UCC Remedies Concerning LLC Interests Pledged to Secure a Mezzanine Loan – a Very General Outline

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UCC REMEDIES CONCERNING LLC INTERESTS PLEDGED TO SECURE A MEZZANINE LOAN – A VERY GENERAL OUTLINE

INTRODUCTION

The popularity of real estate mezzanine loans in the early and middle years of the present decade will almost certainly produce many foreclosure sales of the collateral pledged by the mezzanine borrowers in 2009 and 2010. From a financial perspective, real estate mezzanine lenders generally believed that they were making junior loans secured by real estate. They acted as if their collateral was the real property owned by the mortgage borrower. For underwriting purposes, that might have been a reasonable approach. However, when the time for foreclosure arrives, the "junior loan" model does not hold. The legal structures have a real effect on how the mezzanine lender forecloses. Some of the differences are favorable to the mezzanine lender. Some are not. This article is intended to summarize, very generally, how such foreclosure sales are conducted.

Let's use a typical (and simple – in many cases the actual facts are much more complex) fact pattern. A Delaware limited liability company owns an office building in some jurisdiction (it doesn't matter which jurisdiction). We'll call that LLC the "mortgage borrower." The mortgage borrower is a single member LLC whose single member is another LLC, which we'll call the "mezzanine borrower." The real equity owner of this enterprise owns the mezzanine borrower. The mortgage borrower bought the office building for $100 million. How did it raise the purchase price? The real equity owner invested $10 million in the mezzanine borrower. The mezzanine borrower borrowed $20 million from the mezzanine lender. The mezzanine borrower invested the entire $30 million in the mortgage borrower and the mortgage borrower borrowed $70 million from the mortgage lender. The mortgage borrower put a mortgage (or deed of trust) on the office building to secure the $70 million mortgage loan. The mezzanine borrower pledged its membership interest in the mortgage borrower to secure the mezzanine loan.

The mezzanine lender has no security interest in real property. To be sure, the economic value of the mezzanine lender's collateral depends entirely on the value and performance of the office building. But the collateral is nevertheless not real estate; it is the limited liability company membership interest in the mortgage borrower, which is personal property. This has several significant – for purposes of this summary – consequences. First, the rights, remedies and obligations of the mezzanine lender will be governed by the Uniform Commercial Code (the **UCC**), not by the real estate law of the jurisdiction in which the office building is located, which would govern the lender's rights if it had a mortgage on the building, and by the pledge or security agreement under which the mezzanine borrower has pledged to the mezzanine lender the membership interest in the mortgage borrower (it will be referred to as a **pledge agreement** in this outline). Second, the mezzanine lender's rights and obligations will also be affected by the law of the jurisdiction in which the mortgage borrower is formed – in this case, the Delaware Limited Liability Company Act (the **LLC Act**) – and by the mortgage borrower's limited liability company agreement (the **LLC Agreement**).

REMEDIES UNDER UCC ARTICLE 9

As a general proposition, the mezzanine lender would have three principal remedies under Article 9 of the UCC. First, a secured party has the right to "collect" on the collateral. In this context, it means that the mezzanine lender would have the right to require the mortgage

borrower to pay directly to the mezzanine lender all distributions that would otherwise be paid by the mortgage borrower to the mezzanine borrower.

Second, the mezzanine lender has the right to foreclose on the pledged membership interest in the mortgage borrower.

Third, the mezzanine lender has the right to propose to the mezzanine borrower that the mezzanine lender would retain the pledged membership interest in full or partial satisfaction of the mezzanine loan – like a "deed in lieu of foreclosure" in the real estate context.

Capturing Distributions

The UCC provides that, when there is a default, the mezzanine lender, as pledgee, may notify the mortgage borrower that the mezzanine lender is entitled to any distributions that are payable by the mortgage borrower to the mezzanine borrower.[1] After receiving such a notice, the mortgage borrower would be legally obligated to comply with that instruction and it would remain liable to the mezzanine lender for failure to do so.

In the case of most institutionally originated mezzanine loans, this will probably not be an important remedy, because most institutionally originated mezzanine loans already include lockbox arrangements under which all cash available to the mortgage borrower, after it has paid its own debt service and operating expenses, would be captured by the mezzanine lender in a second lockbox arrangement. However, if the mezzanine loan did not include this feature, it would be an important remedy.

Retention of Pledged Equity by Mezzanine Lender

The UCC contemplates a "deed in lieu of foreclosure" mechanism.[2] The principal focus of this outline is foreclosure, so this treatment will be very brief.

After default, the mezzanine lender can propose to the mezzanine borrower that the mezzanine lender will retain the membership interest in full or partial satisfaction of the mezzanine loan. The mezzanine lender has to give notice of this proposal to the mezzanine borrower, holders of junior security interests in the membership interest (highly unlikely but possible), guarantors of the mezzanine loan and other parties who have requested notice in advance. The mezzanine borrower can't agree to this "deed in lieu" procedure before default but can agree after default. If the mezzanine borrower agrees after default, then, unless one of the other parties to whom the mezzanine lender gave notice of the proposal objects, the mezzanine lender can keep the collateral. If the mezzanine lender proposes to retain the collateral in full satisfaction of the mezzanine loan, the mezzanine borrower will be deemed to have accepted unless it objects in writing within 20 days after the mezzanine lender proposes the retention. If the mezzanine lender proposes a partial satisfaction, the mezzanine borrower is not deemed to have accepted by inaction. In a typical mezzanine loan, which is probably a non-recourse loan, it would only make sense for the mezzanine lender to propose retention in full satisfaction of the

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1 UCC Section 9-607(a)(1).

2 UCC Sections 9-620 to 9-622.

mezzanine loan. Particularly in a case in which there is no junior secured party[3] and no guarantor,[4] it probably makes sense for the mezzanine lender to propose a retention of collateral along these lines.

When this procedure is used, ownership of the collateral transfers to the mezzanine lender free and clear of all subordinate interests. Unlike a real estate deed in lieu, which does not wipe out junior liens, the UCC deed in lieu wipes out junior security interests. As indicated above, the deed in lieu would not occur at all if the holders of those interests do object to the transaction.

Foreclosure Sale of the Pledged Equity

Keep in mind that, in our example, the mortgage borrower still has a $70 million mortgage loan.[5] If that loan is in default, then the mortgage lender might have initiated its own foreclosure proceedings, in which event it is doubtful that anyone would want to purchase the pledged membership interest at a UCC foreclosure sale. The mortgage lender might be willing to allow a buyer of the pledged membership interest to "assume" the mortgage loan if it meets certain qualifications.[6] Even if the mortgage lender is not willing to allow the buyer of the pledged membership interest to assume the mortgage loan, there may be a time period within which the buyer of the membership interest can arrange its own replacement mortgage financing before the mortgage lender will take action to foreclose its mortgage lien. All of the discussion in this outline about how to foreclose on the pledged membership interest assumes that the mortgage lender will either be replaced or will permit the buyer of the membership interest to "assume" the mortgage loan.

Basic Concepts

Under the pledge agreement and the UCC, the mezzanine lender may sell the mortgage borrower's membership interest in a foreclosure sale after an event of default. A foreclosure sale can be a public sale or a private sale. If the foreclosure sale is a private sale, the mezzanine lender can't be the buyer. Neither can any affiliate of the mezzanine lender. The mezzanine

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3 If there is a junior mezzanine loan, the junior mezzanine lender will almost certainly have a security interest in the junior mezzanine borrower's membership interest in the mezzanine borrower. Because this is not the same collateral as the collateral for the mezzanine loan, the mezzanine lender would not be obligated to notify the junior mezzanine lender of the prospective retention of collateral under UCC Section 9-621 merely because of the junior mezzanine lender's security interest in its collateral. However, the junior mezzanine lender might have asked for such notice, pursuant to UCC Section 9-621(a)(1) and, in any case, there will probably be an intercreditor agreement between the mezzanine lender and the junior mezzanine lender that will give the junior mezzanine lender similar rights.

4 A non-recourse carve-out guarantor, which is only liable for "bad-boy" acts, is probably not a guarantor for these purposes. This is intended to refer to a secondary obligor with liability for the debt secured by the collateral.

5 It will almost certainly be the case, if both the mortgage loan and the mezzanine loan were institutionally originated, that there will be an "intercreditor agreement" between the mortgage lender and the mezzanine lender. This might well be the most important document that affects the rights and obligations of the mezzanine lender hoping to foreclose on its collateral. A full discussion of intercreditor agreements is beyond the scope of this brief outline.

6 Technically, this would not be an assumption of the loan, because the existing obligor (the mortgage borrower) would not change. However, the mortgage loan would probably have a "due on sale" clause that would treat the change of ownership of the membership interest as a default unless the mortgage lender approved the purchaser of the membership interest. As a practical matter, this situation would be substantially similar to an actual assumption of the mortgage loan.

lender can only be the buyer if the pledged equity is sold at a public foreclosure sale.[7] If the mezzanine lender wants to be, or is considering being, the buyer, the sale should be public.[8]

Whether public or private, a foreclosure sale must be "commercially reasonable." The UCC does not define "commercially reasonable" in any detail. One provision[9] says that "[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable." Another[10] provides that the disposition must be "[o]therwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition."

The public policy behind the commercial reasonableness requirement is to enable the foreclosing secured party to sell the collateral for the best price obtainable under the circumstances. It is a pro-debtor policy. It is not designed to protect the interests of the foreclosing secured creditor. Instead, it is designed to protect, first, other secured creditors with security interests in the same collateral, if there are any, and second, the mezzanine borrower and its other creditors. Although price may be one of the methods by which the commercial reasonableness of a foreclosure sale is measured after the fact (*e.g.*, in a court battle between the mezzanine lender and the mezzanine borrower), the commercial reasonableness requirement is really more about procedure than results. The idea is that, if the procedures are reasonable, the price will be maximized. Even if the collateral is sold for a very low price, then, although the mezzanine borrower can complain, if the secured party demonstrates that it followed commercially reasonable procedures, the foreclosure sale will not be disturbed by the court.[11]

As stated earlier, the value of the membership interest in the mortgage borrower is based on the value of the office building it owns. It is tempting to think that it would be commercially reasonable to foreclose on the membership interest in exactly the same way as a mortgage lender would foreclose on the office building. That might be a good starting point, but it is unlikely to

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7 Under UCC Section 9-610(c), the secured party may only purchase collateral at a private sale if the collateral is perishable or is sold on a recognized market or is the subject of widely distributed price quotations. None of these tests would be passed in a case in which the collateral is the sole membership interest in a limited liability company that owns an office building.

8 This brings up a complex and important subject. Full treatment of this issue is beyond the scope of this outline, but it is really an "elephant in the room." An interest in a limited liability company could be a "security" under federal and state securities laws. If it were a security, a public sale could not lawfully be conducted without registration with the Securities and Exchange Commission under the Securities Act of 1933 and compliance with applicable state "blue sky" laws. If the mortgage borrower's membership interest is sold only to one purchaser that has to keep it, and not subdivide and resell it, there is a good argument that the membership interest would not be regarded as a security. All of the foreclosure procedures discussed in this outline assume that the mortgage borrower's membership interest is not a security. If, under the applicable circumstances, with the assistance of competent securities counsel, the mezzanine lender were to conclude that the membership interest is a security, then, if the mezzanine lender wants to be the purchaser, it will have to conduct a foreclosure sale that is public for purposes of Article 9 of the UCC even though not public (that is, the sale qualifies for the "private placement exemption") under the securities laws. The SEC has issued many "no-action letters" over the years addressing how this can be achieved. See Comment 8 to UCC Section 9-610.

9 UCC Section 9-610(b).

10 UCC Section 9-627(b)(3).

11 There is a partial exception. Under UCC Section 9-615(f), if the secured party or its affiliate has purchased the collateral at a public sale for a lot less than the collateral would have fetched in a disposition complying with Article 9, then the court will treat the sale as if the collateral had been sold for the amount it would have fetched in a complying disposition. This would have an effect on any deficiency still owed by the mezzanine borrower to the mezzanine lender or any surplus owed by the mezzanine lender to the mezzanine borrower.

be a good ending point; it would be prudent to resist this temptation. Although it is true that the value of the membership interest will not be greater than the value of the office building, it is also true that the value of the membership interest will almost certainly be less than the value of the office building. In a foreclosure sale of the office building, the buyer at the foreclosure sale would have no responsibility for the debts owed by the mortgage borrower or the ongoing contractual obligations of the mortgage borrower. The office building would be sold free and clear of those debts and the buyer at the foreclosure sale would have no obligation to assume the mortgage borrower's ongoing contracts with vendors. The mortgage borrower's debts would include its existing mortgage loan and its trade payables to its vendors who have provided goods and services to the office building and whose invoices have not been paid. The debts might include state and local income tax liabilities if the office building is located in a jurisdiction in which a limited liability company is not a disregarded entity for state income tax purposes. The buyer of the mortgage borrower's membership interest would not, itself, inherit these debts and would not, itself, become liable on continuing contracts, but it would become the owner of a company that continued to have these debts and continued to have these ongoing contracts. These liabilities would ultimately have to be discharged and these contracts (some of which might be non-cancellable without penalty and may be on unfavorable terms) would have to be performed. Accordingly, the value of the membership interest would almost certainly be less than the value of the office building. The import of this observation is clear: a buyer of the membership interest could not make an intelligent, informed decision on how much to bid for the membership interest unless that buyer has reasonably accurate and reliable information concerning the existing mortgage loan, the existing trade debt, other existing liabilities and ongoing contractual obligations.

In the case of a foreclosure sale of an office building, prospective bidders would generally be interested in looking at rent rolls, examining leases and performing other due diligence, just like a buyer in an unforced transaction. However, it is not generally the case that the foreclosing mortgage lender has an obligation, as a matter of foreclosure law, to provide that information. But the "commercial reasonableness" requirement of Article 9 of the UCC might very well impose a greater obligation on the mezzanine lender foreclosing on the membership interest in the mortgage borrower. That mezzanine lender would be well advised to provide substantial due diligence information to prospective buyers of the membership interest, to the extent that information is available to the mezzanine lender. That would include not only the due diligence information mentioned above, but also financial statements and tax returns of the mortgage borrower and mezzanine borrower, copies of the mortgage borrower's ongoing contracts with its vendors, and, perhaps most importantly, copies of the documents evidencing the existing mortgage loan unless the prospective bidder for the membership interest has arranged its own replacement mortgage financing.

Is it absolutely essential that the mezzanine lender provide this extensive due diligence information? Maybe not. But the requirement of commercial reasonableness is not spelled out in any detail in the UCC and the court cases don't provide enough guidance to allow a foreclosing secured party to know for sure that the selected method of foreclosure would be approved by a court.[12] With statutory language like "every aspect of a disposition of collateral, including the

[12] Section 9-627(c) of the UCC provides that a foreclosing secured party would be deemed to have acted in a commercially reasonable manner if the foreclosure procedures have been approved by a court. The absence of a court approval does not imply a failure of commercial reasonableness. One of the advantages of the UCC is that foreclosure sales do not require prior court approval. So there is a trade-off: the secured party would forfeit speed of

method, manner, time, place, and other terms, must be commercially reasonable" and "in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition," it is highly likely that any court challenge of a foreclosure sale by the mezzanine borrower (or a junior mezzanine lender or a guarantor of the mezzanine loan, either of whom could assert a challenge) would be extremely fact-intensive. The court hearing the challenge might easily conclude that, if the mezzanine borrower had been providing regular reports to the mezzanine lender, the mezzanine lender could have easily arranged to make that information available to prospective bidders in advance of the foreclosure sale.

Practical Suggestions

This might be good advice to a prudent mezzanine lender looking for a reasonably high level of protection on the commercial reasonableness question: Act as if you owned the mortgage borrower membership interest as an investment and you wanted to sell it for the best price you could get. Suppose you can't, for some reason, cause the mortgage borrower to sell the office building; for some reason, you are stuck with selling the mortgage borrower membership interest. How would you do it?

Here are some ideas for that prudent mezzanine lender to consider.

1. Engage a well-regarded real estate broker familiar with commercial office buildings in the jurisdiction, preferably one who has had prior experience with auction sales or one who is affiliated with an auctioneer.

2. Tell the broker to plan to conduct a public sale, so that the mezzanine lender could be the buyer. However, if there is no way the mezzanine lender would want to be the buyer, the broker could conduct a private sale if the broker and the mezzanine lender concluded that would produce a better outcome.

3. Instruct the broker to advertise in trade publications and newspapers.

4. Have the broker establish a physical or electronic data room with all of the due diligence materials that can be readily obtained. The broker should assist in determining the due diligence information that would be desired by potential buyers. This would include property-level information about the mortgage loan, copies of the leases, financial information about the tenants, payment histories for the mortgage loan and the leases, a real estate title report, a current survey if available, structural and mechanical studies, environmental assessments, zoning reports, etc. It would also include entity-level information such as financial statements of the mezzanine borrower and mortgage borrower. The foreclosing mezzanine lender would not have to warrant the accuracy of this information, although the absence of a warranty would have some effect on the bidding.

5. When giving notices of the foreclosure sale to the mezzanine borrower, invite the mezzanine borrower to review the due diligence information compiled by the broker and invite the mezzanine borrower to verify and supplement the information by a reasonable deadline. Explain that the presence of the information will, in all likelihood, increase interest and,

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foreclosure in return for certainty on the commercial reasonableness question. Unless the mezzanine lender is very patient, this would almost certainly not work in the context of a mezzanine loan.

hopefully, participation, in the foreclosure sale, and perhaps, with luck, even the price. If the mezzanine borrower believes that the membership interest (after deduction for the mortgage loan and all debts of the mortgage borrower) is worth more than the balance of the mezzanine loan, the mezzanine borrower has an incentive to help increase the sale price of the membership interest by providing this information. If the mezzanine borrower does not provide any assistance in compiling the due diligence information, it will be more difficult for the mezzanine borrower to complain later that the mezzanine lender provided inadequate disclosure to prospective buyers. The requirement of commercial reasonableness does not mean that the mezzanine lender must provide information it does not have and cannot get.

6. Afford prospective buyers adequate time to review the due diligence information. Notwithstanding the 10-day safe harbor rule referred to below, it would be prudent to schedule the foreclosure sale of the membership interest for at least a month after the advertisements start appearing. The broker and auctioneer may suggest more time.

7. Make it clear that the membership interest will be sold to only one bidder, who will be required to represent that it is buying the membership interest without any intention of dividing it into multiple ownership interests and then distributing those multiple interests to other buyers or investors.[13]

Conduct of Sale

The UCC requires the mezzanine lender to give notice of the foreclosure sale to the mezzanine borrower, to all holders of junior security interests (if any) in the pledged membership interest, to all guarantors of the mezzanine loan, and to parties that have previously requested notice in writing. In the case of a private sale, the notice must indicate the date after which the foreclosing secured party may conduct the private sale. In the case of a public sale, the notice must state the time and place of the public sale. There is a safe harbor rule: if the notice is given at least 10 days in advance of the private sale, the notice period is reasonable.[14]

If the sale is a public sale, the party conducting the sale (perhaps an auctioneer) will conduct the sale on the day specified in the notices. The mezzanine lender can bid at the sale. The mezzanine lender can "bid in" the mezzanine loan, which means that, up to the amount secured by the pledge, the mezzanine lender does not have to pay actual cash money if it is the winning bidder. Instead, the mezzanine lender can "pay" for the pledged interest by reducing the amount of the debt secured.

A UCC foreclosure sale of the membership interest is an entirely self-help remedy. The mezzanine lender can exercise this remedy without obtaining any court approval. If the mezzanine borrower wishes to prevent the foreclosure sale from occurring, it can only accomplish that by filing bankruptcy[15] or filing suit against the mezzanine lender and obtaining a court order enjoining the mezzanine lender from conducting the foreclosure sale.[16]

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13 This is intended to minimize exposure to securities laws risks. See footnote #8.

14 UCC Section 9-612(b).

15 A typical mezzanine borrower would have no creditors, other than the mezzanine lender, and no asset other than the membership interest. There is a good chance that the mezzanine lender could get the bankruptcy case dismissed or get relief from the "automatic stay" that would prevent the mezzanine lender from foreclosing.

16 UCC Section 9-625(a).

Once the sale is conducted, the buyer at the sale becomes the owner of the collateral, free and clear of the rights of the mezzanine borrower and all (if any) junior secured parties. This is the case even if the secured party failed to comply with the specific requirements of the UCC, as long as the buyer acted in good faith.[17]

This leads to the discussion of another elephant in the room: what does it mean to become the owner of the membership interest in the mortgage borrower? This is where the LLC Act and the LLC Agreement come into play.

DELAWARE LLC ACT – ADMISSION TO MEMBERSHIP AND ASSUMPTION OF MANAGEMENT CONTROL

Admission to Membership in the Mortgage Borrower

The assignee (including by purchase at a foreclosure sale) of a membership interest in a Delaware limited liability company (which is what the mortgage borrower is) obtains the economic rights, but not the management rights, of the assignor of that interest (*i.e.*, the mezzanine borrower). In order to have the management rights accorded to a member, the owner of the membership interest must be formally admitted to membership. Consequently, unless the mezzanine lender has created a mechanism to ensure that a buyer of the membership interest at the UCC foreclosure sale is admitted to the mortgage borrower as a member, the buyer of the membership interest will have only the same rights of an assignee of the membership interest.[18]

An assignee of a membership interest may become a member of the limited liability company upon compliance with any provisions of the LLC Agreement that entitle an assignee to become a member or upon approval by all of the members of the limited liability company other than the assignor.[19] In the case of our hypothetical mezzanine loan, the only member of the mortgage borrower is the mezzanine borrower. There is no other member that can approve the admission to membership of the buyer of the membership interest at the foreclosure sale. Therefore, the assignee can only be admitted to membership in the mortgage borrower if there is a procedure in the LLC Agreement (or if the mortgage borrower has agreed to admit the buyer of the membership interest at a foreclosure sale in some other document).

A mezzanine lender would therefore hope that the applicable pledge agreement and the LLC Agreement of the mortgage borrower contain procedures that would ensure that the buyer of the pledged membership interest would become a member of the mortgage borrower at the conclusion of the foreclosure sale. If there are no such provisions, the buyer of the pledged membership interest might be in a kind of twilight zone,[20] where the buyer would have no right to manage the mortgage borrower, the defaulting mezzanine borrower would continue to have the sole right to manage the mortgage borrower, and the buyer would only have the right to capture distributions if, as and when they were made by the mortgage borrower. In other words, the foreclosure would have accomplished virtually nothing.

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17 UCC Section 9-617.

18 Section 18-702 of the LLC Act.

19 Section 18-704 of the LLC Act.

20 On Krypton (where Superman was born), criminals were sent to the phantom zone, where they were hardly any trouble to the remaining members of the population.

A pledge agreement may provide that, immediately upon the occurrence of a default under the mezzanine loan, the mezzanine lender has the right to become the member of the mortgage borrower in substitution for the mezzanine borrower. Such a provision should not be read as a shortcut method of strict foreclosure or retention of collateral. Rather, it should be understood as a provisional remedy entitling the mezzanine lender as secured party to take over all membership rights pending the subsequent foreclosure sale of the membership interest. In this sense it would be analogous to the pledgee of corporate stock becoming the registered owner of the stock, to ensure that it has the right to vote the stock and receive payments of corporate dividends after the default but before the foreclosure sale.

Replacement of Manager

A typical pledge agreement provision would allow the mezzanine lender, upon the occurrence of a default under the mezzanine loan, to oust the manager of the mortgage borrower from its role as manager of the mortgage borrower or, if the mortgage borrower is managed by the mezzanine borrower, to take over the mezzanine borrower's management rights. The typical provision would state that these rights are available to the mezzanine lender immediately upon the occurrence of the default, without having to wait for the foreclosure sale.[21]

How can the mezzanine lender enforce this remedy before conducting the foreclosure sale of the pledged membership interest? Section 18-110 of the LLC Act provides " upon application of any manager or member, the Court may hear and determine the validity of any admission . . . removal or resignation of a manager . . . and make such order or decree in any such case as may be just and proper." If the pledge agreement provides, as described above, that after default the mezzanine lender becomes the member, in substitution for the mezzanine borrower, then the Delaware Chancery Court should entertain an action by the mezzanine borrower, as member of the mortgage borrower, to replace the manager of the mortgage borrower.

Because this remedy can be available to the mezzanine lender after a default, and does not require the foreclosure sale to have been conducted, this would often be the most expeditious way to give the mezzanine lender effective operating control over the mortgage borrower. As a tactical matter, this might be extremely important, depending on the circumstances.

If the mezzanine lender pursues and obtains this relief before the foreclosure sale, once the mezzanine lender becomes the manager of the mortgage borrower, the mezzanine lender will not be able to operate the mortgage borrower solely for the mezzanine lender's own benefit. The mortgage borrower has creditors – the trade creditors and the mortgage lender. If the mezzanine lender becomes the manager, it would be prudent for the mezzanine lender to continue managing the mortgage borrower in the ordinary course of business until the foreclosure sale of the membership interest is completed. In other words, the mezzanine lender should probably act in the manner it would act if it were to become a mortgagee in possession of the office building.

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[21] Here, again, the intercreditor agreement between the mortgage lender and the mezzanine lender would almost certainly put some limits on the mezzanine lender's right to seek this remedy without the mortgage lender's consent.

CONCLUSION

The discussion above demonstrates that, although there are commonalities between foreclosing on the office building and foreclosing on the equity of the limited liability company that owns the office building, there are also significant differences. Most professionals involved in the foreclosure process will likely be people whose predominant prior experience will have been in real estate transactions. That will certainly be helpful; those people will have knowledge and understanding that will help the secured party maximize the value of the real property and help the prospective buyers understand the value of the real property. However, an extra set of skills and knowledge will be essential to navigating the foreclosure process when the collateral consists of equity interests in a limited liability company. If you are involved in such a foreclosure, be sure to pay close attention to the other bodies of law that will apply to the process.