

# Six Pack for Breakfast

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# Introduction

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## Developments in Prevailing Wage Law, Post-Northwestern

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### *City of Cincinnati, ex rel., Joseph D. Zimmer, et al. v. City of Cincinnati, et al.*

- Parker Flats condominium project
- The City provided funding to a private developer for a parking garage under the condominium building
- Following the Northwestern case, the trial court ruled that prevailing wage did not have to be paid on the condominium portion of the construction
- See *You Tube* Video of comments by Kimberly Zurz



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*Kimberly Zurz, Director of Commerce v.  
770 West Broad AGA, LLC, et al.*

- State entered into a lease of the project within six months of construction
- State argued that prevailing wage applied pursuant to R.C. 4115.03(C) which says: "When a public authority rents or leases a newly constructed structure within six months after completion of such construction, all work performed on such structure to suit it for occupancy by a public authority is a "public improvement."



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*Kimberly Zurz, Director of Commerce v.  
770 West Broad AGA, LLC, et al.*

- The Court held as follows:
  - “The above sentence is the cornerstone of Plaintiffs' argument that the prevailing wage law applies in this case. However, the above sentence merely provides a definition for what a ‘public improvement’ is. It dictates that in a lease situation, such as in the present case, the construction shall qualify as a ‘public improvement.’”



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*Kimberly Zurz, Director of Commerce v.  
770 West Broad AGA, LLC, et al.*

- The Court held as follows:
  - “As such, a lease can satisfy the public improvement aspect of the Northwestern test. This, however, is the limit of the second sentence of R.C. 4115.03(C). Plaintiffs still cannot overcome the fact that the Northwestern holding also required that public funds be used to make a ‘public improvement.’ It does not matter what supposed tract in relation to R.C. 4115.03(C) a project is on; no public funds, no prevailing wage.”



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Energy Efficiency  
or  
“No Good Deed Goes Unpunished”

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## Energy Efficiency and Peak Demand Reduction

- Why? SB 221 (enacted in 2008)
- What? Statutorily mandated increase in efficiency
- So What? Everyone's electricity bill increases to pay for reduction (4% and growing)
- So What's New? You can avoid the extra charge if you know how to play the game



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## Energy Efficiency Charge or "Rider"

- Can opt-out of charge by implementing own energy efficiency program
- Past projects could qualify
- Work with electric utility provider to qualify the program or file with PUCO



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## What's in Store for the Future?

- Energy efficiency reduction required annually
- Accumulative reduction of 22% by 2025
- Purpose of law - to avoid building costly new coal-fired power plants
- With advanced planning you can avoid all of the extra charge or rider fee
- Need to make sure you get credit for past energy efficiency projects
- Implementation rules still being debated and negotiated at PUCO



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## Nature of the Problem

- Declining real estate values
- Leaving loans with insufficient collateral or higher loan to value than desired



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## Bank Will Seize Opportunity to Fix Problem

- Loan in default
- Borrower request to modify loan
- Some Loan Documents Require Borrower to maintain certain loan to value



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## Additional Collateral

- Bank will want to receive first mortgage on additional real estate or first lien on other marketable assets



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## Not An Ideal Time

- Most Borrowers and Guarantors do not have unencumbered real estate assets or other marketable assets
- These following presentations are designed to discuss the issues associated with “Alternative Collateral”



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## Additional Collateral Mortgages

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## Second Mortgage From Borrower

- Frequently requires consent of first mortgagee
- Example: "Borrower shall not sell, assign, mortgage, pledge or otherwise convey or further encumber the Mortgaged Property, or any portion thereof, or legal, equitable or beneficial interest therein."



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## Second Mortgage From Borrower

- Sometimes not as clear
- Example: “Lender may, at its option, declare the entire balance of the Secured Debt to be immediately due and payable upon the creation of any lien or encumbrance on the Property.”
- No reference in default provisions



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## Second Mortgage From Borrower

- Lender liability concerns if second mortgage taken without first mortgagee consent
- Theories: Undue influence; good faith and fair dealing; damages exposure
- Render non-recourse loan fully- recourse
- First mortgagee consent may be time-consuming or unachievable



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## Second Mortgage From Borrower

- Consent frequently accompanied by Subordination/Standstill Agreement
- Agreement not to foreclose
- Release second mortgage under certain circumstances
- Not modify debt



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## Additional Collateral Mortgage From Guarantor or Another "Affiliate"

- In world of SPEs, frequently the "second" or "additional collateral" mortgage comes from party other than Borrower
- Involves all of same consent issues as second mortgage from Borrower if it is a second mortgage



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## Additional Collateral Mortgage From Guarantor or Another “Affiliate”

- PLUS potential other enforcement hurdles even if a first mortgage (i.e. additional collateral mortgage)
- Preference issues: can mortgage be avoided as a preference? Bankruptcy Code § 547
  1. Was mortgage given for antecedent (as opposed to current) debt?
  2. Made while mortgagor was insolvent?
  3. Within 90 days of bankruptcy filing?



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## Additional Collateral Mortgage From Guarantor or Another “Affiliate”

- Fraudulent conveyance issues: can mortgage be avoided as a fraudulent conveyance? Bankruptcy Code § 548
  1. Did mortgagor receive less than equivalent value for mortgage?
  2. Was mortgagor insolvent when, or rendered insolvent by, giving mortgage?
  3. Was mortgage granted within 2 years of bankruptcy (or 4 years under Ohio law)?



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## Additional Collateral Mortgage From Guarantor or Another “Affiliate”

- Not actual fraud or question of right vs. wrong
- Grab collateral. Ask questions later?
- Title Insurance
- Exclusion from coverage: Any claim, by reason of the operation of Creditor’s rights laws, that the transaction creating the lien of the Insured Mortgage is a fraudulent transfer or a preferential transfer
- ALTA: Deletion of exclusion not available



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## The Basics of Security Interests in Partnership/LLC Member Interests

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## Classification of Collateral – Critical from Lender’s Perspective

- Investment property
- General intangible



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## Partnership/LLC Interest as Investment Property

- “Investment Property” means, among other things, a security (share or equity interest in a corporation, business trust or similar entity)



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## Partnership/LLC Interest is Not a Security Unless

- Dealt in a traded on securities exchanges or in securities markets, or
- Its terms expressly provide that it is an Article 8 security – “OPT-IN”



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## Investigating an Article 8 “Opt-In”?

- Assemble the governing documents
  - Partnership agreements
  - Operating agreements
  - Articles of organization
  - Certificates, if any
  - All amendments
- “Opt-In” is very rare



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## Partnership/LLC Interest as General Intangible

- If Partnership/LLC interest not a “security”, then not “investment property”
- If not “investment property”, then has to be a “general intangible”



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## Security Agreement

- The lender will likely use a “collateral specific” form of security agreement with comprehensive description of collateral (options, warrants, exchanges, dividends, distributions, etc.)



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## Security Agreement Will Include Provisions

- Voting (pre/post default)
- Distributions (pre/post default)
  - Cash
  - Other Property
- Amendments to organizational documents (i.e. prohibition on dilution/change of control) – notice to/consent of SP



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## Perfection of Security Interest in Partnership/LLC Interest

- Filing (Classification Does Not Matter – Sort Of)
  - Filing financing statement against debtor perfects as to both investment property and general intangibles
  - True even as to certificated securities
  - Filing is sole means of perfection as to general intangibles



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## Perfection of Security Interest in Partnership/LLC Interest

- Control (Classification May Matter)
  - If Partnership/LLC interest is “investment property” (i.e. securities), SP may perfect by filing, control, or both (recommended)
  - Control gives greater priority than mere filing



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## What is “Control”?

- Certificated securities
  - Possession with any necessary indorsement, or
  - Registration in SP’s name or in name of a third party acting on SP’s behalf



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## What is “Control”?

- Uncertificated Securities
  - Registered in SP’s name or in name of a third party acting on SP’s behalf, or
  - Control agreement with the issuer, SP and pledgor



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## Certificates Representing Partnership/LLC Interest

- May or may not be relevant to obtaining and perfecting the security interest (classification)
- Possession
- Blank indorsement (undated)



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## Summary

- Execution of written security agreement
- Filing of UCC-1
- Where applicable, control of the Partnership/LLC interest
- Possession of certificates and related powers



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Good as gold!  
“What could possibly go wrong?”



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## “What Can Possibly Go Wrong?”

### Potential Pitfalls in Taking and Giving Pledges of LLC Membership Interests

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## Legal Differences Exist in Pledging and Taking Pledges of

- shares of closely-held corporate stock;
- LLC membership interests; and
- limited partnership interests.

\*\* Generally a lender will not want a pledge of a general partnership interest (unlimited liability stepping into the shoes of an assigning general partner)



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## LLC Issues: Pledging Membership Interests as Additional Lender Security

- **STEP ONE:** Be sure to get **complete** copies of the LLC articles of organization and the LLC operating agreement (including **all** amendments to both).



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## Issue # 1: Is this the kind of collateral Lender wants and/or can use?

- Potential problems in Lender becoming a member on foreclosure of a pledge of an LLC membership interest:
  - Some operating agreements permit/require capital calls – Lender must check the operating agreement to be sure no more capital must be contributed by members (which would include Lender as assignee-member)



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## Issue # 1: Is this the kind of collateral Lender wants and/or can use?

- LLC members owe fiduciary duties (duty of loyalty = no right to compete with business) – review LLC operating agreement to be sure fiduciary duties are waived so Lender not restricted from owning (or making loans to) competing entities



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## Issue # 1: Is this the kind of collateral Lender wants and/or can use?

- If LLC has no written operating agreement, do not take a pledge of a member interest (as a member, assignee-Lender may be bound by verbal agreements of which Lender has no knowledge or way to confirm existence)
- Review LLC loan docs to confirm the pledge of the member's LLC interest to Lender will not violate the loan covenants made by the LLC to its lender



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## Issue #2: Will the pledge violate the LLC operating agreement?

- Most operating agreements restrict “transfers” of membership interests, including pledges by members of their interests (which would be “transfers”)



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## Issue #2: Will the pledge violate the LLC operating agreement?

- “Typical” language:  
“Transfer” shall mean any gift, sale, transfer, alienation, **pledge**, encumbrance or other manner of disposal of any Membership Interest or any interest therein .... **Any Transfer or attempted Transfer in contravention of the terms and conditions of this Agreement shall be null and void and of no force or effect**... A Transfer shall be subject to prior exercise, or termination on exercise of the right of first refusal granted under this Agreement.”



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## Issue #2: Will the pledge violate the LLC operating agreement?

- Failure to comply causes the purported pledge to be “null and void”



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## Solutions to transfers/pledges prohibited in LLC operating agreement

- Written waiver from all parties to the operating agreement (members and the LLC too) that will expressly permit the pledge/transfer
- Pledgor/member causes the LLC operating agreement to be amended to specifically permit the pledge of the interest to Lender in this specific case



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## “Good as Gold”

- After confirming (i) the pledge is collateral Lender wants/can live with, and (ii) the pledge won't violate the LLC governing documents, you are “good as gold”



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## Practical Tips on Analyzing Life Insurance Policies and Annuities as Collateral for Loans

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## Life Insurance Policies

- Understand the product – get the policy before decisions are made
- Not covered by the UCC
- Need to record the assignment with the insurer
- Analyze whether you want to be the beneficiary



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## Life Insurance Policies

- Read the policy
  - Is it assignable?
  - Do loans to the insured by the insurer have priority?
- Confirm status of loans and cash surrender payments
- Ensure payments of premiums/monitor values
- Do a separate agreement with the insured



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## Annuities

- Understand the product – get the annuity contract before decisions are made
- Courts have held that they are covered by the UCC
- Need to record security interest/assignment with the issuer



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## Annuities

- Read the annuity contract
  - Is it assignable?
  - Understand the penalty for early termination
  - Understand tax penalty
- Do a separate agreement with the annuitant



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Thank You For Attending

Questions?

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