

FORECLOSING A PERFECTED SECURITY INTEREST IN LLC MEMBERSHIP UNITS/INTERESTS

In our most recent edition of *The Advisor*, we discussed the process for a lender to obtain and perfect a security interest in membership units/interests in a limited liability company (“LLC”), as collateral for a loan. In this edition, we will address the lender’s rights to foreclose its security interest upon the occurrence of an event of a default under the loan.

In the event of a default under the loan, the lender may elect to foreclose its security interest in the LLC membership units/interest. Should the lender make such an election, the lender must exercise its rights under the applicable pledge agreement and the Uniform Commercial Code (“UCC”).

The first step will be for the lender, or its legal counsel, to prepare any notice of default and demand required by the applicable loan documents, providing the pledgor and any other necessary party with lender’s demand for payment and notice of the party’s right to cure the default, if any such right is provided for in the loan documents.

Assuming there is no cure, the lender then must gain control of the pledged membership units/interests. If the membership units/interests are uncertificated, there is no physical certificate to possess, so control is not an issue. If the membership units/interests are certificated, the lender will generally have obtained possession of the certificates during the loan origination, so control, again, should not be an issue.

Once the membership units/interests are in the lender’s control, the next step is liquidation. The lender will look to the pledge agreement and the LLC’s organizational documents to determine if there is an obligation to first offer the membership units/interests to the LLC or its other members before liquidating the membership units/interests. If there is such a requirement, the terms of the pledge agreement or the LLC’s organizational documents will dictate the process. If not, the lender may proceed to sell the membership units/interests to a third party. In doing so, the primary choice the lender will face is whether to dispose of the membership units/interests by private or public sale. Whether the disposition is public or private dictates the type of “Notice of Disposition” that must be provided prior to the disposition of the membership units/interests.

Prior to preparing a Notice of Disposition, the lender must determine who must be provided with such notice. The UCC requires the lender to provide a Notice of Disposition to the debtor/pledgor, any secondary obligor (i.e. guarantors), and any party holding a security interest or other lien in the membership units/interests, perfected by the filing of a UCC financing statement (collectively, “Parties of Interest”). Thus, the lender will need to perform a current UCC search on the pledgor to determine if any other security interests or liens encumber the membership units/interests.

The lender then must determine how many days notice must be provided. The UCC provides that ten (10) days notice prior to the disposition is “commercially reasonable”. However, twenty-five (25) days notice prior to the disposition is required when a state or federal tax lien has been filed.

Once the applicable period of notice has elapsed, the lender may dispose of the membership units/interests and apply the net proceeds to the amounts due and owing under the loan. The lender may then look to other collateral, the borrower, or any guarantors for payment of any remaining amounts due under the loan.

Finally, there is an alternative to the lender's disposition of the membership units/interests (as described above), which is much less frequently utilized. Under this alternative, the lender may accept and retain the membership units/interests in full or partial satisfaction of the debt due and owing. However, the debtor/pledgor must provide consent to the lender *after the default* (in the event of a partial satisfaction of the debt) or fail to object to the lender's acceptance of the membership units/interests, after being provided with notice of lender's intent to do so (in the event of a full satisfaction of the debt). Given that the relationship with the debtor/pledgor is often strained after the occurrence of an event of default, and that lenders typically do not desire to retain ownership of foreclosed collateral, this alternative is rarely utilized.