

# community BANKER

NOVEMBER / DECEMBER 2018

Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

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The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

## Security Interests in Limited Liability Company and Partnership Interests – The Very Basics

It is not unusual now for a debtor to use his or its ownership interest in a limited liability company (LLC) or a partnership as collateral. Be aware that these interests may be classified as a **general intangible** under Article 9 of the Uniform Commercial Code (UCC) or as a **security** under Article 8 of the UCC. In North Dakota, the interests are typically and usually general intangibles, but lenders should know the difference. The difference of type is important because it determines how the security interest is perfected -- whether a financing statement should be filed for the general intangible, or whether the secured party should file *and* take control of the securities.



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### Which is it?

The first question a secured party must answer when considering LLC or partnership interests as collateral is whether the interests are securities (prompting Article 8's perfection and priority rules) or general intangibles (perfection by filing). Unless an interest in an LLC or Limited Partnership (LP) is a security as defined under Article 8 of the UCC, it is generally classified as a general intangible under Article 9. *See* N.D.C.C. § 41-08-03(3) and N.D.C.C. § 41-09-02(1)(rr).

Perfection of **general intangibles** is set out in N.D.C.C. § 41-09-30, and provides for perfection (and obtaining a first-lien priority) by filing. An Article 8 first-lien priority in securities is obtained by control, not by filing alone.

Under N.D.C.C. § 41-08-03(3), an interest in an LLC or LP is not a security unless **(1)** it is traded on securities exchanges or securities markets; **(2)** its terms expressly provide that it is a security governed by Article 8 (the Article 8 "opt-in"); **(3)** or it is issued by an entity registered with the SEC. (Article 8 does not require the opt-in to be stated in a specific place, so the secured party should look for it in the LLC or LP creation documents and any certificates representing the interests for language that explicitly states that the interests are to be treated as securities under Article 8.)

Whether it's a general intangible or a security, perfection may be established by filing. *See* N.D.C.C. § 41-09-30 and N.D.C.C. § 41-09-32(1). *However*, if the collateral is an Article 8 security and Article 8 applies, the secured party should also perfect by control as described in N.D.C.C. § 41-08-06 in order to obtain first-lien priority. *See* N.D.C.C. § 41-09-48, providing that a security interest in investment property perfected by control under N.D.C.C. § 41-09-06 (and by reference N.D.C.C. § 41-08-06) has *priority* over a security interest not perfected by control.

THE BASICS: Consider whether an equity interest in an LLC or LP is an Article 8 security or an Article 9 general intangible, and the best method of perfection to ensure priority:

1. Are the equity interests securities under N.D.C.C. § 41-08-03(3)?

**Yes**, if:

- ✓ it's traded on a securities exchange or in securities markets
- ✓ the interests specifically state that they are a security under Article 8
- ✓ it is an investment company security

**No** to any of these markers?

- Then the interests are general intangibles under Article 9 and filing will serve to perfect and obtain a first-lien priority.

**Yes** to one of these markers?

- Then perfect by filing, but to ensure priority against a competing secured party, perfect by control as well.

2. Are the interests certificated (are there share certificates on actual paper)?

**If yes**, perfect by taking delivery of the certificate along with a stock power or some other effective endorsement in blank.

**If no**, perfect by obtaining an agreement from the issuer of the securities to follow the instructions of the secured party without any additional consent by the pledging borrower.

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