KEY CONSIDERATIONS FOR LLC MEMBERSHIP INTERESTCOLLATERAL

AMERICAN BAR ASSOCATION

BUSINESS LAW SECTION SPRING MEETING

MONTREAL, CANADA

APRIL 7, 2016

PANELISTS

Moderator:

Daniel J. Sheridan
Stark & Stark, a Professional Corporation
Lawrenceville, NJ

Presenters:

Stephen Sepinuck
Gonzaga Law School
Spokane, WA

Penelope Christophorou
Cleary, Gottlieb, Steen & Hamilton LLP
New York, NY

Tarik J. Haskins
Morris, Nichols, Arsht & Tunnell LLP
Wilmington, DE

OVERVIEW

- Introduction of Speakers
- Task Force on Security Interests in LLC Memberships and Other Unincorporated Entity Interest Collateral (Structure and Progress)
- Background and Purpose of Program

KEY CONSIDERATION #1
Classification of Collateral

- Overview of Applicable Principles
- Advantages of Article 8 Opt-In
- Perfection by Filing (Investment Property and General Intangible) or Possession (including Certification of Interests) (Investment Property)
- Operating and Security Agreement Provisions addressing:
  - RULLCA provision on Operating Agreement provisions for the benefit of non- Parties
  - Opt-In (or Prohibition on Opt-In)
  - Prohibition on Future Opt-In/Opt-Out
  - Prohibition on Certification of Interests or Revocation of Certification

KEY CONSIDERATION #2
Choice of Law and Governing Law

- Overview of Applicable Principles
- Implications for:
  - Governing Law of Loan Transaction (Security Agreement)
  - Governing Law of LLC Relationships (Internal Affairs)
  - Law of Jurisdiction of Debtor or Collateral Location (Perfection and Priority)
- Drafting Considerations:
  - Security Agreement Negative Covenants
  - Operating Agreement Negative Covenants

KEY CONSIDERATION #3
RESTRICTIONS ON TRANSFER

- Overview of Applicable Principles
  - "Pick Your Partner"
  - Separation of "Governance Rights" from "Economic Rights"
  - 9-406 and 9-408 and PEB Draft Commentary
- Entity Perspective
- Lender Perspective
- Applicable Case Law
- Drafting Considerations and Suggestions:

KEY CONSIDERATION #3 RESTRICTIONS ON TRANSFER

- Drafting Considerations and Suggestions:
  - Definitions of “transfer” and “encumbrance” (and comparison to statutory defaults)
  - When consent is required (At grant? At enforcement? Both?)
  - Consequences of a “non-permitted” transfer or encumbrance (Forfeiture of equity position? Lack of attachment? Loss of “member rights” (but retention of “economic rights”?) Damages for “breach” of Operating Agreement? Lender notice and right to cure?)

KEY CONSIDERATION #4
LLC DISTRIBUTIONS

- Overview of Applicable Principles
- Possible Distribution Scenarios:
  - Distributions Prior to Default
  - Distributions Subsequent to Default
  - Distributions in Respect of “Operating Cash Flow”
  - Distributions in Respect of “Capital Transactions”
  - Guaranteed Distributions (Salary)
  - Tax Neutral Distributions
- Distributions as “proceeds” of the Collateral

KEY CONSIDERATION #4
LLC DISTRIBUTIONS

- Taxation of Distributions and Phantom Income Considerations
- Applicable Case Law
- Drafting Considerations
  - Security Agreement Provisions
  - LLC Entity Consent Provisions

KEY CONSIDERATION #5
ENFORCEMENT AND REMEDIES

- Overview of Applicable Principles
- Possible Remedies:
  - Foreclosure and Private Sale
    - Commercial Reasonableness
    - Securities Law Compliance
    - Phantom Income Allocations
  - Use and Implications of Section 9-607
  - Other
- Effect of LLC Consent
- Additional Rights of Members (First Refusal, Call Options, etc.) and Valuation Implications
- Applicable Case Law

KEY CONSIDERATION #5
ENFORCEMENT AND REMEDIES

- Drafting Considerations
  - Foreclosure Notice
  - 9-607 Notice
- Impact of Debtor Insolvency
- Lender Liability Concerns:
  - Capital Calls
  - Designation of Manager
  - Fiduciary Duties
  - Exculpation and Indemnification

ADDITIONAL KEY CONSIDERATIONS

- Identifying the “Operating Agreement” (RULLCA Definition)
- Opinion Practice

Mezzanine Lender LLC

April [ ], 2016

VIA FEDERAL EXPRESS

Mezzanine Borrower LLC
[Address]

Re: NOTICE OF DEFAULT UNDER MEZZANINE LOAN AGREEMENT

Ladies and Gentlemen:

Reference is made to that certain Mezzanine Loan Agreement (the "Loan Agreement"), dated as of April [ ], 2015, between Mezzanine Borrower LLC, as Borrower ("Borrower") and Mezzanine Lender LLC, as Lender ("Lender") (as so amended, the "Loan Agreement"). Capitalized terms used but not otherwise defined herein shall have the respective meanings ascribed to such terms in the Loan Agreement.

Please be advised that one or more unwaived Events of Default have occurred and are continuing under the Loan Agreement. Specifically, the Borrower's failure to pay principal and interest when due in accordance with the terms of the Loan Agreement and the failure to pay the entire Loan on or before the Maturity Date constitute Events of Default under the Loan Agreement.

In connection therewith, pursuant to the Loan Agreement, interest shall accrue on the Indebtedness at the Default Rate. Lender intends to accelerate the Obligations and commence enforcement of Lender's remedies under the Loan Agreement if the Event of Default is not cured by 2 p.m. Eastern Time on April [ ], 2016. As provided in the Loan Agreement, please note that Borrower is required to pay all costs and expenses of Lender and any Servicer, including, without limitation, reasonable attorneys' fees and disbursements. All payments received by Lender shall be applied in accordance with the terms of the Loan Documents.

Lender expressly reserves all of its rights, powers, privileges and remedies under the Loan Agreement, the Guaranties, the other Loan Documents and applicable law, and neither any course of dealing nor any delay or omission by Lender shall be construed to be a waiver thereof or any acquiescence therein. The Loan Agreement, the Guaranties and the other Loan Documents continue to be, and shall remain, in full force and effect in accordance with their respective terms.

In addition to the matters described herein, other Events of Default may

have occurred under one or more of the Loan Documents and may occur from time to time after the date hereof, and this letter does not constitute a waiver of any right, power, privilege or remedy of Lender that may result from such other Events of Default under the Loan Documents.

You are further advised that no oral communication or course of dealing from or on behalf of Lender by any party shall constitute any agreement, commitment, or evidence of any assurance or intention of Lender with respect to the subject matter hereof. Any agreement, commitment, assurance, or intention of Lender shall be effective only if in writing and duly executed by Lender.

Very truly yours,

Mezzanine Lender LLC

By: _____
Name: _____
Title: _____

cc: Mortgage Lender LLC

Mezzanine Lender LLC

April [ ], 2016

VIA FEDERAL EXPRESS

Mezzanine Borrower LLC
[Address]

Re: NOTICE OF ACCELERATION UNDER MEZZANINE LOAN AGREEMENT

Ladies and Gentlemen:

Reference is made to (i) that certain Mezzanine Loan Agreement (the "Loan Agreement"), dated as of April [ ], 2015, between Mezzanine Borrower LLC, as Borrower ("Borrower") and Mezzanine Lender LLC, as Lender ("Lender") (as so amended, the "Loan Agreement") and (ii) that certain Notice of Default (the "Default Notice"), dated as of April [ ], 2016, sent by Lender to Borrower, a copy of which is attached hereto as Exhibit A. Capitalized terms used but not otherwise defined herein shall have the respective meanings ascribed to such terms in the Loan Agreement.

Lender previously delivered the Default Notice to Borrower notifying Borrower of the occurrence of an Event of Default pursuant to Section [ ] of the Loan Agreement and of Lender's intent to accelerate the Obligations and commence enforcement of Lender's remedies under the Loan Agreement if such Event of Default were not cured by 2 p.m. Eastern Time on April [ ], 2016. The Event of Default has not been cured. In accordance with Section [ ] of the Loan Agreement, Lender hereby declares the Obligations to be immediately due and payable. As provided in the Loan Agreement, please note that Borrower is required to pay all costs and expenses of Lender and any Servicer, including, without limitation, reasonable attorneys' fees and disbursements. All payments received by Lender shall be applied in accordance with the terms of the Loan Documents.

Lender expressly reserves all of its rights, powers, privileges and remedies under the Loan Agreement, the Guaranties, the other Loan Documents and applicable law, and neither any course of dealing nor any delay or omission by Lender shall be construed to be a waiver thereof or any acquiescence therein. The Loan Agreement, the Guaranties and the other Loan Documents continue to be, and shall remain, in full force and effect in accordance with their respective terms.

In addition to the matters described herein, other Events of Default may have occurred under one or more of the Loan Documents and may occur from time to time after the

date hereof, and this letter does not constitute a waiver of any right, power, privilege or remedy of Lender that may result from such other Events of Default under the Loan Documents.

You are further advised that no oral communication or course of dealing from or on behalf of Lender by any party shall constitute any agreement, commitment, or evidence of any assurance or intention of Lender with respect to the subject matter hereof. Any agreement, commitment, assurance, or intention of Lender shall be effective only if in writing and duly executed by Lender.

Very truly yours,

Mezzanine Lender LLC

By: _____
Name: _____
Title: _____

cc: Mortgage Lender LLC

EXHIBIT A

Mezzanine Lender LLC

April [ ], 2016

VIA FEDERAL EXPRESS

Senior Lender
[Address]

Re: NOTICE OF DEFAULT AND COMMENCEMENT OF EQUITY COLLATERAL ENFORCEMENT ACTION

Ladies and Gentlemen:

Reference is herein made to the following: (a) that certain Mezzanine Loan Agreement (as amended, the "Mezzanine Loan Agreement"; and the loan evidenced thereby, the "Mezzanine Loan"), between Mezzanine Borrower LLC (the "Mezzanine Borrower"), as borrower, and Mezzanine Lender LLC (the "Mezzanine Lender"), as lender, dated as of April [ ], 2015 and (b) that certain Intercreditor Agreement (as amended, the "Intercreditor Agreement"), by and between Senior Lender, as senior lender and the Mezzanine Lender, dated as of April [ ], 2015. Capitalized terms not otherwise defined herein shall have the meaning set forth in the Intercreditor Agreement.

This letter is to advise you of the occurrence of one or more Events of Default under the Mezzanine Loan Agreement. Specifically, the Mezzanine Borrower failed to pay principal and interest when due in accordance with the terms of the Loan Agreement and such failures constitutes Events of Default under the Loan Agreement. Notice of the Event of Default under the Mezzanine Loan was previously sent to the Mezzanine Borrower on April [ ], 2016 pursuant to the notice attached hereto as Exhibit A. Notice of the Mezzanine Lender's acceleration of the Mezzanine Loan is simultaneously being sent to the Mezzanine Borrower pursuant to the notice attached hereto as Exhibit B.

Accordingly, the Mezzanine Lender is permitted under the Intercreditor Agreement to commence an Equity Collateral Enforcement Action. This letter is to further advise you that the Mezzanine Lender will effect a Uniform Commercial Code public sale pursuant to Section 9-610 of the Uniform Commercial Code in effect from time to time in the State of New York (the "Uniform Commercial Code") to be held on May [ ], 2016, as more particularly set forth in the form of public notice of sale attached hereto as Exhibit C.

This letter constitutes notice of the occurrence of the Event of Default described herein and commencement of an Equity Collateral Enforcement Action pursuant to Sections [ ] and [ ] of the Intercreditor Agreement.

The Mezzanine Lender hereby expressly reserves all of its rights under the Intercreditor Agreement and the Mezzanine Loan Agreement, and any other Mezzanine Loan Document or applicable law, including without limitation, with respect to the Event of Default described herein, the right to commence a private foreclosure sale pursuant to Section 9-610 of the Uniform Commercial Code or to effect a strict foreclosure pursuant to Section 9-620 of the Uniform Commercial Code. No delay or omission by the Mezzanine Lender in the exercise of any right or power accruing to the Mezzanine Lender under the Intercreditor Agreement or the Mezzanine Loan Documents with respect to, or as a result of, the foregoing shall impair any such right or power, or shall be construed to be a waiver thereof or any acquiescence therein.

[*Signature Page Follows*]

Sincerely,

Mezzanine Lender LLC

By: _____
Name:
Title:

SCHEDULE A

EXHIBIT A

EXHIBIT B

EXHIBIT C

Mezzanine Lender LLC

April [ ], 2016

VIA FEDERAL EXPRESS

Mezzanine Borrower LLC
[Address]

Re: NOTICE OF SECURED PARTY'S PUBLIC DISPOSITION OF COLLATERAL

Ladies and Gentlemen:

Reference is made to: (a) that certain Mezzanine Loan Agreement (as amended, restated, replaced, supplemented or otherwise modified from time to time, the "Loan Agreement"), between Mezzanine Borrower LLC (the "Borrower"), as borrower, and Mezzanine Lender LLC (the "Secured Party"), as lender, dated as of April [ ], 2016, (b) that certain Pledge and Security Agreement by the Borrower in favor of the Secured Party, dated as of April [ ], 2016. Capitalized terms not otherwise defined herein shall have the meaning set forth in the Loan Agreement, and if not defined therein, then the meanings given to such terms in the Uniform Commercial Code as in effect in the State of New York from time to time (the "UCC").

In accordance with the applicable provisions of Sections 9-610 through 9-613 (inclusive) of the UCC, NOTICE IS HEREBY GIVEN by the Secured Party to the Borrower and the other parties listed on Schedule 2 attached hereto that the Secured Party, acting in its capacity as a secured party under the Pledge Agreement, will sell, as described on Schedule 1 attached hereto, 100% of the limited liability company membership interests in Property Owner LLC, together with certain related rights and property relating thereto (the "Interests"), at a public disposition, to the highest qualified bidder(s) (the "Sale"), and towards that end, is now soliciting bids from qualified bidders. The Sale shall take place as follows:

May [ ], 2016
11:30 AM
Law Firm LLP
[*Address*]

Pursuant to applicable provisions of the UCC, the Borrower is entitled to an accounting of all of the unpaid indebtedness which is secured by the security interest granted to the Secured Party in the Interests. You may request such an accounting by contacting [*broker* (direct dial: [•]; e-mail: [•])]

THIS NOTICE, WHICH IS GIVEN MORE THAN TEN DAYS IN ADVANCE OF THE DATE OF THE PUBLIC SALE, IS THE ONLY PRIOR NOTICE OF SUCH SALE OF THE INTERESTS THAT YOU WILL BE SENT. HOWEVER, ANY REQUIRED PUBLIC

ADVERTISEMENTS OF THE SALE SHALL BE MADE. THE FORM OF PUBLIC NOTICE IS ATTACHED HERETO AS EXHIBIT A.

This notice of disposition of collateral is being delivered pursuant to Section 9-611 of the UCC. For additional information regarding the Sale, please contact [*broker* (direct dial: [•]; e-mail: [•])]

Please be advised that the Secured Party hereby reserves, without prejudice, all of its rights and remedies under the Pledge Agreement, the Loan Agreement and the other Loan Documents (including without limitation, its right to rescind and annul the foregoing declaration and its consequences).

[Signatures Appear on the Following Page]

Sincerely,

Mezzanine Lender LLC

By: _____
Name:
Title:

DESCRIPTION OF INTERESTS

Schedule 1

Issuer	Owner	Class of Membership Interests	Percentage of Membership Interests
Property Owner LLC	Mezzanine Borrower LLC	Class A	100%

Exhibit A

Form of Public Notice

UCC Public Sale Notice

Please take notice that Brokerage, on behalf of Mezzanine Lender LLC (the "Secured Party") offers for sale at public auction May [ ], 2016 at 11:30 AM in the offices of Law Firm LLP, [*address*], in connection with a Uniform Commercial Code sale, 100% of the limited liability company membership interests (the "Interests") in Property Owner LLC, (the "Mortgage Borrower"), which is the sole owner of the shopping center located at 123 Main Street, New York, NY 10001. The Interests are owned by Mezzanine Borrower (the "Mezzanine Borrower").

The Secured Party as lender has made a loan (the "Mezzanine Loan") to the Mezzanine Borrower. In connection with the Mezzanine Loan, the Mezzanine Borrower has granted to the Secured Party a first priority lien on the Interests pursuant to that certain Pledge and Security Agreement. The Secured Party is offering the Interests for sale in connection with the foreclosure on the pledge of such Interests. The Mezzanine Loan is subordinate to a mortgage loan and other obligations and liabilities of the Mortgage Borrower or otherwise affecting the property.

Please take notice that there are specific requirements for any potential successful bidder in connection with obtaining information and bidding on the Interests, including but not limited to, execution of a confidentiality agreement and a requirement that each bidder must be a Qualified Transferee (as defined in that certain Intercreditor Agreement dated as of April [ ], 2016 (the "Intercreditor")) and that each bidder must deliver such documents as required by the Intercreditor and the applicable governing documents relating to the Interests.

The Interests are being offered as a single lot, "as-is, where-is", with no express or implied warranties, representations, statements or conditions of any kind made by the Secured Party or any person acting for or on behalf of the Secured Party, without any recourse whatsoever to the Secured Party or any other person acting for or on behalf of the Secured Party and each bidder must make its own inquiry regarding the Interests.

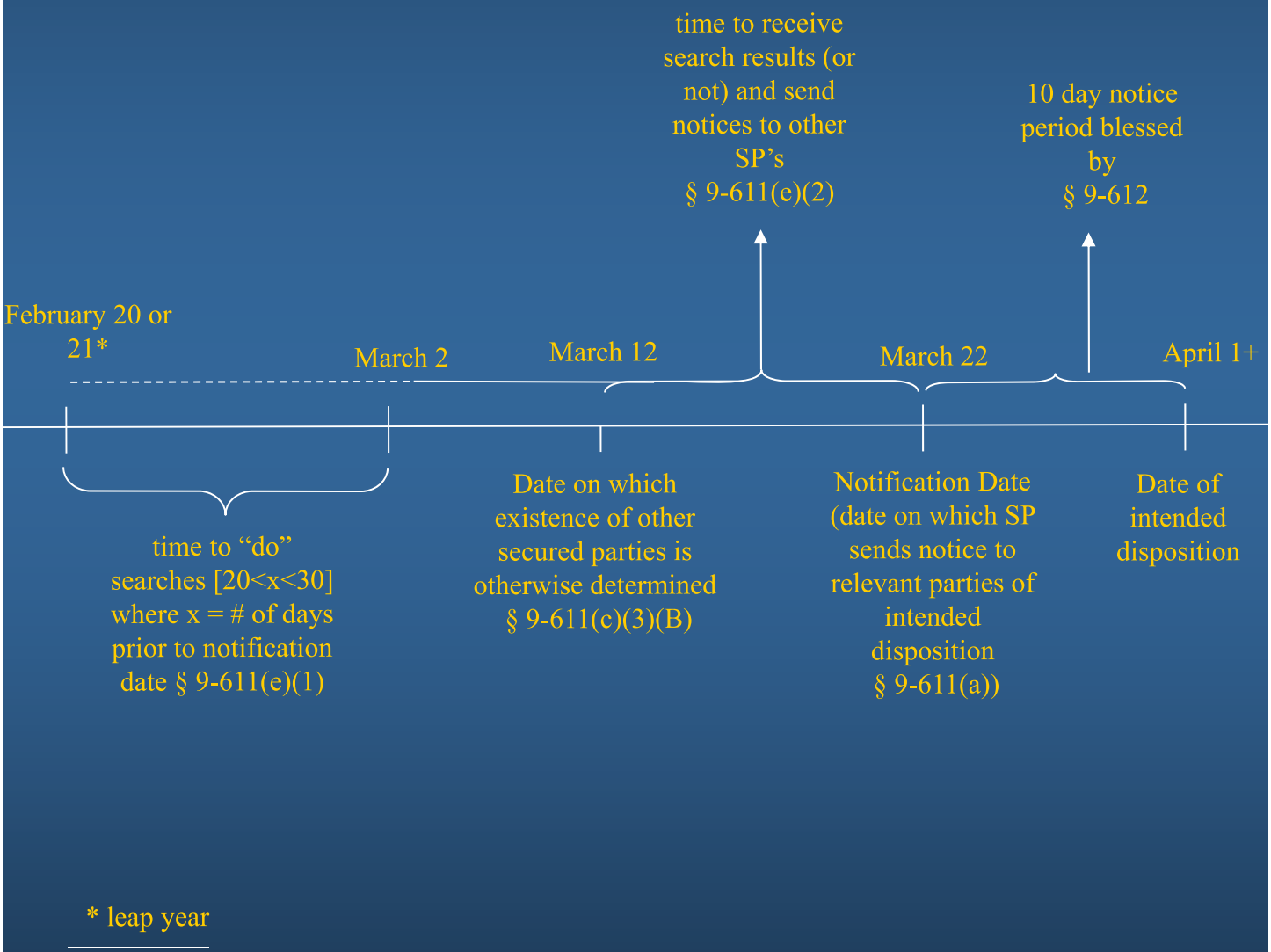
The Secured Party reserves the right to credit bid, set a minimum reserve price, reject all bids (including without limitation any bid that it deems to have been made by a bidder that is unable to satisfy the requirements imposed by the Secured Party upon prospective bidders in connection with the sale or to whom in the Secured Party's sole judgment a sale may not lawfully be made) and terminate or adjourn the sale to another time, without further notice. The Secured Party further reserves the right to restrict prospective bidders to those who will represent that they are purchasing the Interests for their own account for investment not with a view to the distribution or resale of such Interests, to verify that each certificate for the Interests to be sold bears a legend substantially to the effect that such interests have not been registered under the Securities Act of 1933, as amended (the "Securities Act"), and may not be disposed of in violation of the provisions of the Securities Act and to impose such other limitations or conditions in connection with the sale of the Interests as the Secured Party deems necessary or advisable in order to comply with the Securities Act or any other applicable law.

All bids must be for cash, and the successful bidder must be prepared to deliver immediately available good funds within 24 hours after the sale and otherwise comply with the bidding requirements. Further

information concerning the Interests, the requirements for obtaining information and bidding on the interests and the Terms of Sale can be found at [*dataroom website*].

Broker (direct dial: [•]; e-mail: [•]).

ILLUSTRATION OF R9-611 SAFE HARBOR



* leap year

895406

Financing LLC Interests:

Case Law 2005 – March 2016

Prepared by
Professor Stephen L. Sepinuck

updated 2/3/16

SECURITY INTERESTS IN LLC INTERESTS

Attachment Issues

1. *In re Brown*,
   479 B.R. 112 (Bankr. D. Kan. 2012)
   Security agreement that referred to the collateral as "investment property," "securities," and "7.000 shares of preferred stock in Kansas Medical Center, LLC," was effective even though the debtor's interest in the LLC was a general intangible, not investment property, securities, or stock, because the property covered was objectively determinable from the description.

2. *In re McKenzie*,
   737 F.3d 1034 (6th Cir. 2013)
   Creditor did not have a security interest in the debtor's LLC interest because the LLC operating agreement expressly provided that no member could transfer such an interest without the prior written consent of the board and that any attempted transfer without consent was void, and the creditor's evidence of *subsequent* consent did not prove that the requisite *prior* consent was given.

3. *McDonald v. Yarchenko*,
   2013 WL 3809512 (D. Or. 2013)
   Lender did not comply with term in LLC operating agreement requiring prior written consent of majority of the five non-transferring members to debtor's encumbering his membership interest because fax purporting to express consent of two members was signed by at most one of them and letter that stated consent was given by another member at the time the lender made the loan was signed six years later. However, the debtor waived the right to challenge the validity of the transfer by signing the agreement to encumber his interest.

4. *In re McKenzie*,
   2012 WL 4742708 (E.D. Tenn. 2012)
   Creditor did not have a security interest in the debtor's LLC interest because the LLC operating agreement expressly provided that no member could transfer such an interest without the prior written consent of the board and that any attempted transfer without consent was void, and the creditor's evidence of *subsequent* consent did not prove that the requisite *prior* consent was given.

5. *In re McKenzie*,
2011 WL 2118689 (Bankr. E.D. Tenn. 2011)
2011 WL 6140516 (Bankr. E.D. Tenn. 2011) (subsequent decision)
No security interest attached to the debtor's LLC interest because the operating agreement required the prior written consent of the LLC's Board of Governors, and no such consent was obtained. The court asked for more briefing on whether § 9-408 allows a security interest to attach to the proceeds of the LLC interest despite a restriction on assignment in the operating agreement.

Slight errors in the names of the LLCs in which the debtor had pledged membership interests were immaterial because it was possible to determine the interests pledged by looking at the names of the entities in which the debtor had an interest. However, pledge of membership interest in "Exit 20, LLC" was inadequate because the debtor had a membership interest in two entities whose names began with "Exit LLC" – Exit 20 Properties, LLC and Exit 20 Development, LLC – and it was not objectively possible to ascertain which interest had been pledged.

Pursuant to subsequent decision, debtor could grant a security interest in wholly owned LLCs regardless of restrictions in membership agreement because consent to the transfer is presumed. As to remaining LLCs, secured party failed to submit evidence that the debtor's interests were freely transferrable. While § 9-408 does override restrictions on the transfer of an interest in general intangibles, such as partnership interests and some LLC interests, by failing to submit the operating agreements, the secured party failed to prove that the LLC interests were general intangibles and not securities.

6. *Meecorp Capital Markets, LLC v. PSC of Two Harbors, LLC*,
2011 WL 1119191 (D. Minn. 2011)
2011 WL 6151487 (D. Minn. 2011) (subsequent decision)
Summary judgment denied on whether lender acquired a security interest in LLC interests because LLC agreements required unanimous consent of all members to the creation of a security interest and it was not clear that all the members had consented.

Pursuant to subsequent decision, guarantor did not grant a security interest in his LLC interest because there was no evidence that written notice was provided to all members, as required by the member control agreement. The guarantor also did not grant a security interest in his general partnership interests because the member control agreements prohibit transfer of governance interests without the unanimous, written consent of all other members and the resolutions of the Boards of Governors consenting to the transfer were insufficient to satisfy this requirement.

7. *In re Westbay*,
2011 WL 2708469 (Bankr. C.D. Ill. 2011)
Although LLC agreement required the written consent of all members to use of the debtor's membership interest as collateral, that requirement was impliedly waived because all the members knew of and benefitted from the transaction, which was in exchange for a loan of working capital to the LLC.

8. *In re Young*,
2011 WL 3799245 (Bankr. D.N.M. 2011)
Debtors' member withdrawals from LLC – a form of distribution on account of their equity interests– were not proceeds of their LLC interests and hence Bank's security interest in those membership interests did not attach to the withdrawals. The court treated as dispositive the ruling in *In re Hastie*, 2 F.3d 1042 (10th Cir. 1993), without considering subsequent enactment of § 9-102(a)(64)(B).

9. *Lebedowicz v. Meserole Factory LLC*,
941 N.Y.S.2d 538 (N.Y. Sup. Ct. 2011)
Security agreement signed by members of LLC on behalf of the LLC, and not in their personal capacities, did not grant a security interest in the members' LLC interests because the LLC itself did not have rights in those membership interests.

10. *Becher v. Freeman-Waag*,
2010 WL 3545656 (Minn. Ct. App. 2010)
Restriction against assignment in LLC membership control agreement was not manifestly unreasonable and thus was enforceable under Minnesota law. As a result, creditor acquired no security interest in LLC member's interest.

11. *In re Weiss*,
376 B.R. 867 (Bankr. N.D. Ill. 2007)
Debtor could not grant security interest in his LLC and limited partnership interests because the operating agreements prohibited any transfer of the interest of a member or limited partner without the consent of the manager or general partner and no consent was provided until years later.

12. *In re Rabinowitz*,
2011 WL 6749068 (Bankr. D.N.J. 2011)
Although LLC operating agreement purported to make void any grant of a security interest in a member's LLC interest without the consent of a majority of members, state court judgment in action by lender against member and stating that the security agreement remained in full force and effect was binding on the debtor's bankruptcy trustee pursuant to the entire controversy doctrine because the validity of the security agreement could have been litigated in the state action.

13. *Vanderhorst v. 6105 N. Dixie Drive, LLC*,
2009 WL 4893184 (Ohio Ct. App. 2009)
Whether assignment of membership interest in limited liability company was outright or for security was a factual issue not appropriate for summary judgment.

14. *In re Dreiling*,
2007 WL 172364 (Bankr. W.D. Mo. 2007)
Debtor's interest in a limited liability company was a general intangible, not a security, because the LLC interest was not traded on an exchange and the LLC agreement did not provide that the interests were securities.

Perfection Issues

15. *In re Faison*,
518 B.R. 849 (Bankr. E.D.N.C. 2014)
Husband who, in connection with divorce proceedings, filed lis pendens against wife did not thereby perfect any interest he might have in the wife's 20% interest in an LLC, which is a general intangible. Filing a financing statement is the only way to perfect an interest in a general intangible.

Priority Issues

16. *Feresi v. The Livery, LLC*,
2014 WL 7021107 (Cal. Ct. App. 2014), *modified*,
182 Cal. Rptr. 3d 169 (Cal. Ct. App. 2015)
Perfected security interest of the manager of an LLC in the debtor's membership interest in the LLC was equitably subordinated to the previously created but unperfected security interest of the debtor's ex-wife, who was also a member of the LLC, because the manager breached his fiduciary duty to the ex-wife by destroying the value of her security interest. The manager, knowing of the ex-wife's security interest and that the debtor was in default on his obligations to his ex-wife, loaned money to the debtor, created a conflicting security interest, and then surreptitiously perfected it to gain an advantage over the ex-wife.

Enforcement Issues

17. *Sirazi v. General Mediterranean Holding, SA*,
2015 WL 1541087 (N.D. Ill. 2015)
Although the creditors' security interest in the debtor's right to the proceeds of a sale of his membership interest in a limited liability company might have been unperfected – because the collateral description in the filed financing statement referenced an exhibit that was apparently not attached – the security interest was nevertheless enforceable.

18. *Lefkowitz v. Quality Labor Management, LLC*,
2014 WL 5877850 (Fla. Dist. Ct. App. 2014)
Trial court erred in denying secured party's request to intervene in action in which creditor obtained a charging order on the debtor's ownership interests in limited partnerships and LLC, which constituted the secured party's collateral.

19. *In re Strata Title, LLC*,
2013 WL 2456399 (Bankr. D. Ariz. 2013)
"Self-operative" term in LLC operating agreement between two 50% owners providing that one of them would become the 100% owner if its capital contribution was not repaid by a specified date created a security interest. Although that security interest was unperfected and the date had not yet occurred when the other member filed for bankruptcy protection, the bankruptcy trustee took subject to that term because Arizona law gives LLC members the authority to adopt provisions in an operating agreement governing the relations between members, changes in classes of members, and the right to acquire other member's interests. As a result, the debtor's interest ceased to be property of the estate when the specified date passed without the other member receiving its capital contribution.

20. *In re Crossover Financial I, LLC*,
477 B.R. 196 (Bankr. D. Colo. 2012)
Clause in security agreement providing that, upon default, the debtor's rights as the sole member of limited liability company to vote and give consents, waiver or ratifications shall cease and that the secured party vote any or all of the pledged interest did not operate automatically; Colorado law requires a secured party to enforce the security agreement and become admitted as a member before the secured party may exercise voting rights associated with a membership interest pledged as collateral.

21. *Sanders v. Ohmite Holding, LLC*,
17 A.3d 1186 (Del. Ch. Ct. 2011)
Creditor that had a security interest in 7.75% of membership units in LLC and which later received a complete assignment of those units and became a member, only to subsequently discover that the units have been diluted to 0.000775% of the total units, was entitled to inspect the books and records of the LLC for the period in which the dilution occurred. Nothing in the LLC agreement restricted members' rights to inspect records, the creditor had a proper motive – investigating a possible breach of the duty of loyalty – and members were not limited to inspecting books and records solely for the period in which they were members.

22. *Oyster Technologies, Ltd. v. Environmental Developers Group, LLC*,
2011 WL 6213747 (D. Mass. 2011)
Creditor with nonrecourse loan secured only by a 50% interest in a limited liability company was entitled to preliminary injunction against the debtor withdrawing funds from or pledging the assets of the limited liability company.

23. *In re Lake County Grapevine Nursery Operations*,
2010 WL 4928488 (Bankr. N.D. Cal. 2010)
Despite language in pledge agreement to the contrary, under California law neither the pledging of membership rights in an LLC nor the declaration of a breach by the secured party is sufficient to divest the pledging member of the right to vote.

24. *Royal Palm Senior Investors, LLC v. Carbon Capital II, Inc.*,
2009 WL 1941862 (S.D.N.Y. 2009)
Settlement agreement, by which debtor agreed that upon failure to pay the debt by a specified date its previously pledged membership interests in an LLC would automatically transfer to the secured party, was enforceable and thus secured party became the owner of the LLC and could assume management of the business.

25. *Olmstead v. F.T.C.*,
44 So. 3d 76 (Fla. 2010)
Judgment creditor seeking debtor's interest in single-member LLC was not limited to a charging order, but could instead obtain order compelling debtor to sign over interest in LLC.

26. *McDonald v. Yarchenko*,
2013 WL 3809512 (D. Or. 2013)
By sending a written proposal and receiving no objection thereto within 20 days, the secured party conducted an effective acceptance of the collateral – the debtor's $^1/_6$th interest in an LLC – in full satisfaction of the secured obligation even though the collateral was worth at least $407,000 and possibly as much as $1.6 million while the secured obligation was only about $12,000.

27. *395 Lampe, LLC v. Kawish, LLC*,
2014 WL 221814 (W.D. Wash. 2014)
A secured party with a security interest in the debtor's one-third ownership of an LLC did not, merely by transferring to itself after default title to that ownership interest, effect a disposition or an acceptance of the collateral. There was no disposition because a secured party cannot buy at a private sale and there was no public sale. There was no acceptance because there was no proposal therefor and the debtor had objected. As a result, there was no reason to determine the value of the LLC interest to determine what deficiency or surplus existed.

28. *First Bank v. S&R Grandview, L.L.C.*
2014 WL 846671 (N.C. Ct. App. 2014)
Judgment creditor that obtained a charging order against the judgment debtor's LLC interest did not thereby effect an assignment of the LLC interest and could not enjoin the debtor from exercising management rights or require that those rights lie fallow.

Liability Issues

29. *In re Roden*,
2013 WL 414450 (Bankr. N.D. Ala. 2013)
Manager and sole employee of LLC that originated and serviced equipment leases was liable to the bank to which the leases had been sold, even though he had not personally guaranteed payment, for damages caused by commingling the rental payments received with the proceeds of leases assigned to other lenders in an effort to spread the losses among all lenders.

30. *CML V, LLC v. Bax*,
6 A.3d 238 (Del. Ch. Ct. 2010)
While creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties, the language of the LLC Act bars creditors of an insolvent limited liability company from bringing derivative actions.

31. *Tredit Tire & Wheel Co., Inc. v. Regency Conversions, LLC*,
636 F. Supp. 2d 598 (E.D. Mich. 2009)
Unpaid supplier to limited liability company had pled claim, based on piercing corporate veil, against secured party that by foreclosure had become the only member of the LLC, replaced the LLC's president with its own employee, began running the company, and "made the tactical and strategic decisions about the LLC's business affairs," including which of its vendors would be paid.

32. *Eureka VIII LLC v. Niagara Falls Holdings LLC*,
899 A.2d 95 (Del. Sup. Ct. 2006)
LLC member's breach of LLC agreement by allowing secured creditor to gain control over the member warranted loss of membership interest and retention of only passive economic rights.

SECURITY INTERESTS IN ASSETS OF LLC

33. *Zaremba Group, LLC v. FDIC*,
2011 WL 721308 (E.D. Mich. 2011)
Husband of managing member of LLC had no apparent authority to grant bank a security interest in LLC's certificates of deposit because apparent authority must arise from acts of the principal, not the agent, and the LLC did nothing other than make the initial deposit shortly after the husband said it would occur. The LLC did not ratify the purported grant by signing a bank resolution ratifying all transactions purportedly done on the LLC's behalf because the LLC had no knowledge of the husband's actions at the time and the loan purportedly secured by the CDs was not for the LLC's benefit. The LLC had a valid contract claim against the bank for failure to honor the CDs, but not a claim for conversion, unjust enrichment, or wrongful detainer.

34. *Zurita v. SVH-1 Partners, Ltd.*,
2011 WL 6118573 (Tex. Ct. App. 2011)
Landlord acquired a security interest in equipment used by individual tenant even though the equipment was purchased by a limited liability company because the tenant wholly owned the LLC and therefore had the power to transfer rights in the equipment. Although security agreement referred to property "owned or hereafter acquired" by the tenant, that language did not limit the scope of the security interest.

35. *Assets Resolution Corp. v. Che LLC*,
2010 WL 1345284 (W.D. Ark. 2010)
Individual member of LLC who signed note and security agreement on behalf of LLC lacked authority under the LLC operating agreement and therefore was personally liable but did not bind the LLC.

36. *Pitman Place Development, LLC v. Howard Investments, LLC*,
2010 WL 4773404 (Mo. Ct. App. 2010)
Manager of LLC that provided fraudulently altered copy of LLC agreement to potential lender had apparent authority to execute notes and mortgage even though the other members did nothing to create this appearance other than to appoint the manager. Lender, as payee of note, was a holder in due course and lender's rights sheltered the rights of subsequent holder of the note.

37. *Development Specialists, Inc. v. R.E. Loans, LLC*,
2010 WL 4055570 (N.D. Cal. 2010)
Although Agreement Letter was signed by individual "for: R.E. Loans, LLC, B-4 Partners, LLC, Bar-K, Inc.," three separate entities, extrinsic evidence indicates that the latter two entities signed merely as members of the first. All the invoices identified only the first named entity as the debtor, the subsequent security agreement did not mention the latter two parties in its text, the security agreement was not signed at all by the third entity, and the signature line on the security agreement identified the second entity as "managing member" of the first entity.

38. *Credit Suisse Securities (USA) LLC v. West Coast Opportunity Fund, LLC*, 2009 WL 2356881 (Del. Ch. Ct. 2009)
Individual who signed in his individual capacity a lockup agreement promising not to pledge "directly or indirectly" certain corporate stock for one year did not thereby prevent LLC which owned the stock and of which he was the sole member and manger from pledging the stock to its broker. While the individual may have breached the lockup agreement, that did not impair the validity of the pledge.

39. *Peoples Bank v. Cornerstone Bank*, 504 F.3d 549 (5th Cir. 2007)
Security agreement signed by individual would grant security interest in business assets if the business was a sole proprietorship, but not if the business was operated as a partnership or LLC.

BANKRUPTCY ISSUES RELATING TO LLCS

40. *In re Talbut*, 2015 WL 5145598 (Bankr. N.D. Ohio 2015)
Although the term in the operating agreement for a LLC giving the LLC the option to purchase a member's interest in the event the member files a bankruptcy petition was an unenforceable *ipso facto* clause, another term giving the LLC a right of first refusal before any transfer of a membership interest was enforceable. Consequently, the bankruptcy trustee for one member would not be permitted to sell the debtor's membership interest absent evidence that the trustee had complied with the right of first refusal.

41. *In re Denman*, 513 B.R. 720 (Bankr. W.D. Tenn. 2014)
Operating agreement for LLC of which the debtor was a member was not an executory contract. Such agreements might lack mutual assent, consideration, and privity among the parties. Moreover, a member's failure to perform under an LLC operating agreement does not excuse the other members of their performance obligations under the agreement. Term in operating agreement that gave each member the right to purchase the interest of a member who files a bankruptcy petition was invalid under § 541(c)(1)(B).

42. *In re Wilson*,
2014 WL 3700634 (Bankr. N.D. Tex. 2014)
Term in LLC operating agreement providing that any member who wishes to transfer his or her interest must notify the other members, whereupon they will each have the right to purchase the interest at the lesser of book value or the proposed purchase price was generally effective in the Chapter 7 bankruptcy proceeding of one member. The bankruptcy trustee could auction the debtor's economic rights but the other members will have the right to buy at the highest price bid. The other members will not have the right to buy for book value because that would undermine the bankruptcy trustee's ability to realize fair value for the debtor's interest.

43. *In re Jundanian*,
2012 WL 1098544 (Bankr. D. Md. 2012)
Debtor's membership and distribution rights in Maryland LLC became part of his bankruptcy estate but nothing in the Bankruptcy Code overrode the restrictions on transfer of the membership rights and thus the trustee's sale to the debtor included only the distribution rights and the debtor did not re-acquire rights as member to participate in the management of the LLC.

44. *In re Blixseth*,
484 B.R. 360 (9th Cir. BAP 2012)
For venue purposes, the debtor's principal assets – intangible interests in LLCs – were located in the jurisdiction of organization because that is where collection efforts must be pursued, even though for UCC purposes the assets would be located at the jurisdiction of the debtor's residence.

45. *In re First Protection, Inc.*,
2010 WL 5059589 (9th Cir. BAP 2010)
All of debtors' rights and interest in single-member LLC – including their management rights – became property of the estate under § 541(a)(1) because § 541(c) overrides the restrictions in both the operating agreement and the Arizona LLC Act on the assignment of debtors' interest. The debtors' interest will not be treated as an executory contract under § 365 because that section is designed to protect third parties, and there is no third party in a single-member LLC.

46. *In re Player Wire Wheels, Ltd.*,
421 B.R. 851 (Bankr. N.D. Ohio 2009)
Creditor of LLC member with a security interest in the member's LLC interest was a party in interest the LLC's Chapter 11 bankruptcy because the creditor has a stake in how the membership interest is valued. However, the creditor cannot vote on the reorganization plan because the creditor is not a creditor of the LLC and, until the creditor forecloses on the membership interest, is also not an equity holder.

47. *In re Orchards Village Investments, LLC*,
405 B.R. 341 (Bankr. D. Or. 2009)
Despite appointment of receiver to administer assets of manager-managed LLC, manager could file bankruptcy petition for the LLC because that act was ratified by the LLC members. However, the receiver would not be required to turn the assets of the business over to the debtor in possession.

OTHER CASES RELATING TO INTERESTS IN LLCS

48. *In re Min Sik Kang*,
2015 WL 5786692 (E.D. Va. 2015)
The amended operating agreement for a limited liability company was effective even though not signed by the designed "independent member" because that individual had no interest in the company, was unaware of the operating agreement, and never accepted the position. A sale of a 60% interest in the company was void because the operating agreement, as permitted by Virginia law, required a secured party's consent to any transfer of more than 49% and the secured party had not consented.

49. *Wells Fargo Bank v. Barber*,
85 F. Supp. 3d 1308 (M.D. Fla. 2015)
Because Florida law allows a judgment creditor not merely to get a charging order against the judgment debtor's interest in a limited liability company, but also to foreclose against the LLC interest if the LLC has only one member, a judgment creditor could foreclose on the judgment debtor's interest in a single-member, Nevis LLC. It did not matter that Nevis law does not authorize foreclosure because Florida law governs given that the interest in the LLC is personal property and the situs of that property is Florida, where the judgment debtor is located.

50. *First Bank v. S&R Grandview, LLC*,
755 S.E.2d 393 (N.C. Ct. App. 2014)
Judgment creditor that obtained a charging order against the judgment debtor's LLC interest did not thereby effect an assignment of the LLC interest and could not enjoin the debtor from exercising management rights or require that those rights lie fallow.

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Application of UCC Sections 9-406 and 9-408 to Transfers of Interests in Unincorporated Business Organizations

Draft for Public Comment

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Submitted by

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Comments on this draft must be submitted by no later than April 2, 2012.

Comments may be submitted as follows:

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PEB COMMENTARY NO. __
APPLICATION OF UCC SECTIONS 9-406 AND 9-408 TO TRANSFERS OF INTERESTS IN UNINCORPORATED BUSINESS ORGANIZATIONS

INTRODUCTION

Article 9 of the Uniform Commercial Code (the "UCC") contains several provisions that facilitate the assignability of specified types of property in transactions to which Article 9 applies.[1] Building on common-law concepts of free alienability of property and on policies implemented in former § 9-318(4),[2] § 9-406 and § 9-408 override in specified ways restrictions on certain transfers of rights in certain types of personal property.[3] These sections contain provisions that can override both transfer restrictions imposed by law (including statutes) and transfer restrictions imposed by agreement. However, commentators have noted that a fundamental characteristic of the law and practice related to unincorporated business organizations is the "pick your partner" principle by which an owner can decide who the owner's business partner or partners may be through the use of those very transfer restrictions.[4] Thus it is important to examine the extent to which § 9-406 and § 9-408 have an effect on contractual and statutory transfer restrictions with respect to interests in unincorporated business organizations.

This examination is especially important because, apparently as a result of a perception that § 9-406 and § 9-408 are at odds with the types of transfer restrictions that are common in the context of unincorporated business organizations,[5] some state legislatures have enacted statutory provisions that make those two sections of Article 9 inapplicable to transfer restrictions that relate to partnerships and limited liability companies organized under the laws of those states.[6] However, as the following analysis demonstrates, § 9-406 and § 9-408 do not override otherwise effective transfer restrictions in a manner that undermines the "pick your partner" principle.

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[1] U.C.C. § 9-406 cmt. 5 (2001).

[2] *Id.*

[3] *I.e.*, "accounts," "chattel paper," "general intangibles" (including "payment intangibles"), and "promissory notes" as defined in U.C.C. § 9-102(a).

[4] *See* Revised Uniform Limited Liability Company Act (2006) § 502 cmt. (discussing the "pick your partner" principle and its fundamental importance to the law of unincorporated business organizations); *see also* the Prefatory Comment referring to the "pick your partner" principle as "fundamental" to the law of unincorporated business organizations. A few unincorporated business organizations do not depend on transfer restrictions. *See e.g.* Uniform Statutory Trust Entity Act (2009), § 601(a) (stating that "[a] beneficial interest in a statutory trust is freely transferable").

[5] The examples used in this Commentary involve general and limited partnerships and limited liability companies, but the analysis is generally applicable to unincorporated business entities whose ownership interests are not freely transferable.

[6] *See, e.g.*, Del. Code Ann. tit. 6 § 18-1101(g); Va. Code Ann. § 13.1-1001.1.B (both providing that U.C.C. §§ 9-406 and 9-408 "do not apply to any interest in a limited liability company"). To determine which state's partnership or limited liability company law governs the effect of U.C.C. §9-406 and § 9-408 on a transfer restriction, *see* Official Comment 3 to U.C.C. § 9-401.

This Commentary (i) describes the role of transfer restrictions in the law and practice of unincorporated business organizations[7]; (ii) explains how the UCC's approach to transfer restrictions applies in relation to that law and practice; and (iii) analyzes and applies the relevant parts of § 9-406 and § 9-408 to transactions within the scope of Article 9 that involve transfers of interests in unincorporated business organizations.

The Commentary also contains, as an appendix, a chart that provides an overview of the effect of § 9-406 and § 9-408 on the different types of transactions and different types of property involved in the analysis.

In this Commentary, unless the context indicates otherwise:

- "*Agreement*" means a partnership agreement among the partners of a general or limited partnership or an operating agreement among the members of a limited liability company.

- "*Economic rights,*" sometimes referred to in the statutes governing unincorporated business organizations as a "transferable interest,"[8] means the partner's or member's right to receive distributions from the general or limited partnership or a limited liability company. The term does not include any of a partner's other rights *qua* partner in a general or limited partnership or any of a member's other rights *qua* member of a limited liability company; in particular, the term does not include governance rights of a partner or member.

- *"Governance rights"* means an owner's rights *qua* owner to participate in management, obtain information, sue derivatively, and seek judicial dissolution. The term includes all rights flowing from a person's status as owner other than economic rights.

- "*Owner*" means a partner in a general or limited partnership and a member of a limited liability company.

- "*Ownership interest*" means all of a partner's rights *qua* partner in a general or limited partnership and all of a member's rights *qua* member of a limited liability company. The term includes the partner's or member's governance rights as well as the partner's or member's economic rights.[9]

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[7] The analysis in this Commentary assumes that restrictions imposed by agreement in this context are enforceable under law other than the UCC.

[8] Revised Uniform Partnership Act (1997) § 502; Uniform Limited Partnership Act (2001) §§ 102(22), 701; Revised Uniform Limited Liability Company Act (2006) §§ 102(21), 501. The original Uniform Limited Liability Company Act (1996) used the term "distributional interest." Uniform Limited Liability Company Act (1996) § 501.

[9] In both contracts and statutes, the terms "partnership interest" and "membership interest" can be used in an ambiguous manner, sometimes referring to all of an owner's rights and sometimes only to an owner's right to receive distributions. As used in this Commentary, the term "ownership interest" means all of an owner's rights, but the Commentary frequently refers to a "complete ownership interest" to emphasize that the interest

- "*Transfer*" includes a security interest, assignment, conveyance, deed, bill of sale, lease, mortgage, encumbrance, gift, and transfer by operation of law.[10]

- "*Transfer restriction*" means a restriction on the transfer of a complete ownership interest, or any part thereof, including an owner's economic rights or governance rights, regardless of whether the restriction is created by law or by agreement. The term includes a requirement that one or more other owners consent to the transfer.

I. TRANSFER RESTRICTIONS UNDER THE LAW AND PRACTICE OF UNINCORPORATED BUSINESS ORGANIZATIONS

Statutory transfer restrictions and statutory validations of contractual transfer restrictions (as discussed below) implement the "pick your partner" principle in the law of unincorporated business organizations.[11] These statutes typically provide that, while an owner of an interest in a limited partnership or limited liability company may freely transfer the owner's economic rights to a non-owner absent agreement to the contrary among the owners, the owner may not freely transfer its governance rights to a non-owner. For a transfer that includes governance rights to be effective, the other owners must consent, thus preserving the "pick your partner" principle.

Many partnership agreements and operating agreements also contain contractual transfer restrictions. Sometimes these transfer restrictions merely repeat the statutory restrictions on the transfer of governance rights, but many agreements go further. For example, a partnership or operating agreement might provide a "first refusal" or other "buy-sell" mechanism or otherwise limit or even prohibit the assignment of economic rights even though under the relevant statutory provisions the economic rights are otherwise freely transferable.

This Commentary addresses both the statutory transfer restrictions and transfer restrictions arising from an agreement. As the analysis demonstrates, Article 9 has only a limited, benign effect on transfer restrictions.

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comprises both governance and economic rights. Of course, the analysis applicable to a transaction involving a complete ownership interest or economic rights would apply to a transaction involving the transfer of a portion of the complete ownership interest or economic rights. This Commentary generally does not address transactions in which an owner seeks to transfer some or all of its governance rights without also transferring some or all of its economic rights. Such an unusual transaction would involve a general intangible that is not a payment intangible, and the analysis in this Commentary relating to such general intangibles would be applicable.

[10] Uniform Limited Partnership Act (2001) § 102(21); Revised Uniform Limited Liability Company Act (2006) § 102(20).

[11] The statutory transfer restrictions first appeared in a uniform act in the Uniform Partnership Act (1914) § 27, and have since been replicated in the Uniform Limited Partnership Act (1916) §§ 19 and 25; the Revised Uniform Limited Partnership Act (1976 and 1985) §§ 702 and 704; the Uniform Limited Liability Company Act (1996) §§ 502 and 503; the Revised Uniform Partnership Act (1997) § 503; the Uniform Limited Partnership Act (2001) § 702; the Revised Uniform Limited Liability Company Act (2006) § 502.

II. THE EFFECT OF UCC ARTICLE 9 ON TRANSFER RESTRICTIONS IN THE LAW AND PRACTICE OF UNINCORPORATED BUSINESS ORGANIZATIONS

A. Scope of UCC Article 9

As discussed in the Introduction, § 9-406 and § 9-408 have potential applicability to transfer restrictions. Those sections apply, however, only to transactions within the scope of Article 9. Thus, at the outset, it is important to identify which transfers of interests in unincorporated business entities are governed by Article 9.

With limited exceptions that are not germane to this Commentary, Article 9 applies to all transactions, regardless of their form, in which personal property (including a complete ownership interest, an owner's governance rights, and an owner's economic rights) secures payment or performance of (*i.e.*, is collateral for) an obligation.[12] Article 9 also applies to the sale of certain payment rights – accounts, chattel paper, payment intangibles, and promissory notes.[13] Article 9 does not apply, however, to the sale of other types of property including, most importantly for purposes of this Commentary, general intangibles that are not payment intangibles. As a matter of vocabulary, Article 9 uses the term "security interest" to include not only an interest in personal property that secures payment or performance of an obligation but also the interest of a buyer of the payment rights listed above.[14] As discussed in some detail below, the economic rights of an owner normally constitute a payment intangible,[15] while the owner's complete ownership interest is a general intangible that is not a payment intangible, as are an owner's governance rights. Thus, Article 9 applies to a transaction in which an owner's complete ownership interest (a general intangible), governance rights (a general intangible) or economic rights (a payment intangible) serve as collateral for an obligation *and* also to the sale of only economic rights (a payment intangible). Article 9 does not apply to the sale of a complete ownership interest (a general intangible) or of only governance rights (a general intangible).

B. An Overview of Sections 9-406 and 9-408

As noted above in Section II(A), Article 9 applies not only to transactions in which personal property is collateral for an obligation but also to the sale of some payment rights. As a result, § 9-406 and § 9-408 have potential applicability not only to transactions in which a complete ownership interest or an owner's governance or economic rights secure an obligation but also to transactions in which only economic rights are sold.

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[12] U.C.C. § 9-109(a)(1).

[13] U.C.C. § 9-109(a)(3).

[14] *See* U.C.C. § 1-201(b)(35).

[15] If a general partner's or managing member's economic rights serve primarily to compensate that person for the provision of services to the entity, it could be argued that the economic rights constitute an "account" under Article 9. *See* U.C.C. § 9-102(a)(2). *See also*, U.C.C. § 9-109(d)(3) (excluding from scope of Article 9 assignment of claim for wages, salary, or other compensation of employee). The application of U.C.C. §§ 9-406 and 9-408 discussed below is somewhat different as applied to accounts as compared to payment intangibles. This Commentary does not address the application of those sections to accounts.

As a general matter, § 9-406 applies to transfer restrictions that limit the use of economic rights as collateral for an obligation and § 9-408 applies to transfer restrictions that limit the sale of such rights. Section 9-408 also applies to restrictions that limit the use of a complete ownership interest or of only governance rights as collateral for an obligation. Neither section applies to restrictions on the sale of a complete ownership interest or of only governance rights because such sales, as discussed above in Section II(A), are not governed by Article 9. As demonstrated by the detailed analysis below, as a general matter, § 9-406 overrides transfer restrictions to a greater extent than does § 9-408.

However, the actual effect of § 9-406 and § 9-408 cannot be understood "as a general matter." Rather, a proper understanding requires consideration of the subsidiary issues addressed below.

C. A Preliminary Question: Is the membership interest "investment property"?

As will be explained below, § 9-406 and § 9-408 are irrelevant to a transfer of an ownership interest unless the ownership interest is a "general intangible." Thus, determining whether an ownership interest is within the category "general intangible" is pivotal to the application of § 9-406 and § 9-408 to such transfers.[16]

The term "general intangible" is defined by what it is *not*. An item of property is a general intangible if (and only if) it does not fit into any of the other types of personal property identified by Article 9. As a practical matter, it is usually obvious that an interest in an unincorporated business entity does not fit into most of the Article 9 property types. However, an ownership interest in an unincorporated business entity may, under some circumstances, qualify as "investment property." By definition, since property that is "investment property" cannot be a general intangible,[17] the applicability of § 9-406 and § 9-408 depends on whether the ownership interest fits within the category of "investment property."

Article 9 defines "investment property" to include a "security",[18] a term defined in Article 8.[19] Article 8 contains both a general definition of "security" and a special provision pertaining to "[a]n interest in a partnership or limited liability company."[20] Under that special provision, § 8-103(c), a partnership or limited liability company interest "is not a security" unless: (i) the interest is dealt in or traded on securities exchanges or in securities markets; (ii) the interest is an investment company security as defined in § 8-103(b); or (iii) the terms of the

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[16] As explained below, for purposes of this Commentary the key constructs are "general intangibles" and a subset of that construct - "payment intangibles." U.C.C. § 9-406 and § 9-408 also apply to the sale of accounts, chattel paper, and promissory notes. An ownership interest clearly does not fit into the chattel paper or promissory note categories. As discussed in note 15, *supra*, an owner's economic rights might constitute an account, but this Commentary does not address that possibility.

[17] U.C.C. § 9-102(a)(42) (defining "general intangible" as *inter alia* "personal property …other than …investment property").

[18] U.C.C. § 9-102(a)(49).

[19] U.C.C. §§ 9-102 (a)(49) (defining "investment property" as inter alia "a security" and §9-102(b) (incorporating by reference the definition of "security" in §8-102)).

[20] U.C.C. §§ 8-102(a)(15) (providing a definition "except as otherwise provided in Section 8-103") and 8-103(c) (providing a special rule for partnership and LLC interests).

interest "expressly provide" that it is a security governed by Article 8.[21] It is unusual for an ownership interest in a partnership or limited liability company to fit into either of the first two categories because, subject to a narrow range of exceptions, such entities lose their favorable tax classification if their interests are publicly traded.[22]

In contrast, an ownership interest in a partnership or limited liability company can fall into the third situation described in § 8-103(c) if the terms of the ownership interest expressly provide that the ownership interest is a security governed by Article 8. In such a case, those terms, often referred to as an "opt in" provision, will result in the ownership interest being categorized as a "security" under Article 8 and, accordingly, "investment property" under Article 9.[23] As "investment property," the ownership interest is removed from Article 9's pivotal category of "general intangible"[24] and, thus, excluded from the ambit of both § 9-406 and § 9-408.

As a result, the parties to a partnership agreement, operating agreement or other agreement can exclude the ownership interests from the ambit of § 9-406 and § 9-408 by including in the terms governing the ownership interests an Article 8 "opt in" provision under U.C.C. § 8-103(c).

D. The Two Key Article 9 Property Definitions.

The operation of Article 9 depends on a set of defined terms that categorize the property interests involved. For purposes of this Commentary, the relevant terms are "general intangible" and "payment intangible," with the latter being a subset of the former.[25]

As noted above, "general intangible" is the residual type of personal property under Article 9; property is a general intangible if it is not any of the other defined types of property.[26] A general intangible is also a "payment intangible" if the obligor's principal obligation is a monetary obligation.[27] Article 9 refers to the obligor on a general intangible (including a payment intangible) as the "account debtor."[28]

In the context of a partnership or limited liability company:

- A complete ownership interest, which comprises both economic and governance rights, is a general intangible that is not a payment intangible. The owner's economic

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[21] U.C.C. § 8-103(c).

[22] *See generally* Carter G. Bishop & Daniel S. Kleinberger, Limited Liability Companies: Tax and Business Law, ch. 16 (Warren Gorham & Lamont/RIA 2004; Supp. 2010-1).

[23] U.C.C. §§ 9-102(a)(49) (defining "investment property" as "a security"; 9-102(b) (incorporating by reference the definition of "security" in § 8-102); 8-102(a)(15) (identifying additional rules for applying "security" to specified types of property); 8-103(c) (providing a special rule for partnership and LLC interests).

[24] U.C.C. § 9-102(a)(42) (defining "general intangible" as *inter alia* "personal property …other than …investment property").

[25] U.C.C. § 9-102(a)(42).

[26] U.C.C. § 9-102(a)(42).

[27] U.C.C. § 9-102(a)(61).

[28] U.C.C. § 9-102(a)(3). A person may be an account debtor even if the person is not obligated on an account. The person may instead be obligated on chattel paper or a general intangible. *Id.*

rights consist of the owner's right to receive distributions from the entity but, because the owner's governance rights (and the entity's duty to honor those rights) are typically viewed as at least equally important,[29] the *principal* obligation of the account debtor (*i.e.*, the entity) would not be a monetary obligation.

- *A fortiori*, an owner's governance rights are a general intangible but not a payment intangible.

- An owner's economic rights, when considered separately from the owner's governance rights, constitute a payment intangible.[30]

E. Sections 9-406 and 9-408 Do Not Apply to (i) a Sale of a Complete Ownership Interest or of only Governance Rights or (ii) a Gift or, as a General Matter, a Transfer by Operation of Law of All or Part of a Complete Ownership Interest

As discussed above in Section II(A), neither § 9-406 nor § 9-408 applies to a transaction involving the sale of a complete ownership interest or of governance rights not associated with economic rights. This is because sales of general intangibles that are not payment intangibles are outside the scope of Article 9.[31]

Example 1: The Revised Uniform Limited Liability Company Act (2006) provides, as default rules, that: (i) after formation of a limited liability company, no person can become a member without the consent of all the existing members; (ii) a member cannot transfer any rights other than economic rights without the consent of the other members; and (iii) a transferee of only economic rights obtains no governance rights whatsoever.[32] A member seeks to sell its complete ownership interest (both governance and economic rights) to a non-member. Neither § 9-406 nor § 9-408 applies to the statutory transfer restrictions because Article 9 does not apply to the sale of a general intangible. Thus, Article 9 does not interfere with the effectiveness of these statutory provisions insofar as they limit the sale of the member's complete ownership interest. The same analysis applies if the member seeks to sell only the member's governance rights.

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[29] U.C.C. § 9-102 cmt. 5(d) provides guidance on the distinction between payment intangibles and other general intangibles. A right to the payment of money may be buttressed by ancillary covenants but will still constitute a payment intangible if the right to receive money is the principal right. In the context of a complete ownership interest, this Commentary assumes that the governance rights are more than mere ancillary covenants buttressing the economic rights.

[30] Several uniform acts contemplate debt (perhaps in the form of an instrument) being issued as a distribution. *See* Uniform Limited Liability Company Act (1996) § 406, Uniform Limited Partnership Act (2001) § 508, and Revised Uniform Limited Liability Company Act (2006) § 405. However, the issuance of an instrument does not mean that the *right* to a distribution is an instrument (and, thus, not a general intangible or payment intangible). Rather, once the distribution is made by the issuance of debt (whether evidenced by an instrument or not), the distributee is an ordinary creditor of the entity. *See* Uniform Limited Liability Company Act (1996) § 405(c), Uniform Limited Partnership Act (2001) § 507, and Revised Uniform Limited Liability Company Act (2006) § 404. Applying Article 9 to the debt instruments and other debt obligations of the entity is neither unusual nor problematic in the law and practice of unincorporated business organizations.

[31] *See* U.C.C. § 9-109(a); *see also* U.C.C. § 9-408 cmt. 4 (2001).

[32] Revised Uniform Limited Liability Company Act (2006) §§ 401(d)(3), 502 and 503.

Example 2: Same facts as Example 1, except the member seeks to sell one-half of the member's complete ownership interest. The result is the same. Neither § 9-406 nor § 9-408 applies to the statutory transfer restrictions.

Example 3: The operating agreement of XYZ, LLC prohibits the transfer of any governance rights (defined in the operating agreement) to any non-member without the consent of XYZ's manager and members owning 60% of the interests in profits owned by members. A member seeks to sell the member's complete ownership interest to a non-member. Neither § 9-406 nor § 9-408 applies to the contractual transfer restrictions. Thus, Article 9 does not interfere with the effectiveness of this contractual prohibition insofar as it limits the sale of the member's complete ownership interest. The same result obtains if a member seeks to sell all or part of the member's governance rights.

Example 4: Same facts as Example 3, except the member seeks to sell one-half of the member's complete ownership interest. The result is the same. Neither § 9-406 nor § 9-408 applies to the contractual transfer restrictions.

Sections 9-406 and 9-408 also are irrelevant to a transfer of all or part of an ownership interest by gift or to transfers by operation of law, such as by court order or upon the death of the owner. This is because Article 9 applies primarily to (i) transactions in which, by contract, personal property serves as collateral for an obligation and (ii) sales of certain payments rights including payment intangibles.[33] Neither of these situations is present in the case of a gift. When property is the subject of a gift, there is no obligation for which the property is collateral. Moreover, even if the ownership interest that is transferred constitutes a payment right, there is no "sale" of the payment right in the case of a gift. A sale consists of the passing of title from the seller to the buyer for a price.[34] Since there is no "price" in the case of a gift, there is no "sale." Accordingly, § 9-406 and § 9-408 do not apply to any restrictions on transfer by gift, regardless of whether the restrictions apply to economic rights, governance rights, or a complete ownership interest.

Similarly, because Article 9 does not generally apply to a transfer of a complete ownership interest or an owner's governance or economic rights by operation of law, such as by court order or upon the death of the owner, § 9-406 and § 9-408 do not apply to those situations.[35]

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[33] See U.C.C. §§ 9-109(a)(1) and (3).

[34] *See* U.C.C. § 2-106(1), made applicable to Article 9 by U.C.C. § 9-102(b).

[35] The qualifier "generally" is used here and elsewhere in this Commentary in this context, because Article 9 does apply to certain security interests arising by operation of law. *See* U.C.C. §§ 9-109(a)(2), (5) and (6). However, a security interest arising by operation law in original collateral under Article 9 is only in goods, "items" as defined in Article 4, "documents" as defined in Article 5, or "securities" or other "financial assets" as defined in Article 8 (defined in Article 9 as "investment property"). *See* U.C.C. §§ 9-110, 4-104(a)(9), 4-210, 5-102(a)(6), 5-118, 8-102(a)(9), 8-102(a)(17), 9-102(a)(49) and 9-206. Conceivably, these types of property could be exchanged for the types of interests discussed in this Commentary, and the security interest could attach to those interests through a proceeds analysis under U.C.C. § 9-315. It would be quite unusual for a security interest in economic rights, governance rights or an ownership interest to arise in that manner.

III. ANALYSIS AND APPLICATION OF THE PERTINENT PORTIONS OF SECTIONS 9-406 AND 9-408

If the transfer of an interest in an unincorporated business entity (other than an interest constituting investment property) is within the scope of Article 9, an analysis of §9-406 and § 9-408 is necessary in order to determine whether the effectiveness of any statutory or contractual restriction on that transfer is limited by Article 9. In Part B of this Section, each statutory provision is quoted in relevant part and is followed by an analysis. First, however, the meaning of one more Article 9 term must be addressed.

A. Another Key Article 9 Definition: Account Debtor

Both § 9-406 and § 9-408 express their overrides with regard to certain transfer restrictions for the benefit of the "account debtor." To understand how these sections affect transfer restrictions, it is essential to identify the account debtor.

In pertinent part, § 9-102(a)(3) defines "account debtor" as "a person obligated on … [a] general intangible." Thus, as to all or part of an ownership interest, the entity (the partnership or the limited liability company) is the account debtor. With regard to economic rights, *i.e.*, the right to receive distributions, the obligation runs from the entity to the members.[36] With regard to governance rights – which, together with the economic rights, comprise the complete ownership interest – again the entity is the obligor.[37]

A partner's or member's co-owners may also owe duties to the partner or member but these co-owners are not account debtors with respect to any part of the partner's or member's ownership interest. This analysis is correct even though, under the relevant partnership and limited liability company law, the owners, rather than the entity, have the right to grant or withhold consent to transfers. In other words, with respect to an owner's economic and governance rights, the "account debtor" typically is distinct from some of the persons whose rights are protected by transfer restrictions under the law and practice of unincorporated business organizations.[38]

B. Section 9-406(d) and (e)

Section 9-406(d) and (e) state:

> (d) **[Term restricting assignment generally ineffective.]**… a term in an agreement between an account debtor and an assignor … is ineffective to the extent that it:

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[36] Revised Uniform Limited Liability Company Act (2006) §§ 404 and 502.

[37] *See*, *e.g.*, Revised Uniform Limited Liability Company Act (2006) § 410(a)(2) (addressing information rights of members and stating that "[t]he company shall furnish to each member" specified information).

[38] *See* Newcombe v. Sundara, 274 Ill. App. 3d 590, 654 N.E. 530 (1995) (finding that former U.C.C. § 9-318(4) did not apply to override a transfer restriction in a limited partnership agreement that required the general partner to consent to a limited partner granting a security interest in his limited partnership interest, because the general partner was not an "account debtor" under former Article 9).

> (1) prohibits, restricts, or requires the consent of the account debtor … to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the … payment intangible …; or
>
> (2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the … payment intangible.
>
> (e) **[Inapplicability of subsection (d) to certain sales.]** Subsection (d) does not apply to the sale of a payment intangible … other than a sale pursuant to a disposition under section 9-610 or an acceptance of collateral under section 9-620.[39]

Section 9-406(d) applies to a transfer of an economic right only if and to the extent that the entity is a party to the agreement containing the transfer restriction, because the language of § 9-406(d) confines the subsection to situations involving "an agreement between an account debtor and an assignor." Rarely, if ever, is a partnership a party to its partnership agreement, and it is atypical for a limited liability company to be a party to its operating agreement.[40]

Moreover, because subsection (d) refers to payment intangibles, but not to general intangibles that are not payment intangibles, the subsection applies only to transfer restrictions on an owner's economic rights. The subsection has no effect at all on restrictions limiting the transfer of an owner's complete ownership interests or governance rights.

Even if the entity is a party to the agreement containing a transfer restriction on economic rights, § 9-406(d)(1) renders the restriction ineffective only to the extent that the restriction runs to the benefit of the account debtor, i.e., the entity. By its terms, subsection (d)(1) simply does not apply to a transfer restriction that runs to the benefit of other owners that are parties to the agreement, including any requirement for the consent of the other owners, because the other owners are not obligors with respect to the economic rights.

Likewise, while subsection (d)(2) can apply to an agreement containing transfer restrictions if the entity is a party to the agreement, by its terms the subsection: (i) applies only to

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[39] The language "other than a sale pursuant to a disposition under section 9-610 or an acceptance of collateral under section 9-620" was added in the 2010 amendments to Article 9 (which have an effective date of July 1, 2013). U.C.C. § 9-406(f) [not quoted here] overrides transfer restrictions created by "a rule of law, statute, or regulation," but its application is limited to accounts and chattel paper and thus it is inapplicable to the types of assets – general intangibles (including payment intangibles) - that are the subject of this Commentary.

[40] An entity may still be bound by the partnership agreement or operating agreement by statute even though it has not manifested assent to the agreement or otherwise bargained for it. *See*, *e.g.*, Revised Uniform Limited Liability Company Act (2006) § 111(a) (providing that "[a] limited liability company is bound by and may enforce the operating agreement, whether or not the company has itself manifested assent to the operating agreement"); Del. Code Ann. tit. 6 § 18-101(7) (providing that "[a] limited liability company is bound by its limited liability company agreement whether or not the limited liability company executes the limited liability company agreement"). However, such a statutory provision does not create an "agreement" as that term is used in U.C.C. § 9-406 or .§ 9-408. *See* U.C.C. § 1-201(b)(3) (" 'agreement', as distinguished from 'contract', means the bargain of the parties *in fact*, as found in their language or inferred from other circumstances….")(emphasis added).

an owner's economic rights (payment intangible), and (ii) does not affect any remedy of other owners that are parties to the agreement for breach of a transfer restriction contained in it.

These points are worth emphasizing. Even in those unusual cases in which the entity itself is a party to the partnership agreement or operating agreement along with the other partners or members, only the entity is an "account debtor" with respect to the economic rights and thus § 9-406(d) affects the agreement only insofar as it provides rights to the entity and has no effect on the agreement to the extent that it provides rights to the other parties.

Example 5: A limited liability company is a party to its own operating agreement. The operating agreement:

A. uses the words of the company's governing statute and requires unanimous member consent for any transfer of a complete ownership interest;

B. subjects any sale, creation of a security interest to secure an obligation, or other transfer of a member's economic rights to a right of first refusal, first in favor of the limited liability company and then in favor of the other members;

C. provides that any attempt to make a transfer in violation of the stated transfer restrictions is a breach of the operating agreement; and

D. recites that the limited liability company is a party to the operating agreement.

To the extent that the transfer restriction in Point A relates to a sale of the complete ownership interest, Article 9 does not apply at all since the sale would be a sale of a general intangible, and Article 9 does not apply to a sale of a general intangible that is not a payment intangible. But, in any event, § 9-406(d)(1) has no effect on any of the transfer restrictions described in point A, whether the restriction relates to a sale of the complete ownership interest or to a security interest in the complete ownership interest securing an obligation, because subsection (d) does not apply to general intangibles that are not payment intangibles.

As to the right of first refusal described in point B, subsection (d)(1):

- renders ineffective the company's right as applied to the creation, attachment, perfection, or enforcement of a security interest in the member's economic rights securing an obligation;
- due to § 9-406(e), has no effect on the company's right as applied to a sale of the economic rights by the member; and
- has no effect on the other members' rights of first refusal because the other members are not account debtors with respect to either economic rights or governance rights.

As to the provision in point C making a transfer in violation of a restriction a breach of the operating agreement:

- because of the limitation in § 9-406(e), subsection (d)(2) has no effect on the "breach" characterization as applied to an outright sale of the member's economic rights;

- § 9-406 has no effect on the provision as applied to a sale of the member's complete ownership interest or governance rights, because Article 9 does not apply to the sale of general intangibles that are not payment intangibles; and

- § 9-406(d)(2) overrides the "breach" characterization as it applies to the grant of a security interest in the member's economic rights to secure an obligation, but only insofar as the provision runs to the benefit of the company; subsection (d)(2) has no effect on the "breach" characterization to the extent that the breach creates rights for the other owners (who, by definition, are not account debtors with respect to the economic interest).[41]

Thus, the effect of § 9-406(d) is limited to transactions in which an owner grants a security interest in its economic rights as collateral for a loan or other obligation. Section 9-406(d) is further limited by the fact that it applies only to transfer restrictions concerning economic rights in an agreement between the owner and the entity, not to transfer restrictions among the owners *inter se*. Thus, as against the entity, only in these limited circumstances may the secured party exercise its remedies under part 6 of Article 9 notwithstanding the transfer restriction in favor of the entity. Those remedies would include the remedy:

- under § 9-607(a)(1) to collect distributions that would otherwise be paid to the owner;

- under § 9-610 to sell or otherwise dispose of the owner's economic rights in the entity;[42] and

- under § 9-620, with the consent or failure to object of the owner and other persons with an interest in the economic rights, to accept the economic rights in whole or in some cases partial satisfaction of the secured obligation.[43]

These remedies do not materially affect the "pick your partner" principle; they concern solely economic rights. Indeed, these Article 9 remedies provide no greater transferability than

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[41] The remedies available to the other owners arising from a breach would be determined by law other than Article 9.

[42] Prior to the 2010 amendments to U.C.C. §§ 9-406(e) and 9-408(b), U.C.C. § 9-406(e) was susceptible to the interpretation that U.C.C. § 9-406(d) would not apply to a sale of a payment intangible under U.C.C. § 9-610. The 2010 amendments clarify that U.C.C. § 9-406(d) does apply to the sale.

[43] Prior to the 2010 amendments to U.C.C. §§ 9-406(e) and 9-408(b), U.C.C. § 9-406(e) was susceptible to the interpretation that U.C.C. § 9-406(d) would not apply to the secured party's acceptance of a payment intangible under U.C.C. § 9-610 in whole or partial satisfaction of the secured obligation. The 2010 amendments clarify that U.C.C. § 9-406(d) does apply to the acceptance.

do the default rules under both partnership and limited liability company statutes, which, as explained above, leave entirely unrestricted an owner's right to transfer economic rights. Moreover, the remedies, when applicable, do not affect the rights of other owners that are parties to the agreement containing the transfer restriction.

C. Section 9-408(a) and (b)

As noted earlier, § 9-408, rather than § 9-406, applies to a transfer restriction to the extent that the transfer is either a sale of the owner's economic rights or the grant of a security interest in the owner's ownership interest or governance rights as collateral for an obligation.

Section 9-408(a) and (b) state:

> (a) **[Term restricting assignment generally ineffective.]** … a term in … an agreement between an account debtor and a debtor *[i.e., an owner]* which relates to … a general intangible… and … prohibits, restricts, or requires the consent of … the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the … general intangible, is ineffective to the extent that the term:
>
> (1) would impair the creation, attachment, or perfection of a security interest; or
>
> (2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the … general intangible.
>
> (b) **[Applicability of subsection (a) to sales of certain rights to payment.]** Subsection (a) applies to a security interest in a payment intangible … only if the security interest arises out of a sale of the payment intangible … other than a sale pursuant to a disposition under section 9-610 or an acceptance of collateral under section 9-620.[44]

As noted above, the account debtor with respect to an ownership interest, governance rights, or an economic interest is the entity itself. Thus, § 9-408(a), like § 9-406(d), is inapplicable unless the agreement containing the transfer restriction includes the entity as a party. Even then, § 9-408(a), like § 9-406(d), does not affect transfer restrictions with respect to an ownership interest, governance rights, or an economic interest to the extent the transfer restrictions run in favor of the other owners that are parties to the agreement rather than the entity. This is because the other owners are not account debtors with respect to those interests or rights.

Moreover, when § 9-408(a) does apply, it overrides restrictions only on "the creation, attachment, or perfection of a security interest." Because the override does not extend to enforcement of a security interest, § 9-408(a) is benign as to the "pick your partner" principle. Indeed, as further elaborated in § 9-408(d)(6), restrictions pertaining to the *enforcement* of the security interest are not affected for transactions governed by § 9-408 (as opposed to § 9-406).

[44] The language "other than a sale pursuant to a disposition under section 9-610 or an acceptance of collateral under section 9-620" was added in the 2010 amendments to Article 9.

Creation and attachment affect the existence of the security interest as between the debtor and the secured party as a matter of contract, and perfection affects the priority rights of the secured party as against other creditors of the owner, such as a lien creditor, a trustee in bankruptcy, competing secured parties, and other purchasers. Accordingly, as to the concerns of the entity (the limited partnership or the limited liability company) and the other owners, § 9-408(a) is a non-issue.

Consider first two examples pertaining to transactions with respect to a complete ownership interest (a general intangible that is not a payment intangible).

> **Example 6:** The operating agreement of a limited liability company to which the company is a party precludes a member from transferring its complete ownership interest without the consent of the other members. The member grants to Secured Party a security interest in its complete ownership interest as collateral for an obligation. With regard to the company, § 9-408(a) overrides the transfer restriction to the extent described above (*i.e.*, to the extent it impairs creation, attachment and perfection of the security interest). Section 9-408(a) has no effect on the rights of the other members that are parties to the operating agreement. The same analysis applies if the security interest pertains only to governance rights.
>
> **Example 7:** Same facts as Example 6 except that the member defaults under its security agreement with Secured Party. Although, as described in Example 6, § 9-408(a) overrides the transfer restriction insofar as it prevented creation, attachment or perfection of the security interest, the section has no effect on the restriction to the extent that it limits Secured Party's enforcement of its security interest, including its remedy of collection under § 9-607, its remedy of disposition under § 9-610, and its remedy of acceptance of collateral under § 9-620.

Consider next the application of § 9-408(a) to the outright sale of an owner's economic rights.

> **Example 8:** The operating agreement of a limited liability company to which the company is a party precludes members from transferring any part of their ownership interest, including their economic rights, without the consent of the other members. A member sells its economic rights to Buyer. Because, in UCC parlance, the sale creates a security interest, § 9-408(a) renders the contractual transfer restriction, to the extent that it runs in favor of the company, ineffective to prevent the sale from taking place as between the member and Buyer. As in Example 7, however, the provision does not override the transfer restriction to the extent that it restricts enforcement by Buyer of that security interest. Thus, as further elaborated in § 9-408(d), the transfer restriction remains effective, even as applied to the company, to deny Buyer the right to collect from the company any distributions to which the member is entitled. Indeed, the company has no obligation to recognize Buyer as the owner of the economic rights.[45]

[45] There may be a concern that, if the owner has transferred all of the owner's economic rights in the limited liability company, the owner would have no further economic incentive to exercise governance rights in the

More fundamentally, § 9-408(a) does not apply to a transfer restriction that runs in favor of other owners that are parties to the agreement containing the restriction. Because transfer restrictions in agreements invariably give rights to the other owners, § 9-408(a) has limited practical effect.

To emphasize these points as well as points made earlier in this Commentary, consider an example that is a variation of Example 5 and an analysis of the example under § 9-408(a).

> **Example 9**: A limited liability company is a party to its own operating agreement. The operating agreement:
>
> A. uses the words of the company's governing statute and requires unanimous member consent for any transfer of a complete ownership interest;
>
> B. subjects any sale, creation of a security interest to secure an obligation, or other transfer of a member's complete ownership interest to a right of first refusal, first in favor of the limited liability company and then in favor of the other members;
>
> C. provides that any attempt to make a transfer in violation of the stated transfer restrictions is a breach of the operating agreement; and
>
> D. recites that the limited liability company is a party to the operating agreement.
>
> In the case of a sale by a member of a complete ownership interest, subsection (a) has no effect at all. A sale of a complete ownership interest is a sale of a general intangible, and Article 9 itself does not apply to a sale of a general intangible.
>
> In the case of a security interest in the complete ownership interest securing an obligation, subsection (a):
>
> - has no effect on the other members' rights described in point A to consent to the security interest, because the other members are not account debtors with respect to ownership rights;
> - renders ineffective the company's right of first refusal described in point B as applied to the creation, attachment, or perfection of the security interest;

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best interest of the limited liability company and the other members. However, many limited liability company statutes now expressly authorize non-economic members. Revised Uniform Limited Liability Company Act § 401(e), Del. Code Ann. tit. 6 § 18-301(d). Also, under most statutes governing partnerships and limited liability companies, an owner that sells all of its economic rights may be expelled or will cease to have governance rights. *See*, *e.g.*, Revised Uniform Limited Liability Company Act (2006) § 602(4)(B); Del. Code Ann. tit. 6 § 18-702(b)(3). Certainly, an operating or partnership agreement may so provide. Moreover, a non-economic member will continue to be subject to the implied covenant of good faith and fair dealing and in some circumstances to fiduciary obligations as well.

- does not render ineffective the company's right of first refusal as applied to the enforcement of the security interest;[46]

- has no effect on the other members' rights of first refusal, because the other members are not account debtors with respect to ownership rights;

- overrides the "breach" characterization described in point C as it applies to the creation, attachment or perfection of the security interest, but only insofar as the provision runs to the benefit of the company;

- does not override the "breach" characterization as it applies to the enforcement of the security interest insofar as the provision runs for the benefit of the company; and

- has no effect on the "breach" characterization to the extent that the breach creates rights for the other members, because the other members are not account debtors with respect to ownership rights.[47]

D. Section 9-408(c)

Section 9-408(c) states:

> (c) **[Legal restrictions on assignment generally ineffective.]** A rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a[n] … account debtor to the assignment or transfer of, or creation of a security interest in, a …general intangible, … is ineffective to the extent that the rule of law, statute, or regulation:
>
> (1) would impair the creation, attachment, or perfection of a security interest; or
>
> (2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the … general intangible.

Section 9-408(c) applies to non-contractual, legal transfer restrictions, but the analysis for subsection (c) is the same as for subsection (a). Even if § 9-408(c) applies, its override of transfer restrictions does not apply to transfer restrictions that run in favor of the other owners

[46] U.C.C. § 9-408(a) would not create any duty of the company to pay to the secured party any distributions from the company otherwise payable to the member, or otherwise to recognize the secured party, if the secured party sought to exercise its right of collection under U.C.C. § 9-607. Nor would U.C.C. § 9-408(a) override the company's right of first refusal if the secured party sought to exercise its right of disposition under U.C.C. § 9-610 or its right of acceptance under U.C.C. § 9-620. *See also* U.C.C. § 9-408(d).

[47] Once again, the remedies available to the other members arising from a breach would be determined by law other than Article 9.

and, in any event, does not override restrictions on enforcement. Thus, the scope of § 9-408(c) is very limited.

IV. CONCLUSION

The transfer restriction "override" provisions of § 9-406 and § 9-408 do not apply to sales of complete ownership interests or governance rights or to gifts or, as a general matter, transfers by operation of law of a complete ownership interest, governance rights or an economic interest because such sales, gifts, or, as a general matter, transfers by operation of law are outside the scope of Article 9. Nor do the provisions apply to ownership interests that are "securities" governed by Article 8.

When § 9-406 and § 9-408 do apply to the transfer of a complete ownership interest or a governance or economic interest, these sections override transfer restrictions that run in favor of the entity under an agreement to which the entity is a party or that are imposed in favor of the entity by statute or other rule of law. But § 9-406 and § 9-408 leave intact transfer restrictions that run in favor of the entity's other owners. Therefore, the override provisions have little or no effect on the transfer restrictions that protect the "pick your partner" principle under the law of unincorporated business organizations.

Sections 9-406 and 9-408 can affect transfer restrictions that operate in favor of the entity itself, but even those effects are benign. With regard to restrictions on transfer of economic rights, the UCC provisions result in no greater transferability than exists under the default rules of all partnership and limited liability company statutes. With regard to restrictions on the use of complete ownership interests as collateral, the UCC provisions permit a security interest to be created, attach, and become perfected notwithstanding such restrictions, but this result has no effect on the entity because the transferee does not acquire enforcement rights free of the transfer restriction.

The chart in the appendix to this Commentary summarizes the effect of § 9-406 and § 9-408 on legal and contractual transfer restrictions in the various contexts discussed in this Commentary.

APPENDIX

Article 9 classification of property subject to a transfer restriction	**Effect of §§ 9-406 and 9-408 on a transfer restriction that would limit use of the property as collateral**	**Effect of §§ 9-406 and 9-408 on a transfer restriction that would limit sale of the property**	**Effect of §§ 9-406 and 9-408 on a transfer restriction that would limit a gift of the property or, as a general matter, a transfer of it arising by operation of law**
Investment property	Neither section is applicable	Neither section is applicable	Neither section is applicable
Payment intangible (economic rights and sometimes referred under the uniform laws for unincorporated business organizations as a "transferable interest")	Section 9-406(d) overrides contractual transfer restrictions with and in favor of the entity, including contractual transfer restrictions on enforcement No effect on contractual transfer restrictions in favor of the other owners	Section 9-408(a) overrides contractual transfer restrictions with and in favor of the entity that would otherwise prevent creation, attachment, or perfection No effect on contractual transfer restrictions on enforcement No effect on contractual transfer restrictions in favor of other owners Section 9-408(c) overrides legal transfer restrictions that would otherwise prevent creation, attachment, or perfection No effect on legal transfer restrictions	Neither section is applicable

Article 9 classification of property subject to a transfer restriction	**Effect of §§ 9-406 and 9-408 on a transfer restriction that would limit use of the property as collateral**	**Effect of §§ 9-406 and 9-408 on a transfer restriction that would limit sale of the property**	**Effect of §§ 9-406 and 9-408 on a transfer restriction that would limit a gift of the property or, as a general matter, a transfer of it arising by operation of law**
		on enforcement	
General intangible that is not a payment intangible (economic rights and governance rights)	Section 9-408(a) overrides contractual transfer restrictions with and in favor of the entity that would otherwise prevent creation, attachment, or perfection No effect on contractual transfer restrictions on enforcement No effect on contractual restrictions in favor of other owners Section 9-408(c) overrides legal transfer restrictions that would otherwise prevent creation, attachment, or perfection No effect on legal transfer restrictions on enforcement	Neither section is applicable	Neither section is applicable

SECURITY AGREEMENT
(LIMITED LIABILITY COMPANY INTERESTS)

THIS SECURITY AGREEMENT (this "Agreement") is made on [_____], between [_____] ("Debtor") and [_____] ("Secured Party").

1. Defined Terms; Rules of Construction.

[Grant/Perfection Subcommittee: (a) Capitalized terms used in this Agreement and not otherwise defined herein shall have the meanings assigned to them in the Financing Agreement.

(b) Terms Defined by Statute:

(i) Unless otherwise defined in this Agreement [or the Financing Agreement] and where plainly apparent by the context in which such terms are used, [capitalized] terms used in this Agreement have the meanings assigned in the UCC or in RULLCA.

(ii) The terms "Filing Office"[1] "Financing Statement"[2] "Investment Security"[3] and "Proceeds" shall have their respective meanings as defined in the UCC.[4]

(c) As used in this Agreement, the following terms have the respective meanings set forth below:

"***Agreement***" means this Security Agreement as amended, modified, supplemented and/or restated from time to time.

"***Collateral***" is defined in Section 2.[5]

"***Debtor***" is identified in the preamble to this Agreement.

"***Event of Default***" is defined in Section 6(c).

"***Financing Agreement***" means the [Credit Agreement/Indenture/_____ Agreement] among the Obligor, the Secured Party and [*specify*] dated as of [the date hereof][_____. 20___] as amended, modified, supplement and/or restated from time to time.]

"***Future LLC Interests***" is defined in Section 2(a)(i).

"***Issuing Entity***" means the limited liability company that issues LLC Interests.

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[1] **Reps/Warranties Subcommittee:** See UCC § 9-102(37) Define the office designated in § 9-501 as a place to file financing statements.
[2] **Reps/Warranties Subcommittee:** See UCC § 9-102(39).
[3] **Reps/Warranties Subcommittee:** See UCC § 9-102(49).
[4] **Reps/Warranties Subcommittee:** See UCC § 9-102(64).
[5] **Enforcement Subcommittee:** The definition of "Collateral" should be revised to include broadly defined concepts of equity interests and capital accounts and distributions of the Issuing Entity. The Enforcement Subcommittee can provide sample language if that would be helpful.

"***Issuing Entity Governing Documents***" means the Certificate of Formation[6] and the Operating Agreement[7] [8] of the Issuing Entity.

"***LLC Interests***" is defined in Section 2(a)(i).[9]

"***Loan Documents***" means [_____].

"***Obligor***" means [_____], the party obligated for repayment of the Secured Obligations.

"***RULLCA***" means the Revised Uniform Limited Liability Company Act approved by the Uniform Law Commission in July, 2006, as enacted in _____.[10]

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[6] **Reps/Warranties Subcommittee:** Certain states refer to the initial organization filing of an LLC as the "Certificate of Formation." *See* DEL. CODE ANN. tit. 6, § 18-201 (LEXIS through 2014 Fiscal Sess.). *Accord* N.J. REV. STAT. § 42:2B-11 (LEXIS through 2014 Reg. Sess.) (certificate of formation); TEX. BUS. ORGS. CODE ANN. § 3.001 (LEXIS through 2013 3rd Called Sess.) (certificate of formation);); WASH. REV. CODE § 25.15.070 (LEXIS through 2013 3rd Special Session.) (certificate of formation); REVISED PROTOTYPE LTD. LIAB. CO. ACT § 201, 67 BUS. LAW. at 117, 142 (2011) (certificate of formation). In certain states the initial filing with the Secretary of State is designated "Articles of Organization." *See, e.g.*, KY. REV. STAT. ANN. § 275.025 (LEXIS through 2013 First Extra. Sess.) (articles of organization); N.Y. LTD. LIAB. CO. LAW § 203 (Consol. 2014) (articles of organization); VA. CODE ANN. § 13.1-1010 (LEXIS through 2014 Regular Session and Acts 2014, Sp. Sess. I, c. 1, of the General Assembly.) (articles of organization) Still another label used for the initial organizational filing is "Certificate of Organization." *See* REVISED UNIF. LTD. LIAB. CO. ACT § 201, 6B U.L.A. 456 (2008) (certificate of organization).

[7] **Grant/Perfection Subcommittee:** The Revised Uniform Limited Liability Act (the "RULLCA") defines Operating Agreement broadly to mean: "the agreement, whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all the members of a limited liability company, including a sole member, concerning the matters described in Section 110(a). The term includes the agreement as amended or restated." This definition is very broad and recognizes a wide scope of authority for the operating agreement: "the matters described in Section 110(a)." Those matters include not only all relations inter se the members and the limited liability company but also all "activities of the company and the conduct of those activities." Section 110(a)(3). Moreover, the definition puts no limits on the form of the operating agreement. To the contrary, the definition contains the phrase "whether oral, in a record, implied, or in any combination thereof". Different states have very different definitions and indeed many states do not even use the term Operating Agreement but rather use terms such as "Limited Liability Company Agreement" see, e.g. 18-101(7) of the DE LLC Act. Similarly, not all jurisdictions use the defined term Certificate of Formation. You should review the statutory definition in your applicable jurisdiction to ensure that you are using the right terms and that such terms encompass everything that you intend to cover.

[8] **Reps/Warranties Subcommittee:** *See, e.g.*, IND. CODE § 23-18-1-16 (definition of "operating agreement"); KY. REV. STAT. ANN. § 275.015(20) (same). Under some laws the equivalent agreement is defined as the "limited liability company agreement." *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-101(7); REV. PROTOTYPE LIMITED LIABILITY COMPANY ACT § 102(14), 67 BUS. LAW. 117, 129 (Nov. 2011). Most states permit the operating agreement to be entirely or in part oral. See, **Ribstein and Keatinge on Limited Liability Companies**, 2nd Edition, 2014, Appendix 4-19. It is important to appreciate that the "operating agreement" is a functional agreement, essentially the agreement as to the operation of the LLC. For that reason (a) the operating agreement need not be the document bearing that label and (b) it is possible that any number of distinct documents will collectively constitute the "operating agreement."

[9] **Enforcement Subcommittee:** Comment on impact of obtaining a security interest in less than one hundred percent of the equity interests in the Issuing Entity

[10] **Grant/Perfection Subcommittee:** This reference should be replaced with a reference to the limited liability company act under which the Issuing Entity was organized. It is important to review and understand how the relevant limited liability company act varies from the RULLCA used in this model.

"***Secured Obligations***" means all indebtedness or other obligations of Obligor to Secured Party of any nature or character [arising out of, under or un connection with, the Loan Documents].[11]

"***Secured Party***" is identified in the preamble to this Agreement.

"***UCC***" means the Uniform Commercial Code-Secured Transactions (2010 Official Text with Comments) as adopted and in effect in [***jurisdiction***] [12] [13]

(d) Rules of Construction. The following rules of construction and interpretation apply to this Agreement:

(i) Paragraph headings are for convenience only and are not relevant to the construction or interpretation of any provision of this Security Agreement.

(ii) The terms "hereof," "herein," "hereby," "hereto" and derivative or similar words refer to either the entire Security Agreement or to specified clauses, as the context requires.

(iii) Pronouns include the corresponding masculine, feminine or neuter forms, and the singular form of nouns, pronouns and verbs includes the plural and vice versa.

(iv) The word "including" is by way of example rather than limitation.

(v) Reference to any agreement, document or instrument, including this Security Agreement, means such agreement, document or instrument as amended or modified from time to time in accordance with the terms thereof and, if applicable, hereof.

(vi) The words "or", "either", "any" or "all" are not exclusive.

(vii) References to a Person include the Person's successors and permitted assigns.

(viii) No presumption or burden of proof will arise in favor of or against any Party by virtue of the authorship of any provision of this Agreement.

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[11] **Reps/Warranties Subcommittee:** If the pledge of security interest in the LLC Interests is to a bank or other institutional lender this is a typical description of "Secured Obligations." However, if the pledge of the security interest is made in connection with a specific loan (as is the presumed construct for the purposes of this annotated model), or to finance the capital contribution of the Debtor to the Issuing Entity, the definition is likely to refer only to a particular loan. In other situations, the pledge may be given as additional security for a particular obligation. Accordingly, the definition of Secured Obligations must be tailored for the particular transaction.

[12] **Grant/Perfection Subcommittee:** See note 6 above. Insert agreed jurisdiction, which may be jurisdiction of organization of Issuing Entity, or may be jurisdiction whose law governs this Security Agreement. Note that while it is unclear whether the override of restrictions on assignment found in Sections 9-406 and 9-408 of the Official Text would be applicable to equity interests in a limited liability company in any event, in some states any such reliance would face additional hurdles and/or be impossible. For example, 18-1101(g) of the DE LLC Act provides: (g) Sections 9-406 and 9-408 of [Article 9 of the DE Uniform Commercial Code] do not apply to any interest in a limited liability company, including all rights, powers and interests arising under a limited liability company agreement or this chapter. This provision prevails over §§ 9-406 and 9-408 of [Article 9 of the DE Uniform Commercial Code]." Several other states have similar provisions, see Section 101.106 of the Texas Business Organizations Code, Kansas Revised Statutes 275.255(4), Virginia Code 13.1-1001.1(B). Note also that some states, e.g. New York, did not enact the override of legal restrictions on assignment found in Section 9-408(c) of the Official Text of the UCC.

[13] **Enforcement Subcommittee:** Comment on non-uniform provisions, especially in Delaware. Also consider whether the "internal affairs" law of the Issuing Entity may conflict with the governing law of the Agreement. For example, if the Debtor is located in Illinois, the Issuing Entity is formed in Delaware, and the governing law of the Agreement is New York, what version of 9-406 and 9-408 will apply?

(ix) The word "will" shall be construed to have the same meaning and effect as the word "shall."

2. Grant and Continuation of Security Interest.

(a) Debtor hereby grants to the Secured Party, as collateral security for the prompt and complete payment when due of the Secured Obligations, a security interest in all of the Debtor's right, title and interest in and to the following, wherever located, in which Debtor now has or at any time in the future acquires any right, title or interest (collectively, the "***Collateral***"):

(i) all equity interests in the Issuing Entity in which Debtor currently has any rights (the "***Existing LLC Interest***") including, without limitation, the equity interests identified on Schedule 1 annexed hereto[14], and all equity interests in the Issuing Entity in which the Debtor hereafter acquires any rights (the "***Future LLC Interests***" and, together with the Existing LLC Interests, collectively, the "***LLC Interests***"), in each case, no matter how characterized[15] [16] including, without limitation, all rights [as owner of such equity interests] to the profits and losses of the Issuing Entity, all rights to receive distributions of the Issuing Entity's assets, voting rights, management rights and all other rights of the Debtor under the Operating Agreement or the RULLCA (collectively, the "***LLC Interests***"[17]);

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[14]**Grant/Perfection Subcommittee:** This model assumes that all current and future equity interests of the Debtor in the Issuing Entity are intended to be pledged. In the less common case where only a specified portion of the Debtor's interest in the equity interests in the Issuing Entity are intended to be pledged this language should be revised to refer only to the equity interests identified on Schedule 1. Even if the Debtor pledges all of its equity interests in the Issuing Entity, if this is less than 100% of all equity interests in the Issuing Entity (i.e. there are also equity interests held by persons who are not pledgors) counsel for the secured party should carefully review the Operating Agreement and the applicable limited liability statute in order to determine the limitations on the secured party becoming, or conveying to third parties the right to become, a member. Additionally, the RULLCA and the limited liability company acts generally allow wide latitude in allocating economic and management rights and the Operating Agreement should be reviewed in order to understand the nature of the Debtor's rights. For example a Debtor may have economic rights but little or no right to participate in the management of the Issuing Entity.

[15] **Reps/Warranties Subcommittee**: This form is based on RULLCA. Under RULLCA the Transferable Interest is defined as the right, as a member, to receive distributions from the Issuing Entity. The Transferable Interest does not include the right of a member to vote or consent to matters affecting the limited liability company or the rights to obtain information from the limited liability company. The Delaware Limited Liability Company Act defines a limited liability company interest and provides that an assignee does not have any rights to participate in the limited liability company agreement except as provided in the Limited Liability Company Agreement **(GET CITE).** It is important to understand the terminology utilized in the law of the Issuing Entity's law of organization and the rights of an assignee which typically do not include voting rights and rights to information. A Secured Party can obtain additional rights by agreement with the Issuing Entity. A pledgee or purchaser of a pledged limited liability company interest does not become a member of the Issuing Entity. A sample of the provisions that a Secured Party might seek are attached as Exhibit __ hereto.

[16]**Enforcement Subcommittee:** Comment on the fact that membership interests may differ from economic interests (which are a subset of membership interests).

[17] **Reps/Warranties Subcommittee**: Most if not all LLC acts expressly permit membership interests to be represented by a physical certificate. *See*, *e.g.*, GA. CODE ANN. § 14-11-501(b) (LEXIS through 2014 Reg. Sess.); KY. REV. STAT. ANN. § 275.255(2) (LEXIS through 2013 First Extra. Sess.). However, depending upon applicable state law and modifications to those definitions contained in the operating agreement, a certificate might evidence only a member's economic rights (*see*, *e.g.*, GA. CODE ANN. § 14-11-101(13) (LEXIS through 2014 Reg. Sess.); VA. CODE ANN. § 13.1-1002) (LEXIS through the 2014 Regular Session and Acts 2014, Sp. Sess. I, c. 1, of the General Assembly.) and not the entirety of the management rights that might be commonly perceived as being component to

(ii) any right or option to acquire LLC Interests, including subscription rights, warrants or analogous rights;

(iii) certificates, if any, representing the LLC Interests or that may be issued from time to time with respect to the LLC Interests;

(iv) all securities, moneys or property representing LLC Interests or distributions[18] [19] or interest on the LLC Interests (or on capital contributions made in respect of the LLC interests), or resulting from a split up, revision, reclassification, conversion or other like change of the LLC Interests or otherwise received in exchange for the LLC Interests;

(v) all other payments, if any, due or to become due to the Debtor in respect of the LLC Interests;

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a "membership interest." Note that, if it is desired that physical certificates be governed by and have the effect of a certificated security under Article 8 of the Uniform Commercial Code, it is necessary that a specific election to that effect be made in the operating agreement. 8-103. Absent that election, interests in a limited liability company are general intangibles governed by Article 9 of the Uniform Commercial Code. See Lynn A. Soukup, *"Opting In" to Article 8 – LLC, GP & LP Interests as Collateral*, COMMERCIAL LAW NEWSLETTER (newsletter of the ABA Uniform Commercial Code Committee), July, 2002, reprinted in PUBOGRAM (newsletter of the ABA Committee on Partnerships and Unincorporated Business Organizations), November, 2002; *see also* Robert R. Keatinge, *Taking and Enforcing Security Interests in Interests in Unincorporated Businesses*, LIMITED LIABILITY ENTITIES IN TIME OF CHANGE, ALI-ABA (Mar. 12, 2003), in VPC0312 ALI-ABA 245; Robert R. Keatinge, *Interests in Unincorporated Associations as Securities Under Article 8 of the UCC*, LIMITED LIABILITY ENTITIES IN TIME OF CHANGE, A.L.I.-A.B.A. (Mar. 12, 2002), in WPC0312 A.L.I.-A.B.A. 361. *See generally* BISHIP AND KLEINBERGER, ¶ 5.04[2][b][ii][C]; RIBSTEIN AND KEATINGE, § 7:7. If the LLC interests are general intangibles the certificates will lack legal significance for purposes of creating and perfecting a security interest in the LLC interests. Nevertheless, it is customary and advisable to include any certificates in the granting clauses and for the secured party to take possession thereof. Additionally, if such LLC Interests are a "security" under Section 8-103(c) of the UCC, it is customary for the secured party to require that such LLC Interests be evidenced by a certificate and delivered to the secured party together with an endorsement in blank. If an Article 8 election is made, then a security interest in the LLC Interest can be perfected by obtaining "control" of the certificated security within the meaning of Section 8-106 of the UCC (which generally means taking possession of the certificated security) pursuant to the rules of Section 9-314 and 9-106 of the UCC. The security interest held by a secured party having control of a certificated security (which constitutes investment property under the UCC) takes priority over a security interest in the same collateral perfected by filing pursuant to Section 9-328 of the UCC.

[18] **Enforcement Subcommittee:** Comment on covenants regarding right to receive and retain pre-default distributions.

[19] **Reps/Warranties Subcommittee:** The description of the rights and interest pledged used includes all distributions, including distributions of cash flow from operations. If the loan financed the capital contribution of the Debtor, typically all distributions will be required to be paid to the Secured Party; however, the Debtor may want to seek the agreement of the Secured Party that exempts all or a portion of "tax distributions" from such application. Tax distributions in this context, are distributions from the limited liability company made to provide funds for the payment of estimated or current year taxes on taxable income of the Issuing Entity and the Debtor would prefer to retain the tax distribution. If the pledge is to provide additional security for a loan the parties likely intend to provide that only distributions of the proceeds of capital events or liquidating distributions should be applied to pay down the loan, in which case the granting provisions or covenants should be modified. In other cases, the pledge may be of some, but not all of the Debtor's interest in the Issuing Entity (although this is unusual). However, in most instances, even if the Secured Party only expects to receive distributions from capital events, if a default occurs with respect to the underlying debt, the Secured Party generally has the right to receive all distributions. Accordingly, the granting clauses should reflect the actual agreement of the parties.

(vi) all rights, privileges, authority and power arising from the Debtor's ownership of the LLC Interests and all of the Debtor's rights under any Issuing Entity Governing Documents or otherwise to exercise and enforce every right, power, remedy, authority, option and privilege of the Debtor relating to the LLC Interests, including the right to execute any instruments and to take any and all other action, on behalf of and in the name of the Debtor in respect of the LLC Interests or the Issuing Entity, to make determinations, to exercise any election (including election of remedies) or option or to give or receive any notice, consent, amendment, waiver or approval, together with full power and authority to demand, receive, enforce or collect any of the foregoing or any property of the Issuing Entity, to enforce or execute any checks or other instruments or orders and to file any claims and to take any action in connection with any of the foregoing;[20]

(vii) all equity interests or other property now owned or hereafter acquired by the Debtor as a result of exchange offers, recapitalizations of any type, contributions to capital, options or other rights relating to the LLC Interests;

(viii) all books and records, documents and other information (tangible or electronic) evidencing or relating to any of the foregoing; and

(ix) Proceeds of any of the foregoing (including any proceeds of insurance thereon).

(b) The security interest in the Collateral is not terminated, abated, affected or impaired by the happening from time to time of (i) the impairment, modification, discharge or limitation of the liability of the Debtor, Obligor or any Issuing Entity, or its respective estate, in bankruptcy, conservatorship or receivership; or (ii) the dissolution, liquidation or termination of the Debtor, Obligor or the Issuing Entity. Notwithstanding anything herein to the contrary, Debtor shall remain liable for all obligations under the Collateral and nothing contained herein is intended or shall be a delegation of duties to the Secured Party.

3. Perfection.

(a) Debtor authorizes Secured Party to file Financing Statements in all applicable Filing Offices, naming such Debtor as the debtor and the Secured Party as the secured party which describes the Collateral generally or specifically and contains any other information required under Article 9 of the UCC or other applicable law for perfection of the security interest in the Collateral.

(b) If any of the Collateral is or shall become evidenced or represented by any certificate, such certificate shall be immediately delivered to the Secured Party, duly endorsed in a manner satisfactory to the Secured Party, to be held as Collateral pursuant to this Agreement.

(c) At any time and from time to time, upon the written request of the Secured Party, and at the cost and expense of Debtor, Debtor shall promptly and duly give, execute, deliver, file and record such further instruments and documents and take such further actions as the Secured

[20] Query whether the non-economic rights should be defined into different categories of rights, such as "Governance Rights", "Contractual Rights" etc.

Party may reasonably request (subject to any limitations in the relevant transaction documents or the Issuing Entity Governing Documents)[21], for the purposes of obtaining, creating, perfecting, enforcing, validating or preserving the full benefits of this Agreement and the rights and powers herein granted, including filing of amendments to or continuations of Financing Statements. Debtor shall obtain the consent of the Issuing Entity and any other owner of equity interests in the Issuing Entity to execute and deliver to the Secured Party the Issuing Entity and Co-Member Consent and Acknowledgement in substantially the form of Exhibit __ hereto] [Debtor shall cause the Operating Agreement to include the language specified in Exhibit __ hereto or such other language as the Secured Party shall agree.][22]

(d) At any time and from time to time, upon the written request of the Secured Party, Debtor will furnish to the Secured Party statements and schedules further identifying and describing the LLC Interests and other Collateral owned by Debtor, all in reasonable detail.

(e) Debtor, (i) if not an individual, will not change its name, identity or structure, or reorganize or reincorporate under the laws of another jurisdiction, or otherwise change its "location" as determined under Section 9-307 of the UCC, or (ii) if an individual, will not change his or her name or principal residence, unless, in each such case, Debtor shall have given to the Secured Party not less than thirty (30) days' prior written notice of such change and Secured Party either (x) reasonably determines that such event or occurrence will not adversely affect the validity, perfection or priority of the Secured Party's security interest in the Collateral, or (y) takes such steps (with the cooperation of Debtor to the extent necessary or advisable and at the cost and expense of Debtor) as are necessary or advisable to properly maintain the validity, perfection and priority of the Secured Party's security interest in the Collateral.[23]

4. Representations and Warranties. Debtor represents and warrants to Secured Party that:

(a) Debtor has the requisite power and authority to enter into this Agreement and to perform its obligations hereunder;[24]

(b) the execution and delivery of this Agreement by Debtor and the performance by Debtor of its obligations under this Agreement have been duly approved, consented to or

[21]**Grant/Perfection Subcommittee:** Comment on the impact of restrictions on transfer, and possible ways to address those restrictions at grant, rather than at enforcement.

[22]**Grant/Perfection Subcommittee:** As discussed in note [21] above, the Operating Agreement and applicable limited liability company act may restrict the ability of the Secured Party to foreclose on the LLC Interests. This can often be addressed by either obtaining advance consent of the other members and the Issuing Entity or amending the Operating Agreement to facilitate future foreclosure.

[23]**Grant/Perfection Subcommittee:** While a name change alone would have no effect on collateral in existence on the date of the name change, if the new name would cause the financing statement to be seriously misleading then per UCC 9-507(c) the financing statement will cease to be effective as to collateral acquired by the debtor more than 4 months after the name change unless the financing statement is amended to provide the new name. To the extent the collateral is acquired by a new debtor in the same jurisdiction, a similar rule is provided in UCC 9-508 except that a new UCC-1 financing statement rather than a UCC-3 amendment will be required. To the extent that the debtor change's its jurisdiction, the secured party will need to file a new UCC-1 in the new jurisdiction in order to remain perfected as to all collateral, See UCC 9-316.

[24]**Reps/Warranties Subcommittee:** This representation is not necessary if the Debtor is an individual.

authorized by [the members/stockholders] and does not and will not result in any violation of any agreement, indenture or other instrument, license, judgment, decree, order, law, statute, ordinance or other governmental rule or regulation applicable to such Debtor;[25]

(c) this Agreement has been duly executed and delivered by Debtor and constitutes the legal, valid and binding obligation of Debtor enforceable against Debtor in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, or similar laws affecting creditors' rights generally;

(d) the performance by Debtor of its obligations under this Agreement does not conflict with, result in a breach of, or constitute a default under any provision of the Issuing Entity Governing Documents;[26]

(e) upon filing of the Financing Statement with the Filing Office, the security interest granted by Debtor to the Secured Party in this Agreement will constitute a valid, perfected first priority security interest in the Collateral, enforceable as such against Debtor and all other creditors of Debtor or any other persons purporting to purchase the LLC Interests from Debtor;

(f) Debtor's jurisdiction of organization, exact legal name as it appears on file with the Secretary of State of the State of _____, and chief executive office or principal place of business, are as set forth on the signature page of this Agreement;[27]

- or-

(f) Debtor's principal residence is located at _____, and Debtor's name as set forth on his/her driver's license as issued by the jurisdiction in which the principal residence is located is _____;[28]

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[25]**Reps/Warranties Subcommittee:** This representation is not necessary if the Debtor is an individual. The representation references the internal governance process of requirements of the Debtor, not the Issuing Entity. There is a second representation relating to whether the pledge is permitted under the organizational documents of the Issuing Entity.

[26]**Reps/Warranties Subcommittee:** This representation may be unnecessary if there is an analogous representation in a Loan Agreement. However, it is important for the Pledgee's counsel to review the Operating Agreement of the Issuing Entity to confirm that this representation appears to be accurate and to determine what, if any, limitations appear in the Operating Agreement that bear on pledges. For example, the Operating Agreement could provide options in favor of the Issuing Entity or the other members if a pledge of an interest in the Issuing Entity is being enforced.

[27]**Reps/Warranties Subcommittee:** In Delaware the state organizational filing is the "Certificate of Formation." *See* DEL. CODE ANN. tit. 6, § 18-201 (LEXIS through 2014 Fiscal Sess.). *Accord* N.J. REV. STAT. § 42:2B-11 (LEXIS through 2014 Reg. Sess.) (Certificate of formation); TEX. BUS. ORGS. CODE ANN. § 3.001 (LEXIS through 2013 3rd Called Sess.) (certificate of formation)); WASH. REV. CODE § 25.15.070 (LEXIS through 2013 3rd Special Session.) (certificate of formation); REVISED PROTOTYPE LTD. LIAB. CO. ACT § 201, 67 BUS. LAW. at 117, 142 (2011) (2011) [hereinafter RPLLCA] (certificate of formation). In certain states the initial filing with the Secretary of State is designated "Articles of Organization." *See, e.g.*, KY. REV. STAT. ANN. § 275.025 (LEXIS through 2013 First Extra. Sess.) (articles of organization); N.Y. LTD. LIAB. CO. LAW § 203 (Consol. 2014) (articles of organization); VA. CODE ANN. § 13.1-1010 (LEXIS through 2014 Regular Session and Acts 2014, Sp. Sess. I, c. 1, of the General Assembly.) (Articles of organization); REVISED UNIF. LTD. LIAB. CO. ACT § 201, 6B U.L.A. 456 (2008) [hereinafter RULLCA] (certificate of organization). In Maryland, the filings are done with the State Department of Assessments and Taxation rather than the Secretary of State.

[28]**Reps/Warranties Subcommittee:** This paragraph (e) is applicable if and only if the Debtor is an individual.

(g) Debtor makes the representations and warranties set forth in the [Loan Documents] as they relate to Debtor or to the Collateral, each of which is incorporated herein by reference;

(h) Debtor is the sole, direct, legal owner of the Collateral, has good and marketable title to the Collateral[29], and no part of the Collateral is subject to any lien, option, restriction on sale, claim, encumbrance; voting agreement, proxy or voting trust; option, right of first refusal or first offer or right of others [except for any rights of existing co-members in Issuing Entity as set forth in Issuing Entity Governing Documents provided to Secured Party prior to the date hereof] [, except as otherwise disclosed on Schedule ____ hereto] and no other Person has a beneficial interest in the Collateral;[30]

(i) Debtor has made all capital contributions heretofore required to be made to the Issuing Entity with respect to the Collateral and no additional capital contributions are required to be made with respect to the Collateral other than as described on Schedule __ hereto;[31]

(j) Debtor has provided to Secured Party true and correct copies of all Issuing Entity Governing Documents, and other documents or agreements representing, governing, or otherwise relating to the Collateral, Debtor's ownership of the Collateral or the exercise of Debtor's rights with respect to the Collateral, and, (i) all of the foregoing are in full force and effect in accordance with their written terms, (ii) there are no other agreements or understandings, written or oral, between or among Debtor, the Issuing Entity or any other person having an interest in the Issuing Entity relating to the Collateral or the rights of the Debtor with respect to the Collateral, (iii) to the knowledge of Debtor, Debtor is not in breach or default of Debtor's obligations under any of the foregoing, and (iv) no event has occurred that would now, or upon the lapse of time or giving of notice, or both, constitute an event of dissociation with respect to the Debtor from the Issuing Entity or a dissolution of the Issuing Entity under the terms of the Issuing Entity Governing Documents or otherwise;

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[29] **Reps/Warranties Subcommittee:** Marketable title generally means that the transferee would have sufficiently good title so that the property could be sold for fair market value.

[30] **Reps/Warranties Subcommittee:** The representation is intended to determine what, if any, restrictions may apply to a sale of the pledged interest. Generally, there are likely to be restrictions on transfers in the Operating or LLC Agreement applicable to the Collateral. The Secured Party should determine what restrictions are provided for and determine whether such restrictions would impede realization on the Collateral. The Secured Party would have to put in place an agreement with the Issuing Entity and/or the co-members to address restrictions that would impede realization upon the Collateral. Please note that unlike other types of collateral, creditors holding limited liability company interests as collateral have limited remedies and may not have the right to foreclose and sell the Collateral and the buyer generally would not have the right to become a substitute member in the Issuing Entity absent an agreement to do so by the other members of the Issuing Entity. If the Debtor is the sole member of the Issuing Entity or has control of the Issuing Entity, the Secured Party may be able to obtain such rights by contract as part of the Loan Documents.

[31] **Reps/Warranties Subcommittee:** Counsel should review whether and under what conditions additional capital contributions can be required to be made by the Debtor and what the penalties are for failing to make additional capital contributions. If additional capital contributions can be required, then the Collateral may be subject to dilution and or the cash flow distributions to the Debtor may be diverted to repay a forced loan from other members who funded the Debtor's capital contribution.

(k) The Issuing Entity has not opted to treat the LLC Interests as Investment Property under Article 8 of the UCC.[32]

(l) Other than the Issuing Entity Governing Documents, there are no certificates or other writings evidencing the LLC Interests;[33]

(m) No consent, approval or authorization of, notice to or filing with, or other act by or in respect of, any governmental authority or any other person or entity (including without limitation the Issuing Entity or any person that has an interest in or is responsible for managing the Issuing Entity) is required (i) for the execution, delivery and performance of this Agreement by the Debtor, (ii) for the grant of a security interest in the Collateral by the Debtor pursuant to this Agreement, or (iii) for the exercise by the Secured Party of the voting or other rights and remedies provided for in this Agreement, except those which have been obtained, made or taken and are in full force and effect, except as has already been obtained or taken or as may be required in connection with any disposition of the LLC Interests by laws affecting the offering and sale of securities generally;[34]

(n) The LLC Interests are not "securities" within the meaning of the Securities Act of 1933 or the analogous laws of any state.[35][36] purposes and for federal securities law purposes.

(o) Schedule 1 completely and accurately sets forth the equity interests in the Issuing Entity held by Company as of the date hereof, no matter how characterized, now owned by Debtor;[37] and

(p) None of the LLC Interests constitutes margin stock (as defined in Regulation U of the Board of Governors of the Federal Reserve System).

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[32]**Reps/Warranties Subcommittee:** See footnotes 17 and 19.

[33] **Enforcement Subcommittee:** The commentary for this Agreement should indicate that a secured party may want to have the Debtor opt in to Article 8 and certificate its equity interests in order to obtain a better perfection position. In addition, we believe the commentary should also include sample language to opt in to Article 8.

[34]**Reps/Warranties Subcommittee:** If the Debtor does not control the Issuing Entity, voting rights may not offer much protection to the Secured Party. Generally, assignees (such as pledgees) are not entitled to exercise voting rights. See footnote __.

[35]**Reps/Warranties Subcommittee:** Members of the committee were divided on the propriety of requiring this representation. The representation requires a legal conclusion and is not a simple factual representation. Even certificated LLC Interests for which there has been an "opt-in" to Article 8 may not be classified as securities for purposes of federal securities laws. Alternatively, a general intangible (Article 9) LLC interest owned by a passive holder in a manager-managed LLC may be a security for federal securities law purposes. The classification is more properly relevant in the enforcement and remedies sections (disposition of Collateral that is a "security" raises additional concerns and possible legal compliance obligations for the Secured Party as well as limitations on potential purchasers.).

[36]**Enforcement Subcommittee:** Comment on classification as a "security" for UCC purposes and for federal securities law purposes. Even certificated LLC Interests for which there has been an "opt-in" to Article 8 may not be classified as securities for purposes of federal securities laws. Alternatively, a general intangible (Article 9) LLC interest owned by a passive holder in a manager-managed LLC may be a security for federal securities law purposes. The classification is more relevant in the enforcement and remedies sections (disposition of Collateral that is a "security" raises additional concerns (and possible legal compliance obligations) for the Secured Party.

[37]**Reps/Warranties Subcommittee:** The Secured Party needs to confirm whether and to what extent the Debtor has control. If the Debtor does not have control, the representation provides a base-line to the Secured Party as to ownership and control.

5. Covenants. Debtor covenants and agrees with Secured Party that until the Secured Obligations are fully paid and satisfied:

(a) Any sums paid upon or in respect of any LLC Interests upon the liquidation or dissolution of the Issuing Entity shall be paid over to the Secured Party and applied to the payment in whole or in part of the Secured Obligations, and (ii) in case any distribution representing a return of capital or the proceeds of a capital transaction (but not ordinary course distributions of profit), including, without limitation, cash or non-cash proceeds or other property distributed, paid to or received by Debtor in respect of the LLC Interests in connection with any recapitalization, reorganization or change in control of the Issuing Entity, shall be delivered to the Secured Party and applied to the payment in whole or in part of the Secured Obligations. If any sums of money or property paid or distributed in respect of the LLC Interests as described in clause (i) or clause (ii) of this subsection are received by Debtor, pending delivery thereof to the Secured Party, Debtor agrees to hold such money or property in trust for the Secured Party, segregated from other funds of such Debtor, as additional Collateral hereunder.[38] [39]

(b) Without the prior written consent of the Secured Party, Debtor shall not (i) sell, assign, transfer, exchange or otherwise dispose of, or grant any option with respect to, any direct or indirect interest in the Collateral, (ii) allow the Issuing Entity to issue any other membership units in addition to or in substitution for the Collateral, except to Debtor,[40] or (iii) create, incur, authorize or permit to exist any lien, right of first refusal, option or other encumbrance affecting the Collateral in favor of, or any claim of any Person with respect to, any of the Collateral, or any interest therein, except for (x) the security interest hereunder, or (y) any purchase rights of existing co-members in an Issuing Entity as set forth in Issuing Entity's Governing Documents.[41] Subject to the foregoing, Debtor shall defend the right, title and interest of the Secured Party in and to the Collateral against the claims and demands of all Persons whomsoever.

(c) Debtor shall promptly pay and discharge before the same become delinquent, all taxes, assessments, and governmental charges or liens imposed on the Debtor or any of the Collateral, including, without limitation, all stamp, excise, sales or other similar taxes, and shall

[38] **Reps/Warranties Subcommittee:** If the Collateral is security for a loan, then distributions of cash flow/income would not typically be paid to the Secured Party, unless an event of default with respect to the loan has occurred. However, distributions in respect a capital transaction might be required to be held as additional collateral because they reduce the value of the collateral pledged. Example: "Following notice from the Borrower or the Secured Party of a Default or an Event of Default, all Collateral at any time received or held by the Debtor shall be received and held by the Debtor in trust for the benefit of the Secured Party, shall be kept separate and apart from, and not commingled with, the Debtor's other assets, and shall be immediately delivered to the Secured Party." In any event, if the Collateral is to be the source of payment of an obligation, the pledge needs to reflect whether and to what extent cash flow distributions are intended to be paid to the Debtor.

[39] **Enforcement Subcommittee:** This covenant makes clear that any and all distributions, interim, ordinary or liquidating, shall be prohibited following an Event of Default.

[40] **Reps/Warranties Subcommittee:** This covenant assumes that the Debtor is in the position to unilaterally preclude the Issuing Entity from undertaking any of the described transactions.

[41] **Reps/Warranties Subcommittee:** A Secured Party will have to understand any purchase right in the Issuing Entity's Governing Documents (a) to determine if the right will be triggered by enforcement of the pledge, (b) if so, how the purchase price is determined. If the price is fair market value the price will reflect discounts for lack of control and possibly lack of marketability. If the price is fair value, it will not reflect such discounts. **Ribstein & Keatinge on Limited Liability Companies**, 2nd Edition, 2014 § 11.3 at 698.

save the Secured Party harmless from, any and all such liabilities with respect to, or resulting from any delay in paying, any and all stamp, excise, sales or other similar taxes that may be payable or determined to be payable with respect to any of the Collateral or in connection with the transactions contemplated by this Agreement.

(d) Debtor shall not consent to any amendment of the Issuing Entity Governing Documents.[42]

(e) Debtor shall not allow the Issuing Entity to opt-in to Article 8 of the UCC or otherwise facilitate any action that would result in the issuance by the Issuing Entity of any certificates or evidencing any of the Collateral.[43]

(f) In the event that the Secured Party exercises any rights or remedies under this Agreement, or in the event of the bankruptcy, insolvency, receivership, conservatorship, dissolution, liquidation, rehabilitation or other similar proceeding of the Debtor, or any assignment by the Debtor for the benefit of creditors, Debtor and its successors and assigns shall pay all reasonable costs of collection and defense, including reasonable attorneys' fees and costs, incurred by the Secured Party in connection therewith and in connection with any bankruptcy (including cash collateral, relief from stay, adequate protection, plan confirmation, and general case administration matters) appellate proceeding, or post-judgment action involved therein, together with all required service or use taxes.

(g) Debtor (i) shall take, and (to the extent of its rights under the Issuing Entity Governing Documents or under applicable law) use commercially reasonable efforts to cause the Issuing Entity to take, any and all actions either necessary or reasonably requested by the Secured Party to ensure compliance in all material respects with the terms and provisions of this Agreement, and (ii) shall not take any actions that violate the terms and provisions of this Agreement, or the Issuing Entity Governing Documents to the extent consistent with the Debtor's obligations under this Agreement.

(h) Debtor will appear in and defend, at Debtor's own expense, any action or proceeding that may affect Debtor's title to, or Secured Party's interest in the Collateral.

(i) Debtor shall not change its legal name or place or organization and registration without giving Secured Party not less than thirty (30) days' prior advance notice.

(j) Debtor shall give prompt notice to Secured Party of any judgment or other lien which might give rise to an attachment, charging order or other lien or enforcement action with respect to the Collateral and Distributions on the Collateral.

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[42]**Reps/Warranties Subcommittee:** Debtor may not be in the position to unilaterally preclude amendments, so that this covenant may not be meaningful. Debtors may, far a variety of reasons object to the total prohibition on amendments (same might be necessary to comply with financing requirements or to admit a substitute member or other internal changes that are not material to the value or rights of the pledged interest. Another formulation of the covenant is "Debtor shall not consent, approve or otherwise facilitate any amendment to the provisions of the Issuing Entity's Organizational Documents that may adversely affect Debtor's share of distributions with respect to the Collateral."

[43]**Reps/Warranties Subcommittee:** See footnotes 17 and 19.

(k) Debtor shall promptly, upon request by the Secured Party, execute, acknowledge and deliver any financing statement, endorsement, notices, assignment, continuation statement, certificate or other document as the Secured Party may require in order to perfect, preserve, maintain, protect, continue, realize upon, and/or extend the Lien of and the assignment to the Secured Party under this Agreement and the priority thereof.

(l) Debtor will defend title to the Collateral against all Persons and will, upon request of Secured Party, (a) furnish such further assurances of title as may be required by Secured Party, and (b) deliver and execute or cause to be delivered and executed, in form and content satisfactory to Secured Party, any assignment, security agreement, or other document as Secured Party may request in order to perfect, preserve, maintain, or continue the perfection of Secured Party's security interest in the Collateral and/or its priority or to facilitate payment of Distributions to Secured Party in accordance with this Agreement. Debtor will pay to Secured Party on demand by Secured Party the costs of preparing and filing any financing, continuation or termination statement as well as any recordation or transfer tax required by law to be paid in connection with the filing or recording of any such statement with respect to the security interests granted hereunder. Debtor hereby authorizes Secured Party at any time and from time to time to file in any appropriate filing office any initial financing statements and amendments thereto and continuations thereof covering the Collateral. Debtor shall not file any amendments, corrections statements or termination statements concerning the Collateral without the prior written consent of Secured Party.

[Enforcement Subcommittee: (m) So long as no Event of Default shall have occurred and be continuing, Debtor shall be entitled to exercise all voting and other consensual rights pertaining to the Collateral; provided, however, that Debtor will not cast any vote, give any consent, waiver or ratification, or take or fail to take, any action, in any manner that would, or could reasonably be expected to, violate or be inconsistent with any of the terms of this Agreement, or have the effect of impairing the position or interests of the Secured Party. All such rights of Debtor to vote and give consents, waivers and ratifications with respect to the Collateral shall cease upon the occurrence and during the continuation of an Event of Default hereunder.[44] In addition, Debtor hereby grants to Secured Party an irrevocable proxy to vote the Collateral and to exercise all other rights, powers, privileges and remedies to which a holder of the Collateral would be entitled (including, without limitation, giving or withholding written consents of members, calling special meetings of members and voting at such meetings), which proxy shall be effective, automatically and without the necessity of any action (including any transfer of any Collateral on the record books of the Issuing Entity) by any other Person (including the Issuing Entity or any manager, officer or agent thereof), upon the occurrence and during the continuation of an Event of Default.

Subject to Debtor's compliance with the foregoing, Secured Party agrees that for so long as no Event of Default has occurred or is continuing with respect to the Secured Obligations, Debtor may exercise such rights, privileges, authority and power vested in the Debtor as a limited liability company member of the Issuing Entity as provided in the Issuing Entity Governing Documents.

[44] **Enforcement Subcommittee:** Add language to the commentary regarding hardwiring directly into the Issuing Entity's LLC Agreement protections on voting and other matters, to the extent the secured party has sufficient leverage.

6. Remedies.

(a) Following and during the continuance of an Event of Default, the Secured Party, in addition to all other rights and remedies granted in this Agreement at law or in equity:

(i) may exercise all rights and remedies of a secured party under the UCC (whether or not the UCC applies to the Collateral and whether or not the UCC is in effect in the jurisdiction where the rights and remedies are asserted) and such additional rights and remedies to which a secured party is entitled under the laws in effect in any jurisdiction where any rights and remedies hereunder may be asserted;

(ii) may make any reasonable compromise or settlement deemed desirable with respect to any of the Collateral and may extend the time of payment, arrange for payment in installments, or otherwise modify the terms of, any of the Collateral; and

(iii) in its discretion may, in its name or in the name of any Debtor or otherwise, demand, sue for, collect, direct payment of or receive any money or property at any time payable or receivable on account of or in exchange for any of the Collateral, but is under no obligation to do so.

Without limiting the generality of the foregoing, following and during the continuance of an Event of Default, the Secured Party, without demand of performance or other demand, presentment, protest or advertisement or notice of any kind (except any notice or advertisement required by law or otherwise required hereby) to or upon the Debtor, any Issuing Entity or any other person (all and each of which demands, presentments, protests, advertisements or notices, or other defenses, are hereby waived to the extent permitted under applicable law), may collect, receive, appropriate and realize upon the Collateral or any portion thereof, and may sell, assign, give an option or options to purchase or otherwise dispose of and deliver the Collateral or any portion thereof (or contract to do any of the foregoing), in one or more parcels at public or private sale or sales, in the over-the-counter market, at any exchange, broker's board or office of the Secured Party or elsewhere upon such terms and conditions as the Secured Party may deem advisable and at such prices as the Secured Party may deem best in its reasonable discretion, for cash or on credit or for future delivery without assumption of any credit risk. The Secured Party shall have the right, without notice or publication, to adjourn any public or private sale or cause the same to be adjourned from time to time by announcement at the time and place fixed for such sale, and any such sale may be made at any time or place to which the same may be adjourned without further notice. The Secured Party has the right upon any such public sale or sales, and, to the extent permitted by law, upon any such private sale or sales, to purchase the whole or any portion of the Collateral so sold free of any right or equity of redemption of the Debtor, which right or equity of redemption is hereby waived or released to the extent permitted by law. The Secured Party shall apply any Proceeds from time to time held by it and the net proceeds of any such collection, recovery, receipt, appropriation, realization or sale, to repayment, in whole or in part, of the Secured Obligations. To the extent permitted by applicable law, Debtor waives all claims, damages and demands Debtor may acquire against the Secured Party arising out of the exercise by the Secured Party of any of its rights hereunder or at law or in equity, except for any claims, damages and demands arising from the willful misconduct, illegal acts, fraud or gross

negligence of the Secured Party or any of their respective officers, directors, employees, agents or contractors.

(b) Upon the written request of the Secured Party following and during the continuance of an Event of Default, Debtor shall:

(i) assemble and make available to the Secured Party the Collateral owned by Debtor and all records relating thereto at any place or places specified by the Secured Party; and

(ii) permit the Secured Party, acting through its representatives and agents, to enter any premises where all or any part of the Collateral, or the books and records relating thereto, or both, are located, to take possession of all or any part of the Collateral and to remove all or any part of the Collateral.[45]

(c) The occurrence of any one or more of the following shall be an event of default ("Event of Default") hereunder:

(i) The occurrence of any Event of Default (as defined in the **[*Financing Agreement*]**);

(ii) The failure of Debtor to keep, observe or perform any provisions of this Agreement, which failure is not cured and remedied within fifteen (15) calendar days after notice thereof is given to Debtor, unless such failure is incapable of cure within fifteen (15) calendar days, in which case Debtor shall immediately initiate steps that the Secured Party deems in its sole discretion to be sufficient to cure the failure and Debtor thereafter continues and completes all reasonable and necessary steps sufficient to produce compliance as soon as reasonably practical; or

(iii) If any representation or warranty furnished by Debtor under or in connection with this Agreement shall, at any time, be materially false or incorrect.

7. Certain Acknowledgments Concerning Disposition of Collateral.

(a) To the extent permitted under applicable law, the Secured Party shall not be required to conduct any foreclosure sale of the Collateral or any portion thereof. Following and during the continuance of an Event of Default, Secured Party may, in its sole and absolute discretion, to the extent permitted by applicable law, retain and acquire for itself or its designees or nominees the Collateral or any portion thereof by instructing the applicable Issuing Entity to register on its ledgers and books the Secured Party's (or its nominee's) acquisition of such Collateral or portion thereof, subject to any rights of the Debtor any other person to object in accordance with the UCC, if the Debtor or such other person has not previously renounced or waived such rights in accordance with the UCC. Each Debtor hereby acknowledges that the sale by the Secured Party of any Collateral pursuant to the terms hereof in compliance with the Securities Act of 1933 as now in effect or as hereafter amended, or any similar statute hereafter adopted with similar purpose or effect (the "Securities Act"), as well as applicable "Blue Sky" or

[45] Note to draft: Taking possession of the "Collateral" is probably not applicable, unless LLC Interests are certificates and designated in the Operating Agreement as "securities" under Article 8 of the UCC.

other state securities law, to the extent that any of the foregoing laws are applicable to the Collateral or the portion thereof being sold, may require strict limitations as to the manner in which the Secured Party or any subsequent transferee of such Collateral may dispose thereof. Debtor hereby waives any objection to sale in such a manner and agrees that the Secured Party shall have no obligation to obtain the maximum possible price for the Collateral or any portion thereof as long as the Secured Party proceeds in a commercially reasonable manner. Without limiting the generality of the foregoing, each Debtor agrees that in conducting a disposition of the Collateral or any portion thereof to which the Securities Act or "Blue Sky" or other state securities laws are or may be applicable, Secured Party may seek to sell such Collateral or a portion thereof by private placement, restricting the bidders and prospective purchasers to those who will represent and agree that they are purchasing for investment only and not for distribution. Debtor acknowledges and agrees that in order to protect the Secured Party's interest, it may be necessary to sell the Collateral or a portion thereof at a price less than the maximum price attainable if a sale were delayed or were made in another manner, such as a public offering under the Securities Act. In addition, Debtor acknowledges that the Secured Party may also conduct a disposition in which the bidders and prospective purchasers are limited to those who would otherwise meet any requirements applicable to a transferee of such Collateral or portion thereof established by applicable law or the Issuing Entity Governing Documents. In so doing, the Secured Party may solicit offers to purchase the Collateral or any portion thereof from a limited number of bidders reasonably believed by the Secured Party to be institutional investors or other accredited investors and that meet such other criteria that might be interested in purchasing the Collateral or such portion thereof. If the Secured Party solicits such offers in a commercially reasonable manner, then acceptance by the Secured Party of one or more of such offers shall be deemed to be a commercially reasonable method of disposition of the Collateral or applicable portion thereof and the Secured Party will not be responsible or liable for selling all or any portion of the Collateral at a price that the Secured Party may in good faith deem reasonable under the circumstances. The Secured Party is under no obligation to delay a disposition of any portion of the Collateral that are securities under the Securities Act or applicable "Blue Sky" or other state securities law for the period of time necessary to permit any Debtor or the Issuing Entity to register such securities for public sale under the Securities Act or under applicable "Blue Sky" or other state securities laws, even if Debtor or the Issuing Entity agrees to do so. In addition, to the extent not prohibited by applicable law, Debtor hereby waives any right to prior notice (except to the extent expressly provided in this Agreement) or judicial hearing in connection with the taking possession or the disposition of any of the collateral, including any such right which Debtor would otherwise have. If any notice of a proposed sale or other disposition of any part of the Collateral shall be required under applicable law, the Secured Party shall give Debtor at least ten (10) calendar days prior notice of the time and place of any public sale and of the time after which any private sale or other disposition is to be made, which notice Debtor agrees is commercially reasonable. This section does not limit any other rights of the Secured Party under this Agreement.

(b) Debtor shall use its commercially reasonable efforts to do or cause to be done all such other acts as may be reasonably necessary to make any disposition or dispositions of all or any portion of the LLC Interests and other Collateral pursuant to this Section valid and binding and in compliance with any and all other applicable legal requirements. Without limiting the generality of the foregoing, if any consent, approval or authorization of, or filing with, any governmental authority or any other person is necessary to effect any disposition of the

Collateral, including under any federal or state securities laws, Debtor agrees to execute all such applications, registrations and other documents and instruments as may be required in connection with securing any such consent, approval or authorization, and will otherwise use commercially reasonable efforts to secure the same. Debtor agrees to use commercially reasonable efforts to effectuate any sale or other disposition of the Collateral as the Secured Party may reasonably deem necessary pursuant to the terms of this Agreement. Debtor agrees that a breach of any of the covenants contained in this Agreement will cause irreparable injury to the Secured Party, that the Secured Party shall have no adequate remedy at law in respect of such breach and, as a consequence, that each and every covenant contained in this section is specifically enforceable against Debtor, and to the maximum extent permitted by law, Debtor waives and agrees not to assert any defenses against an action for specific performance of such covenants except for a defense that no Event of Default has occurred or is continuing.

(c) The Secured Party shall not incur any liability as a result of the sale of any Collateral, or any portion thereof, at any private sale conducted in a commercially reasonable manner, it being agreed that some or all of the Collateral is or may be of one or more types that threaten to decline speedily in value and that are not customarily sold in a recognized market. Debtor acknowledges and agrees that any private sale may result in prices and other terms less favorable to the Secured Parties than if such sale were a public sale and, notwithstanding such circumstances, agrees to not assert that any such private sale was not made in a commercially unreasonable manner solely by virtue of being a private sale. Debtor waives any claims against the Secured Party arising by reason of the fact that the price at which any of the Collateral may have been sold at such a private sale was less than the price that might have been obtained at a public sale or was less than the aggregate amount of the Secured Obligations, even if the Secured Party accept the first offer received and do not offer any Collateral to more than one offeree, provided that the Secured Party has acted in a commercially reasonable manner in conducting such private sale.

(d) Debtor acknowledges and agrees that the Secured Party may elect to conduct a sale of an economic interest in the LLC Interests that does not result in the purchaser thereof becoming a substitute limited liability company member in the Issuing Entity, and that the Secured Party may conduct such a disposition as the Secured Party may in good faith deem reasonable under the circumstances, notwithstanding the possibility that a substantially higher price might be realized if the purchaser were to become a substituted limited liability company member rather than only an assignee of an economic interest in the Issuing Entity.

(e) In connection with any disposition of the Collateral, the Secured Party may disclose to prospective purchasers all of the information relating to the Collateral (and the Issuing Entity) that is in the Secured Party's possession or otherwise available to the Secured Party.

(f) Debtor hereby irrevocably appoints Secured Party as its lawful attorney-in-fact to do, with full authority in the place of Debtor and in the name of Debtor to take any action and to execute any instrument which Secured Party may deem necessary to accomplish the purposes of this Agreement, including, without limitation, (i) to ask for, demand, collect, sue for, recover, compromise, receive and give acquittance and receipts for monies due and to become due under or in respect of any of the Collateral; (ii) to receive, endorse and collect any drafts or other

instruments and documents in connection with clause (i) above; (iii) to file any claims or take any action or institute any proceedings that the Secured Party may deem necessary or desirable to enforce the rights of the Secured Parties with respect to any of the Collateral; and (iv) upon the occurrence and during the continuance of an Event of Default, to execute endorsements, assignments, or other instruments of conveyance or transfer with respect to all or any of the Collateral, and/or to arrange for the transfer of any of the Collateral on the books of the Company, including for purposes of the admission of Secured Parties or any other transferee of any LLC Interests as a member of the Company. The foregoing power of attorney, being coupled with an interest, is irrevocable for so long as this Agreement is in effect with respect to Debtor. Debtor shall indemnify and hold harmless Secured Party from and against any liability or damage which such Secured Party may incur in the exercise and performance, in good faith, of any of such Secured Party's powers and duties set forth herein. Secured Party shall have the right to exercise the power of attorney granted in this Section directly or to delegate all or part of such power. Secured Party shall not be obligated to act on behalf of Debtor as attorney-in-fact.[46]

(g) Secured Party, at its option, may obtain the appointment of a receiver to take possession of the Collateral and, at the option of Secured Party, such receiver may be empowered (i) to collect, receive and enforce all distributions, rights to payment and payment intangibles; (ii) to exercise the rights of Secured Party as provided in this Agreement; (iii) to collect all other amounts owed to Debtor as and when due to Debtor; (iv) to otherwise collect, sell or dispose of the Collateral; and (v) to turn over all net proceeds to Secured Party. Debtor irrevocably and unconditionally agrees that a receiver may be appointed by a court for such purpose without regard to the adequacy of the security for the Secured Obligations; and the actions of such receiver may be in the name of the receiver, Debtor or Secured Party.

8. Indemnification of Secured Party. Debtor agrees:

(a) To indemnify and hold harmless Secured Party and each of its directors, officers, employees, agents and affiliates from and against any and all claims, damages, demands, losses, obligations, judgments and liabilities (including, without limitation, reasonable attorneys' fees and expenses) in any way arising out of or in connection with this Agreement, the Collateral and the Secured Obligations, except to the extent the same shall arise as a result of the gross negligence or willful misconduct of the party seeking to be indemnified; and

(b) To pay and reimburse Secured Party upon demand for all reasonable costs and expenses (including, without limitation, reasonable attorneys' fees and expenses) that Secured Party may incur in connection with (i) the custody, use or preservation of, or the sale of, collection from or other realization upon, any of the Collateral, including the reasonable expenses of preparing for sale or other disposition of the Collateral; (ii) the exercise or enforcement of any rights or remedies granted under this Agreement or otherwise available to it at law or in equity; or (iii) the failure by Debtor to perform or observe any of the provisions hereof. The provisions of this Section shall survive the execution and delivery of this

[46] **Enforcement Subcommittee:** Add language to the commentary regarding hardwiring directly into the Issuing Entity's LLC Agreement a provision to permit a transferee to become a member automatically upon acquiring an LLC Interest.

Agreement, repayment of the Secured Obligations, and the termination of this Agreement, any Financing Statement or related writing.

9. General Provisions.[47]

(a) THE VALIDITY OF THIS AGREEMENT, ITS CONSTRUCTION, INTERPRETATION AND ENFORCEMENT, AND THE RIGHTS OF THE PARTIES HERETO SHALL BE DETERMINED UNDER, GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF _____ (WITHOUT REFERENCE TO THE CHOICE OF LAW PRINCIPLES THEREOF).

(b) No amendment or waiver of any provision of this Agreement nor consent to any departure by Debtor herefrom shall in any event be effective unless the same shall be in writing and signed by Secured Party, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given. No failure on the part of Secured Party to exercise, and no delay in exercising any right under this Agreement or otherwise with respect to any of the Secured Obligations, shall operate as a waiver thereof; nor shall any single or partial exercise of any right under this Agreement or otherwise with respect to any of the Obligations preclude any other or further exercise thereof or the exercise of any other right. The remedies provided for in this Agreement or otherwise with respect to any of the Secured Obligations are cumulative and not exclusive of any remedies provided by law.

(c) Unless otherwise specifically provided herein, all notices shall be in writing addressed to the respective party as set forth below, and may be personally served, faxed, telecopied or sent by overnight courier service or United States mail:

If to Debtor:

with a copy to:

If to Secured Party:

with a copy to:

Any notice given pursuant to this section shall be deemed to have been given: (i) if delivered in person, when delivered; (ii) if delivered by fax, on the date of transmission if transmitted on a Business Day before 4:00 p.m. at the place of receipt or, if not, on the next succeeding Business Day; (iii) if delivered by overnight courier, two (2) days after delivery to such courier properly addressed; or (iv) if by United States mail, four (4) Business Days after depositing in the United States mail, with postage prepaid and properly addressed. Any party hereto may change the address or fax number at which it is to receive notices hereunder by notice to the other party in writing in the foregoing manner.

(d) This Agreement creates a continuing security interest in the Collateral and shall: (i) remain in full force and effect until the indefeasible payment in full of the Secured

[47] **Enforcement Subcommittee:** Add the following provisions to this section: (i) a Consent to Jurisdiction provision and (ii) a Service of Process provision.

Obligations, (ii) be binding upon Debtor and its successors and assigns; and (iii) inure to the benefit of Secured Party and its successors, transferees and assigns. Upon the indefeasible payment in full of the Secured Obligations, the security interests granted herein shall automatically terminate and all rights in and to the Collateral shall revert to Debtor. Upon such termination, Secured Party will, at Debtor's expense, execute and deliver to Debtor such documents as Debtor shall reasonably request to evidence such termination. Such documents shall be prepared by Debtor and shall be in form and substance reasonably satisfactory to Secured Party.

(e) To the maximum extent permitted by law, all rights of Secured Party, all security interests hereunder, and all obligations of Debtor hereunder, shall be absolute and unconditional irrespective of any lack of validity or enforceability of any of the Secured Obligations or any other agreement or instrument relating thereto, any change in the time, manner or place of payment of, or in any other term of, all or any of the Secured Obligations, or any other amendment or waiver of, or any consent to any departure from, any agreement or instrument relating to the Secured Obligations, any exchange, release or non-perfection of any other collateral, or any release or amendment or waiver of, or consent to departure from, any guaranty for all or any of the Secured Obligations; or any other circumstances that might otherwise constitute a defense available to, or a discharge of, Debtor.

(f) In case any provision in or obligation under this Agreement is held to be invalid, illegal or unenforceable in any jurisdiction, the validity, legality and enforceability of the remaining provisions or obligations, or of such provision or obligation in any other jurisdiction, shall not in any way be affected or impaired thereby.

(g) This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same Agreement. Delivery of an executed counterpart of this Agreement by facsimile or other electronic method of transmission shall be equally as effective as delivery of an original executed counterpart of this Agreement. Any party delivering an executed counterpart of this Agreement by facsimile or other electronic method of transmission also shall deliver an original executed counterpart of this Agreement, but the failure to deliver an original executed counterpart shall not affect the validity, enforceability or binding effect hereof.

(h) Each of Debtor and Secured Party acknowledges and agrees that in exercising any rights under or with respect to the Collateral, Secured Party: (i) is under no obligation to marshal any Collateral; (ii) may, in its absolute discretion, realize upon the Collateral in any order and in any manner it so elects; and (iii) may, in its absolute discretion, apply the proceeds of any or all of the Collateral to the Secured Obligations in any order and in any manner it so elects.

(i) DEBTOR AND SECURED PARTY HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF THIS AGREEMENT OR ANY OF THE TRANSACTIONS CONTEMPLATED HEREIN, INCLUDING CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS AND ALL OTHER COMMON LAW OR STATUTORY CLAIMS. DEBTOR AND SECURED PARTY REPRESENT THAT EACH HAS REVIEWED THIS WAIVER AND EACH KNOWINGLY AND VOLUNTARILY WAIVES ITS JURY

TRIAL RIGHTS FOLLOWING CONSULTATION WITH LEGAL COUNSEL. IN THE EVENT OF LITIGATION, A COPY OF THIS AGREEMENT MAY BE FILED AS A WRITTEN CONSENT TO A TRIAL BY THE COURT.

IN WITNESS WHEREOF, Debtor and Secured Party have caused this Agreement to be duly executed and delivered by their officers thereunto duly authorized as of the date first written above.

[DEBTOR] **[SECURED PARTY]**

SCHEDULE 1 – ISSUING ENTITIES AND LLC INTERESTS

ISSUING ENTITY AND CO-MEMBER CONSENT AND ACKNOWLEDGEMENT

COMPANY ACKNOWLEDGEMENT AND CONSENT[48]

Parties:

_____, LLC (the "Company")[49]

_____ Bank (the "Lender")

_____ (the "Member")

Background Statements:

The Member owns a limited liability company interest (the "***LLC Interest***") in the Company.

The Member desires to grant to the Lender a security interest in the LLC Interest.

As a condition to its acceptance of a security interest in the LLC Interest, the Lender has requested the Company's confirmation and agreement with respect to certain matters, all as more fully set forth in below.

As a condition to its consent to the grant by the Member of a security interest in the LLC interest,[50] the Company desires the Lender's confirmation and agreement with respect to certain matters, all as more fully set forth below.

Intending to be legally bound, the Company, the Lender and the Member agree as follows:

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[48] Under the UCC, sections 9-406 and 9-408 provide, *inter alia*, that a limitation on the ability to pledge a general intangible will not be enforceable. This rule is in conflict with the general rule of LLCs that the parties to the operating agreement will have maximum flexibility in structuring their relationship, including the ability to limit the ability of a member to pledge LLC interests as collateral. See, e.g., Rev. Prototype LLC Act § __, 67 Bus. Law. 117, ___ (Nov. 2011); Del. Code Ann. tit. 6, § 18-___; Rev. Unif. Ltd. Liab. Co. Act § ___, 6B U.L.A. ___ (2008); Ky. Rev. Stat. Ann. § 275.003(1). Several states, by means of amendments to either the LLC Act or the state adoption of the UCC, have addressed this conflict and provided that an operating agreement may limit or preclude the pledge of a limited liability company interest notwithstanding otherwise applicable 9-406 and 9-408. See, e.g., Del. Code Ann. tit. __, § _____; Tex § ____; Va. Code § _____; Colo. Code § _____; Ky. Rev. Stat. Ann. § 275.____. *See also* Robert R. Keatinge and Ann E. Conaway, Keatinge & Conaway on Choice of Business Entity § 8:32 (Thomson West 2011); Rutledge, *The 2007 Amendments to the Kentucky Business Entity Statutes*, 97 Ky. L.J. 229, 249 (2008-09). In those states it is clear that a limitation on the ability to pledge an LLC interest will control over the dictates of UCC sections 9-406 and 9-408. Note that in other states there remains a continuing conflict between the LLC acts, especially those which expressly address limitations upon pledging interests (see, e.g., _____) and the UCC.

[49] The Company's governance structure must be carefully reviewed. In some cases, a "manager" may have sufficient authority to bind the Company. In other cases, some level of member consent may be required.

[50] It is important to carefully review all restrictions on transfer contained in the Company's operating agreement. The agreement may or may not expressly include the grant of a security interest within the definition of "transfers" that are restricted under the Agreement. Under RULLCA, a member's "transferable interest" (often referred to in an operating agreement as an economic interest) is the member's right to receive distributions of profit and loss, but not to participate in the management of the affairs of the entity.

1. Confirmation and Agreement of the Company.

(a) The Company hereby confirms to Lender that:

(i) The Company is a limited liability company formed and existing under the Revised Uniform Limited Liability Company Act as enacted and in effect in the State of _____ ("***RULLCA***"). A copy of the Company's certificate of formation as filed with the filing office of the State of _____ on _____ (the "***Certificate***") is annexed hereto as Exhibit A.

(ii) The Company and the members of the Company (including the Member) have executed an operating agreement dated _____ (the "***Operating Agreement***"), a copy of which (together with all amendments and supplements thereto) is annexed hereto as Exhibit B.

(iii) The Certificate and the Operating Agreement are the only writings that govern the internal affairs of the Company.

(iv) According to the records of the Company, the LLC Interest held by the Member consists of [_____] .[51]

(v) The LLC Interest is not certificated.[52]

(vi) All required capital contributions in respect of the LLC Interest have been received by the Company.

(vii) The Company has no right to require the Member to make any additional contributions of capital to the Company in respect of the LLC Interest.

(viii) The Company has no knowledge of any other grant, transfer or assignment (including any prior grant of a security interest) by the Member of or affecting the LLC Interest.

(ix) The grant by the Member to the Lender of the security interest in the LLC Interest is not prohibited by, and does not otherwise violate, the Certificate or the Operating Agreement.

(b) The Company hereby agrees with the Lender that:

[51] The capital structure of the Company should be reviewed. Very often, there is more than one "Class" of membership interest, and each class may vary the rights and preferences of the interest holder. It is important to carefully describe the Interest as it exists on the date of grant. Some interests are measured in terms of "units", others in terms of "percentages". In any event, the Lender should understand the extent of rights held by the Member, as well as the Lender's and Member's relative ability (or inability) to preserve those rights.

[52] If the Interest is in fact certificated, it is important to ascertain if the Company has "opted in" to Article 8 of the UCC. If it has, the security interest may be perfected by obtaining perfection of the certificate. A security interest perfected in this manner has priority over other perfected security interests in the same collateral. See UCC Section _____.

(i) The Company will not contest the validity or enforceability of the Lender's security interest in the LLC Interest.

(ii) The Company will provide prompt notice to the Lender of any of the following events:

A. A breach or default by Member of any obligations under the Certificate or Operating Agreement that could result in termination or forfeiture of the LLC Interest;

B. The Member's withdrawal (voluntary or involuntary) from the Company;

C. The cessation of business operations by the Company; or

D. The liquidation or dissolution of the Company.

(iii) Upon Company's receipt of Lender's written demand in the form of Exhibit A annexed hereto, all distributions by the Company to the Member in respect of the Interest[53] will be sent to Lender.

(iv) No interest in the Company (including the LLC Interest) will be certificated.

2. Confirmation and Agreement of the Lender.

(a) The Lender hereby confirms to the Company that:

(i) Its status with respect to the LLC Interest is that of secured party only.

(ii) It has reviewed the Certificate and Operating Agreement, including all restrictions on future transfers of the LLC Interest.

(iii) The security interest in the LLC Interest has not been granted or accepted as part of any plan or scheme of distribution that would violate the Securities Act of 1933 or the Securities Exchange Act of 1934.

(b) The Lender hereby agrees with Company that:

(i) The Lender will provide prompt notice of any event of the following events:

[53] Presumably, this would not include "guaranteed distributions" under Code Section 707(c) on account of services provided.

A. A default by the Member in respect of which Lender is entitled to exercise any remedies that may affect the LLC Interest; or

B. Satisfaction of the obligations secured by the LLC Interest.

(ii) The Lender is bound by the restrictions on transfer of the LLC Interest as set forth in the Certificate and Operating Agreement.

(iii) The Lender will not interfere with the business and management of the Company.

3. Release and Indemnification by Member. Member releases the Company and the Lender from any claim or cause of action arising out of or based upon this Consent and Acknowledgment or any action taken by either of them pursuant to or in reliance upon its terms. Member will indemnify and defend Company and Lender from any loss, liability, damage, cost or expense (including reasonable attorney's fees and other costs of defense) incurred by either of them in connection with or arising out of any action taken by either of them pursuant to this Consent and Acknowledgement.

4. Miscellaneous.

[*To be added as required or desired for each particular transaction*].