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Uniform Commercial Code/ Commercial Real Estate Issues

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Article 9 considerations in commercial foreclosures/collections

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SOUTH STATE BANK

I. COMMERCIAL SPECIAL ASSET LITIGATION

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Commercial special asset litigation is different than most consumer transactions. Commercial transactions typically involve multiple notes (and renewals, extensions, and/or modifications). Collateral consists of real property (or multiple pieces of real property sometimes located in multiple counties or states), collateral assignments of rents and leases, personal property (such as furniture, fixtures, equipment, machinery, and inventory), other collateral such as deposit accounts, certificates of deposit, and almost always personal guaranty agreements of the principals of the borrowing entity.

In addition, the same commercial borrowers and/or guarantors could have multiple loans with the same lender and also multiple loans with other lenders. When a commercial loan goes into default and is referred to litigation, it is likely that all or many of the borrower's loans are also in default.

To complicate matters, there can be many different procedures for liquidating the collateral, and the final litigation analysis determined by the attorney and the secured party is often based on multiple judgment calls, and could result in multiple actions.

STEP ONE: Understand the Transaction.

First of all, Review All Loan Documentation.

The following is a list of documents that are typically sent to the lender's attorney when the matter is referred. If anything is missing, it is prudent to ask the client whether the missing items exist, and if so, ask for full copies.

A. Promissory Note (original note is required in some counties and can be specifically requested if needed in other counties or if the case becomes contested), including all renewals, modifications, renewals, assignments and/or endorsements, if any.
   a. Place close attention to the "chain" of the notes, renewals, etc.:
      1) Does the loan number change?
      2) Are there gaps between maturity dates and the next renewals?
      3) Are they all signed by the same borrower?

B. Recorded Mortgage and any and all Assignments.

C. Recorded Assignments of Rents and Leases and all Assignments.

D. Mortgagee title insurance binder and policy or title certificate. Were opinions/assurances of counsel issued at the origination of the loan?

a. The client decides whether or not to order a full title search or update from the title policy, but it is your job to make the recommendation.
b. If there is only a title opinion, recommend a full title search.
c. If there is anything that raises red-flags in a title policy or the title update, recommend a full title search.
d. If the loan amount is very high, it is often prudent to go ahead and order a full search to avoid delay in OREO.
e. Full search for commercial properties is 60 years; full search for residential properties is 40 years.

E. Security Agreements, UCC-1 Filings, and UCC-3 Amendments/Continuations.

a. Were the UCC-1 filings properly continued and/or assigned?
b. Always order a new UCC Search with the Secretary of State of the state in which the owner of the collateral is incorporated or lives.

F. Corporate (or LLC) Documents - If the borrower, owner of any of the collateral, or guarantor is an entity, request copies of the resolutions/certificate of members/partnership agreements from the origination of the loan. Order copies of the Articles and Certificate of Existence with Secretary of State of the state in which the entity was formed, and articles authorizing business to be conducted in South Carolina, if applicable.

G. Personal Guaranty Agreements.

H. All default letters and correspondence.

I. PACER searches on all borrowers, guarantors and owners of collateral.

a. Department of Defense searches on individuals, as well

J. The lender should, in addition, provide the following items of information, IF they are available to the lender:

a. Loan number (or "numbers", if renewals, modifications, or if loans are cross-collateralized or cross-defaulted).
b. Current name(s) and mailing address(s).
c. Social Security Numbers of individuals and EIN of entities
d. Any known occupants of property who are not the owners.
e. Property address.
f. Identity of any insurer/government guarantor (such as SBA, etc.).
g. Itemized payoff statement, including the unpaid principal balance, date of default, corporate advances already made (i.e., insurance, taxes, late fees)
h. Current interest rate.

i. If a servicer of the loan is involved, get the name and address of the holder of the note and mortgage, and make sure the loan has been properly assigned. (For purposes of this discussion, there are no servicers)
j. Escrow account status, if applicable.
k. Items of correspondence between lender/mortgagee and borrower.

STEP TWO: Discuss Your Understanding of the Transaction with the Lender and Understand the Lender's End Goal.

I. LEGAL ISSUES LENDER NEEDS TO UNDERSTAND IN ORDER TO COMPLETE ITS BUSIENSS ANALYSIS

A. Loan Documents:

(1) Are the security instruments signed by the owner(s) of the collateral?

(2) Cross-collateral provision(s): If the loan documents contain a valid cross-collateral provision, confirm with the lender that there is not other collateral that can be liquidated based on the default of the present loan, or that the lender does not want to exercise its rights under this provision.

(3) Cross-default provision(s): Find out if the borrower and/or guarantors have any other loans which be accelerated due to the current default, and if so, does the lender want to exercise its rights under this provision?

(4) Default Provisions:

(a) What interest rate applies when the loan is in default and has the client applied the applicable interest rate at the date of acceleration?

(b) Are there any notices required to be sent upon default?

(c) If so, were these provisions complied with?

B. Acceleration/Demand Letters:

(1) Has the lender stopped accruing late fees after the date of acceleration?

(2) Did the lender follow the proper procedures set forth in the loan documents?

C. Consumer Protection Laws:

(1) If the FDCPA, FCRA, TILA, SC Consumer Protection Code, Foreclosure Intervention ("FIT"), or any other consumer laws apply, is the lender in compliance?

(2) Typically, commercial transactions are not subject to these laws, but there can be exceptions, most commonly due to contract provisions.

(3) FDCPA defines "debt" as "any obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family or household purposes" 15 U.S.C. §1692a(5)

(4) For application of this definition, courts look at the transaction as a whole.

(5) For example, FIT could apply:

1. To a business loan in which the lender has a mortgage or the guarantor's primary residence; or

2. Even if a loan was originally obtained to purchase property meant to be "rental property," if the borrower later moves into the property prior to the foreclosure, it is still considered the mortgagors' primary residence for purposes of FIT.

(6) SC Consumer Protection Act does not apply to commercial loans unless the parties agree in writing. S.C. Code § 37-3-105(a)

(7) Likewise, TILA should not apply to commercial transactions unless any of the loan documents state that it applies.

(8) Therefore, if a commercial loan was made using standard "consumer" loan documents, the lender needs to know if it has to comply with the consumer statutes.

D. Right of Redemption/Notices of Default: Lender's requirement to send demand letters and/or redemption notices, etc. is governed by:

(1) Language of the loan documents;
(2) If any consumer protection statutes apply (whether by contract or otherwise); or
(3) If collateral is governed by the UCC, a debtor has a statutory right to redeem the collateral under S.C. Code §36-9-623 at any time before the secured party:
   i. Has collected collateral under §36-9-607;
   ii. Has disposed of collateral under §36-9-610[1]

[1] Referring to sale of the collateral in a commercially reasonable manner

iii. Has accepted the collateral as full or partial satisfaction of the obligation which is secured by the collateral under §36-9-622

E. Authority - Was the borrower and/or guarantor authorized to execute the applicable loan documents?

F. Bankruptcy - Are any of the parties in bankruptcy and/or been discharged from bankruptcy since the loan was entered?

G. Probate Issues –

(1) Are any of the borrowers or guarantors deceased?
(2) Is there an estate? (or should there be an estate?)
(3) Do claims need to be made against the estate?

H. Legal Priority of Lien: When a loan involves multiple collateral and/or multiple guarantors, the lender's representative can usually tell you what collateral it believes is worth pursuing and which it does not believe is worth pursuing.

I. Receivers

(1) S.C. Code 15-65-10 et al.

(2) If Lender has right to rents and profits which are in danger of being materially impaired, Plaintiff can seek to have a receiver appointed.

(3) Lender usually has to post a bond.

(4) Receivers can be expensive and Lender needs to understand the costs involved.

(5) Can be requested at the outset of the case.

(6) Lender must be able to show that rents and profits are in danger.

J. Other Issues to Present to Lender So that it Can Make an Informed Decisions:

(1) All possible collateral it is entitled to, and whether it is not entitled to any collateral that it believes it has a right to;

(2) Real Property - Title Issues:
(a) Outstanding taxes (including machinery/equipment taxes)

(b) Tax sales, and deadlines for redemption

(c) Survey Issues:
    a. Lack of survey
    b. Access issues
    c. Major encroachments

(d) Senior Liens and/or mortgages
    a. Does it appear that the mortgage should have been satisfied at the closing?
    b. If lender knew about the lien, does it plan to foreclosure subject to the senior lien, or does it plan to negotiate with the senior lienholder?

(e) Are there any equitable causes of action available to try to establish priority, and if so, what is the likelihood of success?

(f) Liens of the United States
    a. IRS liens – 120 day redemption
    b. SBA and other US liens – one year redemption
    c. Forfeitures

(g) If there is an appraisal (from origination and/or current), does the mortgage cover the property the lender believed it had a lien on?

(h) Are there any minor issues in the legal description that can be fixed in the foreclosure action?

(i) Are there any major title issues or unresolved estates?

(j) Are the title issues covered by the title policy?
    a. If not, is it easier to resolve the issues in the foreclosure action, or is there going to need to be a subsequent action if the lender is the successful bidder (i.e., lender does not have standing to resolve certain title issues until and unless it is the owner of the property).

K. Assignment of Rents: If there are tenants, does the lender have a valid collateral assignment of rents and leases which can be exercised?

L. Personal Property, Accounts, Chattel Paper, etc.:
    (1) If a UCC-1 Financing Statement was required:
        i. Does the UCC search from the office in which the debtor resides or is incorporated show that lender is the lien position it believes it is in?
        ii. Was lender's UCC properly continued?
        iii. Was it filed in the proper office?

iv. If the lien in on equipment, furniture, or machinery, and there are other secured parties, does the lender have a list or copies of invoices proving the collateral in which it intended to have a security interest in at the time of the loan?

(2) Inventory: If the collateral is inventory, especially perishable inventory, does the lender even want to pursue its rights in the inventory?

(3) Fixtures/Timber: If the collateral was fixtures and/or rights to timber, was the UCC and/or mortgage containing proper fixture filing language filed in the ROD office of the county in which it was located?

(4) Collateral perfected by possession: Does the lender have possession and does it intend to exercise its rights to repossess that collateral?

(5) Applicable State Law - Which state's law applies to the validity and enforcement of UCCs?

i. Was the proper state's law applied?

II. IMPORTANT INFORMATION NEEDED FROM LENDER:

A. Prior Discussions with Borrower: Lenders usually try to work with the borrower and reach a resolution before the case is referred to an attorney. If the lender's representative can tell you about his or her experience, it is often much easier and faster to understand what is expected of you.

B. Relevant Business Issues: Outside whether or not the lender has the legal right to liquidate properly perfected collateral, there are often business reasons the lender does not want to pursue certain avenues, because certain avenues could be more expensive and time consuming. For those reasons, as to the collateral, it is helpful to know whether:

(1) The secured party knows where the collateral is located;
(2) There is a danger that the debtor might remove or damage the collateral;
(3) There are environmental issues with real property;
(4) Any collateral is already in the possession of the secured party, such as deposit accounts or certificates of deposit, which can be repossessed and applied to the loan balance prior to litigation;
(5) Whether the secured party knows the current estimated value of the collateral;

1. If necessary, is the collateral valuable enough to justify putting up a bond? (For claim and delivery, an affidavit providing the value must be executed.)
2. Is the value of repossession worth repossessing it and reselling it?

3. Is the real estate and personal property more valuable collectively as a business, so that the goal should be to sell it all together?
4. Should a receiver be appointed/is it worth the cost?

(6) Based on communications with the borrowers/guarantors, do they plan to contest the action or have they pretty much closed the business?

(7) Money or Deficiency Judgment: Is the secured party seeking a money or deficiency judgment against the borrower and/or guarantors?

ii. Do the borrowers/guarantors appear to have assets outside of the collateral?

iii. If a deficiency judgment is not being sought:

1. Will the borrower cooperate with the secured party in securing the collateral?
2. Are the borrowers/guarantors likely to do whatever necessary to delay the completion of the litigation?
3. Are there junior lien holders that need to be foreclosed out?

STEP THREE: ANALYZE SECURITY INTEREST

I. APPLICABLE LAW

A. The extent of property interests, the requirements for liens, and the priority of liens are defined by state law. Most states, including South Carolina, have adopted the Uniform Commercial Code. However, there are some states or territories which have only adopted parts of the UCC, and some territories which have not adopted the UCC at all.

The resolution of UCC perfection and priority depends on the law in the state in which the Debtor is incorporated. *See* S.C. Code Ann. § 36–9–301 ("Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or non-perfection, and the priority of a **security** interest in collateral");
See also S.C. Code Ann. § 36–9–307 (providing that a "registered organization that is organized under the law of a State is located in that State").

B. The law of secured transactions in South Carolina is governed by the Uniform Commercial Code—Secured Transactions as adopted in § 36–9–101 *et seq.* The creation of security interests, the validity of security agreements and the rights of the parties to those agreements are governed by § 36–9–201 *et seq.*, and the perfection of a security interest in goods covered by a certificate of title is governed by §§ 36–9–303(c), 36–9–311, 36–9–313(b), 36–9–316(d) and (e), 36–9–337, 56–19–620, and 56–19–630. *In re Lewis*, 363 B.R. 477 (Bankr. D.S.C. 2007) (citations omitted)

C. Mortgages and Assignments of Rents and Leases are governed by state property law and the recording statutes.

II. SECURITY AGREEMENT REQUIREMENTS

A. Did the borrower/owner of the collateral sign a document which qualifies as a "Security Agreement" (as opposed to an "Assignment" or "Collateral Assignment")?

B. In order to have a valid security interest in collateral, there always has to be a signed security agreement.

C. The name of the document is irrelevant to determine whether a document is a security agreement or an assignment.

D. A signed document is a valid security agreement if it meets the following requirements:

1. A security interest is indicated where the assignee (lender) retains a right to a deficiency on the debt.
2. A security interest is also indicated when the assignee (lender) acknowledges that his rights in the assigned property would be extinguished if the debt owed were to be paid through some other source.
3. ... A security interest is indicated if the assignee (lender) must security to the assignor (borrower/debtor) for any surplus received from the assignment over the amount of the debt.
4. Evidence that the assignor's debt is not reduced on security of the assignment is also evidence that the assignment is intended as security.
5. Finally, the contract language itself may express the intent that the assignment is for security only. In contrast, assignments have been found to be absolute transfers where the assignment operates to discharge the underlying debt.

In re Carolina Utilities Supply Co., Inc., 118 B.R. 412, 415-16 (1990).

E. Specific requirements of a security agreement:

a) Signature of debtor is required
b) Electronic signatures are ok
c) Descriptions Requirements of Collateral:
- "All asset" description is insufficient (§9-108(c))
- Must "reasonably" identify the collateral

2. Identification of the collateral:

A) Equipment/furniture/machinery:

a. Best practice is to include a list of each major piece of equipment, including serial numbers, etc. so that there is no confusion later regarding priority and identification of the collateral. The reasons for this are:

(a) If the loan goes into default and the secured party wants to liquidate the collateral, the secured party can determine whether the debtor improperly disposed of equipment

(b) If the debtor attempts to sell any of the equipment without informing the secured party, this provides solid proof of the secured party's lien.

(c) It avoids later disputes as to who owns the collateral (business entity versus principal of the business entity; or tenant versus landlord).

(d) This is especially important if the loan proceeds were used to purchase the equipment.

B) Timber - If the collateral is timber to be cut, the legal description of the property must be included. (§9-203(b)(3)(A))

C) Fixture filings should also include the legal description of the property.

D) After-acquired Property: security agreements can include "after-acquired property" (§9-204(a))

Exception: After-acquired Consumer Goods is not allowed unless the debtor obtains the collateral within 10 days after the secured party gives value. (§9-204(b)(1)

F. Security Agreement can secure future advances and can provide for cross-collateralization of other obligations. (§9-204(c))

III. ATTACHMENT

A. Attachment refers to when a security interest is enforceable against a debtor (§9-203(a)) (but not necessarily against other secured creditors or purchasers)

1. Exception: Agriculture liens (*see §9-308(b))*

B. Requirements of Attachment:

1. Value (consideration) must have been given to the Debtor (§1-204);

a) Examples: making a loan; acting as an accommodation party; partial or full satisfaction of pre-existing claim (such as an agreement to renew or modify a loan)

2. Debtor must own or have rights in the collateral; and
3. Either:

a) The collateral must be in the possession of the secured party by agreement (§9-203); or
b) The collateral is in the "control" of the secured party (§9-203(b)(3)(A); or
c) Debtor must have executed a security agreement which contains a description of the collateral

C. Attachment by Control:

1. Possession of the Property. S.C. Code Ann. § 36–9–313(a) (Supp.2002) ("[A] secured party may perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral.").

2. Possession of Collateral by a Third Party. This constituted control if there is an agreement by the debtor which is acknowledged by the third party in writing.

3. Control of the property is required for the following collateral:

a) Deposit Accounts;
b) Electronic chattel paper;
c) Electronic documents;
d) Letters of Credit; and
e) Investment Property.

IV. PERFECTION

A. Security interests MUST be perfected in order to prevail over other creditors, including a trustee in bankruptcy, and third party purchasers.

B. Non-perfected, but "attached" security interests are still valid as between the lender and debtor, by virtue of contract law.

C. In order for a security interest to be perfected, it must FIRST have attached. (§9-308(a))

D. Ways in which an attached security interest may be perfected:

1. Filing a properly completed financing statement in the appropriate office (*see* §9-102(a)(39); §9-102(a)(37));
2. Possession of the collateral by secured party;
3. Control of the collateral – usually by agreement with a third party in possession that it will obey the secured party and not the debtor
4. Automatic Perfection.
5. Titled Property (vehicles/mobile homes): In South Carolina "a security interest in a vehicle ... is not valid against creditors of the owner or subsequent transferees or lienholders of the vehicle unless perfected ...." as

provided in § 56–19–610 *et seq.* § 56–19–620. "A security interest is perfected by the delivery to the Department of Motor Vehicles of the existing certificate of title, if any, an application for a certificate of title containing the name and address of the lienholder and the date of his security agreement and the required fee. It is perfected as of the time of its creation if the delivery is completed within ten days thereafter, otherwise, as of the time of delivery." § 56–19–630. *In re Lewis*, 363 B.R. 477 (Bankr. D.S.C. 2007).

V. PERFECTION BY FILING FINANCING STATEMENT

A. Financing statements must be properly completed (§9-516(b))

1. See UCC-1 Financing Form and instructions.
2. Minor and not seriously misleading errors might be ok.

   For example, if a search of the records would still disclose the fixture filing, a minor error in the debtor's name might be ok
3. Debtor's name should appear exactly as it does on the articles of organization or articles of incorporation, unexpired driver's license, or first name and surname as shown on driver's license.
4. Must include mailing address of Debtor.
5. Must include type of entity of Debtor.

B. Authorization by Debtor to file Financing Statement (usually by signing the security agreement):

1. Financing statements do not have to be signed by the debtor, but secured party cannot file the financing statement unless it is authorized by debtor (usually via the security agreement).
2. If a secured party files a financing statement without debtor's authorization, it might be liable for actual or statutory damages (§9-625(b) and (e)(3)).
3. BUT: If a secured party pre-files a financing statement prior to the execution of the security agreement, secured party needs the financing statement to be authenticated by the Debtor.

C. Description of Collateral in Financing Statement:

1. A description of "all assets" is ok in a financing statement, even though it is insufficient in a security agreement.

2. Secured party CANNOT describe the collateral in a financing statement more broadly than it is described in the security agreement signed by the debtor. (§9-509(b))

3. Timber to be Cut or Fixture Filings: Except as otherwise provided in Section 36-9-501(b), to be sufficient, a financing statement that covers as-extracted collateral or timber to be cut, or which is filed as a fixture filing

and covers goods that are or are to become fixtures, must satisfy the other requirements and also:

a) Indicate that it covers this type of collateral;
b) Indicate that it is to be filed for record in the real property records;
c) Provide a description of the real property to which the collateral is related sufficient to provide constructive notice of a mortgage under the law of the state if the description were contained in a record of the mortgage of the real property; and
d) If the debtor does not have an interest of record in the real property, provide the name of a record owner.

D. A recorded mortgage is effective, from the date of recording, as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut only if the:
1. Record indicates the goods or accounts that it covers;
2. Goods are or are to become fixtures related to the real property described in the record or the collateral is related to the real property described in the record and is as-extracted collateral or timber to be cut;
3. Record satisfies the requirements for a financing statement in this section, but the:
a) record need not indicate that it is to be filed in the real property records; and
b) record sufficiently provides the name of a debtor who is an individual if it provides the individual name of the debtor or the surname and first personal name of the debtor, even if the debtor is an individual to whom Section 36-9-503(a)(6) applies; and
c) record is duly recorded.

E. When to File the Financing Statement - A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.

F. Where to File Financing Statement:
1. Depends on the Collateral
2. Central office (usually Secretary of State) of the state in which the debtor is incorporated:
a) Personal property, such as equipment, furniture and machinery, or
b) Inventory,
c) Goods (or by possession),
d) Instruments (or by possession)
e) Certified Securities (or by possession or control)
f) Tangible documents, such as negotiated documents (or by possession)

3. Register of Deeds Office of county in which the property is located:
a) Fixtures or

b) Timber to be cut (§9-501)

4. Central office (usually Secretary of State) in which the real estate is located:
   a) Transmitting utility

G. Lapses/Terminations
1. Most lapse after 5 years, and must be continued no earlier than 6 months before they lapse (except Mortgages which are also fixture filings)
2. Continued by filing a UCC-3 Continuation Statement
3. If UCC lapses, security interest is unperfected and treated as if it were never perfected as to a **purchaser** (but not a lien creditor) (§9-515(c))
4. When Obligation secured by Financing Statement is Terminated (§9-513; 9-509(d)(2):
   a) Consumer - secured party MUST file a termination statement; or
   b) Commercial – provide UCC Termination to the debtor; or
   c) Debtor may file the termination
      (1) Failure of Secured Party to terminate UCC can result in damages (§9-625(b) and (e)(4)
      (2) BUT: If Security Agreement includes future advance provisions, cross-collateral provisions and/or cross- default provisions, secured party may be justified in not terminating the UCC

VI. PERFECTION BY POSSESSION OR CONTROL

A. Perfection by Possession
1. Money (§9-312(b)(3);
2. Instruments (or by filing);
3. Certified Securities (or by filing or control);
4. Tangible documents, such as negotiated documents (or by filing);
5. Bailee – a third party who takes possession of collateral. Typically used with certificated securities;
6. §9-313(c)(1); §8-106(a) and (b); §8-301(a)(2)

B. Perfection by Control
1. Deposit accounts - §9-104
   a) Can ONLY be perfected as "original collateral" by the secured party who has control over the deposit account. §9-312(b)(1) and §9-314(a)
   b) Control includes being the depository bank or if the account is in the secured party's name
   c) Can also gain control by having an agreement with the depository bank that it will comply with the secured party's instructions without further permission from the debtor

2. Electronic chattel paper and Electronic documents - §9-105
3. Investment Property - §9-106
   a) Includes delivery of certificated securities to the secured party and an agreement by the issuer of the uncertificated securities that it will honor instructions from the secured party without the consent of the debtor
4. Letter-of-Credit - §9-314(a)
   a) Main way to perfect is by control
   b) Control includes obtaining an agreement from the issuing bank agreeing to follow the secured party's instructions without the permission of the debtor

VII. AUTOMATIC PERFECTION

A. Purchase money security interest in consumer goods;
B. Sale of promissory notes or payment intangibles; and
C. Assignment of accounts or payment intangibles (as long as the secured party does not have a significant part of the outstanding accounts or payments of the assignor).

VIII. PERFECTION BY CERTIFICATE OF TITLE

A. A security interest in a mobile home or vehicle is perfected by listing the interest of the secured party on the certificate of title, which is filed with the DMV (at least in South Carolina). S.C. Code §§ 36–9–302(3)(b), 56–19–210, 56–19–290(3), 56–19–340.
B. Motor Vehicles – *see* Chapter 19**,** Title 56, Protection of title to and interests in motor vehicles
   a. Filing of watercraft and outboard motors – *see* Chapter 23, Title 50
   b. UNLESS the mobile homes and/or vehicles are considered inventory.
   - If the collateral is inventory held for sale by a person in the business of selling goods of the type to which the certificate of title laws apply, then the security interest and perfection issues during the time the goods are inventory are governed by Part 5 of Article 9. § 36–9–311(a)(2).

IX. OTHER METHODS OF PERFECTION

A. Other federal and state statutes provide for perfection of other types of collateral.
B. Other examples, not discussed here, are aircraft, vessels, and intellectual properties

STEP FOUR: DETERMINING THE PRIORITY OF CREDITORS

I. Priority of Collateral in which Financing Statement is required to be filed in the Secretary of State's Office:

A. UCC Search - Request a UCC Search from the Secretary of State's office in which the debtor resides or is incorporated. (In SC, can request through the Secretary of State website)

1. Search name of all Borrowers, Guarantors, and "doing business as" names
   - Less is more – don't need to include the whole name; just enough to identify the debtor

2. A title search in the Register of Deeds Office is NOT a proper UCC search

M. Super-Priority: §36-9-103

1. Purchase money security interest in collateral which is taken by supplier or lender who gave loan in which the proceeds went to purchase collateral.
2. Inventory – must be perfected before debtor obtains possession of the inventory
   - Purchase Money Secured Party must notify existing holders of security interests of record in the same type of inventory prior to debtor receiving possession of collateral

3. Other collateral - Must be perfected within 20 days after debtor obtains possession of collateral

C. First to File:

1. First Secured Party to perfect its security interest has priority, except:

   a) Future advances of Secured Parties with Perfected Interests can maintain their priority, as long as:
      (1) Future advance was made within the later of 45 days from the lien creditor's lien, or before secured party had knowledge of lien creditor's lien; or
      (2) If advance was made pursuant to a commitment prior to knowledge of the lien creditor's lien

   b) Purchase Money Security Interests – secured party has priority as long as secured party perfected lien before 20 days after debtor received possession of collateral

   c) Buyer in Ordinary Course of Ordinary Business - Take free of security interest, even if they know about it

2. Secured Party with unperfected security interest

   a) Security interest still enforceable against debtor, unless debtor is in bankruptcy.

b) A Trustee or Debtor in Possession obtains rights of a bona fide purchaser without knowledge

3. Junior, PERFECTED, secured parties who properly perfected their security interest can trump

4. Lien Creditors

5. Buyers Not in Ordinary Course of Business
   a) Does not take collateral free and clear, and secured party still has right to liquidate collateral

D. Special Priority Rules:

1. Chattel Paper

   a) If only perfected by filing, if a new purchaser takes possession of the chattel paper in the ordinary course, the purchaser has priority

   b) If security interest in chattel paper is taken "merely as proceeds" of other collateral, a purchaser who takes the chattel paper in ordinary course will still have priority

2. Deposit Accounts

   a) A security interest in a deposit account perfected by control is superior to a security interest in the deposit account perfected by another method §36-9-327(l).
   b) If competing security interests both obtained by control, they are ranked by first in time
   c) If security interest perfected by control of debtor's depository bank, and the depository bank has a right of recoupment or set-off, are superior to other security interests UNLESS the competing secured party's name is also on the deposit account. §36-9-327(3) and (4); §36-9-340
   d) HOWEVER, a transferee of money from a deposit account in which a secured party has a security interest takes it free and clear unless the transferee acted in collusion with the debtor.

STEP FIVE: CHOICE OF REMEDIES

I. SUMMARY OF REMEDIES:

A. S.C. Code § 36-9-601[2] states:

[2] ***See*** **S.C. Code § 36-9-619 for requirements of notification of disposition of collateral**

After default, a secured party has the rights provided in this part and, except as otherwise provided in Section 36-9-602, those provided by agreement of the parties. A secured party:

> (a) (1) ***may reduce a claim to judgment, foreclose, or otherwise enforce the claim***, security interest, or agricultural lien ***by any available judicial procedure***; and *[emphasis added]*
>
> (2) if the collateral is documents, may proceed either as to the documents or as to the goods they cover.
>
> (b) A secured party in possession of collateral or control of collateral under Section 36-7-106, 36-9-104, 36-9-105, 36-9-106, or 36-9-107 has the rights and duties provided in Section 36-9-207.
>
> (c) The rights under subsections (a) and (b) are cumulative and may be exercised simultaneously.
>
> (d) Except as otherwise provided in subsection (g) and Section 36-9-605, after default, a debtor and an obligor have the rights provided in this part and by agreement of the parties.
>
> (e) If a secured party has reduced its claim to judgment, the lien of any levy that may be made upon the collateral by virtue of an execution based upon the judgment relates back to the earliest of:
>
> (1) the date of perfection of the security interest or agricultural lien in the collateral;
>
> (2) the date of filing a financing statement covering the collateral; or
>
> (3) any date specified in a statute under which the agricultural lien was created.
>
> (f) A sale pursuant to an execution is a foreclosure of the security interest or agricultural lien by judicial procedure within the meaning of this Section. A secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this chapter.
>
> (g) Except as otherwise provided in Section 36-9-607(c), this part imposes no duties upon a secured party that is a consignor or is a buyer of accounts, chattel paper, payment intangibles, or promissory notes.

In summary, the ways of recovery are:

(1) Non-Judicial Means as specifically set forth in the UCC
(2) Obtain Judgment Against Debtor
(3) Foreclose the Collateral
(4) Enforce Claim by Any Other Available Judicial Procedure (i.e., pursuant to state law or federal statute)

II. NON-JUDICIAL UCC REMEDIES:

A. Proceeds – Secured party may take proceeds in which it is entitled (S.C. Code §36-9-607(a)(2); 36-9-315)

B. Deposit accounts – it may apply the balance of the deposit account to the obligation secured by the deposit account (S.C. Code §§ 36-9-607(a)(4); 36-9-104(a)(1); 36-9-104(a)(2) or (3))

C. Right to Peaceful Possession after Default - § 36-9-609.

(a) After default, a secured party:
(1) may take possession of the collateral; and
(2) without removal, may render equipment unusable and dispose of collateral on a debtor's premises under Section 36-9-610.

(b) A secured party may proceed under subsection (a):
(1) pursuant to judicial process; or
(2) without judicial process, if it proceeds without breach of the peace.

(c) If so agreed, and in any event after default, a secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties.

D. If not demanding a deficiency, secured party can retain the goods in satisfaction of the claim. *Andrews v. von Elten & Walker, Inc.*, 315 S.C. 199, 432 S.E.2d 500 (Ct. App. 1993)

III. MONEY JUDGMENT:

A. Considerations (Breach Of Note and/or Breach Of Guaranty)
1. Possibly Subject to Right of Jury Trial, which could prolong litigation and make litigation costly
2. Right to Jury Trial can be waived in loan documents
3. Under Rule 38(a), SCRCP, issues of fact in an action for money only must be tried by a jury unless a jury trial is waived. *Mortgage Recovery Fund-*

Riverbend, Ltd. v. Heritage Clipper Riverbend Trust, 327 S.C. 491, 493 (Ct. App. 1997)

B. Obtaining a money judgment prior to disposing or liquidating collateral is NOT a bar to later foreclosing or liquidating collateral

IV. <u>FORECLOSURE OF COLLATERAL:</u>

A. **Qualifies as a Pre-Code Remedy under S.C. Code §36-9-601(a)**

1. Leading Pre-Code Case – *Stokes v. Liverpool & London & Globe Insurance Co.*, 130 S.C. 521, 531, 26 S.E. 649 (1925):

   "When a chattel mortgage becomes past due, the mortgagee has three remedies for realizing upon his security:

   (1) He may peacefully take possession of the collateral, advertise and sell and apply the proceeds to his secured debt, paying the surplus, if any, to the mortgagor;

   (2) If possession be refused, he may institute claim and delivery proceedings to get possession of the chattel for the purpose of sale in the first instance; or

   (3) He may institute a proceeding similar to the foreclosure of a mortgage on real estate.

   See also National Bank of S.C. v. Daniels, 283 S.C. 438, 441 (Ct. App. 1984)

2. In the case of a foreclosure of the personal property, the plaintiff is asking the court of equity to order the sale of the property to satisfy the lien.

B. **Benefits of Foreclosure Action**

1. Foreclosure is an Equitable Cause of Action

   a) Whether or not an action seeks legal or equitable relief is determined by the character of the action as framed in the Complaint.

   b) Foreclosure of a chattel mortgage is an equitable proceeding. *National Bank of S.C. v. Daniels*, 283 S.C. 438 (Ct. App. 1984)

2. Judicial Sale of the Collateral considered Commercially Reasonable

3. Can still seek a deficiency, or money judgment

4. Case Law suggests that even when a foreclosure action is combined with a breach of guaranty agreement, case is still considered an equitable action, in which there is no right to a jury trial. *Carolina First Bank v. BADD, L.L.C.*, 414 S.C. 289 (2015)

V. CLAIM AND DELIVERY

A. Action at Law - South Carolina Code sections 15–69–10 to –210.

B. Magistrate Court has concurrent jurisdiction with Circuit Court for claim and delivery of property worth $7,500 or less. S.C. Code §22-3-10(11)

C. Purpose: Secured party is seeking to ***obtain money or recovery of specific property***.

1. If secured party intends to also or subsequently seek a deficiency judgment against the Borrower or Guarantors, the secured party must the value of the collateral.
   a) Debtor has rebuttable presumption that value of collateral is the same as the debt
   b) Proof of value – sale in commercially reasonable manner
2. *See* S.C. Code § 36-9-306

D. Jury Trial Considerations:

1. "An action in claim and delivery is an action at law for the recovery of specific personal property." *First Palmetto State Bank & Trust Co. v. Boyles*, 302 S.C. 136, 138, 394 S.E.2d 313, 314 (1990).

2. However, case may be referred to a Master in Equity if:
   a) The issues are complicated, but only for the limited purpose of making factual findings to be received by the circuit court as evidence only. *Id.*
   b) The parties consent.
   c) Defendants are in default in the action
   d) There is a jury trial waiver in the loan documents.
   e) *First Palmetto State Bank and Trust Co. v. Boyles*, 302 S.C. 136 (1990).

3. If a claim and delivery is combined with an equitable action, such as a foreclosure action, "legal issues are for determination by a jury and equitable issues for the judge." *Mortgage Recovery Fund-Riverbend, Ltd. v. Heritage Clipper Riverbend Trust*, 327 S.C. 491, 493 (Ct. App. 1997)

E. If Immediate Possession is Demanded:

1. S.C. Code § 15-69-10: Plaintiff may demand immediate possession of the property at the time of the Summons, or anytime afterwards
2. REASONS:
   a) Is the Property in danger of disappearing or being damaged?
   b) Does the secured party have a recent equipment appraisal or have a good faith estimate of the value of the collateral?
   c) Does the secured party mind putting up a bond?
3. Affidavit Requirement:
   a) § 15-69-30 provides that when immediate delivery is claimed, the secured party must submit an affidavit showing:

(1) That the plaintiff is the owner of the property claimed, particularly describing it, or is lawfully entitled to the possession thereof by virtue of a special property therein, the facts in respect to which shall be set forth;
(2) That the property is wrongfully detained by the defendant;
(3) The alleged cause of the detention thereof, according to the affiant's best knowledge, information and belief;
(4) That the property has not been taken for a tax, assessment or fine pursuant to a statute or seized under an execution or attachment against the property of the plaintiff or, if so seized, that it is by statute exempt from such seizure; and
(5) The actual value of the property.

4. Right to Pre-Seizure Hearing.

F. If Immediate Possession NOT Demanded:
1. When immediate possession is not demanded, Plaintiff can request an order from the Court ordering debtor not to conceal or damage property. S.C. Code § 15-69-90. Failure to comply with the Court order can subject debtor to contempt charges
2. Affidavit still required
3. No bond required

VI. OTHER CONSIDERATONS

A. Should a Receiver Be Appointed?
1. S.C. Code 15-65-10 et al.
2. If Lender has right to rents and profits which are in danger of being materially impaired, Plaintiff can seek to have a receiver appointed.
3. Lender usually has to post a bond.
4. Receivers can be expensive and Lender needs to understand the costs involved.
5. Can be requested at the outset of the case.
6. Lender must be able to show that rents and profits are in danger.

B.

VII. CUMULATIVE REMEDIES ALLOWED

A. Holder of promissory note on which maker defaults is entitled to bring action for deficiency judgment/breach of guaranty before liquidating collateral, under South Carolina's Uniform Commercial Code (UCC), providing cumulative remedies for default and permitting secured party in possession of collateral to proceed on guarantee by seeking to reduce claim to judgment without first disposing of collateral. S.C. Code § 36–9–601(a)(1); *First Chatham Bank v. Landers*, 890 F.Supp.2d 623 (D.S.C. 2011)

B. A lender can bring an action on the note, or as a foreclosure action, or as a claim and delivery action, or some or all of these. *See Lever v. Lighting Galleries, Inc.*, 374 S.C. 30 (2007)

C. "[U]ntil the mortgage debt is actually satisfied, the recovery of a judgment on the obligation secured by a mortgage, without the foreclosure of the mortgage, although merging the debt in the judgment, has no effect upon the mortgage or its lien, does not merge it, and does not preclude its foreclosure in a subsequent action." *Id.* at 33-34 (citations omitted)

D. However, the creditor cannot have more than one satisfaction of the same debt, so if one action satisfies the debt, then it is a bar to any further actions.

E. Under S.C. Code 36-9-601, a secured party can seek a money judgment before (or instead of) liquidating the collateral.

F. Chosen remedy must be allowed under Security Agreement:
   1. Example language: "Use any remedy allowed by state or federal law, or provided in any agreement evidencing or pertaining to the Secured debts."

G. Requirements if Secured Party has already "repossessed" the collateral but not disposed of it:
   1. Secured party has the burden of proving the value of the collateral in its possession. *Andrews v. von Elten & Walker, Inc.*, 315 S.C. 199, 432 S.E.2d 500 (1993)

   2. "Possession" and "Repossession" are not the same. Just because a secured party is in physical possession of collateral, such as stock certificates which remain in the name of the debtor, the collateral is not "repossessed" and is not presumed to have a value equal to the debt. *First Chatham Bank v. Landers*, 890 F.Supp.2d 623 (D.S.C. 2011)

   3. If secured party repossesses collateral, and then disposes of it without providing notice to debtor, the debtor has the *rebuttable* presumption that the collateral is worth the amount of the debt. *Mathias v. Hicks*, 294 S.C. 305 (Ct. App. 1987)

STEP SIX: DISPOSING OF COLLATERAL

VIII. UCC Sale Requirements of Personal Collateral

A. Sale must be Commercially Reasonable IF the secured party (1) undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral; and (2) is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or a secondary obligor. S.C. Code §36-9-607(c)

B. A sale is commercially reasonable if the sale is:

1. Advertised for at least 15 days, or advertised once a week for two weeks. S.C. Code §15-29-60 (NOTE: real estate foreclosure sales must to be advertised at least 21 days)

2. *See also* S.C. Code 36-9-627

3. Failure to provide notice to the debtor does not render the sale commercially unreasonable, but it does create a rebuttable presumption that the collateral's value was equal to the debt. *See Republic Nat. Bank v. DLP Industries, Inc.*, 314 S.C. 108 (1994); S.C. Code § 36-9-611

4. *See* S.C. Code § 36-9-619 for requirements of notification of disposition of collateral

S.C. Uniform Power of Attorney Act

Catherine H. Kennedy
Columbia, SC

SC PROBATE CODE

SC Uniform Power of Attorney Act

Passed June 2, 2016

Signed By Governor June 9, 2016

Effective January 1, 2017

http://www.scstatehouse.gov

SC PROBATE CODE CHANGES

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Probate Code Revision Committee 2009 - 2016

- Catherine H. Kennedy – Chair
- Professor S. Alan Medlin – Reporter
- Powers of Attorney Subcommittee Chairs

  Michael Polk

  Donna Sands

HISTORY OF S778

- 5/15/2015 Introduced in SC Senate
  Primary sponsor - Senator Gerald Malloy
- 4/21/2016 Passed Senate
- 6/2/2016 Passed House with amendments
- 6/2/2016 Senate removed House amendments
- 6/2/2016 House concurred in Senate's version

Effective January 1, 2017

S778, R294, Act 279

POWERS OF ATTORNEY

- Added Article 8 to Title 62

  SC Uniform Power of Attorney Act
- Amended Part 5 of Article 5
  - Deleted financial powers of attorney sections
  - Reorganized Health Care Power of Attorney sections

Provisions of Article 8

8-101 <u>Name of Article</u>

- SC Uniform Power of Attorney Act

8-102 <u>Definitions</u>

- Agent
- Durable--not terminated by incapacity
- Incapacity--inability to manage property and business affairs due to
  A. Impairment
  B. Missing, detained, outside U.S. & cannot return
- Principal-individual with contractual capacity

Article 8

8-103 Applicability

- Not applicable to governmental forms for governmental purpose
- Not applicable to bank/brokerage forms used solely at firm

8-104 Presumption of Durability

- Durable unless states otherwise

Article 8

8-105 <u>Requirements</u>

- Signed--Allows for execution by third party as directed by Principal
- Attested like a Will with same witness requirements
- Acknowledged or proved per § 30-5-30

Article 8

8-106 <u>Validity</u>

- Must comply with laws in effect at execution
- Military power of attorney acceptable
- Photocopy or electronically transmitted copy can be used in lieu of original

8-107 <u>Governing Law</u>

- Meaning and effect governed by law indicated
- Otherwise law of execution

Article 8

8-109 <u>Effectiveness</u>

- Effective when executed unless POA provides otherwise
- Springing POA can authorize person to determine incapacity, who is HIPAA agent; default determination provided
- Out-of- state POA acceptable
- After incapacity, POA must be recorded in deed office for agent's authority to continue

Article 8

8-110 <u>Termination of Authority</u>

- Principal or Agent dies
- Principal becomes incapacitated if not durable
- Agent becomes incapacitated
- Principal revokes POA or agent's authority
- Agent resigns
- Change of marital status statute (§62-2-507) revokes

Lapse of time does ***not*** revoke

Article 8

8-110 <u>Termination of Authority</u>

- Termination not effective if agent or third party is without actual knowledge of termination or incapacity and if good faith reliance
- Execution of new POA does not revoke former POA
- Unless otherwise provided, revocation requires same execution formalities as POA
- Revocation must be recorded if POA is recorded

Article 8

8-111 <u>Co-Agents</u>

- Act independently unless otherwise provided

8-114 <u>Fiduciary duties of Agent-Mandatory Duties</u>

Agent must act

- In accordance with Principal's reasonable expectations as known by agent
- In Principal's best interest
- In good faith
- Within authority granted

Article 8

8-114 <u>Fiduciary Duties of Agent-Default Duties</u>

(POA can override)

Agent must

- Act impartially
- Not create a conflict of interest
- Act with care ordinarily exercised considering any special skills of agent
- Act with competence
- Act with diligence

Article 8

8-114 <u>Fiduciary Duties of Agent-Default Duties</u>
(POA can override)

Agent must

- Keep a record of receipts, disbursements, transactions
- Within 30 days after request (maximum 60 days), disclose records to Principal, guardian, conservator, government agency, personal representative, successors, court
- Cooperate with healthcare agent

Article 8

8-114 <u>Fiduciary Duties of Agent-Default Duties</u>
(POA can override)

Agent must

- Attempt to preserve Principal's estate plan if known by agent and if preserving plan is in Principal's best interest considering
  - Value and nature of Principal's property
  - Principal's foreseeable obligations
  - Principal's need for maintenance
  - Minimization of taxes
  - Eligibility for public benefits

Article 8

8-115 <u>Exoneration Provision</u>

Binding on Principal and successors unless

- Agent breaches duty by action committed
  - Dishonestly
  - In bad faith
  - With reckless indifference to purposes of power of attorney
  - Through willful misconduct
  - Through gross negligence
  - With actual fraud
- Provision was included by abuse of confidential or fiduciary relationship

Article 8

8-116 <u>Standing</u>

The following may petition the court

- Principal, Agent
- Guardian, Conservator
- Principal's spouse, parent, adult descendent
- Presumptive heir of Principal, beneficiary
- Government agency with authority to protect Principal
- Caregiver
- Person demonstrating interest in Principal's welfare
- Third Party asked to accept power of attorney

Article 8

8-119
8-120

Third Party Duties Upon Presentation of Acknowledged Power of Attorney

(Acknowledged means executed in accordance with 8-105)

Third party has 7 business days to

- Accept power of attorney without further inquiry
- Request agent's Affidavit certifying facts

  (Form provided in Section 8-119)
- Request English translation
- Request opinion of counsel

Article 8

8-119
8-120

Third Party Duties (Cont'd)

- Opinion of counsel is as to matter of law if power of attorney does not appear to be effective pursuant to 8-109 (*Springing provisions; recordation after incapacity*)

(Request must be in writing and specify reason)

Principal pays expense of translation or opinion unless request made more than 7 days after power of attorney presented

Article 8

8-119
8-120

Third Party Duties After Receipt of Certification, Translation or Opinion

Third Party has 5 business days to

- Accept Power of Attorney
- Reject Power of Attorney

Cannot require an additional or different form for power of attorney

Article 8

8-119
8-120

Acceptable Reasons to Reject

- Not required to engage in same transaction with Principal
- Actual knowledge of termination
- Transaction is inconsistent with federal law
- Request for certification, opinion or translation is refused
- Good faith belief that power of attorney is invalid
- Good faith belief that agent does not have authority to perform transaction

(Knowledge is by employee of third party conducting transaction)

Article 8

8-119
8-120

Acceptable Reasons to Reject

- Third party reports to state agency that Principal is subject to abuse, exploitation, neglect or abandonment by agent
- Third party has actual knowledge that another has made such a report
- Power of attorney does not contain exculpatory language absolving third party from liability for relying upon agent's representation of authority and from responsibility to ensure the proper application of funds or property.

(Knowledge is by employee of third party conducting transaction)

Article 8

8-119
8-120

Third party Reliance Upon Acknowledged POA

Third party may rely on power of attorney if accepting

- In good faith
- Without actual knowledge of invalidity of power of attorney
- Without actual knowledge of invalid authority of agent
- Without actual knowledge of improper exercise of agent's authority

(*Knowledge is by employee of third party conducting transaction)*

Article 8

Third Party Liability for Refusal to Accept Acknowledged POA

8-120

- Third party that refuses to accept power of attorney in violation of law may be liable for attorney's fees and costs in proceeding confirming validity of power of attorney or mandating acceptance of power of attorney

8-121

- Principles of law and equity supplement Article 8

8-123

- Article 8 Remedies are not exclusive

Article 8

8-122 <u>Inconsistent Law</u>

Article 8 does not supersede other law applicable to financial institutions or other entities, and the other law controls if inconsistent with Article 8

Article 8

8-201 <u>Hot Powers (Estate Planning)</u>

- Create, amend, revoke or terminate a trust per 7-602A
- Create or change rights of survivorship
- Create or change a beneficiary designation

Article 8

8-201 <u>Hot Powers (Gifting)</u>

- Make a gift (also subject to 8-217)
- Waive Principal's right to be a beneficiary of a joint survivor annuity including survivor benefit under retirement plan
- Disclaim property
- Reject, renounce, release or consent to modify or reduce Principal's share in estate trust or other beneficial interest

Article 8

8-201 <u>Hot Powers (Authority)</u>

- Delegate agent's authority under power of attorney
- Exercise Principal's fiduciary powers if delegable
- Access Principal's safe deposit box
- Exercise power of appointment to someone other than the Principal
- Deal with commodity futures contracts and call or put options

Article 8

8-201 Hot Powers

- Even if hot power granted, unless POA specifically provides, non-relative agent cannot exercise the power to create an interest in agent or person whom agent has the duty to support
- Broadest authority controls
- If agent can do all acts a Principal can do, agent can perform acts set out in 8-204 through 8-216

Article 8

8-202 Incorporation by Reference

Power of Attorney may incorporate powers set out in 8-204 through 8-217 in full or as modified

8-203 Incidental Authority as to any Power Incorporated

- Litigate to obtain Principal's property
- Receive, invest, disburse and use Principal's property
- Contract to accomplish purpose
- Perform, rescind, terminate, modify Principal's contracts
- Engage in ADR with respect to claims
- Settle, oppose, compromise claims

Article 8

8-203 Incidental Authority as to any Power Incorporated (Cont'd)

- Seek court assistance to carry out authorized act
- Hire professionals even those associated with agent
- Prepare, execute and file documents in Principal's interest
- Communicate with government representatives on Principal's behalf
- Access Principal's communications
- Communicate on Principal's behalf
- Perform lawful acts regarding that subject

Article 8

8-204 Real Property

8-205 Tangible Personal Property

8-206 Stocks and Bonds

8-207 Commodity Futures Contracts and Options

8-208 Bank and Financial Institutions

8-209 Entity Operation

Article 8

8-210	Insurance and Annuities
8-211	Beneficial Interests
8-212	Claims and Litigation
8-213	Personal and Family Maintenance
8-214	Governmental Benefits
8-215	Retirement Plans
8-216	Taxes

Article 8

8-217 Gifts

- Make gifts outright or for benefit of a donee in the amount of the federal gift tax annual exclusion—presently $14,000 (or 2x if split gift)
- Exercise presently exercisable general power of appointment in an amount not to exceed same dollar limits,
- Consent to gift splitting

Article 8

8-217 Gifts (Cont'd)

Gifting must be consistent with Principal's known objectives or, if unknown, Principal's best interest based upon

- Value of Principal's property
- Principal's foreseeable obligations and needs
- Minimization of taxes
- Public benefit eligibility
- Principal's personal history of gifting

Article 8

8-401 Concurrent Jurisdiction

Probate Court and Circuit Court both have jurisdiction

8-403 Effective Date

January 1, 2017. Act applies to

- POAs created on or after the effective date (law in effect at time of creation applies to POA created prior to effective date
- Judicial proceedings commenced on or after the effective date
- Procedural provisions apply to judicial proceeding commenced before its effective date unless the court finds that procedural provision would substantially interfere with the effective conduct of the judicial proceeding or prejudice the rights of a party in which case the procedural provision in effect at the commencement of the proceeding applies

Article 8

Article 8 without Reporter's Comments is found by searching the SC Code of Laws at

Fastcase on the Bar's website **www.scbar.org**
www.scstatehouse.gove/code/title62

To access the statutes with Reporter's Comments, search Act 279 on either website

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SOUTH CAROLINA UNIFORM POWER OF ATTORNEY ACT

CORPORATE BANKING AND SECURITIES LAW

JANUARY 20, 2017

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PART 1 – GENERAL PROVISIONS

8-101 **Name**

SC Uniform Power of Attorney Act

8-102 **Definitions**

Agent—person acting under power of attorney
Principal - individual with contractual capacity
Incapacity – inability to manage property and business affairs because of

A. Impairment
B. Missing, detained, outside U.S.& cannot return

Durable – not terminated by Principal's incapacity

8-103 **Applicability**

Does not apply to governmental form or to banking/brokerage form relating to account at banking/brokerage firm and intended for use solely by firm

8-104 **Durability**

Durable unless states otherwise

8-105 **Requirements**

- Signed--Allows for execution by third party as directed by Principal
- Attested like a Will with same witness requirements
- Acknowledged or proved per § 30-5-30

8-106 **Validity**

- Must comply with laws in effect at execution
- Military power of attorney acceptable
- Photocopy or electronically transmitted copy can be used in lieu of original

8-107 **Governing Law**

Meaning and effect governed by law chosen, otherwise law of execution

8-108 **Appointment of Conservator or Guardian**

Principal can nominate conservator or guardian
Court *shall* appoint Principal's nominee unless good cause shown

8-109 **Effectiveness**

- Effective when executed unless otherwise provided
- Springing power of attorney allowed
  - Can authorize persons to determine that contingency has occurred
  - If no one authorized, then:
    - ❖ MD or psychologist determines under 102(5)(A) if Principal incapacitated

- ❖ Attorney at law or court or governmental official determines under 102(5)(B) if Principal unavailable

- Person authorized is HIPAA PR to access Principal's health care information or communicate with health care provider

- After Principal's incapacity, need to record power of attorney in deed office of county where Principal resides at time instrument is recorded; if Principal resides out of SC, record where Principal's property is located

  Suspends agent's authority until recorded

- Out-of-state power of attorney acceptable if executed per 8-106
  Can be recorded before or after incapacity
  May be recorded even if doesn't comply with § 30-5-30

8-110 Termination

- Power of attorney terminates
  - Principal dies
  - Principal becomes incapacitated if not durable
  - Principal revokes power of attorney
  - Principal revokes agent's authority & no successor agent
- Agent's authority terminates
  - Agent dies
  - Agent becomes incapacitated
  - Agent resigns
  - Principal revokes power of attorney
  - Statute (§62-2-507) revokes agent's authority
  - Power of attorney terminates
- Authority is exercisable despite lapse of time (no staleness)
- Termination is not effective as to agent or third-party without actual knowledge of termination if agent or third-party acts in good faith under power of attorney
- Termination is not effective as to agent or third-party without actual knowledge of incapacity if agent or third-party acts in good faith under power of attorney
- Execution of new power of attorney does not revoke prior power of attorney unless so provided
- Unless otherwise provided, revocation must be executed like power of attorney
- If power of attorney recorded, then revocation must be recorded

8-111 Co-Agents/Successors

- Co-agents act independently unless otherwise provided
- Successors have same authority as original agent unless otherwise provided

- Agents not liable for acts of other agent or predecessor agents unless agent
  - Participated in breach of fiduciary duty, or
  - Concealed breach of fiduciary duty, or
  - Has knowledge of breach or imminent breach and fails to notify Principal, or
  - Has knowledge of breach or imminent breach and, if Principal incapacitated, fails to take action to safeguard Principal
- If agent is liable, reasonably foreseeable damages can be recovered

8-112 **Compensation**

Agent is entitled to reimbursement of expenses and to reasonable compensation unless otherwise provided

8-113 **Acceptance**

Agent accepts appointment by

- Exercising authority
- Performing duties
- By other assertion or conduct indicating acceptance

8-114 **Agent's Duties**

Agent who has accepted appointment shall act:

- In accordance with Principal's reasonable expectations as known by agent
- In Principal's best interest
- In good faith
- Within authority granted

Unless otherwise provided in power of attorney, Agent shall:

- Act loyally for Principal's benefit
- Act impartially
- Not create a conflict of interest
- Act with care ordinarily exercised considering any special skills of agent
- Act with competence
- Act with diligence
- Keep a record of receipts, disbursements, transactions
- Within 30 days after request (maximum 60 days), disclose records to Principal, guardian, conservator, government agency, personal representative, successors, court
- Cooperate with healthcare agent
- Attempt to preserve Principal's estate plan
  - If known by agent
  - If preserving the plan is in Principal's best interest considering
  - Value and nature of Principal's property

- Principal's foreseeable obligations
- Principal's need for maintenance
- Minimization of taxes
- Eligibility for public benefits

Agent who acts in accordance with mandatory duties is not liable because

- agent benefits from action
- agent has conflict of interest
- value of property declines
- of actions of delegee or contractor if agent exercised care in selecting person

Agent who acts in good faith is not liable to beneficiary of estate plan for failure to preserve except as provided in 7-602A-modification to a revocable trust or addition to or creation of an irrevocable trust which alters the amount a beneficiary is to receive

8-115 **Exoneration**

Exoneration provision is binding on Principal and successors unless:

- Agent breaches duty by action committed
  - Dishonestly
  - In bad faith
  - With reckless indifference to purposes of power of attorney
  - Through willful misconduct
  - Through gross negligence
  - With actual fraud
- Provision was included by abuse of confidential or fiduciary relationship

8-116 **Standing**

The following may petition the court

- Principal
- Agent
- Guardian
- Conservator
- Principal's spouse
- Principal's parent
- Principal's adult descendent
- Presumptive heir of Principal
- Beneficiary
- Government agency with authority to protect Principal
- Caregiver
- Person demonstrating interest in Principal's welfare
- Third Party asked to accept power of attorney

Principal can move for dismissal of petition and dismissal is required if court

determines in Principal's best interest

8-117 **Agent's Liability**

Agent who violates provisions is liable for

- Amount to restore Principal's property, and
- Reimbursement of attorney's fees and costs paid on agent's behalf from Principal's property.

8-118 **Resignation**

- Unless otherwise provided, agent must give written notice of resignation to:
  - Principal, and
  - Co-agent or successor agent, and
  - Conservator and
  - Guardian
  - Healthcare agent if no other agent and no court-appointed fiduciary
  - Person interest in Principal's welfare if no health care agent
- Resignation must be recorded where power of attorney recorded

(Reporter's Comments have incorrect numbering)

8-119 **Third Party Reliance**

Acknowledged means executed in accordance with 8-105

Third party accepting acknowledged power of attorney

- In good faith
- Without actual knowledge of invalidity of power of attorney
- Without actual knowledge of invalid authority of agent
- Without actual knowledge of improper exercise of agent's authority

may rely on power of attorney

Knowledge is by Employee of third party conducting transaction

Third party may request and rely on

- Agent's affidavit of facts (*see form included*)
- English translation if POA contains another language
- Opinion of counsel as to matter of law regarding effectiveness of power of attorney under 8-109 (springing or not recorded after incapacity)—Must be in writing with a specified reason for request

Principal pays expense of translation or opinion unless request is made more than 7 days after power of attorney presented

8-120 **Third Party Duties**

Third party has 7 business days to:

- Accept power of attorney

- Request agent certification
- Request opinion of counsel
- Request English translation

Third party has 5 business days after receipt of certification, opinion, translation to

- Accept power of attorney
- Reject power of attorney (see below)

Third party may reject power of attorney if

- Third party not required to engage in same transaction with Principal
- Third party has actual knowledge of termination
- Transaction is inconsistent with federal law
- Request for certification, opinion or translation is refused
- Third party in good faith believes power of attorney is invalid
- Third party is good faith believes agent does not have authority to perform transaction
- Third party reports to state agency that Principal is subject to abuse, exploitation, neglect or abandonment by agent
- Third party has actual knowledge that another has made such a report
- Power of attorney does not contain exculpatory language absolving third party from liability for relying upon agent's representation of authority and from responsibility to ensure the proper application of funds or property.

Third party cannot require an additional or different form for power of attorney

Third party that refuses to accept power of attorney in violation of law may be liable for attorney's fees and costs in proceeding confirming validity of power of attorney or mandating acceptance of power of attorney

8-121 **Additional Principles**

Principles of law and equity supplement Article 8

8-122 **Law re Financial Institutions**

Law applicable to financial institutions or other entities controls if inconsistent

8-123 **Remedies**

Remedies under Article 8 are not exclusive

PART 2 – AUTHORITY

8-201 Authority (Hot Powers)

Agent may NOT perform unless power of attorney expressly grants the authority and the exercise of the authority is not otherwise prohibited by another agreement or instrument to which the authority is subject.

EP	1.	Create, amend, revoke or terminate a trust per 7-602A
G	2.	Make a gift (also subject to 8-217)
EP	3.	Create or change rights of survivorship
EP	4.	Create or change a beneficiary designation
A	5.	Delegate agent's authority under power of attorney
G	6.	Waive Principal's right to be a beneficiary of a joint survivor annuity including survivor benefit under retirement plan
A	7.	Exercise Principal's fiduciary powers if delegable
G	8.	Disclaim property
A	9.	Access Principal's safe deposit box
A	10.	Exercise power of appointment to someone other than the Principal
G	11.	Reject, renounce, release or consent to modify or reduce Principal's share in estate trust or other beneficial interest
A	12.	Deal with commodity futures contracts and call or put options

Even if power of attorney allows above power, unless power of attorney otherwise provides, only ancestor, spouse or descendant agent can exercise authority granted to create an interest in the Principal's property.in the agent or in a person to whom agent has an obligation of support

Subject to the above exceptions,

- Broadest authority granted controls
- Agent may act as to property in another state
- Acts by agent bind Principal and Principal's successors
- If agent can do all acts that a Principal can do, then agent can perform acts set out in 8-204 through 8-216

8-202 Incorporation by Reference

Powers in 8-204 to 8-217 can be incorporated in full or modified

8-203 Incidental Authority

If any powers in 8-204 to 8-217 are incorporated by reference, agent also has authority with respect to that subject to

- Litigate to obtain Principal's property
- Receive, invest, disburse and use Principal's property
- Contract to accomplish purpose
- Perform, rescind, terminate, modify Principal's contracts
- Engage in ADR with respect to claims
- Settle, oppose, compromise claims

- Seek court assistance to carry out authorized act
- Hire professionals even those associated with agent
- Prepare, execute and file documents in Principal's interest
- Communicate with government representatives on Principal's behalf
- Access Principal's communications
- Communicate on Principal's behalf
- Perform lawful acts regarding that subject

8-204 **Real Property**

Buy, lease, sell, quitclaim, surrender, partition, grant easement, subdivide, apply for zoning, transfer to an entity in exchange for an interest in entity, mortgage, extend time of payment of debt, satisfy mortgages, enforce liens, insure, litigate, contest taxes or assessments, make repairs, erect structures, replace or remove structures, change form of title, dedicate to public use.

8-205 **Tangible Personal Property**

Buy, lease, accept, sell, quitclaim, surrender, grant security interests, extend time of payment of debt, satisfy liens, insure, litigate, contest taxes or assessments, move, store, make repairs, change form of title, remove and ship, deliver, execute and deliver a release or bill of lading

8-206 **Stocks and Bonds** (A*ll types of securities but not commodity futures, call or put options [see 8-102])*

Buy, sell, exchange, establish accounts, terminate accounts, pledge, extend time of payment of debt, receive evidence of ownership, exercise voting rights

8-207 **Commodity Futures and Options** (Hot Power)

Buy, sell, assign, exchange, exercise commodity futures contracts, exercise call or put options, establish modify or terminate options accounts

8-208 **Banks and Financial Institutions**

Terminate banking arrangements, establish accounts, rent safe deposit box, withdraw, receive statements and notices, borrow money, extend time of payment of debt, endorse promissory notes and other negotiable instruments, transfer money, receive cash, apply for credit cards and debit cards, obtain travelers checks, consent to extend time of payment

8-209 **Entity Operation** (Subject to terms of operating agreement)

Operate, buy, sell, enlarge, reduce, terminate an ownership interest, exercise Principal's rights, enforce terms of operating agreement, enforce Principal's rights, change name, change form of organization, control and disburse money in operation of business, put in additional capital, reorganize, join in merger, establish value under buy-sell agreement, sign

and file returns, contest taxes, fines and penalties

8-210 **Insurance and Annuities**

Modify, exchange, terminate insurance contract, pay premiums, procure contracts for insurance and annuities for Principal's spouse, children and other dependents, select type of insurance, select mode of payments, apply for loan against policy, surrender policy, receive cash value, exercise elections convert, obtain benefits under law to pay or guarantee premium, pledge interest in policy, deal with taxes related to insurance and annuities (but not change beneficiaries unless specifically authorized because that is hot power).

8-211 **Beneficial Interests in Estates, Trusts, Escrows, Custodianship**

Accept, sell, receipt for, pledge, assign, exchange, demand, exercise power of appointment for Principal's benefit, initiate and settle litigation re: effect of document and fiduciary's actions, transfer Principal's interest in real estate, stocks and bonds, accounts, insurance and annuities to trustee of Revocable Trust created by Principal

8-212 **Claims and Litigation**

Assert and maintain action in court or administrative agency to recover damages, recover property, modify tax liability, seek an injunction, record a judgment, accept service, appear, appeal, act in bankruptcy proceedings, pay judgment, receive settlement

8-213 **Personal and Family Maintenance**

Perform acts necessary to maintain customary standard of living of Principal, Principal's spouse, legal dependents and those customarily supported, pay child support and family maintenance required by court or agreement, provide domestic help, usual vacations and travel, act as HIPAA personal representative in making payments for healthcare, continue autos, maintain and open credit and debit accounts, continue memberships, hire and fire healthcare providers, enter into financial arrangements for care of Principal

Payments under this section are not considered as gifts and are not subject to gifting provisions

8-214 **Governmental Benefits** (*Social Security, Medicare, Medicaid, military or civil service)*

Execute vouchers for payments for Principal, Principal's spouse, legal dependents and those customarily supported, apply for, amend, select and reject benefits, file claims, receive proceeds of claims.

8-215 **Retirement Plans** (*IRAs, Roth IRA, 403(b), pension, 457(b),*

non-qualified deferred compensation, profit sharing) whether Principal is participant, beneficiary or owner
Select form and timing of payments, elect survivor benefits, withdraw benefits, make rollover, establish retirement plan, make contributions, exercise investment powers, borrow from, sell and purchase of assets

8-216 **Taxes**
Pay taxes, collect refunds, receive confidential information, exercise elections, act for Principal with taxing authorities, prepare, sign and file tax returns, claims for returns, extensions, petitions, IRS powers of attorney for past years if statute still running and next 25 years

8-217 **Gifts** (includes gifts to trusts, UTMA, tuition savings accounts, 529 plans)
Make gifts outright or for benefit of a donee in the amount of the federal gift tax annual exclusion (or 2x if split gift), exercise presently exercisable general power of appointment in an amount not to exceed same dollar limits, consent to gift splitting

Gifting must be consistent with Principal's known objectives or, if unknown, Principal's best interest based upon

- Value of Principal's property
- Principal's foreseeable obligations and needs
- Minimization of taxes
- Public benefit eligibility
- Principal's personal history of gifting

PART 3 – RESERVED

PART 4 – GENERAL PROVISIONS

8-401 **Jurisdiction**
Probate court has concurrent jurisdiction with circuit court

8-402 **Electronic Signature**
Coordinates with federal law

8-403 **Effectiveness**
Applies to:

- Power of attorney created on or after effective date 1/1/2017

- Prior law applies to powers of attorney created prior to 1/1/2017

- Procedural provisions apply to judicial proceedings commenced on or after effective date and those commenced before effective date unless court finds new procedures substantially interfere with effective conduct of judicial proceedings or prejudice rights of parties

AGENT'S CERTIFICATION AS TO THE VALIDITY OF POWER OF ATTORNEY AND AGENT'S AUTHORITY

State of _____

County of_____

I, _____ (Name of Agent), certify under penalty of perjury that _____(Name of Principal) granted me authority as an agent or successor agent in a power of attorney dated _____.

I further certify that to my knowledge:

(1) the Principal is alive and has not revoked the Power of Attorney or my authority to act under the Power of Attorney and the Power of Attorney and my authority to act under the Power of Attorney have not terminated;

(2) the action I desire to take is within the scope of my authority granted under the Power of Attorney.

(3) if the Power of Attorney was drafted to become effective upon the happening of an event or contingency, the event or contingency has occurred;

(4) if I was named as a successor agent, the prior agent is no longer able or willing to serve; and

(5) _____
_____
_____ (Insert Other Relevant Statements)

SIGNATURE AND ACKNOWLEDGMENT

_____
Agent's Signature Date _____

_____
Agent's Name Printed

_____

_____
Agent's Address

_____
Agent's Telephone Number

This document was acknowledged before me on _____(Date) by _____

_____ (Name of Agent).

_____ (Seal, if any)
Signature of Notary

Name of Notary: _____

My commission expires: _____

[This document prepared by: _____]

The Specter of Invalid LLC Interest Transfers. The UCC's Impact, and Practice Tips to Avoid Pitfalls

Prof. James R. Burkhard
Columbia, SC

	Current Rule 147 + State Level Crowdfunding Provisions[390]	Regulation Crowdfunding
Investor Base	Rule 147 requires that all investors reside in the state of the issuer	All investors, all states
State Registration	Exemption provided by state	Preemption of state registration
Issuer Incorporation/ Residency Limitations	Rule 147 requires issuer to be incorporated and "doing-business" in state	Excludes foreign private issuers
Excluded Issuers	Investment companies are excluded under the federal exemption. Although not excluded under Rule 147, most state crowdfunding provisions also exclude Exchange Act reporting companies and blank check companies	Exchange Act reporting companies, investment companies, pooled investment funds, and blank check companies
Offering Size Limits	Although not limited under Rule 147, state provisions limit between $250,000 and $4 million, depending on state. Mean (median) limit: $1.6 ($2) million	Up to $1 million
Security Type	Although not limited under Rule 147, equity and debt permitted in some states; equity only in other states; any security in some other states	Any security
Audited Financials Requirement	Although no requirements under Rule 147, most states require, if offer greater than $1 million	Required for offerings greater than $500,000 with the exception of first-time crowdfunding issuers offering more than $500,000 but not more than $1,000,000, who are permitted to provide financial statements reviewed by an independent accountant, unless the issuer has audited statements otherwise available. Reviewed financial statements are required for offerings greater than $100,000 but not more than $500,000, unless the issuer has audited statements otherwise available
General Solicitation	Rule 147 and states allow, but only to investors residing in state	Allowed after filing of Form C and subject to limitations on advertising
Investment Limits	No limits under Rule 147 $2,500-$10,000, depending on state, for non-accredited investors None, in most states, for accredited investors	(a) the greater of $2,000 or 5% of the lesser of the investor's annual income or net worth if either annual income or net worth is less than $100,000, or (b) 10% of the lesser of the investor's annual income or net worth if both annual income and net worth are $100,000 or more, subject to investment cap of $100,000
Restrictions on Resale	Rule 147 restricts interstate resales for nine months[391]	12-month resale limitation; resale within one year to issuer and certain investors
Exemption from Section 12(g) Registration Requirements	None	Conditional exemption, provided that the issuer is current in its ongoing annual reports required pursuant to Rule 202 of Regulation Crowdfunding, has total assets as of the end of its last fiscal year not in excess of $25 million, and has engaged the services of a transfer agent registered with the Commission pursuant to Section 17A of the Exchange Act

2017 South Carolina LLC Issues[1]

This memo considers a number of LLC issues. In sequence they are generally as follows.

I. The Uniform Commercial Code May Interfere With Membership Transfer Restrictions Found In Many South Carolina Operating Agreements.

II. How Do You Avoid The Possible U.C.C. Problems by Causing the LLC Membership Interests and the LLC Distributional Interest to Qualify as a "U.C.C. Security"?

III. If the Membership Interest Qualifies as a "U.C.C. Security," Will It Automatically be a "South Carolina Uniform Securities Act of 2005 Security"?

IV. Lenders, How Do You Obtain a Security Interest In an LLC Member's "Distributional Interest" or "Membership Interest"? Some Problems to Avoid.

V. Is Obtaining a Charging Order the Only Way a Judgment Creditor Can Acquire an Interest In the LLC Member's Membership Interest?

VI. South Carolina Lenders Use "Squeeze Tactics" To Collect Loans Made To LLC Members.

VII. Bankruptcy Trustee of a Delaware LLC is Able to "Resuscitate" a Defunct LLC and Take Control. Procedure is Unavailable in South Carolina.

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[1]James R. Burkhard

I. The Uniform Commercial Code May Interfere With Membership Transfer Restrictions Found In Many South Carolina Operating Agreements.

A. The Problem

There is an evolving controversy whether U.C.C. § 9-406 and § 9-408 may restrict, or in some manner invalidate, some transfer restrictions that are often imposed on membership and financial rights of LLC members. As stated by our friends over in Georgia:

> [M]any LLC practitioners believe the absence of an Article 9 override inevitably means that, in at least some instances, any marginal benefit of organizing an LLC in Geogia, rather than Delaware [that overrides the U.C.C. restrictions], is not worth the risk.[2] (N.B. South Carolina, like Georgia, has not provided a U.C.C. Article 9 override.)

Adding more fuel to the fire, the leading LLC treatise highlighted the following comment made by two U.C.C. experts:

> "[S]ection 9-406 rolls over transfer restrictions like a steamroller."[3]

A leading U.C.C. Secured Transactions treatise includes this comment:

> UCC 9-406 invalidates any clause in a contract between an "account debtor" and an assignor that prohibits the creation of a security interest in a general intangible for money due or to become due, or that requires the account debtor's consent to such security interest. It is unclear, however whether courts will treat an LLC or one of its members as an "account debtor" for purposes of Article 9, and therefore invalidate an antiassignment provision in an LLC's organizational documents.[4]

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[2]Andrew Immerman [Partner, Alston & Bird LLP] & Bryan N. Baird [second-year law student], *The Georgia LLC Act: Recent Developments and Future Possibilities*, 6 J. MARSHALL L. J. 565, 619 (2013).

[3]CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW, ¶ 8.06 "*Pick Your Partner" Confronts Free Transferability Under Article 9 of the Uniform Commercial Code*, ¶ 8.06[4][a] (2016) (citing Cohen & Henning, *Freedom of Contract vs. Free Alienability: An Old Struggle Emerges in a New Context,* 46 GONZ. L. Rev. 353, 366 (2011)).

[4]3 BARKLEY CLARK & BARBARA CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE, §14.06[04], page 14-43 (2016).

The possibility that these U.C.C. provisions will override an LLC provision that, for example, requires a member to first get the consent of the LLC before she pledges her membership as security for a loan, and the problems that this creates, are already with us.[5]

A number of states, including Delaware, Virginia, and now, North Carolina, have determined that these U.C.C. provisions create significant problems and thus have statutorily provided that they do not apply to LLCs. The drafting committee summary provided to the North Carolina Bar Association and that accompanied the bill to its legislative sponsors points out some of the problems.

> Override of UCC §§ 9-406 and 9-408. Because the application of UCC §§ 9-406 and 9-408, as currently in effect, may allow a member to encumber his or her economic interest in breach of the operating agreement which may result in the foreclosure of that interest under circumstances that may result in adverse tax consequences to the other members, the transfer of ownership of the economic interest to a corporation or other ineligible shareholder of an S corporation, for those LLCs that elect to be taxed as S corporations, or a technical termination under I.R.C. § 708(b)(1)(B), the revised Act adopts the approach taken in states such as Delaware and Virginia (among other states, including those states that have recently restated their LLC Acts: Texas, Mississippi, and New Hampshire) to not have UCC §§ 9-406 and 9-408 apply to LLC ownership interests.[6]

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[5]*See, e.g. In re McKenzie*, No. 08-16378, 2011 WL 2118689 at * 9 (Bankr. E.D. Tenn. May 27, 2011), *aff'd.* 737 F. 3d 1034 (6th Cir. 2013) ("Although neither party briefed the issue, the court would also note that Tenn. Code Ann. § 47-9-408 provides for the assignment of, in essence, the proceeds of general intangibles even in situations in which the general intangible prohibits transfers or requires some sort of consent.")

[6]Warren P. Kean, one of the Reporters, worded the discussion slightly differently. He noted that these committee notes were carefully read by the legislative sponsors of the bill.

> The drafting committee discussed at some length whether to include * * * [a provision stating that U.C.C. §§ 9-406 & 9-408 would not apply to LLCs] in the proposed new Act. The drafting committee understood that the potential override by UCC §§ 9-406 and 9-408 containing provisions in an operating agreement restricting transfers of interests only applies to economic interests (and not interests in management, voting, or control). Nevertheless, the foreclosure or other unauthorized transfer of economic interests may impose adverse consequences to the other interest owners, including the possibility that such transfers will cause the LLC to be deemed to have terminated under I.R.C. § 708(b)(1)(B) and the possibility for those LLCs that have elected to be classified as S corporations for federal income tax purposes that a transfer in connection with a foreclosure may be made to an ineligible "shareholder" (such as a corporate lending institution), causing the LLC's S election to terminate and, therefore,

The North Carolina Senate Committee Summary is simpler:

> Sections 31 and 32 exempt ownership interest in LLCs from UCC Article 9 provisions that might result in encumbrances to a member's economic interest in breach of the operating agreement, which could adversely affect the interest of the other members.

B. Caution!

The following discussion of the possible application of U.C.C. § 9-406 and § 9-408 is my attempt to report and adapt various comments and statements made by those expert in the world of the U.C.C. I have done my best to extract statements and analysis of the experts that may apply to our South Carolina LLCs. However, I am not anything close to an expert in the world of the U.C.C., and those of you who want to determine if either code section truly impacts any of the LLC documents that you have drafted need to yourself carefully review the sources that are cited in this section. The following sources seem to be the most helpful, and hopefully the most accurate.

(1) CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW, ¶ 8.06 "*Pick Your Partner" Confronts Free Transferability Under Article 9 of the Uniform Commercial Code*, (2016).

(2) Neil B. Cohen & William H. Henning, *Freedom of Contract vs. Free Alienability: An Old Struggle Emerges in a New Context*, 40 GONZ. L. REV. 353 (2010-2011).

(3) Steven O. Weise, PEB COMMENTARY NO. ____ APPLICATION OF UCC SECTIONS 9-406 AND 9-408 TO TRANSFERS OF INTERESTS IN UNICORPORATED [SIC] BUSINESS ORGANIZATIONS, Draft for Public Comment (Feb. 1, 2012), reproduced in SU040 ALI-CLE 379, Commercial Lending Today (May 2-3, 2013)

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causing the LLC to become subject to taxation as a C corporation.
Email from Warren P. Kean, Reporter, Sept. 30, 2016.

Selected Portions of U.C.C. § 9-406 and § 9-408

S. C. Code Ann.§ 36-9-406. Discharge of account debtor; notification of assignment; identification and proof of assignment; restrictions on assignment of accounts, chattel paper, payment intangibles, and promissory notes ineffective.

(d) Except as otherwise provided in subsection (e) and Sections 36-2A-303 and 36-9-407, and subject to subsection (h), a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:

(1) prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note; 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 account, chattel paper, payment intangible, or promissory note.

(e) Subsection (d) does not apply to the sale of a payment intangible or promissory note, other than a sale under a disposition pursuant to Section 36-9-610 or an acceptance of collateral pursuant to Section 36-9-620.

(h) This section is subject to law other than this chapter which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

S.C. Code Ann. § 36-9-408. Restrictions on assignment of promissory notes, health care insurance receivables, and certain general intangibles ineffective.

(a) Except as otherwise provided in subsection (b), a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health care insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the promissory note, health care insurance receivable, or 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 promissory note, health care insurance receivable, or general intangible.

(b) Subsection (a) applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note, other than a sale under a disposition pursuant to Section 36-9-610 or an acceptance of collateral pursuant to Section 36-9-620.

(c) A rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, person obligated on a promissory note, or account debtor to the assignment or transfer of, or creation of a security interest in, a promissory note, health care insurance receivable, or general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor, 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 promissory note, health care insurance receivable, or general intangible.

C. Why Was the U.C.C. Drafted To Invalidate Transfer Restrictions?

Why does the U.C.C. possibly impose restrictions on any of these transfer restrictions? Assume this situation. Joe buys an expensive TV from Big Box store. The store "finances" this purchase. Joe pays a modest down payment and agrees to pay the Big Box store so much a month. Joe also enters into an agreement with Big Box that Big Box will not "sell" or "transfer" Joe's promissory note to any third party finance company. Per the contract between Joe and Big Box, Joe only has to pay Big Box and no one else. In spite of this contract, can Big Box transfer or "sell" this note to First Finance corporation, and will Joe, in spite of the contract, now be obligated to pay First Finance?

The U.C.C. has opted for a policy of "free transferability of property" over the "sanctity of contractual obligations." The U.C.C. would allow the transfer of the note to First Finance in spite of the contract between Joe and Big Box. The U.C.C. recognizes that this policy should not always apply, but the question is whether it does apply to LLC transfer restrictions. The concern is that it may.

How might the U.C.C. invalidate the typical transfer restrictions? First, there is a problem with terminology. There are some key U.C.C. terms that are critical, and may have counterparts in our typical LLC terminology. The following chart may be a reasonable comparison.

	LLC Term		"Parallel" U.C.C. Term	
(1)	Membership Interest (full voting & financial rights)	=	General Intangible [7]	(but not a Payment Intangible)
(2)	Voting Rights	=	General Intangible	(but not a Payment Intangible)
(3)	Distributional Interest (financial rights only)	=	Payment Intangible	(and a General Intangible)
(4)	LLC as an Entity	=	Account Debtor	

A second complexity is that the two U.C.C. sections that may cause these problems are incredibly complex and confusing. One could spend days trying to understand these two sections if one is not generally well versed in U.C.C. matters. The texts that attempt to explain these sections are not easy to follow or understand.[8]

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[7] *In re Strata Title, LLC,* No. 12-24242, 2013 WL 2456399, *3 (Bankr. D. Ariz. June 6, 2013) ("[I]n most cases membership interests in an LLC are general intangibles which would be perfected by the filing of a UCC statement."); *Davis v. Brown* (*In re Brown*), 479 B.R. 112 (Bankr. D. Kan. Sept. 19, 2012) (LLC membership interest was not a U.C.C. Article 8 security and thus was a general intangible); *In re Dreiling,* No. 05-64189, 2007 WL 172364, at *2 (Bankr. W.D. Mo. Jan. 18, 2007) (generally, a LLC membership interest that is not a security under U.C.C. § 8-103(c), or held in a securities account is a "general intangible").

[8] *See e.g.,* BISHOP & . KLEINBERGER, *supra* note 3; Neil B. Cohen & William H. Henning, *Freedom of Contract vs. Free Alienability: As Old Struggle Emerges in a New Context*, 40 GONZ. L. REV. 353, 363 (2010-2011); Lynn A Soukup & Plamen I. Russev, *Payment Obligations and Other Property as Collateral: Contractual Restrictions on Assignment Rendered Ineffective by Article 9,* 37 UCC L. J. Issue 3, Art. 2, Part II (Winter 2005).

D. Typical LLC Transfer Restrictions.

What type of "transfer restrictions" are common in LLCs? There are three "typical" kinds of restrictions (but plenty more!). First, § 33-44-502 and § 33-44-503 prohibit a member from transferring to a third party his entire membership in the LLC. (The parties can contract around this restriction.) Second, the operating agreement or a agreement among the members often prohibits any member from transferring or pledging as security her "distributional interest" (essentially her financial rights) to another person (or lender) without the consent of someone in the LLC. Third, it is often common for the operating agreement to provide conditions under which a member may dissociate from the LLC and also in what amount and when she will receive payment for her interest. There are obviously other arrangements that owners of an LLC may agree to that impose limits on the transferability of the rights a member may have in the LLC.

E. What Type of Transfer Restrictions May the U.C.C. Invalidate? Summary.

The consensus seems to be that although the U.C.C. can invalidate statutorily imposed transfer restrictions, the South Carolina LLC provision, § 33-44-503(a), that prohibits an LLC member from transferring her full membership rights without the consent of all the members is NOT invalidated by the U.C.C. On the other hand, there is apparently significant risk that a provision that prohibits a member from pledging her "distributional interest" (essentially her financial rights) as security for a loan, may be invalidated by the U.C.C. And lastly, a restriction that merely prohibits a member from actually transferring her "distributional interest" to a third party (not as a security) may not be invalidated by the U.C.C. - but this may be more of an open question.

F. Why Is It important To Restrict a Member From Transferring Only Her Financial Rights - Her Distributional Interest?

A number of commentators have suggested that it is no big deal that the U.C.C. can override LLC provisions that prevent a member from transferring her financial rights – that the U.C.C. does not interfere with the "pick your partner" principle.[9] They say that if the financial

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[9] *See, e.g.*, Steven O. Weise, PEB COMMENTARY NO. ___ APPLICATION OF UCC SECTIONS 9-406 AND 9-408 TO TRANSFERS OF INTERESTS IN UNICORPORATED [SIC] BUSINESS ORGANIZATIONS, ¶ III. B, Draft for Public Comment (Feb. 1, 2012), reproduced in SU040 ALI-CLE 379, Commercial Lending Today (May 2-3, 2013) ("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 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

rights have been pledged to a lender, the only rights the U.C.C. grants the lender are the right to collect distributions, the right to sell or otherwise dispose of the economic rights, and possibly the right to accept ownership of the financial rights in satisfaction of the debt.[10] However, what the U.C.C. folks are missing is that whomever owns these financial rights will most likely be deemed pursuant to "LLC law" as an "assignee," and as such may be able to cause real problems for the other members. The following are samples of some of the problems the transfer may create.

Reason # 1 - Unwanted Person Effectively Becomes a Member

In a significant case, the LLC had a transfer restriction that essentially prohibited the transfer of any rights a member might have in his membership without the prior consent of all the members - a very typical transfer restriction.[11] One of the members was involved in a divorce and either as agreed by the parties in the divorce or as directed by the court, husband not only transferred to the wife his financial interest in the LLC, but also agreed to vote the way his wife instructed - essentially transferring both his financial rights and indirectly his management rights. In response to this, the other two members of the LLC, instead of simply trying to enforce the restriction, purported to buy out husband. (Presumably after the divorce they would have let him buy back in.) If the LLC had not included this transfer restriction, the wife clearly would have effectively become a new, and unwanted, member. This is likely a very common situation.

The wife raised all sorts of challenges to this action. However, ultimately her one main argument was that in Colorado for the anti-transfer provision to be valid it had to include "magic language" and without the "magic language" the transfer restriction could not be enforced against her - the so-called "modern approach." Under the "modern approach" the restriction will only be enforced if the agreement states "that any nonconforming assignment is 'void" or 'invalid.'"

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restriction."

[10]*Id.* Note that the U.C.C. grants a lender a number of rights. S.C. Code Ann. § 36-9-610(a) provides that "[a]fter default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing. § 36-9-620 § 36-9-620(a) provides that "[e]xcept as otherwise provided in subsection (g), a secured party may accept collateral in full or partial satisfaction of the obligation it secures [if the following conditions are met]." In *McDonald v. Yarchenko*, No. 03:12-cv-00656-HZ, 2013 WL 3809512 (D. Or. 2013) the District Judge confirmed that the lender could, pursuant to U.C.C. § 9-620, accept ownership of the debtor's LLC membership which had been pledged to secure the payment of a $22,000 loan when the debtor failed to pay the last $10,000 even though the membership was arguably worth $1.6 million. The borrower had failed to protect his rights that were available to him under § 9-620.

[11]*Condo v. J. Conners,* 266 P. 3d 1110 (Colo. S. Ct. En Banc. 2011).

Although the Colorado Supreme Court indicated that this "modern approach" had merit, the court essentially seemed to conclude that although the exact "magic language" was not in the LLC's transfer restrictions, the policy of freedom of contract (and other reasons) limited the husband's "power" to make the assignment.

The Supreme Court of Connecticut clearly explains the theory and meaning behind this new "modern approach" which requires that for an anti-assignment clause to be effective, the clause must include the so-called "magic words." Critical analysis from this opinion includes the following.[12]

> Our analysis of the effect of the antiassignment provision begins by emphasizing that the modern approach to contracts rejects traditional common-law restrictions on the alienability of contract rights in favor of free assignability of contracts . . .
>
> In interpreting antiassignment clauses, the majority of jurisdictions now distinguish between the assignor's "right" to assign and the "power" to assign (modern approach). For example, in *Bel–Ray Co. v. Chemrite (Pty.) Ltd.,* 181 F.3d 435, 442 (3d Cir.1999), the United States Court of Appeals for the Third Circuit recognized that numerous jurisdictions followed the general rule "that contractual provisions limiting or prohibiting assignments operate only to limit [the] parties' right to assign the contract, but not their power to do so, unless the parties manifest an intent to the contrary with specificity." (Emphasis added.) The court concluded, however, that the "assignment clauses [did] not contain the requisite clear language to limit [the] 'power' to assign" and, therefore, held the assignment valid and enforceable. *Id*., at 443. The court acknowledged that contracting parties could limit the power to assign by including an "assignment provision [that] generally state[s] that nonconforming assignments (i) shall be 'void' or 'invalid,' or (ii) that the assignee shall acquire no rights or the nonassigning party shall not recognize any such assignment." *Id.*, at 442. Without such express contractual language, however, "the provision limiting or prohibiting assignments will be interpreted merely as a covenant not to assign.... Breach of such a covenant may render the assigning party liable in damages to the non-assigning party. The assignment, however, remains valid and enforceable against both the assignor and the assignee." *Id.* . . .
>
> Many other courts similarly have held that an antiassignment provision that limits the right to assign does not void an assignment between an assignor and assignee unless there is also an express provision limiting the power to assign or a provision voiding the assignment itself. [The court cites 13 opinions from other states.] . . .

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[12]*Rumbin v. Utica Mutual Ins. Co*., 254 Conn. 259, 267-278, 757 A.2d 526, 531-536 (S. Ct. 2000).

> The modern approach offers the advantage of free assignability together with full protection for any obligor who actually suffers damages as a result of an assignment. An assignor who breaches a contractual provision limiting his or her right to assign will be liable for any damages that result from that assignment. . . .

I am unaware of whether there are any South Carolina cases that apply or do not apply the "modern approach" and require transfer restrictions to include language that any attempted violation is void or invalid. One professor at the law school suggests that the general gist of contract law may suggest that South Carolina jurisprudence is opposed to transfer restrictions[13] - suggesting that we might follow the "modern approach" and clearly require that any restriction on a member's right to transfer must state that not only the member's "right" to transfer is restricted, but his "power" to transfer is also restricted, "magic words" being required. The only safe thing to do is to make certain that all transfer restrictions have the "magic language" – a caution to all of us in drafting LLC agreements that commonly include these restrictions.

As a side note, if you are representing the wife who wants the family court to order her husband to transfer his financial rights and approve an agreement that he will vote as instructed, assuming that either there are no transfer restrictions or that they do not include the required "magic language," as wife's counsel you need to consider something else. How do you insure that legally the husband will be required to comply with the voting instructions? Presumably the "voting requirement" could be structured in one of two ways. The way mentioned in the Texas case was that the husband signed a contract that he would vote as instructed. How do you insure that this contract will be enforced? Do you have to put "magic language" in this contract that any attempt to vote in a different manner will be void? How do you force him to vote? What if he does not want to vote?

Alternatively, could you structure the voting requirement in a different way? Could the husband appoint his former wife as his "proxy" to vote on his behalf? Does the LLC statute invalidate such a ploy when it says that management rights cannot be transferred without the consent of the other members? The answer should be no. Section 33-44-404 specifically allows either a member or manager to give another person a proxy to vote or otherwise act for the member or manager. This is a rather unusual provision given the "pick your partner" policy as to how LLCs should be structured and managed.

Assuming the proxy is "legal," and it certainly seems to be, how do you make it enforceable? A proxy normally can be cancelled by the act of the party who granted it - here the husband. Presumably the only way you can insure that it is enforceable is to make it irrevocable. The way you make it "irrevocable" is to make it a "proxy coupled with an interest." That seems possible here since the proxy is being given to protect the wife's financial interest, her right to

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[13]" South Carolina jurisprudence has long recognized that a chose in action can be validly assigned in either law or equity." *Moore v. Weinberg,* 373 S.C. 209, 220, 644 S.E. 2d 740, 745 (Ct. App. 2007)

distributions from the LLCs. However, you will certainly have fun drafting that animal. Note that our corporate code at § 33-7-220(d) provides guidance for creating a shareholder irrevocable proxy, but we have no comparable LLC statute. However this § 33-7-220(d) may provide some guidance on drafting an LLC irrevocable proxy.

Reason 2. The transfer of financial rights is an event of disassociation requiring the LLC to purchase the member's interest.

Section 33-44-501(b) and Section 33-44-502 say that the member is entitled to transfer her financial rights - her "distributional interest." Section 33-44-601(3) provides that if a member transfers all her financial rights (distributional interest), other than a transfer for security or by a court order charging the member's interest that has not been foreclosed, she is automatically dissociated from the LLC. Section 33-44-603(1) then requires the LLC to purchase the member's distributional interest if the LLC is at will. If the LLC is for a term, the statute requires a later repurchase. The LLC may not want to make a purchase, and thus may want to limit the ability of the member to make a complete transfer of only his financial rights - his distributional interest.

However, there is also a problem or ambiguity in these provisions. If I transfer all my distributional interest to Joe, which I am allowed to do, and I am thus disassociated from the LLC, what is it that the LLC must buy? Is it something I still own, or is it the distributional interest that Joe now owns? Section 33-44-502 says that Joe is entitled to the distributions to which I would have been entitled. But if he is "bought out," how can he be entitled to these rights?

Note: all of this can be changed in the operating agreement, unless the U.C.C. provisions would make these limitations invalid.

Note - It may be, to the extent the U.C.C. provisions restrict contractually imposed transfer restrictions, they only apply to **pledging** the "distribution interest" as security for a loan - they do not change any contractual imposed limit on the member's ability merely to transfer her financial rights to a third party.[14] As noted above, § 33-44-601(3) says the member is not dissociated if she merely pledges her rights for security. However, if the rights are sold by the lender, this would be an event triggering a buyout.

Reason 3. "Transferee" May Have Rights That Interfere With Smooth Operations of the LLC.

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[14] Cohen & Henning, *supra* note 8, at 371("[I]f a member's transferable interest is used as security for an obligation, section 9-406(d) applies and transfer restrictions in an agreement between the entity and member are overridden to the extent they interfere with creation, attachment, perfection, and enforcement of the security interest.")

Let's assume either: (1) that although prohibited by the operating agreement, the U.C.C. says that the member may and does transfers his distributional interest to Joe, or (2) that likewise prohibited by the operating agreement, the U.C.C. says that the member may pledge, does pledge her distributional interest as security, the lender forecloses, and Joe purchases the member's distributional interest. Thus, in spite of the operating agreement prohibitions, the member's financial rights have been transferred, and Joe is now apparently the owner of these financial rights. Joe has no voting power. Although Joe has no voting power, commentators have opined that he can cause trouble, thus justifying the need for a provision in the operating agreement that puts some limits on my right to make any sort of transfer of my financial rights (distributional interest). What trouble can Joe the "assignee" cause?

One of the things the assignee may be able to do pursuant to South Carolina law is to bring an action to dissolve the LLC - and in LLC language, this practically means ending the business.[15] Section 33-44-801 (5) gives a "transferee of a member's interest" in an at-will company the right to request the court to dissolve (terminate) the LLC on the basis that it is equitable to wind up the company business.[16] (The transferee can make this same request of a term company but only at the end of the term.) There may be some question as to what the phrase "transferee of a member's interest" means. Does it mean a transferee who pursuant to the LLC operating agreement has all the rights of the former member -voting and financial rights - or does it mean a person who has essentially only the member's financial rights? Since § 33-44-801(5)(b) includes in the definition a transferee pursuant to a charging order, and such a transferee clearly only receives the member's financial rights, it would appear that a transferee is such - the person who gets the financial rights. The official comments to this section provide no clarification as to who is a "transferee of a member's interest."

There are already a few cases wherein the court has on very general grounds given an "assignee" the right to bring an action, often to dissolve the LLC.[17] A Texas case,[18] that may be

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[15]Note that the LLC operating agreement can apparently overrule this right of a transferee to seek dissolution. Apparently the U.C.C. "override" provisions may limit the ability to remove this right, but this is not fully considered in this outline.

[16]*See, e.g. LaHood v. Covery (In re LaHood),* Bank. No. 07-81727, 2009 WL 803558, at *12-13 (Bankr. Ill. March 19, 2009), *rev'd on other grounds*, 437 B.R. 330 (D. Ill 2010) (Bankruptcy court, applying Illinois law essentially identical to South Carolina's, recognized that trustee as member's transferee by operation of law has both the right to (a) petition a court for an order compelling the dissolution of the LLC, and (b) standing to apply for judicial supervision of the winding up of the LLC).

[17]*In re Carlisle Etcetera LLC*, 114 A. 3d 592 (Del. Ch. 2015) (Defendant and Plaintiff corporations formed an LLC, with each having the right to designate two of the "board" members. All action required unanimous board action. Defendant's officer was named the LLC's president and ran things. Plaintiff corporation assigned its membership to a subsidiary,

rather typical, was a divorce action. The divorce court awarded the wife the husband's full interest in the LLC. An appellate court noted that the most the wife could get was his financial rights (this would seem to be true under South Carolina law) but when the "partner" started taking un-earned fees from the LLC and refused to provide the wife with financial benefits, she sued.[19] The court upheld a number of her claims against the "partner," awarding her substantial damages as against the "partner," and acknowledged her right to have a receiver for the LLC appointed who required the LLC to sell all its assets (a commercial property), and distributed the proceeds between the wife and "partner."[20] The "assignee" caused a lot of trouble!

A Delaware case also illustrates why it may be very important to restrict a member from transferring any of its rights.[21] In this case the operating LLC, Niagara Redevelopment, was owned by two other LLCs. One of the members, "Holdings LLC," was controlled by a developer. Holdings contributed various rights to develop property at Niagara Falls. "Eureka LLC," the other member, was controlled by wealthy investors who invested $ 4 million in the project. The operating LLC, Niagara Redevelopment, essentially required that no interests in Holdings could be transferred and that the individual owner of Holdings had to retain complete control of the LLC. The owner of Holdings both permitted a security interest to be granted in Holdings and transferred portions of his control to third parties - all in violation of the requirements set forth in Niagara Redevelopment LLC. The holder of the security interest in

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the effect of which was that under Delaware law (and South Carolina is identical) the parent was no longer a member of the LLC, and neither was the subsidiary. As such neither could bring an action to dissolve the LLC pursuant to the Delaware LLC statutes (South Carolina is different). However, the court, providing an extensive discussion of the rights of the chancery court which may not be changed by statute, determined that the plaintiff entities had a common law right to bring an action to dissolve the LLC). *Contra, Styslinger III v. Brewster Park, LLC,* 321 Conn. 312, 138 A. 3d 257 (S.Ct. 2016) (Divorce court assigned wife's financial interest in the LLC to the husband. LLC has paid no distributions to husband. Court refused to allow husband standing to either dissolve or wind up the LLC. Statute only allows member to request dissolution, and dissolution is a pre-condition to winding up. The court refused to consider other relief since it was not appropriately plead, and refused to apply equitable principles since Connecticut LLC statute displaces them.)

[18]*Kohannim v. Katoli,* 440 S.W. 3d 798 (Tex. Ct. App. 2013).

[19]*Id.*

[20]The *Kohannim v. Katoli's* rather broad definition of "oppression" upon which some of the wife's claims were upheld, was disapproved in *Ritchie v. Rupe*, 443 S.W. 3d 856 (S.Ct. Tex. 2014).

[21]*Eureka VIII LLC v. Niagara Falls Holdings LLC*, 899 A. 2d 95 (Del. Ch. 2006) (two other breaches of the LLC occurred in this matter and are not discussed in this brief summary).

Holdings effectively took control of Holdings - the court pointing out that this effectively required the owners of Eureka to deal with someone that they did not want to deal with. Because of these breaches (and others), and although not mandated by statute or the operating agreement, the court deemed Holdings no longer a member of Niagara Redevelopment, but thus merely an assignee. The court did, however, grant Holdings as an assignee the right to bring a derivative suit if it thought Eureka was mis-managing Niagara Redevelopment.[22]

There is another side to this. Assume that because of the U.C.C., the LLC member is permitted to, and does either transfer her "distributional interest" to Joe, or has pledged it and Joe has purchased it at foreclosure. At that point the former member is (unless otherwise provided in the operating agreement) automatically "dissociated from the LLC" (*see,* § 33-44-601(3)). As a "dissociated member" she can also cause trouble. She, like Joe, has the right to request that the LLC be dissolved and terminated (*see,* § 33-44-801(4)).[23]

Reason # 4 - The transfer may terminate favorable tax classification for the LLC.

> Override of UCC §§ 9-406 and 9-408. Because the application of UCC §§ 9-406 and 9-408, as currently in effect, may allow a member to encumber his or her economic interest in breach of the operating agreement which may result in the foreclosure of that interest under circumstances that may result in adverse tax consequences to the other members, the transfer of ownership of the economic interest to a corporation or other ineligible shareholder of an S corporation, for those LLCs that elect to be taxed as S corporations, or a technical termination under I.R.C. § 708(b)(1)(B), the revised Act adopts the approach taken in states such as Delaware and Virginia (among other states, including those states that have recently restated their LLC Acts: Texas, Mississippi, and New Hampshire) to not have UCC §§ 9-406 and 9-408 apply to LLC ownership interests.[24]

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[22]Note that Delaware, different from most states including South Carolina, statutorily grants standing to an assignee to bring a derivative suit on behalf of the LLC.

[23]Note that the LLC operating agreement apparently cannot overrule this right of a dissociated member to seek dissolution. Unfortunately, the language that puts a limit on the operating agreement is very unclear. Section 33-44-103(b)(6) confusingly says that the operating agreement may not "vary the requirement to wind up the limited liability company's business in a case specified in Section 33-44-801(3) or (4)." Subsection ¶801(4) is the right of a member or dissociated member to seek dissolution. Does "not vary wind up" mean you can't eliminate the right to request wind up? Very unclear. Note, it also seems unlikely that the U.C.C. "override" provisions would have any impact on this operating agreement carve out.

[24]Summary of North Carolina LLC statute provided to the North Carolina Bar Association, that also accompanied the bill to its legislative sponsors, and was the basis for the

Reason # 5 - The transfer may violate member licensing requirements.

It may also be necessary to prevent a person from having even a financial interest in the LLC since such might violate a licensing requirement. For example, an LLC of doctors might be required to prevent anyone other than a licensed doctor from having any interest in the LLC, even a financial interest.[25]

G. Why the U.C.C. May Not Override the Statutory Restriction On Transferring the Full Membership Interest, Including the Voting Rights.

Our South Carolina statute provides that a member may NOT transfer her membership interest (essentially her management rights) to a third party without the consent of all the other members (§ 33-44-503(a)). This is the so-called "pick-your-partner" principle. Does the U.C.C. override this statutory limitation on membership transfers? Section 33-9-408(c) does provide that a statute that requires the consent of an account debtor [the LLC] to the assignment, transfer, or creation of a "security interest" in a general intangible [the LLC full membership interest] is ineffective to the extent the statute would impair the creation, attachment , or perfection of a security interest. This is merely a limitation on creating a "security interest" – it is not a limitation on the transfer of the membership interest itself. So the answer to the question should be "no."[26]

Senate Committee's Summary. Email from Warren P. Kean, Sept. 30, 2016.

[25]*See, e.g. In re Marriage of Jay Burstein,* No. 2-13-0098, 2014 IL App (2d) 130098-U (Ill. App. Feb. 13, 2014) (LLC operating agreement prohibited any one but a licensed urologist from having any interest, including only a financial interest, in the LLC. It is unclear whether this limitation was required by state law.)

[26]Weise, *supra* note 9, at ¶ II. E:

> "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. . . .
>
> 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. . . . 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."

Further, although U.C.C. 9-408(c) imposes a limitation on "creating" the security interest in the member's full membership rights, it does not require the LLC to honor an attempt by the lender to enforce the security interest.

> Although section 9-408(c) overrides legal transfer restrictions like those imposed by RULLCA, it does so only to the extent necessary to permit the creation, attachment, and perfection of a security interest. A security interest thus created cannot be enforced under the procedures described in Part 6 of Article 9, meaning for example that if a member of an LLC grants a security interest in her membership interest, the LLC, which is an account debtor for purposes of Article 9, need not honor a demand by the secured party for payment of any money due the member or otherwise recognize the security interest in any way. It also means that the LLC need not recognize any purported transferee of the membership interest pursuant to enforcement of the security interest by disposition under UCC section 9-610.[27]

H. Does The U.C.C. "Override" An Agreement That Limits A Member's Right To Transfer or Pledge Only Her Financial Rights?

Let's assume the most simple transfer restriction. Assume that a member is prohibited from pledging an interest in his or her financial rights in the LLC. The U.C.C. restrictions on such a limitation only apply if the party creating (enforcing?) these restrictions is the LLC itself . (In U.C.C. terms, the LLC must be the "account debtor" who is imposing the restriction - or Joe in our Big Box example). "If the anti-assignment provision is in an LLC agreement . . ., it may be viewed as a restriction in an agreement among the members of the LLC . . . (and not in an agreement between the account debtor [the LLC] and an assignor [the member]), in which case sections 9-406(d) and 9-408(a) **will not apply** to negate the restriction.[28]" [emphasis added]

Further, the U.C.C. § 9-406 "override" apparently only applies to an agreed-to restriction on the "creation, attachment, perfection, or enforcement of a security interest," in the LLC member's financial rights.[29] A provision that simply provides that a member may not sell his

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[27]Cohen & Henning, *supra* note 8, at 371.

[28]*See,* Soukup & Russev, *supra* note 8, at Part VI.

[29]S.C. Code Ann. § 33-9-406(d), paraphrased, provides that a term in an agreement between the LLC and a a member is ineffective to the extent that it (1) prohibits, restricts, or requires the consent of the LLC to the assignment, transfer of, or the creation attachment, perfection or enforcement of a **security interest** in the LLC member's financial rights; or (2) provides that the assignment or enforcement of the **security interest** may impair the LLC

financial rights to a third party may not be impacted by U.C.C. § 9-406.[30] However, it apparently would be impacted by U.C.C. § 9-408.[31] At least one authority provides that a gift of only the financial rights will not be impacted by either § 9-406 or § 9-408. The following two tables summarize what this author believes is the extent of these provisions of the U.C.C. - assuming again it is the LLC itself that is imposing the restrictions.

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member's financial rights. *See, e.g.* Cohen & Henning, *supra* note 8, at 394:

> • Notwithstanding a contractual restriction on transfer, the application of §9-406(d) means that (i) a debtor [LLC member] who owns a transferable interest in an LLC [her "distributional interest"] can pledge that interest to a secured party without approval of the LLC and without liability therefore, (ii) the secured party can perfect such a pledge, and (iii) if the debtor defaults with respect to such a pledge, the secured party (who may be a stranger to the LLC) can collect payments owed on the transferable interest from the LLC (the account debtor) pursuant to § 9-607. [This statement assumes that the LLC is an account debtor - discussed below]

[30]*See,* Weise, *supra* note 9, at ¶ III. B. The author gives the example of an LLC operating agreement (binding on the LLC) that includes a restriction on both the sale or creating a security interest in the member's distributional interest (her financial rights). The author says as to these two restrictions:

> ● 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 . . .
>
> 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. . ..

[31]*Id*. at ¶ III. C, 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. . . [H]owever , 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 entitiled. Indeed, the company has no obligation to recognize Buyer as the owner of the economic rights."

Effect of § 9-406 and § 9-408
on LLC Member's **Financial Rights**

Effect on a transfer restriction that would limit the use of Financial Rights as **collateral**	Effect on a transfer restriction that would limit **sale** of the Financial Rights	Effect of a restriction that would limit **gifting** the Financial Rights, or limit transfer by **operation of law**
§ 9-406(d) overrides transfer restriction including restriction on enforcement	§ 9-408(a) overrides transfer restriction that would prevent creation, attachment, or perfection No effect on restriction on enforcement § 9-408(c) overrides legal transfer restrictions that would otherwise prevent creation, attachment or perfection - but No effect on restrictions on enforcement	No effect

This chart is adapted from the Appendix appearing in Steven O. Weise, PEB COMMENTARY NO. ___ APPLICATION OF UCC SECTIONS 9-406 AND 9-408 TO TRANSFERS OF INTERESTS IN UNICORPORATED [SIC] BUSINESS ORGANIZATIONS, *supra* note 9.

Effect of § 9-406 and § 9-408
on LLC Member's
Membership Interest - Governance Rights

Effect on a transfer restriction that would limit the use of LLC Membership as **collateral**	Effect on a transfer restriction that would limit **sale** of the Membership	Effect of a restriction that would limit **gifting** the Membership, or limit transfer by **operation of law**
§ 9-408(a) overrides transfer restriction that would prevent creation, attachment, or perfection No effect on restriction on enforcement	No effect	No effect
§ 9-408(c) overrides legal transfer restrictions that would otherwise prevent creation, attachment or perfection - but No effect on restrictions on enforcement		

This chart is adapted from the Appendix appearing in Steven O. Weise, PEB COMMENTARY NO. ___ APPLICATION OF UCC SECTIONS 9-406 AND 9-408 TO TRANSFERS OF INTERESTS IN UNICORPORATED [SIC] BUSINESS ORGANIZATIONS, *supra,* note 9.

I. Under What Circumstances is the LLC Itself Imposing the Transfer Restrictions so as to Qualify as the "Account Debtor"?

Maybe the most important question is under what circumstances we will find that the LLC itself is the one imposing the transfer restrictions.

Bishop & Kleinberger agree that for the U.C.C. to apply and nullify the transfer restrictions, one must find that the LLC has consented, the "consent of the LLC." Therefore, if the LLC itself has not signed the document imposing the restrictions, then maybe the U.C.C. restrictions do not apply.[32]

> [S]ection 9-406 remains limited to transfer restrictions in an agreement between an account debtor and an assignor; that is, again using an LLC as our example, it applies only to an agreement between the LLC and the member and does not invalidate transfer restrictions among the members. Even if transfer restrictions are set forth in an operating agreement to which all members and the LLC are made parties, only the restrictions in favor of the LLC are invalidated while those among the members remain valid and enforceable. Thus any incursion of section 9-406, as existing or as amended, into the 'pick-your-partner' principle is minimal.[33]

But is the LLC bound by the operating agreement even if it is not itself a signatory thereto?

Bishop & Kleinberger, state that the U.C.C. does not trump the transfer restrictions if the LLC is member-managed since it is the members and not the LLC itself that have imposed these

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[32] BISHOP & KLEINBERGER, *supra* note 3, at ¶ 8.06[4][a] (2016). "However, for many manger-managed LLCs a counterargument is available, and for all LLCs a "work around" *might* be possible. The counterargument pertains to the lead-in language to UCC Section 9-406(d), which limits the subsection's reach to "a term in an agreement between an account debtor and an assignor." The agreement at issue is the operating agreement, and often (perhaps most often) a limited liability company is not party to the operating agreement. In that circumstance, *by its terms* UCC section 9-406(d) does not apply."

[33] Cohen & Henning, *supra* note 8, at 406. *See also,* Soukup & Russev, *supra* note 8, at Part VI. ("If the anti-assignment provision is in an LLC agreement or partnership agreement, it may be viewed as a restriction in an agreement among the members of the LLC or partnership (and not in an agreement between the account debtor [the LLC] and an assignor), in which case section 9-406(d) and 9-408(a) will not apply to negate the restriction.")

transfer restrictions. The LLC is not a party to the agreement.[34]

However, Bishop & Kleinberger state that the result may be just the opposite if the LLC is manager run. The transfer restrictions would be invalid.

> The restrictions at issue typically involve "the consent of the account debtor"–i.e., the limited liability company In most manager-managed LLCs, it is the manager or managers who have the power to consent to otherwise prohibited transfers. An LLC manager is an agent of the LLC, and, under agency law the role of the manager as agent is imputed to the LLC.[35]

Query: If the managers are agents of the LLC, why shouldn't this same analysis apply to the members who act to impose transfer restrictions? Why aren't they also agents?

The cases and authorities in other areas as to whether the LLC itself is to be bound by a contract entered into only by the members or managers are inconsistent. Most of the cases have revolved around whether the LLC is itself bound by an arbitration agreement included in the operating agreement even though the LLC itself has not signed the operating agreement. Most have held the LLC is not itself a party.[36]

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[34]BISHOP & KLEINBERGER, *supra* note 3, at¶ 8.06[4][a]. ("[I]n a member-managed LLC the transfer restriction typically do not require 'the consent of the account debtor [the LLC].' They require the consent of the members. Thus, UCC Section 9-406(d) does not apply in the context of a typical member-managed LLC. ").

[35]*Id*. at ¶ 8.06[4][a] (2016). (Have the authors got this backwards? Is the LLC the agent and the managers the principals?)

[36] *Trover v. 419 OCR, Inc.*, 397 Ill. App.3d 403, 408–09, 921 N.E.2d 1249, 1254 (Ill. App. 2010) (holding that two LLCs were not parties to their own operating agreements where no member signed the agreement on behalf of the LLC because the Illinois Limited Liability Company Act stated that "[a] limited liability company is a legal entity distinct from its members" and it was clear from the Operating Agreement that the members understood how to legally bind the LLC but did not do so. NOTE that South Carolina has this same statutory language.); *Xereas v. Heiss,* 933 F. Supp. 2d 1 (D.C. 2013) (D.C. LLC statute does not reflect that LLC itself is a party to its operating agreement); *Bubbles & Bleach, LLC v. Becker,* No. 97 C 1320, 1997 WL 285938, at *4 (N.D. Ill. May 23, 1997) (There is no indication that the Wisconsin legislature anticipated that operating agreements would bind LLCs as entities distinct from their members). *See also, Mission Residential, LLC v. Triple NE Prop., LLC,* 275 Va. 157, 654 S.E.2d 888 (2008) (LLC was not a party to arbitration agreement entered into between the two members). *See generally*, BISHOP & KLEINBERGER, *supra* at note 3, ¶ 5.06[6][b] "Standing to Enforce the Operating Agreement: Members or LLC or Both?"

However, an often-cited Delaware Supreme Court opinion essentially concludes that the LLC is the members, and thus any action taken by the members is taken by the LLC itself . It is also bound by the arbitration agreement.

> [3] We are not persuaded by this argument [that since the LLC itself did not sign the operating agreement it is not bound by the arbitration provision in the contract]. Section 18-101(7) [Delaware Code] defines the limited liability company agreement as "any agreement, written or oral, of the member or members as to the affairs of a limited liability company and the conduct of its business." Here, Malek, Inc. and Elf, the members of Malek LLC, executed the Agreement to carry out the affairs and business of Malek LLC and to provide for arbitration and forum selection.
>
> Notwithstanding Malek LLC's failure to sign the Agreement, Elf's claims are subject to the arbitration and forum selection clauses of the Agreement. The Act is a statute designed to permit members maximum flexibility in entering into an agreement to govern their relationship. It is the members who are the real parties in interest. The LLC is simply their joint business vehicle. This is the contemplation of the statute in prescribing the outlines of a limited liability company agreement.[37]

At least one authority notes that the *Elf Atochem* case "could be used to support the view that the issuer of the LLC . . . is effectively a party to the LLC . . .agreement, and therefore section 9-406(d) or 9-408(a) would apply to restrictions created by the agreement .. . [And] until there is guidance on this issue from the courts, the effect of sections 9-406(d) and 9-408(a) on the effectiveness of anti-assignment provisions in LLC . . . agreements will merit careful evaluation."[38]

The LLC may be the party entitled to enforce the provisions of the operating agreement as a third party beneficiary.[39]

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[37]*Elf Atochem North America, Inc. v. Jaffari,* 727 A. 2d 286, 293 (Del. S.Ct. 1999). *Contra, Bubbles & Bleach, LLC v. Becker,* No. 97 C 1320, 1997 WL 285938, at *5 (N.D. Ill. May 23, 1997) (Court refused to adopt a special rule "that says that for the purpose of interpreting agreements of members inter se, the members of the LLC and the LLC itself are one and the same unless some other intent is expressly set forth or the context will not allow such a reading.")

[38]Soukup & Russev, *supra* note 8, at Part VI. (The authors also note that states that have statutes that automatically make the LLC party to the operating agreement create the same issue.)

[39]*See, e.g. Federalpha Steel LLC Creditors' Trust v. Federal Pipe & Steel Corp.* 368 B.R. 679, 694 (N.D. Ill. 2006) ("Federalpha [the LLC] is a third-party beneficiary at least for the

Another treatise opined as follows regarding the case *McDonald v. Yarchenko* 81 UCC Rep. 2nd 165, 2013 WL 3809512, 2013 U.S. Dist. Lexis 102728 (D. Ore. 2013) in which a creditor, in spite of an anti-assignment clause in the LLC, held a security interest in a member's LLC interest and collected by using "strict foreclosure." The authors made this (possibly over-broad) comment:

> Regarding the anti-assignment clause in the operating agreement, the Oregon court never made the important point that such clauses are void under the free-assignability principles of Article 9, particularly 9-406(d) and 9-408(a) and (d). The effect of these rules is that an anti-assignment clause can't stop a security interest from attaching or from being the subject of a secured claim in bankruptcy. The secured party can always reap the economic benefits flowing from the LLC membership interest, even though it has no right to non-economic rights such as voting rights.[40]

The Delaware LLC statute was amended to provide that the LLC is bound by the LLC operating agreement even though the LLC does not execute the agreement.[41] North Carolina likewise provides that the LLC is bound by the operating agreement thus making it a party to any transfer restrictions adopted in the operating agreement.[42] As such, like Delaware and others,

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non-competition provision of the Operating Agreement at issue in this claim. Section 5.4.4 of the Operating Agreement is a non-competition clause preventing either member of Federalpha from operating a competing steel service facility or other facility engaged in the same business as Federalpha. This provision also explicitly gives Federalpha the right to seek injunctive relief or other, further or different relief as may be available. By this language the parties to the Operating Agreement unequivocally intended to confer a benefit (the right to enforce this provision of the Operating Agreement) on Federalpha. Therefore, the Trust [on behalf of the LLC] has the right to pursue this claim."); *Cf. SGK Ventures, LLC v. NewKey Group, LLC (In re SGK Ventures, LLC),* 521 B.R. 842, 867 (N.D. Ill. 2014) ("Under Illinois law, the parties to a contract must have manifested an "intention to confer a benefit upon" an asserted third-party beneficiary. . . .The *Federalpha* court found beneficiary status conferred by a clause that gave the third party a right to seek relief under the contract. . . . . No such provision appears in the SGK operating agreement; at most, the agreements state that SGK will be an operating company, not that SGK has any right of enforcement.")

[40]2 BARKLEY CLARK & BARBARA CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE, § 4.10[9A][e], page 4-292.3 (3rd. Ed. 2016).

[41]*See generally,* Soukup & Russev, *supra* at note 8, Part VI (citing Del. Code Ann. tit. 6 § 18-101(7) (2003)).

[42]N. C. Gen. Stat. Ann. § 57D-2-31 (2014). **Parties to, and other persons subject to or having rights under, the operating agreement**

North Carolina was essentially required (and did) opt out of having the U.C.C. apply to LLC transactions.[43] South Carolina does not have a similar provision, although the 2006 Uniform Act (which the legislature declined to pursue) now has a somewhat similar provision.[44]

Tennessee likewise has a statute that provides that the operating agreement is binding on the LLC, and has used this statute to permit the LLC to enforce the terms of the operating agreement.

> Under Tennessee's Limited Liability Company Act, the LLC itself is granted certain general powers "to do all things necessary or convenient to carry out its business and affairs." Tenn .Code Ann. § 48–212–101 (2002). The first power granted to the LLC under section 48–212–101 is the power to "[s]ue and be sued, complain and defend in its LLC name." *Id.* § 48–212–101(1). As the LLC and its member are bound by the LLC operating agreement under section 48–206–101(c), we believe any breach of the operating agreement would constitute the LLC's "business and affairs." *See id.* § 48–212–101. Thus, the LLC has the authority to

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(a) The LLC is deemed to be a party to the operating agreement and, therefore, is bound by and may enforce the provisions thereunder applicable to the LLC.
(b) A person who becomes an interest owner is deemed to assent to, and is bound by, and, subject to Article 5 of this Chapter, is entitled to the rights applicable to the interest owner's ownership interest provided under, and is otherwise deemed to be a party to, the operating agreement.
(c) A person need not be an interest owner to be a party to the operating agreement.
(d) An operating agreement may require amendments to the operating agreement be approved by persons who are not interest owners and may provide rights to persons who are not interest owners and not otherwise parties to the operating agreement.
(e) Any person bound by the operating agreement is bound by any amendment adopted, as provided in the operating agreement.

[43]N.C. Gen. Stat. Ann. § 57D-10-02(d) (2014) (" G.S. 25-9-406 and G.S. 25-9-408 do not apply to any ownership interest or any portion thereof, including any economic interest. To the extent of any conflict or inconsistency between this subsection and G.S. 25-9-406 and G.S. 25-9-408, this subsection prevails. Accordingly, neither G.S. 25-9-406 nor G.S. 25-9-408 will render invalid, unenforceable, or ineffective any contrary or inconsistent provision contained in an operating agreement.")

[44]Uniform Limited Liability Company Act (2006), § 110 (a) "Except as otherwise provided in subsections (b) and (c), the operating agreement governs: (1) relations among the members as members and between the members and the limited liability company; . . .

sue in its name to enforce its operating agreement.[45]

[45] *Riverside Surgery Ctr., LLC v. Methodist Health Systems, Inc.,* 182 S.W. 3d 805, 814 (Tenn. Ct. App. 2005).

II. How Do You Avoid the Possible U.C.C. Problems by Causing the LLC Membership Interests and the LLC Distributional Interest to Qualify as a U.C.C. Security?

One treatise suggests that the way to avoid the possible problems created by U.C.C. § 9-408 and § 9-406 (that impose limits on the use of transfer restrictions in LLCs) is to make each LLC membership and its financial rights a "security."[46] The theory behind this approach is that the two troublesome U.C.C. sections do not apply if the interest involved is a "security." The U.C.C. restrictions only apply if the membership or financial rights are deemed to be a U.C.C. General or Payment Intangible. If it is not one of these, the "bad" U.C.C. provisions do not apply. The U.C.C. states that a "U.C.C. security" is not one of these intangibles.[47]

However, as a caution, another authority suggests that although one can convert the LLC membership interest into an "exempt U.C.C. security," the member's right to receive distributions from the membership interest is a separate property right that can only be a "non-exempt" U.C.C. "payment intangible" – thus an attempt to put in the operating agreement a provision that says a

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[46] BISHOP & KLEINBERGER, *supra* note 3, at § 8.06[2].

[47] S.C. Code Ann. (2006), **§ 36-9-102. Definitions and index of definitions.**

(a) In this chapter [Chapter 9]:

> (42) **"General intangible**" means any personal property, including things in action, **other than** accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, **investment property,** letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term **includes payment intangibles** and software.
>
> (49) **"Investment property**" means a **security**, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.
>
> (61) "**Payment intangible"** means a general intangible under which the account debtor's principal obligation is a monetary obligation.

(Although a LLC member's financial rights will qualify as a U.C.C. "Payment Intangible," apparently the way one should interpret these definitions is that the last sentence of definition (42) is merely to note that "non-security" Payment Intangibles are covered in § 9-406 & § 9-408.)

member cannot pledge these financial rights to another person will not work.[48] However, if "stock" is an exempt security, and certainly a feature of "stock" is the right to dividends and distributions, why should not a document that describes the LLC member's right to distributions be also fully exempt from the reach of the U.C.C.?

So the question becomes how does one qualify an LLC member's interest (hopefully including both the voting and financial rights) as a security? One might assume that we would look to the South Carolina Uniform Securities Act of 2005 where in § 35-1-102 (29) the term "security" is defined (or the essentially identical definition section found in the United States Securities Act of 1933 [15 U.S.C. §§ 77a et seq.) . Apparently, this is not what one does. Rather one looks to the slightly different definition of "security" found in the U.C.C.[49]

§ 36-8-102. Definitions.

(a) In this chapter [Chapter 8]:

(15) "Security," except as otherwise provided in Section 36-8-103, means an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:

(i) which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;

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[48]*See,* Soukup & Russev, *supra* note 8, at Part VIII ("The right to distributions with respect to an LLC or partnership interest should be categorized as a payment intangible (even if the [LLC membership] interest itself is investment property [a security] or a general intangible. . . . The [U.C.C.] Comment does not address whether a right to payment with respect to investment property or general intangible is a payment intangible that can be categorized separately from the related investment property or general intangible, but that is the logical application of the principle set out in the Comment.").

[49]S.C. Code Ann. (2006), **§ 36-8-103. Rules for determining whether certain obligations and interests are securities or financial assets.**

(c) An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, **its terms expressly provide that it is a security governed by this chapter,** or it is an investment company security. However, an int erest in a partnership or limited liability company is a financial asset if it is held in a securities account.

(ii) which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and

(iii) which:

(A) is, or is of a type, dealt in or traded on securities exchanges or securities markets; or

(B) is a medium for investment and by its terms expressly provides that it is a security governed by this chapter.

(16) "Security certificate" means a certificate representing a security.

Thus in order to avoid the U.C.C. transfer restrictions, the LLC operating agreement (and articles?) must "opt in"[50] and should apparently authorize a typical "stock certificate." The agreement and certificate should provide that it is a designated security certificate as authorized by S.C. Code § 33-44-501(c), representing the member's right to manage and the certificate owner's distributional interest in the LLC, particularly specifying that the certificate represents a security governed by Chapter 8 of title 36 of the Code of Laws of South Carolina. The agreement and certificate likely would state that the certificate represents the member's right to exercise a specified number of votes regarding all matters on which a member shall have the right to vote. It seems likely that they must also recognize that the member is entitled to receive a specified percentage of distributions. The certificate must be in either bearer or registered form,[51] or provide that the transfer of the certificate may be registered upon books maintained for that purpose by or on behalf of the LLC as issuer.[52]

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[50]2 BARKLEY CLARK & BARBARA CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE, Third Edition, § 4.10[9A][e], page 4-292.3 (3rd ed. 2016). ("[T]he LLC interest must qualify as a 'certificated security' under Article 8 of the UCC. UCC 8-102(a)(15)(iii)(B) and 8-103(c). The LLC operating agreement can require that membership interests be certificated"; the usual way to do that is to have the LLC operating agreement expressly "opt-in" to Article 8. (For avoidance of doubt, the opt-in language could appear both in the entity agreement and LLC certificate [articles].").

[51]BLACK'S LAW DICTIONARY (9th ed. 2009) defines "bearer security" as "An unregistered security payable to the holder." "Registered security" is defined as "A security whose owner is recorded in the issuer's books."

[52]*See generally, In re Strata Title, LLC,* No. 12-24242, 2013 WL 2456399 at *3 (Bankr. D. Ariz. June 6, 2013) (LLC membership interest deemed not a U.C.C. security since in part there were no "membership certificates or similar documents indicating that the parties intended to treat the membership interests as securities." However, the court also did note that the

It must also meet the "divisibility" requirement. What does the requirement of "divisibility" mean? Official Comment 15 to U.C.C. § 8-102(a)(15) says:

> "The divisibility test of subparagraph (ii) applies to the security--that is, the underlying intangible interest--not the means by which that interest is evidenced. Thus, securities issued in book-entry only form meet the divisibility test because the underlying intangible interest is divisible via the mechanism of the indirect holding system. This is so even though the clearing corporation is the only eligible direct holder of the security."

However, the New York Court of Appeals gives a much simpler definition by example:

> "Minimum compliance with this formality requires that there be at least two instruments in a specified class or series, or that the single instrument be divisible into at least one additional instrument."[53]

Presumably if the LLC has issued more than two membership interests as certificated "U.C.C. Securities" this should qualify for the "divisibility" requirement.

Assuming that the certificates are not in bearer form, in order to be doubly safe that the certificates are in registered form as also required by § 8-102(a)(15)(i), the LLC should itself maintain formal record books showing the current registered owner of each membership and provide for transfer of such membership by recording such on the LLC formal "registration" records.[54]

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operating agreement acknowledged that the membership interests have not been registered as securities under the Securities Act of 1993, the Arizona Securities Act or the securities laws of any other jurisdiction - suggesting that this also negated the memberships from being a security for U.C.C. purposes.)

[53]*Highland Capital Management LP v. Schneider,* 8 N.Y. 3d 406, 415 (Ct. App. 2007) (quoting *Allegaert v. Chmical Bank*, 657 F. 2d 495, 507 (2nd Cir. 1980)).

[54]In *Highland Capital Management LP v. Schneider,* 8 N.Y. 3d 406, 414 (Ct. App. 2007), the majority and dissent disagreed as to whether to qualify as a security formal books had to be maintained and the certificates formally registered. The majority said "no," it was sufficient if the certificates could have been registered on transfer books established by the entity, not whether they were in fact registered on transfer books. The dissent at 417-419 asserted that the memberships had to be registered and there was an established formal mechanism providing for a change in ownership on the books.

III. If the Membership Interest Qualifies as a "U.C.C. Security," Will It Automatically be a "South Carolina Uniform Securities Act of 2005 Security"?

If the LLC thus issues members "U.C.C. securities," does this mean that the members also have automatically been issued a "security" as defined by § 35-1-102 (29) of the South Carolina Uniform Securities Act of 2005 (or the parallel federal Securities Act of 1933)? The answer is "No."[55] The two definitions are different. Thus a member could own what the U.C.C. defines as a security, but not what our "securities law," the South Carolina Uniform Securities Act of 2005, deems is a security (and vice versa).

For a membership to be a security pursuant to the South Carolina Uniform Securities Act of 2005 (or the parallel Securities Act of 1933), the membership must also qualify either as an "investment contract" or possibly as "stock," and maybe even as a "profit-sharing agreement." Whether what I own qualifies as a security probably should be deemed to be a question of law, but there is at least one case where the court, in a criminal case, permitted the question to go the jury as agreed to by both parties.[56] The Fourth Circuit has been very clear that merely because a member of an LLC receives a certificate for his membership that says it is a "share" and a "security," this does not make the membership a security.[57]

There is some conflict as to whether LLC membership interests can qualify as "stock" and thus automatically be a security pursuant to the South Carolina Uniform Securities Act and the '33 Act. In any event, even if the court concludes that an LLC might have the features of stock, it will be very unusual for an LLC membership interest to so qualify.

The Fourth Circuit noted that for an LLC membership to possibly qualify as "stock" that it most both be called "stock" and have all the usual characteristics of stock.

> [7] The characteristics typically associated with common stock are (i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability;

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[55] *See generally, In re Strata Title, LLC,* No. 12-24242, 2013 WL 2456399 (Bankr. D. Ariz. June 6, 2013)

[56] *U.S. v. Leonard,* 529 F. 3d 83 (2nd Cir. 2008). *See also, Maybank v. BB & T Corp.* 416 S.C. 541, 787 S.E.2d 498 (S. Ct. 2016) (Permitting the jury to consider whether a "Prepaid" was a security.)

[57] *Robinson v. Glynn*, 349 F. 3d 166 (4th Cir. 2003) (Although Robinson received 133,333 "shares" of the LLC, and "on the back of the share certificates that Robinson received, the restrictive legend referred to the certificates as "shares and "securities" . . . and also specified that the certificates were exempt from registration under the Securities Act of 1933, and stated that the certificates could not be transferred without proper registration under the federal and state securities laws" . .. this did not make them securities.)

(iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value.[58]

In the 4th Circuit *Robinson* case (where the certificate the member received was designated as being "shares" and "securities") the court concluded that these memberships were NOT stock, stating:

> First, as is common with interests in LLCs, GeoPhone's members did not share in the profits in proportion to the number of their shares. . . . Pursuant to the ARGOA [operating agreement], Robinson was to receive 100 percent of GeoPhone's net profits up to a certain amount, only after which were funds to be distributed pro rata to the members in proportion to their relative shares.
>
> Second, like interests in LLCs more generally, Robinson's membership interests were not freely negotiable. . . . According to the ARGOA, Robinson could only transfer his interests if he first offered other members the opportunity to purchase his interests on similar terms. Moreover, unlike with stock (except some stock in close corporations), anyone to whom Robinson or other members transferred their interests would not have thereby acquired any of the control or management rights that normally attend a stock transfer. . . . Rather, the ARGOA requires that transferees satisfy several conditions to become members, in addition to receiving the approval of a majority of GeoPhone's managers.
>
> Similarly, Robinson could pledge his interest, but the pledgee would acquire only distribution rights and not control rights. *See id.* ("Unlike stock, however, the pledgee [of a LLC membership interest] acquires no rights to become a substitute owner with rights to participate in control of the entity upon default of the pledgor."). As for the apportionment of voting rights, the parties dispute whether voting rights were conferred in proportion to members' interests in GeoPhone. Even resolving this dispute in Robinson's favor, it remains clear that Robinson's membership interest lacked the ordinary attributes of stock.
>
> Finally, from the very beginning Robinson and Glynn consistently viewed Robinson's investment as a "membership interest," and never as "stock." The purchase and operating agreements that Robinson and Glynn executed, as well as the agreement in which Robinson bought out Glynn's interest in GeoPhone, all termed Robinson's investment as a "membership interest" rather than "stock." Even the shares that Robinson received as a result of his investments declared Robinson the holder of "membership interests in GeoPhone Company, L.L.C., within the meaning of the Delaware Limited Liability Company Act." Robinson

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[58] *Robinson v. Glynn*, 349 F. 3d 166, 173 (4th Cir. 2003).

> thus cannot argue that he was misled into believing that his membership interests were stock whose purchases were governed by the securities laws. . . . And it would do violence to the statutory language of the securities laws to include within the term "stock" an instrument that was neither labeled stock nor [was] like stock.[59]

There are a substantial number of other cases that have found that the LLC membership did not have the features of stock and thus could not be a security,[60] there are others that seem to, or do hold, that an LLC membership interest can never be "stock,"[61] and others where there was a simple failure of proof as to whether the particular LLC interests had the requisite five factors.[62]

Arguments have also been made that LLC membership interests should be classified as securities since according to both the South Carolina and United States definition of a security includes "any interest or instrument commonly known as a security." However, "[the] Supreme Court has indicated that the term 'any interest or instrument commonly known as a security' covers the same financial instruments as referred to by the term 'investment contract.'"[63]

In South Carolina an LLC membership interest will be deemed to be a security if it qualifies as an "investment contract." [64] There are numerous cases from other jurisdictions that have also concluded that LLC membership interests were "investment contracts" and thus were securities.[65] Our South Carolina Uniform Securities Act of 2005 includes two important provisions. First § 35-1-102(29)(D) states that the term "security" includes:

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[59]*Robinson v. Glynn*, 349 F. 3d 166, 173-74 (4th Cir. 2003).

[60]*See, Great Lakes Chemical Corp. v. Monsanto Co.*, 96 F. Supp. 2d 376 (D. Del. 2000).

[61]*Braun v. Schwartz*, Civ. N. 12-6224 (ES), 2013 WL 5467084, at *9 n. 5 (D. N.J Sept. 30 2013); *Compare, Sync Labs LLC v. Fusion Mftr.*, Civ. No. 2:11-03671 (WHW), 2014 WL 37124 (D. N.J., Jan. 6, 2014) (questioning whether LLC interests could qualify as stock).

[62]*Fagan v. Fischer*, Civ. Action No.: 14-7013 (FLW)(TJB), 2016 WL 347318 at *13 (D. N.J. Jan. 28, 2016); *Sync Labs LLC* v. *Fusion Mftr.*, Civ. No. 2:11-03671 (WHW), 2013 WL 4776018, at *11 (D. N.J. Sept. 4, 2013 (summary judgment denied since no evidence supporting the second and third factors of the elements of stock).

[63]*See, Great Lakes Chemical Corp. v. Monsanto Co.*, 96 F. Supp. 2d 376 (D. Del. 2000).

[64]A helpful case that details what is required to create an "investment contract," see *S.E.C. v. Arcturus Corp.,* 171 F. Supp. 3d 512(N.D. Texas, 2016).

[65]*See, e.g. U.S. v. Leonard,* 529 F. 3d 83 (2nd Cir. 2008). *Contra. Wen v. Wills,* 117 F. Supp. 3d 673 (E.D. Pa. 2015) (promoter stole all funds apparent unsophisticated investor invested in an LLC that was organized to manage his money - '33Act Security not found but stated a claim for Pennsylvania security).

> an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor and a "common enterprise" means an enterprise in which the fortunes of the investor are interwoven with those of either the person offering the investment, a third party, or other investors . . .

This is effectively a codification of the so-called *Howey* case that defines what an "investment contract" is. The second important provision is § 35-102(29)(E) which then specifically states:

> "Investment contract" may include, among other contracts, an interest in a limited partnership and a limited liability company . . .

We are also fortunate in that our Supreme Court in *Majors v. S. C. Sec. Comm'n.*[66] has walked through these various elements of the *Howey* test, explaining how they will be applied in South Carolina. (Among other important points, the Court specifically points out that South Carolina applies "strict vertical commonality" which means that the *fortunes* of the investors be tied to the *fortunes* of the promoter - or vice versa.[67])

The most difficult of the three *Howey* elements is whether the investors expected they would earn a profit "solely" from the efforts of others. The *Majors* opinion notes that the term "solely" has been "relaxed."[68] Many courts consider the following non-exclusive factors in determining whether there is such dependence:

1. An agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; OR

2. The partner or venture is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venturer powers; OR

3. The partner or venturer is so dependent on some unique entrepreneurial or managerial ability fo the promoter or manager that he cannot replace the manager

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[66]644 S.E. 2d 710, 310 S.C. 153 (S.Ct. 2007).

[67]The alternative "broad vertical commonality" test merely requires that the fortunes of the investors need be linked only to the *efforts* of the promoter.

[68] 310 S.C. at 163, 644 S.E. 2d at 717 ("As noted by the Court of Appeals in *Garrett*, the third prong of *Howey* has been relaxed.")

of the enterprise or otherwise exercise meaningful partnership or venture powers.[69]

Interestingly, a number of courts have refused to find that the elements of the *Howey* test are met when the buyer purchases all of the membership interests in an LLC. The courts have refused to honor the argument that it is not necessary that an interest be deemed a security in the hands of both the seller and the purchaser.[70]

In the South Carolina *Majors* case, the court also noted that the term "security" also includes any "certificate of interest or participation in any profit-sharing agreement." Interestingly, there appears to be very little authority as to what this includes.[71] Could an LLC membership be included in this if the LLC has in fact issued "certificates"?

Other states have adopted statutory definitions that provide specific rules as to when an LLC membership interest will automatically be a security. As noted above, our South Carolina test is the classic "investment contract - *Howey*" test.

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[69]*S.E.C. v. Arcturus Corp.,* 171 F. supp. 3d 512, 523-24 (N.D. Texas 2016) (citing *Williamson v. Tucker,* 645 F. 2d, 404, 424 (5th Cir. 1981). *Contra, Wen v. Willis,* 17 F. Supp. 3rd 673 (E.D. Pa. 2015) (refused to apply *Williamson* factors).

[70]*Archer Well Co. Inc. v. GW Holdings I LLC,* No. 12 Civ. 6762 (JSR), 2013 WL 2314271 (S.D. N.Y., May 21, 2013).

[71]The leading securities treatise, 1 LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, FUNDAMENTALS OF SECURITIES REGULATION, Ch. 3, Coverage of the Securities Act of 1933:Definitions and Exemptions, 353 (2011), does not even mention as a topic, the term "certificate of interest or participation in any profit-sharing agreement" in the over 100 pages of text.

IV. Lenders, How Do You Obtain a Security Interest In an LLC Member's "Distributional Interest" or "Membership Interest"? Some Problems to Avoid.

Even though qualifying an LLC interest as a U.C.C. security will not likely make it a '33 Act or South Carolina Uniform Act "security," it will have a significant impact on how a lender perfects a security interest in the membership.

> But how does a lender perfect a security interest in a member's interest in an LLC? Unfortunately, this question raises several other questions. Is a member's interest in an LLC a "security" governed by Article 8, or is it a "general intangible" governed by Article 9? Does it matter whether the member's interest is *certificated,* as in a stock certificate? What if it is *un* certificated, as most partnership interests are? Can the LLC itself elect to be governed by Article 8 rather than Article 9? All these questions must be answered when a lender takes a security interest in an LLC. Moreover, little case law is available to guide lenders through these issues.[72]

If the LLC membership is a U.C.C. security, it is thus deemed "investment property" and the lender is often perfected by having either taken delivery of the certificate pursuant to U.C.C. § 8-301, or having obtained control of the "security" pursuant to U.C.C. § 9.06. However, if the LLC membership interest has not "morphed into" a U.C.C. security, in order to perfect, the debtor signs a security agreement that describes the collateral, and a financing statement must be filed.[73] The leading U.C.C. Secured Transactions treatise states:

> The UCC generally excludes LLCs from the definition of "security" under UCC 8-103(c) Accordingly, the debtor's interest in an LLC is treated as a *general intangible* under Article 9. Therefore, the only way to prefect is by *filing a UCC financing statement* in the state where the debtor resides. If the debtor is an organization, this means the state in which it is incorporated. *See* UCC 9-307. The financing statement could describe the collateral as: "All of the debtor's interest, now or hereafter, in Newco, LLC, including without limitation debtor's member's interest herein, and all distributions and proceeds of the foregoing.[74]

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[72] CLARK & CLARK, *supra* note 4, at § 14.06[2], page 14-39.

[73] *In re Dreiling,* No. 05-64189, 2007 WL 172364, at *3 (Bankr. W.D. Mo. Jan. 18, 2007) (Debtor's interest in the LLC is a general intangible, and the "creditors" were required to file a financing statement in order to perfect their security interest which they failed to do). *See generally,* Michael VanNiel & James W. May, *Limited Liability Company Membership Interests: What a Lender Needs to Do with LLC Collateral on Default,* 18 BUS. L. TODAY 47 (March/April 2009).

[74] CLARK & CLARK, *supra* note 4, at § 14.08[6], page 14-50.

It is critical that the correct name of the LLC be used in the "attachment" and on the financing statement, because if there is an error, the creditor simply will not have a security interest.[75] Apparently only an "objective standard" is required for purposes of determining whether the LLC has been identified for purposes of the attachment, but presumably the correct name of the LLC must be used on the financing statement in order to avoid it being seriously misleading to third parties.[76]

In a classic "screw up," the bank loaned an LLC member $315,000 and attempted to secure the loan with a pledge of her LLC membership (that was clearly not a "security" and thus not investment property). The court's recitation of the mess is worth noting.

> Dr. Michelle Brown borrowed $315,000 from the Bank in July of 2010. She gave the Bank a note and executed two security documents: an Assignment of Investment Property/Securities (Assignment) and an Uncertificated Securities Control Agreement (Control Agreement). She executed a financing statement that the Bank filed with the Secretary of State. The terms of the note refer to it being secured by, among other things, an "Assignment of Investment Property/Securities—KANSAS MEDICAL CENTER, LLC." The note also references a "Security Agreement" signed by Dr. Brown. The Assignment and Control Agreement are part of the record on summary judgment; the security agreement is not.
>
> Paragraph 2 of the Assignment reads "To secure the payment ... of the [note], I assign and grant a security interest to you in all of the Property described in this Agreement that I own...." Paragraph 3 defines the "Property" as "Investment Property/Securities: **7.000 shares of Preferred Stock** in KANSAS MEDICAL CENTER, LLC, held by KANSAS MEDICAL CENTER, LLC, 1124 W 21st Street, Andover, KS 67002 recorded in my name." Other than proceeds and replacements, no other property is described in the Assignment. The Control Agreement was signed by the Bank, Dr. Brown, and a representative of Kansas Medical Center, Steven Hadley. Kansas Medical Center is referred to as the Issuer and, in the agreement, the Issuer agrees "to comply with the instructions originated by the Secured Party without further consent by the Debtor." The property that is subject to the agreement "includes the following Investment Property and all proceeds and products ..." and describes the "**7.000 shares of Preferred stock"** referenced in the Assignment. Dr. Brown executed and the Bank **filed a financing statement that refers to "Margin Stock/Securities (uncertificated): 7.000 shares of**

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[75] *In re McKenzie*, No. 08-16378, 2011 WL 2118689 at * 7 (Bankr. Tenn. May 27, 2011), *aff'd.* 737 F. 3d 1034 (6th Cir. 2013) (The creditor claimed security interests in a number of LLCs in which the debtor had a membership. Many used as part of the name the phrase "Exit 20." A witness testified that there were so many "Exit 20" entities that she was confused. The court thus concluded the creditor did not acquire a security interest in an entity listed on the U.C.C. filings as "Exit 20, LLC" and whose legal name was Exit 20 Properties LLC [or maybe Exit 20 Development LLC].)

[76] *Id.*

preferred stock in KANSAS MEDICAL CENTER, LLC, held by KANSAS MEDICAL CENTER, LLC, 1124 W 21st Street, Andover, KS 67002 recorded in Debtor's [Brown's] name."

Dr. Brown **owned 7 units** in the LLC. She **did not own shares** of preferred stock in it—no stock was issued. The LLC's operating agreement, filed under seal here, makes **no provision for the issuing of stock;** rather those members contributing capital **received units,** defined as "an instrument used for purposes of determining certain votes and making certain allocations of profits and losses." There are no "instruments" in the summary judgment record. [Emphasis added]* * *

The Bank's documents refer to the units variously as "investment property," "uncertificated securities," or "margin stock." The units are none of these things. * * *

The collateral is both miscategorized as investment property and misdescribed as preferred stock. Preferred stock is issued by a corporation to accord its holders preference over the holders of common stock in the distribution of dividends or, in the event of liquidation, assets. Limited liability company units are issued to investors in LLC's to evidence members' relative rights in the distribution of profits and liability for losses. Only if the Court can conclude that the Bank's note, Assignment, and Control Agreement, read together as a security agreement, contain descriptive terms that point to Dr. Brown's equity interest in KMC can it conclude that the Bank's security interest attached. But because the Bank used the wrong UCC collateral type-word "investment property" in its security documents, the sufficiency of the description is rightly open to question. * * *

By an admittedly thin margin, the Bank's description "reasonably identifies" the collateral under § 9–108 and therefore complies with § 9–203(b)(3)(A). The Bank's security interest attached to Dr. Brown's 7 units in Kansas Medical Center, LLC. * * *

[5] A security interest in general intangibles may only be perfected by filing a financing statement. A financing statement is sufficient to perfect a security interest when it contains the names of the debtor and the secured party, and when it "indicates the collateral covered." The "indication" of the collateral is sufficient if it meets the description standards set out in § 9–108. The Bank's financing statement exhibits yet more "careless draftsmanship" by referring to the collateral as "margin stock/securities (uncertificated)" and describing it as "7.000 shares of preferred stock" in Kansas Medical Center. But the statement also contains KMC's address and correctly identifies the number of shares of interest that Dr. Brown owns. The misnomers "margin stock," "uncertificated securities," and "preferred stock" are not enough to render the financing statement seriously misleading and, as set out above, the description meets the requirements of § 9–108, if only by a hair.[77]

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[77]*Davis v. Brown (In re Brown),* 479 B.R. 112 (Bankr. D. Kan. 2012).

Unless "overridden" by the U.C.C., the creditor must also be certain that it has complied with all the requirement of the LLC operating agreement in order to obtain a security interest, and often the LLC operating agreement will impose transfer restrictions that include getting other members' or managers' permission to pledge a membership interest for security for a loan. Apparently, at least in the bankruptcy context, it is the creditor's burden to prove that it has complied with these requirements.[78] Likewise in the bankruptcy context, the trustee has the right to challenge whether the creditor does have a valid security interest in the LLC membership.[79]

A parallel corporate case demonstrates a lender's need to determine if there are any valid restrictions on the pledge of an ownership interest. Each shareholder was subject to two separate restrictions on the right to pledge his shares.[80] First, the shareholder could not transfer, including a pledge, without an opinion of counsel that such did not require securities registration. The restriction was apparently imposed by the corporation. Each share had a legend to this effect on the back of the certificate in conformity with the law where the company was formed. The bank which loaned the shareholder funds apparently paid no attention to this restriction. The court ultimately concluded, probably wrongly, that since a pledge is not the same as a sale or distribution, it was inapplicable to the original pledge, but would be applicable if the bank then attempted to sell or transfer the shares.[81]

In that same case, the second restriction was in the shareholder agreement that prohibited a pledge without the consent of all the shareholders in order to insure that the company continued to qualify for Sub Chapter S status. The Court found that the bank was essentially aware of this restriction and also on legal notice that the requirements had not been met. Thus the bankruptcy trustee administering the shareholder's estate was permitted to nullify the pledge and claim the debtor's shares unrestricted.[82] The court also pointed out that since the restriction was imposed by the shareholders, the state statute that controlled restrictions imposed by the issuer had no application. The court further pointed out that in a parallel situation, U.C.C. § 8-204 only applies to restrictions imposed by the issuer and not by a shareholder agreement.[83]

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[78] *Grant, Konvalinka & Harrison, P.C., v. Still* (*In re McKenzie),* 737 F. 3d 1034, 1039 (6th Cir. 2013).

[79]*Id.* at 1041.

[80]*Timberland Banchares, Inc. v. Garrison (In re Garrison),* 462 B.R. 666 (Bankr. Ark. 2011).

[81]*Id*. at 679.

[82]*Id*. at 682.

[83]*Id*. at 679.

Exploring further as to who may have standing to challenge that transfer restrictions imposed on a LLC member are invalid because of the U.C.C. provisions, another opinion similarly concluded that a bankruptcy trustee, among others, would have this right.[84] The trustee might want to assert this if the member is in bankruptcy and the value of her membership would be greater if the liens she agreed to when borrowing funds are found to be invalid. In another case, the bankruptcy court determined that a debtor's lender did not have a perfected security interest in the debtor's LLC membership interests, since the consent of the other members, required by the operating agreement for any transfer, including a pledge for a loan, was not obtained.[85] In this case the lender alternatively argued that it at least had a secured interest in the "proceeds" or "distributions" from the membership interest. The court noted that under Illinois law the right to the interest and the dividends from collateral is inherently tied to the ownership of the collateral itself, and further, different from South Carolina, Illinois defines an LLC member's membership as including the right to receive distributions.[86] Thus a restriction on transfer of "any" interest in the LLC membership clearly would include a limit on the transfer of distributions.[87]

If the LLC has in fact opted into Article 8 and caused the LLC membership to qualify as a "U.C.C. security" one authority suggests how this can cause problems for the lender who wants to acquire a security interest in the membership - now an "investment" property.

> The biggest concern is that the LLC may have opted into Article 8 by making a statement to that effect in its organizational articles or operating agreement. If so, then a UCC filing would protect the secured lender against the debtor's trustee in bankruptcy but not against a competing lender who got "control" of the security by possession (if it were certificated) or through a control agreement with the LLC (if it were uncertificated). One can imagine a scenario where the debtor seeks to double finance by having Secured Lender 1 perfect by filing, then, with knowledge that his LLC has opted into Article 8, borrows from Secured Lender 2 based on control. Opting into Article 8 is unusual, but the statute clearly allows it.[88]

Another mistake to avoid is failing to state that the membership interest is being assigned to the

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[84]*Prime Lending II, LLC v. Buerge (In re Buerge),* No. 11-20325, 2014 WL 1309694 at * 17-19 (B.A.P., 10th Cir. April 2, 2014) (*reversing* 479 B.R. 101).

[85]*In re Weiss,* 376 B.R. 867 (Bankr. Ill. 2007).

[86]*Id*. at 879.

[87]*Id*.

[88] CLARK & CLARK, *supra* note 4, at § 14.06[3], page 14-40.

lender. In one case, the lenders claimed that their claim was secured by virtue of an Agreement and Assignment of Interest in the LLC. However, the lenders made a serious mistake in drafting the assignment document. The critical erroneous language is as follows:

> The Assignment provides, in relevant part, that the Debtors "hereby assign to [the Vaders] a security interest in their ownership shares of Dreiling Arms Associates, L.L.C., in the amount of $24,614.00, plus interest from August 25, 2004, at the rate of 7.5% per annum." It further provides:
>
> > The undersigned acknowledge and understand that this assignment gives to the [Vaders] a sufficient security interest in the [Debtors'] ownership of Dreiling Arms Associates, L.L.C. to allow the [Vaders] to receive the $24,614.00, plus interest from August 25, 2004, from the proceeds of any sale of the [Debtors'] share of the Dreiling Arms Associates, L.L.C. or from the sale of the [Debtors'] share of assets of Dreiling Arms Associates, L.L.C.[89]
>
> The court then noted:
>
> [T]he language of the Assignment does not purport to assign the Debtors' *ownership interest* in the LLC to the Vaders; rather, it purports to assign or create a *security interest* in the Debtor's one-third ownership interest in it. Since there has been no allegation that the Debtors possessed a security interest in the LLC (as opposed to an ownership interest) which they could then assign to the Vaders, I find that the Assignment attempts to grant to the Vaders a security interest in the Debtors' one-third ownership interest in the LLC.[90]

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[89] *In re Dreiling*, No. 05-64189, 2007 WL 172364, at *1 (Bankr. W.D. Mo. Jan. 18, 2007).

[90] *Id*. at *2.

V. Is Obtaining a Charging Order the Only Way a Judgment Creditor Can Acquire an Interest in the LLC Member's Membership Interest?

Our South Carolina LLC statute, as does Illinois', provides that the exclusive remedy that a judgment creditor has to recover against a member-debtor is to obtain and then foreclose a charging order.

> This section [§ 33-44-504. **Rights of Creditor**] provides the exclusive remedy by which a judgment creditor of a member or a transferee may satisfy a judgment out of the judgment debtor's distributional interst in a limited liability company." [§ 33-44-504(e)]

In an Illinois case, a bank who had loaned a member a substantial amount of money obtained a judgment against the member when he did not pay, and then claimed an interest in the member's membership interest by virtue of the Illinois "Judgment by Confession and Citation to Discover Assets."[91] This Illinois "collection" statute basically provides that when a creditor obtains a judgment against the debtor, it becomes a lien on all the "non-exempt" personal property belonging to the debtor, in his possession, control, or which may be acquired when a "citation" is served in accordance with the statutory procedures.[92] The bank argued that through this process that it gained ownership in either the debtor's distributional interest or maybe his full membership interest.

In a first hearing on the matter, the bankruptcy judge concluded that the charging order "exclusive remedy" statute was in fact exclusive, and thus trumped this other possible collection process.

> In this Court's view, the unambiguous term "exclusive remedy" must be interpreted as meaning "to the exclusion of all other remedies." It cannot be interpreted as meaning "in addition to other remedies." Section 30–20(e) forecloses the possibility that the lien obtained via a charging order is simply another alternative to a citation lien. Exclusive means exclusive. The lien provided in Section 30–20(b), conditioned upon entry of a charging order, is the only one available to a creditor seeking to attach or enforce a judgment against the interest of a member in an Illinois limited liability company. The Court determines that HEARTLAND [the bank] did not obtain a lien that attached to MICHAEL'S interest in FLLZ [the

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[91] *LaHood v. Covey (In re LaHood), LLC,* Bank. No. 07-81727, 2009 WL 803558 at *1 (Bankr. C.D. Ill. March 19, 2009)

[92] *See, LaHood v. Covery (In re LaHood),* 437 B.R. 330, 339 (Bankr. C.D. Ill. 2010) (describing the statute and procedure).

LLC] when it served him with a Citation to Discover Assets in March, 2007.[93]

The bank did not give up, and at a second hearing in front of the same bankruptcy judge, the bank essentially argued that the charging order only gave the creditor rights in the member's distributional interest but the "Citation to Discover Assets" gave the bank rights in the member's full membership interest, a different property interest, and thus it was not barred by the "exclusive remedy" language in the charging order statute.[94] The bankruptcy judge said "nope."

> From the nature of its argument, it is apparent that HEARTLAND [the bank] wants to have it both ways. On one hand, it emphasizes the statutory distinction between a membership interest and a distributional interest for purposes of obtaining a lien. Even though it did not obtain a Section 30–20 charging order, and so cannot have a lien on MICHAEL'S distributional interest, HEARTLAND contends that it nevertheless obtained a citation lien on his membership interest. On the other hand, HEARTLAND collapses that distinction for purposes of lien enforcement. By emphasizing its lien rights against MICHAEL'S membership interest, HEARTLAND necessarily implies, based on the facts of this case, that it somehow has the right to enforce that lien against MICHAEL'S distributional interest, which is the only interest that matters at this point, given FLLZ'S [the LLC's] dissolution. This contention directly contradicts the plain language of Section 30–20(e).
>
> HEARTLAND'S [bank's] argument implies that a creditor can bypass the exclusive procedure of Section 30–20 and still, in effect, obtain a lien on a member's distributional interest by obtaining a lien on the entire membership interest, which is broader and includes the distributional interest. Section 30–20(e), however, provides the "exclusive remedy by which a judgment creditor of a member or a transferee may satisfy a judgment out of the judgment debtor's distributional interest." Since a charging order is the only way to obtain a lien on a distributional interest, HEARTLAND'S citation lien did not give rise to a valid lien on MICHAEL'S distributional interest, which includes his right to receive the distribution of any surplus upon the winding up of FLLZ [the LLC].[95]

The court reinforced its argument in stating:

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[93]*LaHood v. Covey (In re LaHood),,* Bank. No. 07-81727, 2009 WL 803558 at *12 (Bankr. C.D. Ill. March 19, 2009)

[94]*LaHood v. Covey (In re LaHood),* Bank. No. 07-81727, 2009 WL 2169879 at *2-3 (Bankr. C.D. Ill. July 16, 2009).

[95]*Id.*

> The Court disagrees with HEARTLAND'S [the bank's] assertion that giving "exclusive" its plain meaning would cause Section 30–20 of the ILLCA to conflict with Section 2–1402 of the Illinois Code of Civil Procedure. Section 2–1402 provides a broad, general collection remedy. The Illinois Legislature is certainly free to create other remedies for specific kinds of property interests and to have those specific remedies operate independently and to the exclusion of Section 2–1402. The Legislature unambiguously did that in Section 30–20 of the ILLCA. The two provisions are not conflicting. A judgment creditor who wishes to obtain a lien and/or enforce collection against the economic entitlements of a limited liability company member must follow the procedure set forth in Section 30–20. If the creditor wishes to obtain a lien against other property, the creditor may follow the procedure set forth in Section 2–1402.[96]

It seems that the bankruptcy judge got this right. However, the District Court, in a rather peculiar opinion, totally disagrees.

> Although also not completely analogous, the Court finds the opinion in *Bobak Sausage Co. v. Bobak Orland Park, Inc.*, 2008 WL 4814693, at *4–5 (N.D.Ill.2008), to be instructive. The debtor in Bobak held a 30% interest in an LLC that was determined to be relatively illiquid as a result of the substantial limitations on the alienability of full membership interests contained in the LLC's operating agreement. *Id*. Given the lack of a ready market for this type of an asset, the district court concluded that the general provision in the first sentence of § 2–1402(e) of the Illinois Code of Civil Procedure that property delivered up by the debtor shall be delivered to the sheriff to be sold may give way to another method that is more appropriate to liquidate the property where the debtor's property cannot readily be delivered for sale pursuant to the second sentence of § 2–1402(e). *Id.*, at *4. . . . The court found the alternative provision in sentence two of § 2–1402(e) to be in accord with § 30–20 of the LLC Act, . . .
>
> Acknowledging that *Dowling* and *Bobak* **arguably** stand for the proposition that liens against a member's interest in an LLC may be created either through the service of a citation or by obtaining a charging order, the Court must respectfully disagree with the Bankruptcy Court's conclusion that Heartland could not have created a lien via the service of the citation in March 2007. [emphasis added][97]

The District Court then added another unusual thought. The court pointed out that another case held that creditors of a member obtained priority in the sequence in which they were granted a charging order. Thus in order to have "priority" it was not enough for the bank to have filed a

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[96] *Id*. at *4.

[97] *LaHood v. Covey (In re LaHood),* 437 B.R. 330, 340 (D. Ill. 2010).

Citation to Discover Assets, but the bank must also obtain a charging order.

Other jurisdictions, including North Carolina, that likewise provide that the charging order remedy is exclusive, have rejected the notion that a creditor can end-run this process by using an alternative remedy such as a forced sale of the member's interest.[98]

In South Carolina, our "attachment" statute certainly seems broad enough to include an LLC member's full membership rights or even just her distributional interest. The statute provides:

> § 15-19-220. Property which is subject to attachment.
>
> The rights or shares which any defendant may have in any vessel or in the stock of any association or corporation, together with the interest and profits thereon, and **all other property of such defendant in this State,** except that exempt from attachment by the Constitution, shall be liable to be attached and levied upon and sold to satisfy the judgment and execution. [emphasis added][99]

The question then is, would a circuit court judge allow a creditor to "attach" a membership interest (or distributional interest) in an action brought by a judgment creditor, as did the Illinois court, or would the court follow both the specific language of the LLC statute and the North Carolina authority, and prohibit such attachment? No doubt, at some point in time, a creditor's lawyer will try this.

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[98] *Herring v. Keasler*, 150 N.C. App. 598, 600-01, 563 S.E. 2d 614, 615-16 (2002).

[99] *See generally, Pelzer Mfg. Co. v Pitts & Hartzog,* 76 S.C. 349, 57 S.E. 29 (1907). *Charles R. Allen, Inc. v Rhode Island Ins. Co.*, 217 S.C. 296, 60 S.E. 2d 609 (1950). *Charles R. Allen, Inc. v Island Cooperative Services Cooperative Ass'n Ltd.,* 234 S.C. 537, 109 S.E. 2d 446 (1959) (generally providing that all property of debtor, legal or equitable, is subject to attachment.)

VI. South Carolina Lenders Use "Squeeze Tactics" To Collect Loans Made To LLC Members.

South Carolina lenders have apparently been successful in using a squeeze tactic to collect when loans made to LLC members go unpaid. When the LLC member of a multi-member "at will" LLC fails to pay his debt to the lender, the lender will:

1. Sue to collect;
2. Obtain a judgment against the LLC member;
3. Next obtain a "charging order" against the member's distributional interest (§ 33-44-504(a));
4. Obtain a receiver of the LLC's member's interest (§ 33-44-504(a));
5. Wait 90 days (§ 33-44-601(7));
6. At the end of the 90 days deem the member "dissociated" (§ 33-44-601(7));
7. Demand that the other members purchase the distributional interest by paying the lender (§ 33-44-603(1); and
8. If the members do not pay, bring an action forcing the members to pay (§ 33-44-701).

Normally, under the South Carolina charging order statute (and essentially under all such statutes), the lender's remedy is either to hold onto the member's distributional interest and collect any payments the LLC may decide to make to the borrower-member, or to have the distributional interest sold (§ 33-44-504(b). The problem with this remedy is that there are no buyers for the distributional interest, and even if the lender is the buyer, the LLC may never make any further payments on this "sold" distributional interest. The lender can likely bring further actions if no payments are ever made, but this is expensive.

It is much simpler to lean on the other members to buy out their dead-beat member; the lender is effectively able to indirectly reach the underlying assets of the LLC.

Note that this practically only works if the LLC is "at will." However, for an LLC to not be "at will," when it was formed the members must have affirmatively specified that the LLC will be for a term and must have designated the term. Most South Carolina LLCs are thus by "inertia" "at will" LLCs and thus this "squeeze" tactic often is very successful.

VII. Bankruptcy Trustee of a Delaware LLC is Able to "Resuscitate" a Defunct LLC and Take control. Procedure is Unavailable in South Carolina.

Nader was the sole owner and member of NYSI (single member Delaware LLC).[100] NYSI LLC was majority shareholder of FACS, a corporation. NYSI as shareholder voted Nader as a director of FACS. Other shareholders obtained a $103 million judgment against Nader, and he filed for bankruptcy. Under Delaware law, he ceased to be a member of his LLC, and the LLC had no members. When he filed for bankruptcy, this also "dissolved" the LLC - an LLC is dissolved if it has no remaining members.

Delaware has two ways to resuscitate a dissolved LLC. First, if within 90 days of dissolution the personal representative of the last remaining member agrees to continue the LLC and be a member, it continues. In this litigation the "personal representative" - the member's trustee in bankruptcy - waited too long.

However, the court noted that tit. 6 § 18-806 of the Delaware LLC statute allows a personal representative to resuscitate a dissolved LLC that has no members if four conditions are met:

1. The LLC must not have yet filed a certificate of cancellation
   [In Delaware, an LLC does not cease to exist legally until the certificate is filed]
2. the last member must have a personal representative
3. that representative must affirmatively vote or consent in writing to continuing the LLC
4. the personal representative must also either become or appoint someone to become a member of the LLC.

All of these steps were done in this case. The court found that a bankruptcy trustee qualified as the former member's personal representative (particularly if there are no other members). Nader argued that by filing for bankruptcy his estate only encompassed his financial rights and not his voting rights. The court said that when there is only one member, § 18-806 trumps and specifically provides that the personal representative has the power to resuscitate the LLC.

In this case the trustee filed a document wherein he as personal representative of the last remaining member consented to the continuation of the LLC and further agreed to himself being admitted as the sole new member of the LLC, all of which the court approved.

Note that we do not have a similar statutory process in South Carolina.

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[100] *In re Modanlo,* Civ. Act. No. DKC 2006–1168, 2006 WL 4486537 (D. Md. Oct. 11, 2006).

§ 230.147 Intrastate offers and sales.

(a) This rule shall not raise any presumption that the exemption provided by section 3(a)(11) of the Act (15 U.S.C. 77c(a)(11)) is not available for transactions by an issuer which do not satisfy all of the provisions of this rule.

(b) *Manner of offers and sales.* An issuer, or any person acting on behalf of the issuer, shall be deemed to conduct an offering in compliance with section 3(a)(11) of the Act (15 U.S.C. 77c(a)(11)), where offers and sales are made only to persons resident within the same state or territory in which the issuer is resident and doing business, within the meaning of section 3(a)(11) of the Act, so long as the issuer complies with the provisions of paragraphs (c), (d), and through (h) of this section.

(c) *Nature of the issuer.* The issuer of the securities shall at the time of any offers and sales be a person resident and doing business within the state or territory in which all of the offers and sales are made.

(1) The issuer shall be deemed to be a resident of the state or territory in which:

(i) It is incorporated or organized, and it has its principal place of business, if a corporation, limited partnership, trust or other form of business organization that is organized under state or territorial law. The issuer shall be deemed to have its principal place of business in a state or territory in which the officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the issuer;It has its principal place of business, as defined in paragraph (c)(1)(i) of this section, if a general partnership or other form of business organization that is not organized under any state or territorial law;

(ii) Such person's principal residence is located, if an individual.

(2) The issuer shall be deemed to be doing business within a state or territory if the issuer satisfies at least one of the following requirements:

(i) The issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in or from the rendering of services within such state or territory;

(ii) The issuer had at the end of its most recent semi-annual fiscal period prior to an initial offer of securities in any offering or subsequent offering pursuant to this section, at least 80% of its assets and those of its subsidiaries on a consolidated basis located within such state or territory;

(iii) The issuer intends to use and uses at least 80% of the net proceeds to the issuer from sales made pursuant to this section (§ 230.147) in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; or

(iv) A majority of the issuer's employees are based in such state or territory.

Instruction to Paragraph (c)(1): An issuer that has previously conducted an intrastate offering pursuant to this section (§ 230.147) or Rule 147A (§ 230.147A) may not conduct another intrastate offering pursuant to this section (§ 230.147) in a different state or territory, until the expiration of the time period specified in paragraph (e) of this section (§ 230.147(e)) or paragraph (e) of Rule 147A (§ 230.147A(e)), calculated on the basis of the date of the last sale in such offering.

Instruction to Paragraph (c)(2)(i): Revenues must be calculated based on the issuer's most recent fiscal year, if the first offer of securities pursuant to this section is made during the first six months of the issuer's current fiscal year, and based on the first six months of the issuer's current fiscal year or during the twelve-month fiscal period ending with such six-month period, if the first offer of securities pursuant to this section is made during the last six months of the issuer's current fiscal year.

(d) *Residence of offerees and purchasers.* Offers and sales of securities pursuant to this section (§ 230.147) shall be made only to residents of the state or territory in which the issuer is resident, as determined pursuant to paragraph (c) of this section, or who the issuer reasonably believes, at the time of the offer and sale, are residents of the state or territory in which the issuer is resident. For purposes of determining the residence of offerees and purchasers:

(1) A corporation, partnership, limited liability company, trust or other form of business organization shall be deemed to be a resident of a state or territory if, at the time of the offer and sale to it, it has its principal place of business, as defined in paragraph (c)(1)(i) of this section, within such state or territory.

(2) Individuals shall be deemed to be residents of a state or territory if such individuals have, at the time of the offer and sale to them, their principal residence in the state or territory.

(3) A corporation, partnership, trust or other form of business organization, which is organized for the specific purpose of acquiring securities offered pursuant to this section (§ 230.147), shall not be a resident of a state or territory unless all of the beneficial owners of such organization are residents of such state or territory.

Instruction to Paragraph (d): Obtaining a written representation from purchasers of in-state residency status will not, without more, be sufficient to establish a reasonable belief that such purchasers are in-state residents.

Instruction to Paragraph (d)(1): A trust that is not deemed by the law of the state or territory of its creation to be a separate legal entity is deemed to be a resident of each state or territory in which its trustee is, or trustees are, resident.

(e) *Limitation on resales.* For a period of six months from the date of the sale by the issuer of a security pursuant to this section (§ 230.147), any resale of such security shall be made only to persons resident within the state or territory in which the issuer was resident, as determined pursuant to paragraph (c) of this section, at the time of the sale of the security by the issuer. *Instruction to Paragraph (e)*: In the case of convertible securities, resales of either

the convertible security, or if it is converted, the underlying security, could be made during the period described in paragraph (e) only to persons resident within such state or territory. For purposes of this paragraph (e), a conversion in reliance on section 3(a)(9) of the Act (15 U.S.C. 77c(a)(9)) does not begin a new period.

(f) *Precautions against interstate sales.* (1) The issuer shall, in connection with any securities sold by it pursuant to this section:

(i) Place a prominent legend on the certificate or other document evidencing the security stating that: "Offers and sales of these securities were made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of six months from the date of the sale by the issuer of these securities, any resale of these securities (or the underlying securities in the case of convertible securities) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer].";

(ii) Issue stop transfer instructions to the issuer's transfer agent, if any, with respect to the securities, or, if the issuer transfers its own securities, make a notation in the appropriate records of the issuer; and

(iii) Obtain a written representation from each purchaser as to his or her residence.

(2) The issuer shall, in connection with the issuance of new certificates for any of the securities that are sold pursuant to this section (§ 230.147) that are presented for transfer during the time period specified in paragraph (e), take the steps required by paragraphs (f)(1)(i) and (ii) of this section.

(3) The issuer shall, at the time of any offer or sale by it of a security pursuant to this section (§ 230.147), prominently disclose to each offeree in the manner in which any such offer is communicated and to each purchaser of such security in writing a reasonable period of time before the date of sale, the following: "Sales will be made only to residents of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer]. Offers and sales of these securities are made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of six months from the date of the sale by the issuer of the securities, any resale of the securities (or the underlying securities in the case of convertible securities) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer]."

(g) *Integration with other offerings.* Offers or sales made in reliance on this section will not be integrated with:

(1) Offers or sales of securities made prior to the commencement of offers and sales of securities pursuant to this section (§ 230.147); or

(2) Offers or sales made after completion of offers and sales of securities pursuant to this section (§ 230.147) that are:

(i) Registered under the Act, except as provided in paragraph (h) of this section (§ 230.147);

(ii) Exempt from registration under Regulation A (§ 230.251 *et seq.*);

(iii) Exempt from registration under Rule 701 (§ 230.701);

(iv) Made pursuant to an employee benefit plan;

(v) Exempt from registration under Regulation S (§§ 230.901 through 230.905);

(vi) Exempt from registration under section 4(a)(6) of the Act (15 U.S.C. 77d(a)(6));

or

(vii) Made more than six months after the completion of an offering conducted pursuant to this section (§ 230.147).

Instruction to Paragraph (g): If none of the safe harbors applies, whether subsequent offers and sales of securities will be integrated with any securities offered or sold pursuant to this section (§ 230.147) will depend on the particular facts and circumstances.

(c) *Offerings limited to qualified institutional buyers and institutional accredited investors*.

Where an issuer decides to register an offering under the Act after making offers in reliance on this section (§ 230.147) limited only to qualified institutional buyers and institutional accredited investors referenced in section 5(d) of the Act, such offers will not be subject to integration with any subsequent registered offering. If the issuer makes offers in reliance on this section (§ 230.147) to persons other than qualified institutional buyers and institutional accredited investors referenced in section 5(d) of the Act, such offers will not be subject to integration if the issuer (and any underwriter, broker, dealer, or agent used by the issuer in connection with the proposed offering) waits at least 30 calendar days between the last such offer made in reliance on this section (§ 230.147) and the filing of the registration statement with the Commission.

* * * *
*

§ 230.147A Intrastate sales exemption.

(a) *Scope of the exemption*. Offers and sales by or on behalf of an issuer of its securities made in accordance with this section (§ 230.147A) are exempt from section 5 of the Act (15

U.S.C. 77e). This exemption is not available to an issuer that is an investment company registered or required to be registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*).

(b) *Manner of offers and sales.* An issuer, or any person acting on behalf of the issuer, may rely on this exemption to make offers and sales using any form of general solicitation and general advertising, so long as the issuer complies with the provisions of paragraphs (c), (d), and (f) through (h) of this section.

(c) *Nature of the issuer.* The issuer of the securities shall at the time of any offers and sales be a person resident and doing business within the state or territory in which all of the sales are made.

(1) The issuer shall be deemed to be a resident of the state or territory in which it has its principal place of business. The issuer shall be deemed to have its principal place of business in a state or territory in which the officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the issuer.The issuer shall be deemed to be doing business within a state or territory if the issuer satisfies at least one of the following requirements:

(i) The issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in or from the rendering of services within such state or territory;

(ii) The issuer had at the end of its most recent semi-annual fiscal period prior to an initial offer of securities in any offering or subsequent offering pursuant to this section, at least 80% of its assets and those of its subsidiaries on a consolidated basis located within such state or territory;

(iii) The issuer intends to use and uses at least 80% of the net proceeds to the issuer from sales made pursuant to this section (§ 230.147A) in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; or

(iv) A majority of the issuer's employees are based in such state or territory.

Instruction to Paragraph (c): An issuer that has previously conducted an intrastate offering pursuant to this section (§ 230.147A) or Rule 147 (§ 230.147) may not conduct another intrastate offering pursuant to this section (§ 230.147A) in a different state or territory, until the expiration of the time period specified in paragraph (e) of this section (§ 230.147A(e)) or paragraph (e) of Rule 147 (§ 230.147(e)), calculated on the basis of the date of the last sale in such offering.

Instruction to Paragraph (c)(2)(i): Revenues must be calculated based on the issuer's most recent fiscal year, if the first offer of securities pursuant to this section is made during the first six months of the issuer's current fiscal year, and based on the first six months of the issuer's current fiscal year or during the twelve-month fiscal period ending with such six-month period, if the first offer of securities pursuant to this section is made during the last six months of the issuer's current fiscal year.

(d) *Residence of purchasers.* Sales of securities pursuant to this section (§ 230.147A) shall be made only to residents of the state or territory in which the issuer is resident, as determined pursuant to paragraph (c) of this section, or who the issuer reasonably believes, at the time of sale, are residents of the state or territory in which the issuer is resident. For purposes of determining the residence of purchasers:

(1) A corporation, partnership, limited liability company, trust or other form of business organization shall be deemed to be a resident of a state or territory if, at the time of sale to it, it has its principal place of business, as defined in paragraph (c)(1) of this section, within such state or territory.

(2) Individuals shall be deemed to be residents of a state or territory if such individuals have, at the time of sale to them, their principal residence in the state or territory.

(3) A corporation, partnership, trust or other form of business organization, which is organized for the specific purpose of acquiring securities offered pursuant to this section (§ 230.147A), shall not be a resident of a state or territory unless all of the beneficial owners of such organization are residents of such state or territory.

Instruction to Paragraph (d): Obtaining a written representation from purchasers of in-state residency status will not, without more, be sufficient to establish a reasonable belief that such purchasers are in-state residents.

Instruction to Paragraph (d)(1): A trust that is not deemed by the law of the state or territory of its creation to be a separate legal entity is deemed to be a resident of each state or territory in which its trustee is, or trustees are, resident.

(e) *Limitation on resales.* For a period of six months from the date of the sale by the issuer of a security pursuant to this section (§ 230.147A), any resale of such security shall be made only to persons resident within the state or territory in which the issuer was resident, as determined pursuant to paragraph (c) of this section, at the time of the sale of the security by the issuer. *Instruction to Paragraph (e)*: In the case of convertible securities, resales of either the convertible security, or if it is converted, the underlying security, could be made during the period described in paragraph (e) only to persons resident within such state or territory. For purposes of this paragraph (e), a conversion in reliance on section 3(a)(9) of the Act (15 U.S.C. 77c(a)(9*)) does not begin a new period.*

(f) *Precautions against interstate sales. (1) The issuer shall, in connection with any securities sold* by it pursuant to this section:

(i) Place a prominent legend on the certificate or other document evidencing the

security stating that: "Offers and sales of these securities were made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of six months from the date of the sale by the issuer of these securities, any resale of these securities (or the underlying securities in the case of convertible securities) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer].";

(ii) Issue stop transfer instructions to the issuer's transfer agent, if any, with respect to the securities, or, if the issuer transfers its own securities, make a notation in the appropriate records of the issuer; and

(2) Obtain a written representation from each purchaser as to his or her residence. The issuer shall, in connection with the issuance of new certificates for any of the securities that are sold pursuant to this section (§ 230.147A) that are presented for transfer during the time period specified in paragraph (e), take the steps required by paragraphs (f)(1)(i) and (ii) of this section.

(3) The issuer shall, at the time of any offer or sale by it of a security pursuant to this section (§ 230.147A), prominently disclose to each offeree in the manner in which any such offer is communicated and to each purchaser of such security in writing a reasonable period of time before the date of sale, the following: "Sales will be made only to residents of the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer]. Offers and sales of these securities are made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of six months from the date of the sale by the issuer of the securities, any resale of the securities (or the underlying securities in the case of convertible securities) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer]."

a. *Integration with other offerings.* Offers or sales made in reliance on this section will not be integrated with:

i. Offers or sales of securities made prior to the commencement of offers and sales of securities pursuant to this section (§ 230.147A); or

ii. Offers or sales of securities made after completion of offers and sales of securities pursuant to this section (§ 230.147A) that are:

1. Registered under the Act, except as provided in paragraph (h) of this section (§ 230.147A);

2. Exempt from registration under Regulation A (§ 230.251 *et seq.*);

3. Exempt from registration under Rule 701 (§ 230.701);

4. Made pursuant to an employee benefit plan;

5. Exempt from registration under Regulation S (§§ 230.901 through 230.905);

6. Exempt from registration under section 4(a)(6) of the Act (15 U.S.C. 77d(a)(6));

or

7. Made more than six months after the completion of an offering conducted pursuant to this section (§ 230.147A).

Instruction to Paragraph (g): If none of the safe harbors applies, whether subsequent offers and sales of securities will be integrated with any securities offered or sold pursuant to this section (§ 230.147A) will depend on the particular facts and circumstances.

b. *Offerings limited to qualified institutional buyers and institutional accredited investors*.

Where an issuer decides to register an offering under the Act after making offers in reliance on this section (§ 230.147A) limited only to qualified institutional buyers and institutional accredited investors referenced in section 5(d) of the Act, such offers will not be subject to integration with any subsequent registered offering. If the issuer makes offers in reliance on this section (§ 230.147A) to persons other than qualified institutional buyers and institutional accredited investors referenced in section 5(d) of the Act, such offers will not be subject to integration if the issuer (and any underwriter, broker, dealer, or agent used by the issuer in connection with the proposed offering) waits at least 30 calendar days between the last such offer made in reliance on this section (§ 230.147A) and the filing of the registration statement with the Commission.

* * * *

Intrastate Offering Exemption

PLEASE NOTE: This exemption became available for use on June 26, 2015. The regulation can be found in the South Carolina Code of Regulations as Rule 13-206. Issuers may use the "Notice Filing: Intrastate Offering Exemption" form found on this website to deliver notice to the Securities Commissioner.

A. The offer or sale of a security by an issuer, conducted solely in this state to residents of this state, shall be exempt from the requirements of Sections 35-1-301 through 35-1-306 and 35-1-504 of the Act, if the offer or sale is conducted in accordance with each of the following requirements:

(1) The issuer of the security shall be a for-profit business entity formed under the laws of the state of South Carolina and registered with the Secretary of State.

(2) The transaction shall meet the requirements of the federal exemption for intrastate offerings in Section 3(a)(11) of the Securities Act of 1933 (15 U.S.C. Section 77c(a)(11)), and SEC Rule 147 (17 C.F.R. 230.147). As such, prior to any offer or sale pursuant to this exemption, the seller shall obtain, from each prospective purchaser, documentary evidence that provides the seller with a reasonable basis to believe that such investor is a resident of the state of South Carolina.

(3) The sum of all cash and other consideration to be received for all sales of the security in reliance upon this exemption shall not exceed one million ($1,000,000) dollars, less the aggregate amount received for all sales of securities by the issuer within the 12 months before the first offer or sale made in reliance upon this exemption.

(4) The issuer shall not accept more than five thousand ($5,000) dollars from any single purchaser unless the purchaser is an accredited investor as defined by Rule 501 of SEC Regulation D (17 C.F.R. 230.501).

(5) The issuer must reasonably believe that all purchasers of securities are purchasing for investment purposes.

(6) A commission or other remuneration shall not be paid or given, directly or indirectly, for any person's participation in the offer or sale of securities unless the person is registered as a broker-dealer or agent under the Act.

(7) All funds received from investors shall be deposited into a bank or depository institution authorized to do business in South Carolina, and all of the funds shall be used in accordance with representations made to investors.

(8) Not less than five days prior to the use of any general solicitation, or within fifteen days after the first sale of the security pursuant to this exemption (provided no general solicitation has been used prior to such sale), whichever occurs first, the issuer shall provide a notice to the Securities Commissioner in writing. The notice shall specify that the issuer is conducting an offering in reliance upon this exemption and shall contain the names and addresses of the following persons:

(a) The issuer;

(b) Officers, directors, and any control person of the issuer;

(c) All persons who will be involved in the offer or sale of securities on behalf of the issuer; and

(d) The bank or other depository institution in which investor funds will be deposited.

(9) The issuer shall not be, either before or as a result of the offering, an investment company as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. Section 80a-3), or subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78m and 78o(d)).

(10) The issuer shall inform all purchasers that the securities have not been registered under the Act and, therefore, cannot be resold unless the securities are registered or qualify for an exemption from

registration under the Act, subject to the provisions of Subsection (e) of SEC Rule 147 (17 C.F.R. 230.147(e)). In addition, the issuer shall make the disclosures required by R.13-204E.

(11) This exemption shall not be used in conjunction with any other exemption under these Rules or the Act, except for offers and sales to officers, directors, partners, or similar controlling persons of the issuer. Sales to such controlling persons shall not count toward the limitation in subsection A(3) above.

(12) Disqualifications. This exemption shall not be available if the issuer, or any of its officers, controlling persons, or promoters is subject to a disqualifying event specified in Subsection (d) of Rule 506 of SEC Regulation D (17 C.F.R. 230.506(d)).

(13) Nothing in this exemption is intended to relieve or should be construed as in any way relieving the issuers or persons acting on behalf of issuers from the anti-fraud provisions of the Act.

(14) Every notice of exemption provided for in Subsection A(8) above is effective for one year from the date of its filing with the Securities Commissioner and shall be accompanied by a non-refundable filing fee of three hundred ($300.00) dollars.

South Carolina Bar

Case Law Update

Prof. James R. Burkhard
Columbia, SC

2016 Case Law Update

Fisher v. Shipyard Village Council of Co-Owners, Inc.
781 S.E.2d 903, 415 S.C. 256 (S. Ct. 2016)

[The Shipyard condo project was built in two phases. Buildings A & B were constructed in 1982. Phase II, buildings C & D, were constructed in 1998. Starting approximately in 1983 there were sever water leaks around the windows and doors in buildings A & B. Over the years the Board went back and forth as to how to remedy these leaks. Initially the Board took the position that the leaks were the responsibility of the individual unit owners. A report in 2003 indicated that the leaks were due to stucco problems and window flashing issues that were not the responsibility of the individual owners. The members refused to amend the bylaws to mandate that the damages were the association's responsibility - no surprise since this would have levied a significant fee on the owners in buildings C & D. The board sent out a subsequent proxy vote - that was not permitted by the bylaws. The board a third time tried to pass a special assessment for $ 12 - $13 million. A "re-vote" to approve an assessment failed. The Board then essentially told the owners in buildings C & D that the cost to repair would be taken out of the annual operating funds. The owners of units in C & D sued, asserting all sorts of wrongdoing by the board.]

Among others, the Supreme Court made the following statements.

> While any ultra vires action of the Board, as well as any failure of the Board to comply with its affirmative duties under the governing documents, are not subject to the business judgment rule, the mere existence of the Master Deed, Bylaws, and the Act does not preclude the application of the business judgment rule. . . .
>
> Even if the Board did commit ultra vires acts, those acts would not preclude the Board from asserting the protection of the business judgment rule for intra vires acts, made in good faith. On that note, we emphasize that because the business judgment rule only applies where a corporation acts within its authority, without corrupt motives, and in good faith, . . . the court of appeals incorrectly stated that " any investigation" conducted by the Board pursuant to its duty to investigate " would be looked at under the business judgment rule to determine if the [Board] met its duty." . . .
>
> The trial court should permit Respondent to assert the business judgment rule as a defense at trial. Nevertheless, the Board will not be entitled to the protection of the business judgment rule if the jury finds that the Board acted beyond the scope of its authority, or acted with corrupt motives or in bad faith. Therefore, ultimately, the jury must decide whether the Board violated the requirements of the Master Deed and Bylaws, which of the Board's actions were intra vires and which were ultra vires, and the impact of that breakdown on Petitioners' negligence claim. . . .
>
> Here, the trial court [also] ruled:

> [The Board] had a duty to investigate[,] when presented with evidence which would show or reasonably show that an individual [co-owner's] neglect in maintaining his or her [u]nit has resulted in damage to the common elements [,] that an investigation is required by the Bylaws. That is the [Council] through its Board, upon receiving such information, would be required to initiate some investigation to determine whether or not it would be appropriate to individually assess the defaulting [co-owner] for the damage....

The trial court then found as a matter of law that the Board breached its duty when it failed to determine: (1) whether the water intrusion damage to the common elements of Buildings A and B was the fault of a particular co-owner, or group of co-owners; and (2) whether other non-defaulting co-owners were entitled to a rebate by individual assessment from the A and B co-owners who caused the damage.

> We find evidence in the record that could support the conclusion that the Board indeed breached its duty to investigate. . . .
>
> However, when viewed in the light most favorable to Respondent, there is at least a scintilla of evidence in the record to indicate an issue of material fact as to whether the Board breached its duty to investigate, as set forth by the trial court. . . . In sum, there is evidence in the record to support a conclusion that the water leaks occurred due to water intrusion through the common elements, and thus, the Board could have made an informed decision not to apportion the costs of the damage to the co-owners. As a result, the trial court should not have decided the question of whether the Board breached its duty to investigate as a matter of law.
>
> Therefore, we hold that the trial court erred in granting Petitioners' motion for summary judgment, as the jury should have decided whether the Board breached its duty to investigate. . . .

Wilson v. Willis
786 S.E.2d 571, 416 S.C. 395 (Ct. App. 2016).

[Persons who purchased insurance policies through Southern Risk Insurance Services, LLC and competing insurance sales persons, sued: (1) Laura Willis and Jessee Dantice (who owned the broker), (2) the broker, Southern Risk, and (2) various insurance companies for whom Willis and Dantice were agents. The claims against the insurance companies were based "under a respondeat superior theory for failure to supervise or audit Willis and Southern Risk." Huh!]

> The Insureds allege . . . Willis forged insurance documents; issued policies on unsigned applications; changed or omitted information on insurance applications, without the Insureds' permission, to reduce quoted premiums; submitted applications using her own personal identifying information, such as driver's license and Social Security numbers, to reduce quoted premiums; accepted cash payments she converted to her own use; and issued fake policies to customers. . . .
>
> According to the Insureds, Willis's actions resulted in harm to them as well as their credit rating within the insurance industry. . . . [These plaintiffs asserted that the insurance companies for whom Willis and Dantice wrote policies, had a duty to investigate, train, and supervise, particularly after Willis] "was fined, publicly reprimanded [,] and placed on probation for dishonesty by the South Carolina Insurance Commission in October 2011." . . .
>
> [Competing agents also sued]. . . . The Agents alleged Willis, Dantice, Southern Risk, and the Insurers engaged in illegal business practices that effectively prohibited them from competing in the local insurance market, resulting in a substantial loss of clients and revenue. Further, the Agents argued the Insurers owed a duty to properly investigate, train, and supervise Willis; failed to detect and stop her wrongdoing; and engaged in statutory unfair trade practices, common law unfair trade practices or unfair competition, and tortious interference with existing and prospective contractual relations. * * *
>
> [The insurance companies moved to compel arbitration pursuant] to an arbitration provision from a 2010 agency agreement the Insurers entered into with Southern Risk.[1] The main thrust of the Insurers' argument in these motions was that each of the Insureds and Agents' claims was premised on alleged duties that would not exist but for the Insurers' contractual relationship with Southern Risk and, thus, the court should compel arbitration based upon the arbitration provision found in the 2010 Agency Agreement. According to the Insurers, the Insureds and Agents could not rely on—and seek to recover damages from the Insurers based upon—some provisions, while ignoring the arbitration provision in the agreement. . . .

[1] Specifically, Liberty Mutual Insurance Company (Liberty), a parent company of Montgomery and Safeco, entered into the agreement with Southern Risk.

The Insureds and Agents . . . alleged they were not signatories or parties to the 2010 Agency Agreement, and their claims against the Insurers did not fall within the arbitration clause in the agreement. . . .

III. Compelling Arbitration on Nonsignatories

"While a contract cannot bind parties to arbitrate disputes they have not agreed to arbitrate, '[i]t does not follow ... that[,] under the [FAA,] an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision.' " . . .*Pearson,* "Rather, a party can agree to submit to arbitration by means other than personally signing a contract containing an arbitration clause." . . .

"The rule in the Fourth Circuit is that 'a broadly-worded arbitration clause applies to disputes that do not arise under the governing contract when a "significant relationship" exists between the asserted claims and the contract in which the arbitration clause is contained.' ". . .. "Well-established common law principles dictate that in an appropriate case a nonsignatory can enforce, or be bound by, an arbitration provision within a contract executed by other parties." . . .

"Equitable estoppel precludes a party from asserting rights 'he otherwise would have had against another' when his own conduct renders assertion of those rights contrary to equity." . . . "In the arbitration context, the doctrine recognizes that a party may be estopped from asserting that the lack of his signature on a written contract precludes enforcement of the contract's arbitration clause when he has consistently maintained that other provisions of the same contract should be enforced to benefit him." . . . "To allow [a plaintiff] to claim the benefit of the contract and simultaneously avoid its burdens would both disregard equity and contravene the purposes underlying enactment of the [FAA]." .... . "A nonsignatory is estopped from refusing to comply with an arbitration clause 'when it receives a "direct benefit" from a contract containing an arbitration clause.' " . . .

In the instant case, although the Insureds and Agents admittedly did not see the 2010 Agency Agreement prior to bringing this action, this does not control our inquiry because the allegations in their complaints necessarily depend upon the terms, authority, and duties created and imposed by that agreement.[2] In other words, while the Insureds and Agents do not expressly rely upon other provisions in the 2010 Agency Agreement, they would not be able to reach the Insurers with their claims in the absence of the agreement establishing the agency relationship between the Insurers and Southern Risk, Dantice, and Willis. Because the duties the Insureds and Agents contend the Insurers

[2] The court also concluded that nothing in either S.C. Code Ann. § 38-51-10, § 38-43-10, or § 33-43-55 gives the plaintiffs any help. "[W]e find the General Assembly contemplated that agency relationships such as the one at issue here would be governed by a contract. Thus, even looking to the statutes upon which the Insureds and Agents purportedly rely, we find they still cannot reach the Insurers without the 2010 Agency Agreement. The agreement defined the parameters of the authority for Willis, Dantice, and Southern Risk to sell insurance on behalf of the Insurers and exclusively governed the agency relationship between them."

allegedly breached arise from the 2010 Agency Agreement, the Insureds and Agents receive a "direct benefit" from that agreement. Accordingly, we find the Insureds and Agents are equitably estopped from arguing their status as nonsignatories precludes enforcement of the arbitration provision when their complaints seek to benefit from the enforcement of other provisions in the 2010 Agency Agreement. *See Pearson*, 400 S.C. at 297, 733 S.E.2d at 605; *see also Int'l Paper,* 206 F.3d at 413–14, 418 . . .

Bank of N.Y. Mellon Trust Co. v. Grier
785 S.E.2d 208, 416 S.C. 63 (Ct. App. 2016)

[Ms. Grier's home was insured by Nationwide. Nationwide decided not to renew her policy due to failure to remedy various hazzards and sent her a letter so advising. GMAC, the mortgage servicing company contacted Nationwide about paying the premium. Grier contends Nationwide welcomed the payment in this converstation and stated it would renew the policy if it received the premium.]

> Thereafter, GMAC mailed a check to Nationwide on March 15, 2011, for the same amount it submitted the prior year for the renewal. Nevertheless, because no active policy was listed for Grier in its records, Nationwide returned the premium to Grier by a check dated April 1, 2011.

[The house burned down and Nationwide asserted there was no coverage. The trial court ruled there was no coverage.]

II. Breach of Contract

> Grier next contends the circuit court erred in holding her breach of contract claim against Nationwide failed as a matter of law. According to Grier, GMAC—the Bank's mortgage servicer—renewed the insurance policy on her behalf as her agent when it contacted Nationwide regarding the payment of the annual premium. We disagree.[3]
>
> "Agency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control." *Froneberger v. Smith,* 406 S.C. 37, 49, 748 S.E.2d 625, 631 (Ct.App.2013) (quoting RESTATEMENT (THIRD) OF AGENCY § 1.01 (Am. Law Inst. 2006)). "Generally, [a]gency is a question of fact." Id. (alteration in original) (quoting *Gathers v. Harris Teeter Supermarket, Inc.,* 282 S.C. 220, 226, 317 S.E.2d 748, 752 (Ct.App.1984)). A court ordinarily should not resolve an agency question on summary judgment if "any facts giv[e] rise to an inference of an agency relationship." *Fernander v. Thigpen,* 278 S.C. 140, 142, 293 S.E.2d 424, 425 (1982) (quoting *Reid v. Kelly & Play–Air, Inc.*, 274 S.C. 171, 174, 262 S.E.2d 24, 26 (1980)). If any facts tend to prove an agency relationship, then the question becomes one for the jury and granting

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[3]Likewise, we reject Grier's alternative argument that she was a third-party beneficiary to a contract of renewal between GMAC and Nationwide. *See Helms Realty, Inc. v. Gibson–Wall Co.,* 363 S.C. 334, 340, 611 S.E.2d 485, 488 (2005) ("A third-party beneficiary is a party that the contracting parties intend to directly benefit."). GMAC and Nationwide were not contracting parties. The contract of insurance was between Nationwide as the insurer and Grier as the insured policyholder. Even assuming, arguendo, GMAC and Nationwide were contracting parties, GMAC did not intend to directly benefit Grier. GMAC's sole reason for contacting Nationwide was to ensure that an active insurance policy covered the Bank's collateral.

summary judgment is inappropriate. Froneberger, 406 S.C. at 50, 748 S.E.2d at 631 (quoting *Gathers*, 282 S.C. at 226, 317 S.E.2d at 752).

In the instant case, although GMAC, the Bank's mortgage servicer,[4] submitted the annual insurance premiums for Grier's policy to Nationwide, GMAC was not subject to Grier's control. Under the mortgage, GMAC—acting on behalf of the Bank—required that Grier purchase homeowners insurance on the dwelling to protect the Bank's collateral for the mortgage loan. Further, GMAC required that the insurance policy contain a standard mortgage clause listing it as the mortgagee. Grier's choice of insurance was also subject to GMAC's approval. Additionally, if Grier failed to maintain property insurance, then the mortgage authorized GMAC to force-place a policy on Grier's home at her expense. Therefore, we find no evidence in the record suggests Grier exercised any control over GMAC's use of the escrow funds. *See Froneberger,* 406 S.C. at 49, 748 S.E.2d at 631 (noting an agent must act on behalf of, and be subject to the control of, the principal); *see also, e.g., Telfair v. First Union Mortgage Corp.,* 216 F.3d 1333, 1340–42 (11th Cir.2000) (finding no agency relationship between a mortgage lender and a borrower concerning the administration of an escrow account). To the contrary, our review of the record reveals GMAC controlled the use of the escrow funds.

Accordingly, because GMAC was not Grier's agent, we find the circuit court properly ruled that Grier's breach of contract claim failed as a matter of law.

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[4]"Mortgage servicing is '[t]he administration of a mortgage loan, including the collection of payments, release of liens, and payment of property insurance and taxes.' " *Bank of Am., N.A. v. Draper,* 405 S.C. 214, 221, 746 S.E.2d 478, 481 (Ct.App.2013) (alteration in original) (quoting *Mortgage Servicing*, BLACK'S LAW DICTIONARY (9th ed.2009)).

> [A] servicer is defined as the person responsible for servicing of a loan (including the person who makes or holds a loan if such person also services the loan). Servicing is defined as receiving any scheduled periodic payments from a borrower pursuant to the terms of any loan, including amounts for escrow accounts ... and making the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the loan.

Id. (first alteration in original) (*quoting Bryant v. Wells Fargo Bank, Nat'l Ass'n,* 861 F.Supp.2d 646, 658 (E.D.N.C.2012))

Hidria, USA, Inc. v. Delo, d.d. d/b/a/ Slovenske Novice
783 S.E.2d 839, 415 S.C. 533 (Ct. App. 2016)

Hidria is a Delaware corporation with its headquarters and principal place of business located in Greenville County, South Carolina. This company, which provides business solutions for multiple industries, regularly transacts business in Greenville and employs persons there.

Delo, a corporation organized and existing under the laws of the Republic of Slovenia, is the publisher of Slovenske Novice, a daily newspaper printed and distributed primarily in Slovenia. Delo publishes a print and online version of the newspaper, and Slovenske Novice articles are available to anyone accessing the website. Both the print version and the online version are published only in Slovene, a language spoken primarily in Slovenia. Delo does not produce English translations of its publications.

This case arises from two articles published in Slovenske Novice—one on December 11, 2011, and one on April 23, 2012—discussing the "luxurious" lifestyle and business dealings of Slovenian businessman Edvard Svetlik. Hidria USA shares common ownership with Hidria, d.d., a Slovenian business entity controlled by Svetlik and his family. As Delo admits, the articles discuss Svetlik's "accumulation and distribution of wealth throughout his family in Slovenia, other European countries, and the United States of America, and compares the Svetlik family's luxurious lifestyle to that of their employees in Slovenia." The articles also reference Svetlik's various business interests, including Hidria.

While Delo denies that its reporter traveled to South Carolina to collect information for the articles, the Delo reporter admitted to corresponding with Hidria employee Darjan Lapanje in gathering information for the April 2012 article. Additionally, the reporter gathered information from several websites maintained by South Carolina governmental entities.

In its March 7, 2012 complaint, Hidria alleged that South Carolina residents read the articles on Slovenske Novice 's website. According to Hidria, Delo "maliciously published the article knowing that it contained falsities concerning the persons and entities targeted therein." Hidria further contended that "[a]s a direct and proximate consequence of [Delo's] publication of the article, the business reputation of Hidria USA has been injured in that because of the irreparable harm to its image and brand ..., it has been damaged in its ability to sell and market its products." It is Hidria's position that Slovenske Novice targeted South Carolina citizens as potential subscribers by publishing articles with content concerning the State of South Carolina.

Delo—through the affidavit of its attorney, Nada Jakopec—admitted it cannot confirm the exact number of South Carolinians who accessed and read the articles at issue. Delo further admitted that it is possible that up to seven South Carolinians viewed the December 2011 article and up to three South Carolinians viewed the April 2012 article. Hidria General Manager Domen Boc˘kor stated by affidavit that the two articles were "read by all of [Hidria's] employees located in South Carolina" and "by many

employees of [Hidria's] customers in South Carolina which directly damaged [Hidria's] relationships with several customers."

Delo filed a motion to dismiss Hidria's complaint for lack of personal jurisdiction on June 15, 2012. . . .

The circuit court subsequently granted Delo's motion to dismiss for lack of personal jurisdiction by order dated January 10, 2013. . . . This appeal followed . . .

[The court of appeals first agreed that the there were not sufficient minimum contacts by the defendant to be subject to "specific jurisdiction." It then considered whether the defendant was subject to jurisdiction under the "effects test," a test that as of yet has not been specifically recognized by the South Carolina Supreme Court, although it is followed in other states.]

2. "Effects Test"

Alternatively, Hidria argues that, even if Delo lacked sufficient minimum contacts with South Carolina, the circuit court erred in dismissing Hidria's complaint because personal jurisdiction over Delo was acquired when Delo intentionally targeted Hidria in South Carolina. As Hidria cannot demonstrate that South Carolina has personal jurisdiction over Delo under the "effects test" established by the United States Supreme Court in *Calder v. Jones,* 465 U.S. 783, 104 S.Ct. 1482, 79 L.Ed.2d 804 (1984), we disagree.[5] . . .

"Rather than focusing only on the defendant's conduct within or contacts with the forum, the 'effects test' set forth in *Calder* allows long-arm jurisdiction to be based on the effects within the forum of tortious conduct outside the forum." *Pitts v. Fink,* 389 S.C. 156, 167, 698 S.E.2d 626, 632 (Ct.App.2010) (citing Calder, 465 U.S. at 787, 104 S.Ct. 1482). To satisfy this test, a plaintiff must establish three elements: "(1) the defendant committed an intentional tort; (2) the plaintiff felt the brunt of the harm in the forum, such that the forum can be said to be the focal point of the harm; and (3) the defendant expressly aimed his tortious conduct at the forum, such that the forum can be said to be the focal point of the tortious activity." . . .

Although South Carolina has not had the opportunity to fully consider the "effects test," the United States Court of Appeals for the Fourth Circuit has provided helpful analyses. In *Young v. New Haven Advocate,* the Fourth Circuit held that, in a defamation context, to show that the forum "can be said to be the focal point of the tortious activity," a plaintiff must establish that the speaker "manifested an intent to target and focus on" the readers of the forum state. 315 F.3d 256, 263 (4th Cir.2002). . . .

The Fourth Circuit ultimately concluded "[t]he newspapers did not post materials

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[5]We recognize that our supreme court has not adopted the "effects test;" however, Hidria raised the question of the "effects test" before the circuit court and in this appeal. Therefore, we address it here.

on the Internet with the manifest intent of targeting Virginia readers" and, therefore, it would violate the defendants' due process rights for a Virginia court to exercise personal jurisdiction over them. Id. at 264.

More recently, the United States Supreme Court reached a similar conclusion in Walden v. Fiore, —— U.S. ——, 134 S.Ct. 1115, 188 L.Ed.2d 12 (2014). . . .

We find Hidria has failed to demonstrate that Delo had a manifest intent to target South Carolina readers. The undisputed evidence establishes that the Slovenske Novice is a Slovenian newspaper—published only in Slovene—directed at its readership of citizens in the Republic of Slovenia on matters of local and national interest. Delo distributes no hard copies of its paper in South Carolina, and web traffic from South Carolinians is insignificant. The two articles in question concern the business activities and lifestyle of a Slovenian businessman, and the few references to Hidria were made in this context. Further, Hidria cannot show that Delo specifically targeted South Carolina readers. Thus, even if our supreme court were to recognize the "effects test," Hidria would be unable to satisfy its elements. Therefore, the circuit court properly declined to exercise personal jurisdiction over Delo.

CONCLUSION

Based on the foregoing, the decision of the circuit court is AFFIRMED.

Jones v. Builders Inv. Group, LLC.
781 S.E.2d 737, 415 S.C. 321 (Ct. App. 2015)

[Arden Homebuilders, LLC borrowed funds. One of the LLC members, Jones, caused the LLC borrowings to be paid off by personally borrowing the funds. The bank marked the LLC loan as satisfied and transferred the balance to Jones's personal loan. Jones was unable to pay his personal debt. Although the bank "charged off" Jones's personal loan, the bank sued Jones on his promissory note, which resulted in a confession of judgment against him.

Jones then sued the other members of his LLC for breach of contract and breach of fiduciary duty. He claimed that pursuant to the LLC operating agreement the other "Class A Members" were each required to pay their proportionate share of the LLC loan that Jones had caused to be paid off. The judge granted respondent's motion for JNOV.]

> Jones first claims that because he paid more than his proportionate share of the Arden Loan, he is entitled to contribution from Respondents pursuant to section 2.3 of the Arden Operating Agreement. We disagree. . . .
>
> In support of his position, Jones cites to section 2.3 of the Arden Operating Agreement, which states as follows:
>
>> 2.3 Guaranty of Loans to Company. Each of the Class A Members (but none of the Class B Members) shall, in its individual capacity, jointly and severally guaranty any loan to the Company ("Guaranteed Loan") for so long as any guaranty of such loan is required by the lender. Notwithstanding any other provision of this Agreement or any provision of the Guaranteed Loan documents, as between the Members, each Class A Member shall be responsible for paying such Class A Member's proportionate share of any Guaranteed Loan ("Guaranty Percentage").... **Any Class A Member who pays more than such Class A Member's Guaranty Percentage of the Guaranteed Loan to the Lender shall be entitled to contribution from the other Class A Members.** (emphasis added).
>
> The dispositive question in this case is whether Jones "paid" the Arden Loan such that he is entitled to contribution from Respondents pursuant to section 2.3. We agree with the circuit court and find Jones's signing of a personal promissory note with SFB in satisfaction of the Arden Loan was insufficient, as a matter of law, to fulfill the plain requirements of section 2.3. Our law is clear that a promissory note is only a promise to pay, not actual payment of a debt. See S.C.Code Ann. § 36–9–102(65) (Supp.2014) . . .(" 'Promissory note' means an instrument that evidences **a promise to pay** a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds." (emphasis added)). We also believe that neither SFB's decision to write off Jones's promissory note nor its execution of a confession of judgment against Jones satisfied the

requirement for payment under the Arden Operating Agreement. By signing the promissory note and satisfying Arden's obligation to SFB, Jones simply incurred a liability on Arden's behalf. Because Jones submitted no proof at trial that he had paid more than his proportionate share of the Arden loan as required by the plain language of the Arden Operating Agreement, we conclude he has suffered no actual damages and is not entitled to contribution from Respondents pursuant to section 2.3 of the Arden Operating Agreement.[6] *See Schulmeyer,* 353 S.C. at 495, 579 S.E.2d at 134 (noting when the contract's language is clear and unambiguous, the language alone determines the contract's force and effect).

II. Construction of the Arden Operating Agreement

Next, Jones contends the circuit court misconstrued the terms of the Arden Operating Agreement regarding personal guaranties. Specifically, Jones argues the court erred in finding section 2.3 unambiguously provided that a Class A member would not have to personally guarantee a loan if a lender did not specifically require that particular member to do so. We disagree.

We hold Jones abandoned this issue on appeal. "An issue is deemed abandoned if the argument in the brief is not supported by authority or is only conclusory." . . .

CONCLUSION Based on the foregoing, the circuit court's decision is AFFIRMED.

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[6]We also concur with the circuit court's ruling that section 2.3 was a contract for indemnity against loss, thereby requiring proof of loss before Jones could assert a claim for breach of contract. Our courts have recognized two types of indemnity contracts: (1) a contract for indemnity against liability and (2) a contract for indemnity against loss. *See Piper v. Am. Fid. & Cas. Co.*, 157 S.C. 106, 112, 154 S.E. 106, 108 (1930). In a contract for indemnity against liability, the obligation to indemnify arises when the liability is incurred, whereas in a contract for indemnity against loss, the indemnitee must have made some form of payment before he can assert a breach of the contract. Id. (quoting 1 Joseph A. Joyce, Joyce on Insurance § 27b (2d ed.1917)). Because the Arden Operating Agreement specifically requires a member to "pay" more than this proportionate share before he is entitled to recover against other members, we believe this is a contract for indemnity against loss and, as such, "liability does not attach until loss has been suffered, that is when the [indemnitee] has paid the damages." Id. (emphasis added) (quoting 1 Joyce, supra); *see also Shealey v. Am. Health Ins. Corp*., 220 S.C. 79, 83, 66 S.E.2d 461, 462 (1951) (noting that when a contract is for indemnity against loss, "no action will lie in favor of the [indemnitee] until some loss or damage has been sustained by him, either by payment of the whole or some part of the claim").

Maybank v. BB & T Corp.
416 S.C. 541, 787 S.E.2d 498 (S. Ct. 2016)

Francis Maybank with at least some "advice" from folks at BB & T Bank, purchased two "variable prepaid forward contracts."

> One of the new strategies touted by the Bank and Asset Management included a variable prepaid forward contract (Prepaid) that was directed at customers with concentrated stock positions. A Prepaid is an investment contract by which a stock is sold to an investment bank for an upfront payment of approximately seventy-five to ninety percent of its value. Significantly, title to the stock is not transferred for two to three years, thereby deferring capital gains taxes and allowing the customer to receive dividends and the benefit of appreciation. A Prepaid provides four meaningful benefits for its holder: (1) protection against a collapse of the stock, (2) immediate liquidity, (3) an opportunity to partially participate in future gains, and (4) an opportunity to receive dividends.[7]

Maybank initially "purchased" the first "Prepaid" by pledging 220,000 BB & T Corporation shares that he acquired when he sold his trust company to BB & T.The shares pledged were worth $9,300,000 and Maybank received $7,120,000 pursuant to the "Prepaid" contract. Maybank received a "form" approval letter before investing.

> The letter stated "a [Prepaid] may allow Mr. Maybank to reduce the risk of his concentrated position in BB&T, while raising cash to create a diversified portfolio." It further stated "implementation of this [Prepaid] will protect Mr. Maybank from an extraordinary reduction in the overall value of his investment portfolio and resulting net worth. It will also help him achieve important diversification goals we have discussed throughout the financial planning process."

Maybank also signed a Wealth Management Agreement (WMA) with BB & T,[8] but only after the

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[7]In addition to fees connected with a Prepaid and any subsequent rollovers, it is undisputed a Prepaid is a risky strategy and a hedge. It has no diversification and may not effectively minimize a client's risk—primarily because future dividends could be reduced or eliminated by the company.

[8]"The WMA served as the umbrella for the various services BB&T was offering to Maybank through Wealth Management and Asset Management [divisions of the bank]. The WMA established the Bank would (1) gather information about the client's investment objectives, risk, financial situation, and needs; (2) make a recommendation to the client; and (3) coordinate and supervise the account. The WMA stated the Bank will do what is in the "best interest" of the client."

"Although Wealth Management [division of the bank] portfolio advisors were neither trained nor licensed to make any trades or investments, they were experienced in BB&T's platform investment strategies and products. According to David Fisher, head of Wealth Management, a portfolio manager's job was to be an "issue spotter" so as to identify opportunities and inform clients of potential BB&T

fact of making his investment in the "Prepaid." Three years later he rolled the first "Prepaid" into a second one. Unfortunately the dividends that BB & T was paying were reduced, and of course, the value of the BB & T stock was decreasing. Maybank was losing money and thus sued asserting all sorts of claims.

Lawyers for BB & T were stuck between the proverbial "rock and the hard place." On one hand they tried to argue that none of the BB & T folks were involved in selling securities so as to avoid liability based on the securities laws, but on the other hand argued that the "Prepaid" was a security and thus the securities exemption in the UTPA controlled.

The Jury awarded Maybank $ 3 million actual damages, trebled to $9.3 as unfair trade practices, $ 5 million punitives, $2,450,000 attorney fees, and $ 245,000 costs.

The following are some of the issues decided on appeal.

A. UTPA

> Appellants argue the trial court erred in failing to grant JNOV because Prepaids are exempt from the UTPA as a matter of law. . . . We disagree. . . .
>
> Appellants moved for a directed verdict and JNOV, asserting that Prepaids fell under the UTPA's industry exemption [as a regulated security]. The trial court denied the motions, finding Appellants failed to carry their burden of proving the exemption applied. Specifically, the trial court noted it was undisputed that Appellants were not registered to sell securities as broker-dealers, thus explaining the SEC investigation into Appellants' fees that appeared to be "broker-esque." Moreover, the trial court found Appellants presented no evidence that Prepaids were a registered security or initial public offering that was regulated by another administrative body.
>
> Appellants now assert the trial court erred in submitting the issue of whether Prepaids were subject to the UTPA to the jury because it is a question of law. We recognize section 35–1–102(29) of the South Carolina Code (Supp. 2014) provides that the definition of a security includes an "investment contract," and that courts in other

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products that could best serve clients' needs. In Fisher's words, portfolio managers possessed a general knowledge that was "a mile wide and an inch deep." Asset Management's role was to connect the client to a given product. Essentially, Asset Management served as an investment advisor, for which it received compensation, but it neither made the trade nor sold a security. Asset Management served as a middle-man between the client and groups like Scott & Stringfellow, which executed the security transaction."

jurisdictions have held as a matter of law that a Prepaid is a security.[9] Nevertheless, we find the trial court correctly submitted the issue to the jury based on the alternative theories of relief posited by Maybank and based on Appellants' position at trial that they were not subject to the Securities Act, and that they did not effectuate transactions and sell securities.

Appellants' own expert, Thorne, testified a Prepaid was not a security. He stated no sale occurred on the date the Prepaid was entered, and he believed the Prepaid was a contract. Furthermore, Fisher's testimony was that a Prepaid and the practice of advising on alternative investments created a gray area in the view of the SEC. Thus, through the testimony of their own witnesses, Appellants put forth evidence that was susceptible to more than one reasonable inference regarding the applicability of the exemption. Therefore, we find no error in the trial court's decision to submit this question to the jury.

We also find sufficient evidence in the record to support the jury's finding of a UTPA violation [including the WMA, the Approval Letter, and the Refund Letter]. . . .

As to the impact on the public interest,[10] we find the fact the Approval Letter as well as the Refund Letter were utilized by BB&T Corporation for multiple customers would allow a jury to conclude that these deceptive practices affected the public. We thus agree with the trial court that under the evidence adduced at trial, the question of whether Maybank's claim under the UTPA fell under the UTPA's industry exemption was for the jury. Moreover, we find sufficient evidence exists to uphold the jury verdict as to this cause of action. Accordingly, we find the trial court did not err in refusing to grant Appellants' motion for JNOV on this issue.

B. Punitive Damages

Appellants contend the trial court erred in denying their motion for JNOV on Maybank's claim for punitive damages because such damages are barred by the WMA's limitation on liability clause. We agree.

Paragraph F.1 of the WMA states, in pertinent part:

> F. Limitation of Liability and Indemnification. Client agrees:

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[9] *See, e.g., Chechele v. Sperling,* 758 F.3d 463, 471 (2d Cir. 2014) (explaining a Prepaid transaction was a sale of stock and qualified as the sale of an underlying security); *Anschutz Co. v. Comm'r,* 664 F.3d 313, 326 (10th Cir. 2011) (finding the entry into a Prepaid established a security interest).

[10] *See Daisy Outdoor Advert. Co. v. Abbott*, 322 S.C. 489, 493, 473 S.E.2d 47, 49 (1996) ("Since 1986, South Carolina courts have required that a plaintiff bringing a private cause of action under UTPA allege and prove the defendant's actions adversely affected the public interest.").

> 1. Bank and Investment Advisor shall not be liable with respect to their services under this Agreement except for any loss attributable to their negligence or willful misconduct. **In no event shall Bank or Investment Advisor be liable for any incidental, indirect, special, consequential or punitive damages.** (Emphasis added). . . .

Turning to Paragraph F.1, we find the clause is neither violative of public policy nor unconscionable. Under its terms, it does not deprive Maybank of all damages arising under the contract but merely limits the type of damages he is entitled to recover. Specifically, Maybank is precluded from seeking consequential damages, indirect damages, special damages, or punitive damages in claims arising from his relationships with Appellants; he is still entitled to actual damages. While clauses limiting liability are to be strictly construed, we find no reason to ignore the plain language of the clause based on either public policy or unconscionability grounds.

Turning next to the scope of the exculpatory clause, the trial court held the clause only applied to "services under the [WMA]," and the common law causes of action did not arise in connection with the services set forth in the WMA. . . .

We find the WMA governs all aspects of the investment relationship between Maybank and Appellants, and the common law causes of action are subject to the limitations contained in Paragraph F.1. . . .

Accordingly, we find the trial court erred in failing to grant JNOV to Appellants on the award of punitive damages based on the limitation of liability clause found in the WMA. . . .

IV. TREBLING

Appellants contend the trial court erred in trebling damages because the WMA limits Maybank's recovery of statutory treble damages under the UTPA, and their alleged conduct did not constitute "willful or knowing" violations of the UTPA. Appellants further argue there is no evidence they knew or should have known their conduct violated the UTPA. We disagree. . . .

We again note limitation of liability provisions and exculpatory clause are disfavored and will be strictly construed against the drafter. . . . Here, the exculpatory clause prohibits "incidental, indirect, special, consequential or punitive damages," but does not specifically prohibit statutory or multiple damages. Appellants failed to explicitly limit statutory or multiple damages when they drafted the WMA, and we decline to extend its terms to prohibit the statutory treble damages awarded to Maybank under the UTPA. . . .

> We find the evidence in the record supports the trial court's decision to treble damages. . . .

Patterson v. Witter

Appellate Case No. 2014–000963, 2016 WL 3349133 (S.C. Ct. App. June 15, 2016).

[Members of the South Carolina Home Builders Self Insurers Fund ("Fund') challenged the decision of its trustees to remove $ 5 million from the Fund to establish a separate member-owned insurance company that the plaintiffs argued would provide no benefit to existing fund members.]

> Respondents [board] moved to dismiss under Rule 12(b)(6), SCRCP, arguing Appellants failed to meet the pleading requirements for derivative suits under Rule 23(b)(1), SCRCP. Respondents alternatively asserted the suit involved the internal affairs of a trust and, thus, was under the exclusive jurisdiction of the probate court pursuant to section 62–7–201 of the South Carolina Code (Supp. 2015).
>
> After bouncing between the probate court and circuit court, it was determined that the fund was not a trust but rather was a unincorporated association and thus even though the plaintiffs had filed a second complaint, that suit should be dismissed since the plaintiffs failed to properly plead a derivative claim. The Court of Appeals essentially addressed three issues: (1) was the Fund a trust or corporation, (2) was this a direct or derivative claim, and (3) if a derivative action, was the claim properly plead?

(1) Is the Fund a trust or corporation?

> We acknowledge that, at first glance, the Agreement contains language that could be indicative of the Fund being a trust. The Agreement refers to HBASC [Home Builders Association of South Carolina] as the "Settlor." Further, the Agreement grants the Board all powers conferred by the South Carolina Uniform Trustee's Powers Act and authorizes it to invest assets of the Fund. . . . Additionally, the Agreement mentions the Fund's compliance with the rule against perpetuities and states the situs of the Fund is the State of South Carolina.
>
> The Agreement, however, also contains provisions usually associated with business corporations. The Board, for example, is elected by the Fund's members. . . . In addition, the Agreement provides notice requirements for regular and special meetings of the Board. . . . Likewise, the Agreement requires that the Board establish an office to house the Fund's books and records. . . . Under the Agreement, the Fund must indemnify the Board for negligence in all actions made in good faith. . . . Moreover, the Agreement authorizes the Board to obtain liability insurance at the expense of the Fund for all actions, except those made in bad faith or in gross negligence. . . .
>
> Based upon our review of the Agreement and applicable law, we find the circuit court correctly held the Fund was not a trust. . . . While the Agreement—arguably a declaration—most likely satisfies the first element for creating a trust, Appellants cannot prove the remaining elements. . . . First, HBASC did not transfer any money or property to the Board to hold in trust for the Fund's members. . . . After the Fund was created, its members began to contribute membership dues and premiums into the Fund in exchange for protection for its workers' compensation obligations.

Second, the Agreement contains no provision for "beneficiaries." . . . Homebuilders must apply to become Fund members. Further, a third party—the Commission—must approve Fund members. Thus, even assuming the Agreement is a declaration of trust, potential Fund members are not ascertainable from the Agreement.

Moreover, we agree with the circuit court that the Fund resembles an unincorporated association. . . . The Fund is a common enterprise of homebuilders who have voluntarily joined together to form a fund to provide workers' compensation coverage for their businesses. Additionally, the Fund's members are joint and severally liable for any shortfall in Fund assets. . . .

Therefore, we find the circuit court properly concluded the Fund was an unincorporated association and not a trust.

(2) Is this a Direct or Derivative Claim ?

Appellants next argue their claims are not derivative and, thus, do not need to comply with the pleading requirements of Rule 23(b)(1), SCRCP. We disagree. . . .

Individual shareholders may not directly sue corporate directors for losses suffered by the corporation. "An action seeking to remedy a loss to the corporation is generally a derivative one." . . .

"A derivative action is, in essence, a challenge to a board's managerial authority." . . . "[A] shareholder's suit is derivative if the gravamen of his complaint is an injury to the corporation and not to the individual interest of the shareholder." . . .

Nevertheless, the general rule that a shareholder cannot bring a direct suit for injuries to a corporation has two exceptions: (1) when the shareholder suffers an injury separate and distinct from that suffered by other shareholders, and (2) when the alleged wrongdoer owes a fiduciary relationship to the shareholder and full relief cannot be accomplished through recovery by the corporation. . . .

In the instant case, Appellants allege the Board's decision to remove $5 million from the Fund harmed the Fund's ability to adequately cover its risks. Thus, the action is premised on the alleged harm to the overall Fund, not to individual members. Accordingly, we find the circuit court correctly held Appellants' claims were derivative and subject to the pleading requirements of Rule 23(b)(1). . . . "a shareholder's suit is derivative if the gravamen of his complaint is an injury to the corporation and not to the individual interest of the shareholder").

Appellants also argue their action falls under the fiduciary relationship exception to the general rule for derivative suits because the Board owed a special fiduciary duty to the Fund's members to protect the Fund's assets. . . . The circuit court did not rule on the special duty argument, and it is nowhere mentioned by Appellants in their complaints, the transcript of the motions hearing, or their Rule 59(e) motion to alter or amend judgment.

Because Appellants raise this argument for the first time on appeal, we find the issue is not preserved for appellate review and decline to address it. . . .

Therefore, we find the circuit court properly concluded Appellants' claims were derivative and, thus, subject to the requirements of Rule 23(b)(1).

(3) Was the Action Properly Plead As a Derivative Suit?

Finally, Appellants assert that, even if their claims are derivative, they properly complied with Rule 23(b)(1) by alleging a demand on the Board. We disagree. In pursuing a derivative suit, shareholders must first make a demand on the board of directors to take the action they desire or allege that such demand would be futile. . . .

The heightened and particularized pleading requirements of Rule 23(b)(1) are intended to allow the court to perform a gatekeeping function to prevent the unrestrained use of derivative actions. . . .

This court has previously upheld the dismissal of a derivative suit when the shareholders' complaint failed to comply with Rule 23(b)(1). *See Whittle,* 343 S.C. at 184–91, 539 S.E.2d 406–10. . . .

In the instant case, Appellants assert they complied with Rule 23(b)(1), pointing to paragraph eight of their complaint:

> 8. To the extent required by South Carolina Rule of Civil Procedure 23, the [Appellants] allege:
>
> > a. The [Appellants] were beneficiaries of the trust at all times relevant including when the transactions complained of were made.
> >
> > b. The [Appellants], their agents or others on their behalf have made efforts to obtain the action they desire in this matter including correspondence to Counsel for the [Respondents], meetings with counsel for the [Respondents], correspondence to the Trust and a previous lawsuit to no avail.

Contrary to Appellants' contention, we find they failed to allege sufficient particularized facts in their complaint to demonstrate they made a demand on the Board. We first note Appellants' allegations concerning their demand are vague and similar to those made in *Whittle.* 343 S.C. at 189, 539 S.E.2d at 406. . . .

In paragraph eight of the complaint, however, Appellants provided no guidance on exactly what recourse they sought from the Board prior to this suit. Therefore, the circuit court could not discern whether Appellants simply requested the $5 million be

returned to the Fund or whether they, among other things, demanded that members of the Board resign or called for a new election. As a result, the circuit court was not in a position to determine whether the Board's refusal of the demand was wrongful and decide whether to allow the lawsuit to proceed. . . .

Appellants nevertheless counter that their January 20, 2013 letter—a proper demand on the Board—was incorporated by reference in their Second Complaint.[11]

We find Appellants did not specifically incorporate the letter by reference in merely stating they sent "correspondence" to Respondents. Moreover, Appellants conceded the letter was not attached to the complaint, but rather was only included with their memorandum in opposition to Respondents' motion to dismiss. . . .

Therefore, we find the circuit court properly concluded that Appellants failed to comply with the requirements of Rule 23(b)(1).

CONCLUSION

Based on the foregoing, we hold the circuit court properly concluded the Fund was not a trust, Appellants' claims were derivative, and Appellants failed to comply with the pleading requirements of Rule 23(b)(1). Accordingly, the circuit court's grant of Respondents' motion to dismiss is AFFIRMED.

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[11]After Respondents alerted Appellants to the Rule 23(b)(1) requirements by moving to dismiss the First Complaint for failure to comply with the rule, Appellants sent the January 20, 2013 demand letter. Respondents replied, stating they were withholding a substantive response until the circuit court ruled on their motion to dismiss. The circuit court dismissed the First Complaint for lack of subject matter jurisdiction on March 5, 2013. Respondents contend that, before they were able to provide a substantive reply, Appellants filed the Second Complaint in probate court on April 9, 2013, and removed the matter to circuit court. The circuit court then dismissed the Second Complaint and gave Respondents sixty days to respond to the demand letter, allowing Appellants to file another complaint that complied with Rule 23(b)(1). Appellants, however, instead chose to appeal the circuit court's dismissal.

Palmetto Mortuary Transport, Inc. v. Knight Systems, Inc.
786 S.E.2d 588, 416 S.C. 427 (Ct. App. 2016)

Knight sold its mortuary transport business to Palmetto. The sale was an asset purchase agreement that included, tangible assets, goodwill, and customer accounts - the key accounts being body removal service contracts with Richland County, Lexington County, and the University of South Carolina.[12] Knight, as seller, entered into a covenant not to compete as part of the sale, agreeing that it would not provide mortuary transport services within 150 miles of their business, located in Lexington County, for 10 years following the date of sale.

When the Richland County contract came up for renewal 5 years after the non-compete was signed, the contract with Richland County being then held by Palmetto as part of the purchase agreement, Knight bid on the contract and won.[13] Palmetto sued, asserting a breach of the non-compete covenant. Knight, the seller of the business, asserted the covenant not to compete was invalid as being unreasonable as to both time and scope.

The special referee held in favor of Palmetto, the buyer of the business. The Court of Appeals reversed finding that the territorial restriction was unreasonable. The court noted that South Carolina does not apply the "blue pencil" rule which allows a court to modify a covenant. The court cited to *Somerset v. Reyner,* 233 S.C. 324, 104 S.E. 3d 344 (1958) in which a covenant executed by the seller of a small jewelry store in Columbia that prohibited the seller from competing anywhere in South Carolina was too broad.

The Court in this *Palmetto v. Knight* litigation gives very little direction as to how one determines whether a geographic restriction is too broad.

> Second, the special referee relied upon Buddy's [seller's] testimony that he did not intend to get back into the mortuary transport business after the sale to Palmetto. As suggested in Somerset, we do not believe Appellants' intention of not returning to the mortuary transport business is a relevant factor for analyzing whether a territorial restriction is reasonable. We also note Donald testified that Palmetto included the 150–mile restriction in the Covenant. Although Knight Systems, with the assistance of counsel, agreed to the territorial restriction in the Covenant, we believe no rational basis exists for enforcing a territorial restriction covering the entire state and parts of neighboring states that prohibits Appellants from engaging in the mortuary transport business. In our view, the 150–mile restriction was overly broad and did not protect the rights and interests of Palmetto in a reasonable manner. *See Metts,* 158 S.C. at 415, 155 S.E. at 735 (holding a territorial restriction must not be "more enlarged than essential for a reasonable protection of the

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[12]Palmetto agreed to buy four types of body bags exclusively from Knight, the seller of the business.

[13]Knight's alleged basis for being able to bid, was that Palmetto had breached its contract to buy body bags. The facts indicate that if there was a breach, it was insignificant.

> rights of the purchasing party"). Accordingly, contrary to the special referee, we find the geographic restriction in the covenant is unreasonable and, therefore, is unenforceable.

The court also noted that the agreement did not include a "step down" feature. The court suggested that the court could ignore the larger impermissible 150 radius if the agreement provided that if such were invalid, that a stated much smaller radius would govern. Should you automatically include such a provision in your non-compete agreements?

What may be most disturbing about this situation is that the seller apparently explicitly sold the "good will" of the business - which in part was the existing contract with Richland County. It was this relationship that the seller, Knight, "took back." Perhaps if Palmetto, as buyer, had argued that the primary wrong here was the "reacquisition" of the business "good will" the court, applying the so-called "Mohawk Doctrine," the case might come out differently. The "Mohawk Doctrine" provides that in the sale of business, that the seller as a matter of common law cannot re-solicit the business customers, and that this implicit restriction is not limited in time, and is not subject to any "reasonableness" requirement.[14]

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[14]*Mohawk Maintenance co., Inc. v. Kessler,* 419 N.E. 2d 324, 437 N.Y. S. 2d 646 (Ct. App. 1981).

Callawassie Island Members Club, Inc. v. Dennis
790 S.E.2d 435 (S.C. Ct. App. 2016)

Dennis resigned from the Callawassie Island Member Club, and assumed that pursuant to the membership documents and representations that had been made to him, that he would owe no more dues to the club. The club insisted he owed dues until his membership was sold to another person – however, because of restrictions that non-property owners cannot join the club, it is very unlikely that Dennis will ever be able to sell his membership.

The circuit court found that Dennis was required to continue to pay his membership dues, and that the club was entitled to summary judgment, awarding it $ 51,131.

The Court of Appeals concluded that there were ambiguities in the club documents and thus summary judgment was inappropriate. The court then considered whether the South Carolina Nonprofit Corporation Act protected Dennis.

II. The Nonprofit Corporations Act

Appellants argue the circuit court erred in failing to properly apply the Act.

> Specifically, Appellants contend the circuit court erred in finding that assigning liability for continuing obligations post resignation is not statutorily prohibited under section 33–31–620 of the South Carolina Code (2006).
>
> Section 33–31–620 provides "(a) [a] member may resign at any time. (b) The resignation of a member does not relieve the member from any obligations the member may have to the corporation as a result of obligations incurred or commitments made before resignation."
>
> Section 33–31–620 obligates resigned members to pay any dues incurred before resignation. This section does not require resigned members to continue to pay any dues that accrue after resignation. To do so, we believe, would create an unreasonable situation in which clubs could refuse to allow a member to ever terminate their membership obligations. In essence, Appellants would be trapped like the proverbial guests in the Eagles' hit Hotel California, who are told "you can check-out anytime you like, but you can never leave."
>
> Appellants state in their brief it is undisputed that CIMC membership is no longer available to non-Callawassie property holders. With only 85 lots remaining for development and every fourth purchase coming off the resale list, it is possible only 21 names will ever come off the list. Appellants are 72nd on the resale list. Therefore, it appears unlikely Appellants will ever be able to sell their membership. We find section 33–31–620 protects club members from such continuing liability after resignation.

CONCLUSION

We REVERSE the circuit court's order granting summary judgment and REMAND this case for trial.

Delaney v. First Fin. of Charleston, Inc.
Appellate Case No. 2014–000824, Opinion No. 5442
2016 WL 5400500 (S .Car. Ct. App. Sept. 28, 2016)

Delaney's truck was reposed. He brought an action pursuant to S.C. Code § 36-9-625 which grants aggrieved consumer purchasers the right to have a penalty imposed on the creditor that sends a defective notice of sale of the collateral. The question was whether a six year, three year, or one year statute of limitations applied. Delaney brought his action against the lender within the six year time period but if his cause of action accrued when he received the notice, his claim was not timely filed within either the three year or one year time periods.

The applicable statutes are:

§ 36-2-725(1) Six year statute:

> An action for breach of any contract for sale must be commenced within six years after the cause of action has accrued.

§ 15-3-540 Three year statute:

> Providing for a three-year statute of limitations for "[a]n action upon a statute for a penalty or forfeiture."

§ 15-3-570 One year statute:

> Establishing a one-year statute of limitation for "[a]n action upon a statute for a penalty or forfeiture given, in whole or in part, to any person who will prosecute for it must be commenced within one year after the commission of the offense."

§ 36-9-625 Recovery of the credit service charge plus ten percent of the principal

> (a) If it is established that a secured party is not proceeding in accordance with this chapter, a court may order or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions.
>
> ***
>
> [c](2) if the collateral is consumer goods, a person that was a debtor or a secondary obligor at the time a secured party failed to comply with this part may recover for that failure in any event an amount not less than the credit service charge plus ten percent of the principal amount of the obligation or the time-price differential plus ten percent of the cash price.

The trial court first concluded that the six year statute could not apply since Delaney failed to even plead that there was a breach of contract. The Court of Appeals agreed. The court also commented that even if Delaney had properly pled the contract claim that the six year statute

would not apply, that what he was trying to recover was clearly a "penalty" and as such only one of the other two statutes would be the appropriate statute of limitations - both apply to penalties.

So should it be the three year or one year statute? The court did not have to decide because they decided that the cause of action accrued when Delaney received the notice of sale, not the later date when the court sold the truck. Since he failed to bring his action within three years of the date of the notice, he was barred by either of the two statutes.[15]

One Judge dissented and asserted that the operative event would have been the wrongful sale. The majority disagreed.

> According to the dissent, "the only way a secured party can fail to comply with section 36–9–611(b) is by failing to give reasonable notice AND disposing of the collateral." Further, the dissent maintains if the secured party never disposes of the collateral, it never has to provide notice under section 36–9–611(b), and if a secured party sends unreasonable notice to a debtor but subsequently fails to dispose of the collateral, it has not failed to comply with section 36–9–611(b). . . .
>
> We believe the statute of limitations begins to run when the secured party sends noncompliant notice to the debtor, not when the secured party disposes of the collateral. Initially, we note section 36–9–625 provides several remedies for noncompliance with the notice requirement. Among them, the statute provides, "[i]f it is established that a secured party is not proceeding in accordance with this chapter, a court may order or restrain ... disposition of collateral on appropriate terms and conditions." § 36–9–625(a). It is clear a party must be able to state a cause of action in order to request a court restrain disposition of the collateral. Therefore, if Delaney could have asked a court to restrain disposition of his collateral, his cause of action must have arisen upon his receipt of the noncompliant notice. . . .
>
> Further, we believe the Official Comments to section 36–9–611 and 36–9–625(c)(2) supports our conclusions. . . .
>
> In addition, Official Comment . . . states the penalty "is designed to ensure that every noncompliance with the requirements of Part 6 [§§ 36–9–601 to –629 (2003 & Supp. 2015)] in a consumer-goods transaction results in liability, regardless of any injury that may have resulted." Because an injury is not required for a secured party to be liable for failing to comply with the notice requirement, the statute of limitations can begin to run before the secured party injures the debtor by disposing of the collateral in a commercially unreasonable manner.

Note that the court did not have to, and did not decide, whether the three or one year statute should be applied. We do know that the six year statute is inapplicable.

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[15]Unfortunately, the three year statute, different from the one year statute, does not designate when the cause accrues

Coastal Federal Credit Union v. Brown
790 S.E.2d 417 (S. Car. Ct. App. 2016)

On May 4, 2008, Brown entered into a retail installment sales contract with Johnny's Subaru Isuzu, LLC (the dealership), to purchase a vehicle. Brown financed the purchase, and the contract gave the dealership a security interest in the vehicle. The contract also provided that the financed portion of Brown's purchase would accrue interest at an annual rate of 12.4 percent. The dealership immediately assigned the contract to CFCU, and Brown's certificate of title listed CFCU as first lienholder. Brown failed to make payments as required by the contract, and in October 2009, CFCU repossessed the vehicle. On November 19, 2009, CFCU sold the vehicle at auction, leaving an outstanding balance under the contract. On November 24, 2009, CFCU sent Brown a letter notifying her of the sale and resulting deficiency.

On October 21, 2013, CFCU filed the summons and complaint in the current action seeking to collect Brown's debt. The caption of the complaint stated the action was for "debt collection," and the complaint alleged Brown "defaulted in making the regularly-scheduled monthly payments due under the [c]ontract." The complaint further alleged CFCU repossessed and sold the vehicle "in accordance with the terms of the [c]ontract and applicable law," CFCU applied the proceeds "to the [c]ontract," and Brown owed an outstanding balance including interest and collection costs pursuant to the contract. Brown answered, asserting a statute of limitations defense. CFCU filed a motion for summary judgment, arguing the six-year statute of limitations contained in Article 2 of the South Carolina Uniform Commercial Code (SCUCC) applied to the case, while neither the SCCPC nor the FDCPA were applicable. Brown filed a motion for summary judgment asserting the case was barred by the general three-year statute of limitations contained in section 15–3–530 of the South Carolina Code (2005).

At a hearing on the motion, the circuit court engaged in the following exchange with CFCU:

THE COURT:	Did you sell the car?
CFCU:	We did Your Honor.
COURT:	And then you established a balance owing.
CFCU:	Correct, in deficiency only.
....	
COURT:	You're now suing on the deficiency, and now you've got a situation [in which] you needed to do it sooner. I grant [Brown's] motion for summary judgment.

In its order disposing of the parties' motions, the circuit court found CFCU's action was one for the collection of a defaulted debt; therefore, the three-year statute of

limitations applied and barred the action because it was initiated more than three years after CFCU repossessed the vehicle. It also ruled, "The [SCCPC] and the [FDCPA] apply to this case." The circuit court granted Brown's motion for summary judgment and denied CFCU's motion. This appeal followed. . . .

This issue—whether Article 2 [with a 6 year statute of limitations] of the Uniform Commercial Code (UCC) applies to an action for the recovery of a deficiency following the repossession and sale of collateral by a secured creditor who is also a party to the sales contract creating the security interest in the collateral—is one of first impression in South Carolina. Additionally, there is a split of authority on this issue nationally. . . .

The majority of jurisdictions applies Article 2 [6 year statute of limitations] to such actions, reasoning "a deficiency suit is more closely related to the sales aspect of a combination sale and security interest than to the security aspect." . . .We believe the majority's reasoning is more persuasive and adopt it here. . . .

Admittedly, CFCU exercised its right to repossess the vehicle under SCUCC Article 9 [that includes the shorter 3 year statute of limitations]. . . . However, as assignee to the sales contract, CFCU gained the dealership's rights thereunder, including the right to sue Brown for a breach of the contract. . . .

Here, although CFCU captioned its complaint as a "debt collection" action, it alleged Brown defaulted under the contract, CFCU repossessed and sold the vehicle "in accordance with the terms of the [c]ontract and applicable law," CFCU applied the proceeds "to the [c]ontract," and Brown owed an outstanding balance that included interest and collection costs pursuant to the contract. Accordingly, CFCU's action relates to the sales contract and is governed by SCUCC Article 2. Because CFCU's action was filed within the six-year statute of limitations in section 36–2–725, we reverse the circuit court's grant of summary judgment to Brown.

Judge Short disagreed and dissented on this aspect of the case, stating that we should follow the reasoning from North Carolina and apply the shorter 3 year statute of limitations.

Brust executed the POA on January 25, 2006, appointing Finger or Rosenberg as his true and lawful attorney and granting Finger and Rosenberg the authority

> to execute any and all documents, and to perform any lawful act or to execute or amend any document, instrument, or thing, which may be involved in the financing of [the Property], including, but not necessarily limited to, the power to execute ... any document, instrument, contract, [n]ote, [m]ortgage, agreement, assignment, affidavit, disclosure, etc[etera] ... or to execute any such other documents as may be necessary to close the [L]oan with First South Bank in the original principal sum of $2,600,000.00.

First South and Ecological closed the Loan on February 2, 2006. At the closing, Rosenberg executed his personal guaranty as well as the Guaranty, signing as Brust's attorney-in-fact. The Guaranty, executed to induce First South to make loans to Ecological [Investments, LLC of which Rosenberg and Brust were members] , stated the following:

> [Brust] absolutely and unconditionally guarantees [First South] the full and prompt payment when due ... of the debts, liabilities[,] and obligations as follows:
>
> ....
>
> [Brust] guarantees to [First South] the payment and performance of each and every debt, liability[,] and obligation of every type and description [that Ecological] may now or at any time hereafter owe to [First South] (whether ... now exist[ing] or ... hereafter created or incurred ...).
>
> ....
>
> The liability of [Brust] shall not be affected or impaired by ... any one or more extensions or renewals of [i]ndebtedness (whether ... for longer than the original period) or any modification of the interest rates, maturities[,] or other contractual terms applicable to any [i]ndebtedness ....

Ecological defaulted under the Loan on November 30, 2012. On March 8, 2013, First South filed a summons and complaint against Rosenberg and Brust, claiming the guaranties induced it into making the Loan, and Rosenberg and Brust were in default under their respective guaranties. First South requested judgment against Brust and Rosenberg for the remaining amount due under the terms of the Loan.

Brust asserted he was not liable on the guarantee. He asserted many defenses. For example, he argued that the POA was ambiguous, which argument was essentially negated. He

also argued that an agent cannot sign a guaranty on behalf of the principal unless such is specifically authorized in the POA document. The court said:

> Moreover, we reject Brust's contention that an agent cannot sign a guaranty on behalf of his principal pursuant to a power of attorney unless the power of attorney specifically authorized the execution because this assertion is unsupported by South Carolina law. Accordingly, we affirm the circuit court's grant of summary judgment as to this issue because Rosenberg possessed actual authority to bind Brust to the Guaranty's terms.

Ethics Advisory Opinion 16-04

Lawyer A believed that Lawyer B, in the context of an ongoing mortgage foreclosure sales action, made a misrepresentation when Lawyer B asserted that he was a bona fide purchaser "under *Spence.*" Apparently Lawyer B was actually the party in this litigation. Lawyer A believed that Lawyer B misrepresented that he was a BFP since Lawyer B knew of the potential title defect in the property prior to paying the balance of the purchase price and acquiring title.

The question was whether Lawyer A was obligated to formally report Lawyer B's conduct to disciplinary counsel, and if so, must the misconduct be reported immediately, or may the report wait until the conclusion of the litigation or appeal.

The Committee "suggested" that Lawyer A had a duty to report. As to when:

> The Committee believes it is appropriate for the lawyer to consider any potential adverse impact to his client in determining the timing of a report against another lawyer. If Lawyer A believes the conduct of Lawyer B raises a "substantial question as to [Lawyer B's] honesty, trustworthiness or fitness as a lawyer in other respects," then Lawyer A must report such misconduct to the disciplinary authority. Because the Rule is silent regarding the timing of such report, Lawyer A may wait until the conclusion of the matter if Lawyer A determines immediate reporting may hurt the client. However, the misconduct should be reported "promptly" at the conclusion of the litigation or appeal.

S.C. Dept. Rev. v. Meenaxi, Inc.
790 S.E.2d 792 (S. Car. Ct. App. 2016)

The Administrative Law Court upheld the Revenue Department's revocation of a beer and wine permit when the business allowed the operation of video poker machines on the premisses. All sorts of challenges were made to this revocation. The following is the court's discussion that the wrong party was named in the ALC litigation. Apparently Mr. Patel owned Meenaxi, Inc. that operated the store under the name "Corner Mart."

2. Permit Revocation Action

Appellant [identified in the first line of the opinion as "Meenaxi, Inc. d/b/a Corner Mart (Appellant)] argues the ALC erred in refusing to dismiss this case on the ground that the Department failed to sue the correct parties. Specifically, Appellant argues the permit was issued to Patel and Meenaxi, Inc. but neither was made a party to this action. In addition, Appellant asserts there was no evidence at trial that "Meenaxi, Inc. d/b/a Corner Mart"—the corporate entity designated as the defendant in this action—exists. We disagree.

Patel testified his corporation, Meenaxi, Inc., owned and operated the Corner Mart. Appellant's beer and wine permit listed the following information:

> Malkesh Patel
> Meenaxi Inc.
> 713 Britton St
> Anderson[,] SC 29621–2614
>
> Corner Mart
> 1010 E Shockley Ferry Road
> Anderson, SC 29624

Title 61 of the South Carolina Code governs "Alcohol and Alcoholic Beverages," and section 61–2–100 of the South Carolina Code (2009) describes the "[p]ersons entitled to be licensees or permittees." As used in Title 61 "and unless otherwise required by the context," the term " '[p]erson' includes an individual, a trust, estate, partnership, limited liability company, receiver, association, company, corporation, or any other group." S.C. Code Ann. § 61–2–100(H)(1) (2009). "Licenses and permits may be issued only to the person who is the owner of the business seeking the permit or license." S.C. Code Ann. § 61–2–100(A) (2009).

Based on Patel's testimony and the information listed on the permit, we find it was reasonable for the ALC to conclude that Meenaxi, Inc. owned and operated the Corner Mart—and in effect was doing business as the Corner Mart—even though the permit did not include the words "doing business as" or "d/b/a."

We further find that Appellant was the sole permit holder and Patel—the owner

of Appellant—was simply Appellant's principal and designated agent. See S.C. Code Ann. § 61–2–100(H)(2)(a),(g) (2009) (stating under Title 61, "a person who owns twenty-five percent or more of the value of the business entity" and "an officer of the business or entity which owns the business" are considered "principals" of the business or entity); S.C. Code Ann. § 61–2–100(F) (2009) ("Businesses licensed or permitted by the department under this title must designate with the department an agent and mailing address for service of notices."). Because the permit at issue here was held by a business rather than an individual, section 61–2–100(F) mandated that Appellant designate an agent to receive service of notices. As the Department explained at oral argument, Patel was not the permit holder—he was simply Appellant's contact person. Because Patel was not the permit holder, the Department was not required to add him as a party to this permit revocation action.

B. Due Process

Appellant argues the ALC erred in finding the Department did not violate Patel's due process rights by failing to add him as a party to this action. Appellant also argues the Department's failure to name Patel as a party prejudiced Patel because he had no opportunity to inspect the machines destroyed upon the magistrate's order. We disagree. . . .

As stated previously, Patel was not a proper party to the magistrate court action, and the Department was not required to add him as a party to this permit revocation action because he was not the permit holder. Therefore, Patel cannot complain of prejudice from the fact that he was not a party to those actions.

South Carolina Bar

Environmental Due Diligence: Risk Management in 2017

Michael B. Dodd
Greenville, SC

Ty Hawkins
Greenville, SC

January 20, 2017

South Carolina Bar

Environmental Due Diligence

Risk Management in 2017

HRP

What is Due Diligence?

- Due Diligence
  - An assessment of a business or person prior to signing a contract
- Environmental Due Diligence
  - An assessment of environmental liabilities that may impact real estate or a business.

Regulations That May Affect Property Transactions

- Resource Conservation and Recovery Act (RCRA)

- Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)
  - Gives EPA the power to seek out "Responsible Parties"
  - Includes "Superfund" and "Brownfields" programs

Defenses to Liability Under CERCLA

Available to:

1. Innocent Landowners
2. Bona Fide Prospective Purchasers
3. Contiguous Property Owners

To assert this defense:

1. Must perform "all appropriate inquiries" <u>before</u> acquiring the property
2. Satisfy continuing obligations after acquisition.
3. Bona Fide Prospective Purchasers and Contiguous Property Owners also must prove that they are not potentially responsible parties or affiliated with any potential responsible party.

Phase I Environmental Site Assessment (ESA)

- The Phase I ESA is recognized as the tool used to satisfy "all appropriate inquiries" under CERCLA.

- American Society For Testing and Materials (ASTM) developed the "Standard Practice for Environmental Site Assessments : Phase I ESA Process".
  - Most recent version is ASTM 1527-13.

- The goal of a Phase I is to identify Recognized Environmental Conditions, or "RECs".

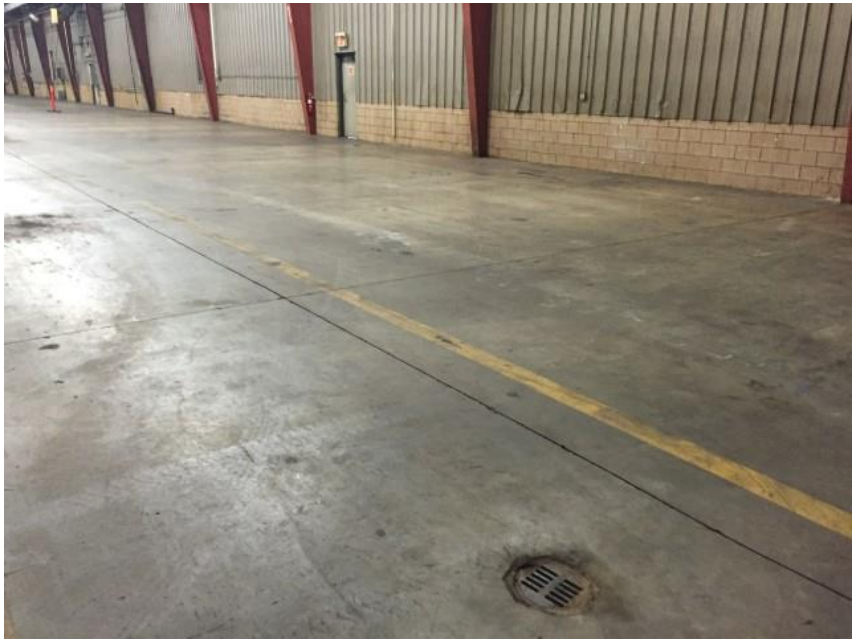
Identify and Quantify Environmental Risk

- There are several other environmental "tools":
  - Desktop Reviews
  - Transaction Screens
  - Business Environmental Risk Evaluations
  - Subsurface Investigations (i.e. Phase II ESA)
  - Property Condition Assessments (PCAs)

- Selecting the right tool may depend on the anticipated future use, risk tolerances, business decisions, etc.

Common RECs

Common RECs



Where Phase I ESAs Can Go Wrong

- Not completed by a qualified Environmental Professional
  - Requires specific education, training and experience
- Relying on an old Phase I
  - Environmental standard of care changes.
  - Phase Is greater than 1 year old do not satisfy CERCLA
- Phase I is not explicitly prepared for the User
- Data gap relevance, lack of interviews/file reviews, lack of User understanding of the scope

A Phase I ESA is not exhaustive.

Evaluation of Business Environmental Risks

- "Non-scope" items that <u>can</u> be included in a Phase I:
  - Asbestos
  - Radon
  - Lead based paint
  - Mold
  - Lead in drinking water
  - Wetlands/ecological resources
  - Cultural/Historical resources
  - Endangered Species
  - Industrial hygiene concerns (indoor air quality)
  - Regulatory compliance
  - Stormwater management

Due Diligence - Example #1

- Owner was donated property and took title
- No environmental due diligence was completed
- Dozens of drums were abandoned at the site, one was fuming

SOLUTION: Damage control. Identify RPs, and attempt to share liability.

Due Diligence - Example #2

- Owner took title to partially developed subdivision.
- No environmental due diligence was completed.
- No RECs identified.
- Substantial storm water issues ($1MM+).

SOLUTION: Negotiate an Agreement with the State to drastically limit liability, obligations, and timelines. Stabilize a lot of dirt!

Due Diligence - Example #3

- Previous investigation found Site was impacted, and Owner could not afford to mitigate.
- Groundwater and vapor issues.
- Purchaser was still interested, but doesn't want the liability.

<u>SOLUTION:</u> Conduct sufficient Phase II to meet the State's intent for the Voluntary Cleanup Contract, enter the VCC, and purchase the property. Both parties greatly limit liability!

What's New for 2017

- CERCLA protection is no longer the preeminent purpose of completing environmental due diligence. In transactions, its about risk mitigation and financial leverage.
- Environmental liabilities are now identified in most assessments. RECs don't always "kill the deal".
- Knowing what tools are available to navigate these risks are key.
  - Voluntary Cleanup Contracts
  - ESCROW's
  - State/Federal Cleanup Funds
  - Risk Allocations
  - Tax Incentives
  - Environmental Insurance

What's New for 2017

- Emerging Contaminants (e.g., 1,4-dioxane, pfoas/pfos, PCBs, perchlorates, namomaterials, pharmaceutical wastes) are ever-changing
- Vapor Intrusion – New regulations are continually enacted or revised.
- Environmental risk management is now a calculated part of real estate transaction.

Summary

Prior to Real Estate Transactions:

- Engage an Environmental Professional early in the process.
- Select the right assessment depending on anticipated future use, risk tolerances, business decisions, etc.
- Ensure the report is being prepared for the appropriate entity and by an experienced professional.
- Navigating environmental liabilities is now a routine part of real estate transactions. Being aware of the tools to navigate these risk are key to effectively supporting transactions.

Build a relationship with an environmental professional(s) that you can trust and understands your risk tolerances!

THANK YOU.

MOVE YOUR ENVIRONMENT FORWARD

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