freely given when justice so requires.'" *Zenobile v. McKecuen*, 144 N.C. App. 104, 109, 548 S.E.2d 756, 759 (2001) (quoting N.C. R. Civ. P. 15(a)). "Acceptable reasons for which a motion to amend may be denied are undue delay, bad faith, dilatory motive, repeated failure to cure deficiencies, undue prejudice and futility of the amendment." *Nationsbank of N.C., N.A. v. Baines*, 116 N.C. App. 263, 268, 447 S.E.2d 812, 815 (1994) (citation and quotation marks omitted).

20. Potts contends that, following the repossession and disposition of the shares, Rives has no ownership interest in Steel Tube. (*See* Opp'n Br. 8, 17–19.) On that basis, Potts contends that the motion is futile, due to a lack of standing, to the extent Rives seeks to add counterclaims premised on his rights as a shareholder of Steel Tube. This includes Rives's claim for a declaration that he remains a shareholder, his claim seeking to enjoin any action by Steel Tube requiring approval of shareholders, and his claim for judicial dissolution. *See, e.g.*, N.C. Gen. Stat. § 55-3-04(b)(1) ("A corporation's power to act may be challenged . . . by a shareholder."); *id.* § 55-14-30(2) (providing for dissolution "[i]n a proceeding . . . by a shareholder"). It also includes Rives's second claim for violations of Article 9 to the extent Rives seeks to enjoin disposition of the shares. (*See* Countercl. ¶¶ 43(d), 43(f), 44(a), 46–47.)

21. At the hearing, counsel for Potts clarified that he does not oppose the claims for breach of fiduciary duty and for violations of Article 9 to the extent those claims seek money damages for past harms. Potts also does not oppose the claim for

declaratory relief to the extent it concerns actions taken by Potts and Steel Tube prior to the repossession and disposition of the shares.

22. Accordingly, the sole issue before the Court is whether Rives has standing to pursue claims that depend upon a present ownership interest in Steel Tube. In analyzing this jurisdictional issue, the Court may consider matters outside the proposed pleading. *See Keith v. Wallerich*, 201 N.C. App. 550, 554, 687 S.E.2d 299, 302 (2009).

23. Rives's standing turns on the validity of the repossession and public sale of the 15,000 shares he purchased from the Lazenbys and pledged as collateral as part of the sale. These issues are "governed by Article 9 of the Uniform Commercial Code as codified in Chapter 25 of the North Carolina General Statutes." *Country Boys Auction & Realty Co. v. Carolina Warehouse, Inc.*, 180 N.C. App. 141, 148, 636 S.E.2d 309, 314 (2008).

24. At the outset, it is clear that the Lazenbys obtained an enforceable security interest as part of their agreement to sell the shares to Rives. "A security interest attaches to collateral when it becomes enforceable against the debtor." N.C. Gen. Stat. § 25-9-203(a). This occurs when three conditions are met. First, value has been given. *Id.* § 25-9-203(b)(1). Second, the debtor has received "rights in the collateral or the power to transfer rights in the collateral to a secured party." *Id.* § 25-9-203(b)(2). Third, "the debtor has authenticated a security agreement that provides a description of the collateral." *Id.* § 25-9-203(b)(3)(a).

25. The purchase agreement between Rives and the Lazenbys specifically states that the Lazenbys obtained "a security interest in the stock" being sold, including the right to "repossess" it "upon default." (Purchase Agreement at 2.) In short, value was given for the shares, Rives acquired rights in the collateral, and Rives authenticated the agreement. *See* N.C. Gen. Stat. § 25-9-102(7) (defining "authenticate" as "[t]o sign"). "Thus, a valid security interest was created and had attached to the collateral." *Kindred of N.C., Inc. v. Bond*, 160 N.C. App. 90, 106, 584 S.E.2d 846, 856 (2003).

26. It is also clear that Avalon1 obtained the Lazenbys' security interest via an assignment. The Lazenbys purported to assign their security interest twice: first to Avalon, LLC, an entity that did not exist; and then to Avalon1, LLC, which was formed to rectify that error. (Countercl. ¶¶ 14–18; Mot. Exs. B, C.) The clumsiness of these transactions may bear on a number of disputes (*e.g.*, when the assignment became effective and whether the resulting disposition was commercially reasonable), but Rives does not contend that the ultimate assignment to Avalon1 was ineffective.

27. Thus, at least as of February 27, 2017, Avalon1 became the assignee of the Lazenbys' security interest. That is important because "the assignee stands absolutely in the place of the assignor . . . upon precisely the same terms as with the original parties." *Credigy Receivables, Inc. v. Whittington*, 202 N.C. App. 646, 652, 689 S.E.2d 889, 894 (2010).

28. At the time of the assignment, Rives was in default, having failed to make monthly payments to the Lazenbys since August 2016. (Opp'n Br., Ex. 1 at 1.) Upon default, Article 9 provides a secured party with several remedies. A secured party "[m]ay take possession of the collateral," including "[w]ithout judicial process, if it proceeds without breach of the peace." N.C. Gen. Stat. § 25-9-609(b)(2); *see also id.* § 25-9-503 ("Unless otherwise agreed a secured party has on default the right to take possession of the collateral."). The secured party may also "sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing." *Id.* § 25-9-610(a). Further, the secured party may purchase the collateral "[a]t a public disposition." *Id.* § 25-9-610(c). "The rights and remedies . . . are cumulative." *Kindred*, 160 N.C. App. 90, 106, 584 S.E.2d 846, 856 (2003) (citing *Ken-Mar Finance v. Harvey*, 90 N.C. App. 362, 367, 368 S.E.2d 646, 650 (1988)).

29. The evidence before the Court shows that Avalon1 exercised these rights. The company possesses Rives's stock certificate. (*See* Repossession Notice at 1.) On June 5, 2017, it put the shares up for public sale and, as the only bidder, purchased the shares. (*See* Countercl. ¶ 20; Mot., Ex. D at 9–10; Opp'n Br. 6.)

30. The completion of the public sale by Avalon1, the secured party, is dispositive. The sale deprived Rives "of any interest in the underlying collateral and thus divested" him of standing to pursue claims premised on his continuing ownership of the shares. In re *Commercial Money Ctr., Inc.*, 2008 U.S. Dist. LEXIS 79071, at *34 (N.D. Ohio Sept. 15, 2008); *see also* N.C. Gen. Stat. § 25-9-617(a) ("A

secured party's disposition of collateral after default" transfers "all of the debtor's rights in the collateral.").

31. Rives contends that the sale was invalid and void. (Reply 2, ECF No. 51.) He points to the fact that the collateral is a certificated security in registered form, as defined by Article 8. (Reply 5 (citing N.C. Gen. Stat. § 25-8-102(2), (13)).) Under Article 8, the holder of a certificated security in registered form must endorse the shares to effect a change of control. *See* N.C. Gen. Stat. § 25-8-106(b). Because Rives has not "endorsed, delivered, or surrendered the stock certificate," (Countercl. ¶ 21), he contends that Avalon1 did not "obtain[] possession through proper endorsement and delivery prior to purporting to sell [the stock certificate] at foreclosure sale." (Reply Br. 2.) As a result, Rives asserts, Avalon1 could not have sold or purchased any interest in the shares. (Countercl. ¶ 22; *see also* Reply Br. 2.)

32. The Court disagrees. First, to be clear, "[t]he Court does not interpret § 9-625(a) to authorize voiding the foreclosure sale even if [the secured party] did not act in a commercially reasonable manner." In re *Inofin, Inc.*, 512 B.R. 19, 89–90 (Bankr. D. Mass. 2014). Because the sale "has already occurred," Rives's remedy, in the event Avalon1 "did not comply with the requisite provisions of Article 9, would be an action for damages under section 9-625(b) of the U.C.C. and not an invalidation of the sale." In re *Enron Corp.*, 2005 Bankr. LEXIS 3469, at *32 (Bankr. S.D.N.Y. June 16, 2005). Although Rives could have sought to enjoin the sale *before* it took place, N.C. Gen. Stat. § 25-9-625(a), the plain language of the statute provides that Rives's only remedy post-sale is damages, *id.* § 25-9-625(b).

33. Second, Rives's focus on Article 8 is misplaced. Article 8 "is not a comprehensive codification of all of the law governing the creation or transfer of interests in securities. " N.C. Gen. Stat. § 25-8-302 cmt. 2. Specifically, "the formal steps necessary to effectuate such a transfer [of a security interest in a security] are governed by Article 9 not by Article 8." *Id.* Accordingly, "a security interest in a certificated or uncertificated security can be created by the execution of a security agreement under Section 9-203." *Id.*

34. Article 9 makes clear when its provisions are subject to the law contained in other Articles, including Article 8. For example, control of a certificated security is relevant to the issue of perfection (which is not in dispute here). *See id.* § 25-9-314; *see also Kindred*, 160 N.C. App. at 106, 584 S.E.2d at 856 ("issues of perfection and priority are irrelevant in disputes between the debtor and the secured party."). And delivery of a certificated security is an alternative to an authenticated security agreement for purposes of attachment. *See* N.C. Gen. Stat. § 25-9-203(b)(3)(c).

35. By contrast, Article 9 entitles a secured party, in the event of default, to "take possession" and "dispose" of the collateral, without any such qualifications. *Id.* §§ 25-9-609(a)(1), -610(a). Neither section requires "control," refers to Article 8, or otherwise creates special rules for certificated securities. *See id.* § 25-9-202 ("[T]he provisions of this Article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.").

36. Rives's briefs do not cite any authority invalidating a disposition of collateral under section 25-9-610(a). In a suggestion of additional authority, Rives cites In re

Domestic Fuel Corp., 71 B.R. 734 (Bankr. S.D.N.Y. 1987). In that case, the court concluded that a secured party's "failure to obtain possession" of the collateral stock "impaired the validity of the attempted nonjudicial sale." *Id.* at 740. The court explained that the secured party held the right "to proceed with a nonjudicial sale after first *having obtained repossession* of the stock peaceably," but the secured party had failed to do so. *Id.* (emphasis added).

37. There was no such failure here. Avalon1 first repossessed the collateral prior to disposing of it at a public sale. *Domestic Fuel* is therefore inapposite. Although damages may be available if Rives can demonstrate that the sale was commercially unreasonable, Rives cannot void the sale after it has already happened. *See* N.C. Gen. Stat. § 25-9-625(a), (b).

38. Accordingly, the Court concludes that Rives's fifth counterclaim for judicial dissolution would be futile. The Court also concludes that the second, third, and fourth counterclaims would be futile to the extent those claims are premised on Rives's continued ownership interest in Steel Tube. Having reached this conclusion, the Court need not address whether Rives unduly delayed in seeking to amend his answer several months after first receiving notice that the shares had been repossessed.

39. As discussed above, the motion is unopposed as to the proposed counterclaims for breach of fiduciary duty and violations of Article 9 to the extent those claims seek money damages. In addition, Rives's proposed third and fourth

counterclaims would not be futile to the extent those claims challenge actions taken by Steel Tube during the period in which Rives was a shareholder.

40. The Court therefore **GRANTS** in part and **DENIES** in part the motion. The Court **ORDERS** that Rives shall file an amended answer and counterclaims consistent with this Order no later than September 29, 2017.

This the 15th day of September, 2017.

/s/ Adam M. Conrad
Adam M. Conrad
Special Superior Court Judge
for Complex Business Cases