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LLC AND PARTNERSHIP INTERESTS AS COLLATERAL

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INTRODUCTION

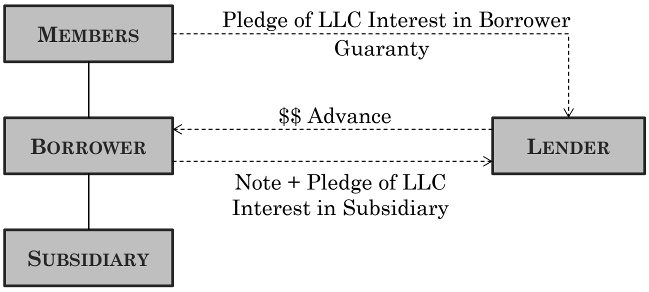
- LLCs are the preferred organizational form for new entities in the State of Texas.
- As a result, lenders who require an equity pledge to collateralize a loan are increasingly taking pledges of LLC interests rather than pledges of shares of stock in a corporation.
- Perfection of a security interest in shares of stock is relatively straightforward:
  - A share of stock is defined as a "security" (UCC Sec. 8.103(a)), which means that the perfection rules for "investment property" under Chapter 9 apply (UCC Sec. 9.102(a)(49)).
  - A secured party may perfect its security interest in investment property either (i) by filing a financing statement (UCC Sec. 9.312(a)), or (ii) by control (UCC Sec. 9.314(a)) – however, control has priority over filing (UCC Sec. 9.328(1)).

INTRODUCTION

- Perfection of a security interest in a partnership or limited liability company interest is somewhat more complicated:
  - Contrary to shares of stock in a corporation, "(a)n interest in a partnership or limited liability company is not a security unless … ***its terms expressly provide that it is a security governed by this chapter***…." (UCC Sec. 8.103(c)).
  - Therefore, if the issuer of the partnership or limited liability company interest (hereinafter an "LLC Interest") has not affirmatively "opted-in" to the definition of a "security" under Chapter 8, different perfection rules apply than would apply to a security interest in a "security".
- The remainder of this presentation will focus on (i) a typical loan transaction secured by a pledge of an LLC Interest, (ii) necessary due diligence, (iii) applicable perfection rules, and (iv) realizing on the collateral.

TYPICAL LOAN TRANSACTION

- Assume Lender has elected to require a pledge of an LLC Interest to secure (in whole or in part) its loan to Borrower (typically, either an LLC Interest held by Borrower in a subsidiary or an LLC Interest held by guarantors/members in Borrower).



DUE DILIGENCE

<u>CERTIFICATE OF FORMATION/COMPANY AGREEMENT:</u>

- Has the issuer "opted-in" to Chapter 8 of the UCC?
  - "The Membership Interests are securities and are governed by Chapter 8 of the Uniform Commercial Code, as adopted now or in the future in the State of Texas."
- Are the LLC Interests certificated or uncertificated?
  - "The Company will issue certificates evidencing the ownership of the Membership Interests and will maintain a ledger for the purpose of registration of the issuance, surrender, transfer and ownership of such certificates, including the determination of rights under UCC Sec. 8.207(a)."
  - "The Membership Interests shall not be represented by certificates."

-OR-

  - "The Membership Interests of the Company may be either certificated interests or uncertificated interests."

Title search: LLC and Partnership Interests as Collateral

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