

## **Proposed Amendments to Fla. Stat. §§ 679.4061 & 679.4081**

### ***Uniform Commercial Code §§ 9-406 & 9-408***

#### **Exclusion of LLC and Partnership Interests from UCC Article 9 Overrides**

##### **Executive Summary**

To facilitate the free transferability of intangibles rights, Sections 9-406 and 9-408 of the Uniform Commercial Code (“UCC”) operate to override terms in agreements that would otherwise restrict the transfer of such rights, including the granting or enforcement of security interests. Section 9-406 applies to override transfer restrictions relating to accounts, chattel paper, payment intangibles, and promissory notes. Section 9-408 overrides transfer restrictions relating to general intangibles and applies not only transfer restrictions contained in contractual agreements, but also overrides restrictions contained in any statute or other rule of law. These UCC provisions are enacted in Florida as Section 679.4061 and 679.4081 of the Florida Statutes.

When applied to partnership or LLC interests, the overrides contained in UCC Sections 9-406 and 9-408 interfere with the “pick your partner” principle, which generally protects members of LLCs and partners in partnerships from being forced into business with people they never intended to go into business with. The overrides in Sections 9-406 and 9-408 apply to LLC membership interests and partnership interests because such interests are typically categorized as general intangibles, which fall under the purview of UCC Section 9-408. Additionally, an LLC member’s or partner’s *economic* rights—the right to receive distributions on account of the membership or partnership interest—are typically categorized as payment intangibles, which fall under the purview of UCC Section 9-406. A detailed discussion of these issues can be found in the enclosed article: *LLC and Partnership Transfer Restrictions Excluded From UCC Article 9 Overrides*, authored by Carl S. Bjerre, Daniel S. Kleinberger, Edwin E. Smith, Steven O. Weise

The issue can be illustrated as follows. Two individuals go into business together and form an LLC. Each owner is a 50/50 member in the LLC. Their operating agreement (like most operating agreements) restricts the ability of one member to convey or encumber their membership interest without the consent of the other member, in keeping with the “pick your partner” principle engrained in LLC and partnership law. If one partner unilaterally encumbered their 50% membership interest to secure a personal loan from a bank (in violation of the operating agreement), then arguably Section 9-406 and 9-408 would “override” the restriction in the operation agreement. If the member defaulted on the loan, the lender could foreclose on its security interest in the LLC membership interest and take ownership of the membership interest. The other member would now be saddled with a bank as its new business partner, a result not contemplated or permitted by the members’ contract (the operating agreement).

Practitioners can debate whether these override provisions would apply to a specific operating agreement, the outcome of which could turn on how the operating agreement is drafted. But more commonly, sophisticated corporate attorneys elect to “opt in” to Article 8 of the UCC solely to avoid the potential effect of these override provisions. By opting into Article 8, the ownership interests in an LLC or partnership are treated as securities—categorized as “investment

property” under the UCC—which are not subject to Sections 9-406 or 9-408. However, opting into Article 8 brings its own hurdles and generally increases transaction costs for the parties involved.

To simplify the law in this area, and to eliminate potential conflicts between the “pick your partner” principle and the Section 9-406 and 9-408 overrides, the Uniform Law Commission and the American Law Institute approved amendments to the Uniform Commercial Code in 2018. The 2018 amendments provide that the override sections do not apply to “a security interest in an ownership interest in a general partnership, limited partnership, or limited liability company.” This clause is added as a subsection at the end of both Section 9-406 and 9-408. These amendments went through the formal approval channels and are now part of the UCC’s official text. A draft of 2018 UCC amendments applied to Florida’s version of the pertinent UCC provisions, Sections 679.4061 and 679.4081 of the Florida Statutes, is enclosed with this summary.

Several other states have enacted provisions substantially identical to the 2018 amendments. Delaware, Colorado, North Carolina, Texas, and Virginia have all amended their versions of Sections 9-406 and 9-408 of the UCC to exclude LLC and partnership ownership interests. Other states have amended their LLC and partnership statutes to reach a similar result. A chart received from the Uniform Law Commission detailing other states’ legislative responses to this issue is enclosed with this summary.

Enacting the 2018 amendments to Florida’s UCC Sections 9-406 and 9-408 would protect freedom of contract principles that underly the “pick your partner” doctrine and provide desired clarity to courts, practitioners, and business people that these provisions do not apply to LLC interests and partnership interests, reducing the potential for litigation over these issues. Additionally, the amendment would reduce transaction costs for business by obviating the need to opt in to Article 8 to avoid the potential effect of the override provisions.

1       **679.4061 Discharge of account debtor; notification of**  
2       **assignment; identification and proof of assignment;**  
3       **restrictions on assignment of accounts, chattel paper,**  
4       **payment intangibles, and promissory notes ineffective.—**

5       (1) Subject to subsections (2) through (9), an account  
6       debtor on an account, chattel paper, or a payment  
7       intangible may discharge its obligation by paying the  
8       assignor until, but not after, the account debtor receives  
9       a notification, authenticated by the assignor or the  
10      assignee, that the amount due or to become due has been  
11      assigned and that payment is to be made to the assignee.  
12      After receipt of the notification, the account debtor may  
13      discharge its obligation by paying the assignee and may not  
14      discharge the obligation by paying the assignor.

15      (2) Subject to subsection (8), notification is ineffective  
16      under subsection (1):

17      (a) If it does not reasonably identify the rights assigned;

18      (b) To the extent that an agreement between an account  
19      debtor and a seller of a payment intangible limits the  
20      account debtor's duty to pay a person other than the seller  
21      and the limitation is effective under law other than this  
22      chapter; or

23      (c) At the option of an account debtor, if the notification  
24      notifies the account debtor to make less than the full

25 amount of any installment or other periodic payment to the  
26 assignee, even if:

27 1. Only a portion of the account, chattel paper, or payment  
28 intangible has been assigned to that assignee;

29 2. A portion has been assigned to another assignee; or

30 3. The account debtor knows that the assignment to that  
31 assignee is limited.

32 (3) Subject to subsection (8), if requested by the account  
33 debtor, an assignee shall seasonably furnish reasonable  
34 proof that the assignment has been made. Unless the  
35 assignee complies, the account debtor may discharge its  
36 obligation by paying the assignor, even if the account  
37 debtor has received a notification under subsection (1).

38 (4) Except as otherwise provided in ~~subsection~~ subsections  
39 (5) and (12), and ss. 680.303 and 679.4071, and subject to  
40 subsection (8), a term in an agreement between an account  
41 debtor and an assignor or in a promissory note is  
42 ineffective to the extent that it:

43 (a) Prohibits, restricts, or requires the consent of the  
44 account debtor or person obligated on the promissory note  
45 to the assignment or transfer of, or the creation,  
46 attachment, perfection, or enforcement of a security  
47 interest in, the account, chattel paper, payment  
48 intangible, or promissory note; or

49 (b) Provides that the assignment or transfer or the  
50 creation, attachment, perfection, or enforcement of the  
51 security interest may give rise to a default, breach, right  
52 of recoupment, claim, defense, termination, right of  
53 termination, or remedy under the account, chattel paper,  
54 payment intangible, or promissory note.

55 (5) Subsection (4) does not apply to the sale of a payment  
56 intangible or promissory note, other than a sale pursuant  
57 to a disposition under s. 679.610 or an acceptance of  
58 collateral under s. 679.620.

59 (6) Except as otherwise provided in subsection (12) and  
60 ss. 680.303 and 679.4071 and subject to subsections (8) and  
61 (9), a rule of law, statute, or regulation that prohibits,  
62 restricts, or requires the consent of a government,  
63 governmental body or official, or account debtor to the  
64 assignment or transfer of, or creation of a security  
65 interest in, an account or chattel paper is ineffective to  
66 the extent that the rule of law, statute, or regulation:

67 (a) Prohibits, restricts, or requires the consent of the  
68 government, governmental body or official, or account  
69 debtor to the assignment or transfer of, or the creation,  
70 attachment, perfection, or enforcement of a security  
71 interest in the account or chattel paper; or

72 (b) Provides that the assignment or transfer or the  
73 creation, attachment, perfection, or enforcement of the

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74 security interest may give rise to a default, breach, right  
75 of recoupment, claim, defense, termination, right of  
76 termination, or remedy under the account or chattel paper.

77 (7) Subject to subsection (8), an account debtor may not  
78 waive or vary its option under paragraph (2)(c).

79 (8) This section is subject to law other than this chapter  
80 which establishes a different rule for an account debtor  
81 who is an individual and who incurred the obligation  
82 primarily for personal, family, or household purposes.  
83 Subsections (4) and (6) do not apply to the creation,  
84 attachment, perfection, or enforcement of a security  
85 interest in:

86 (a) A claim or right to receive compensation for injuries  
87 or sickness as described in 26 U.S.C. s. 104(a)(1) or (2).

88 (b) A claim or right to receive benefits under a special  
89 needs trust as described in 42 U.S.C. s. 1396p(d)(4).

90 (c) The interest of a debtor who is a natural person in  
91 reemployment assistance or unemployment, alimony,  
92 disability, pension, or retirement benefits or victim  
93 compensation funds.

94 (d) The interest of a debtor who is a natural person in  
95 other benefits which are designated solely for his or her  
96 maintenance, support, or education, the assignability of  
97 which is expressly prohibited or restricted by statute.

98 (9) Subsections (4), (6), and (8) apply only to a security  
99 interest created after January 1, 2002.

100 (10) This section does not apply to an assignment of a  
101 health-care-insurance receivable.

102 (11) This section prevails over any inconsistent statute,  
103 rule, or regulation.

104 (12) Subsections (4), (6), and (11) do not apply to a  
105 security interest in an ownership interest in a general  
106 partnership, limited partnership, or limited liability  
107 company.

108

109       **679.4081 Restrictions on assignment of promissory notes,**  
110       **health-care-insurance receivables, and certain general**  
111       **intangibles ineffective.**—

112       (1) Except as otherwise provided in ~~subsection~~ subsections

113       (2) and (8), a term in a promissory note or in an agreement  
114       between an account debtor and a debtor which relates to a  
115       health-care-insurance receivable or a general intangible,  
116       including a contract, permit, license, or franchise, and  
117       which term prohibits, restricts, or requires the consent of  
118       the person obligated on the promissory note or the account  
119       debtor to, the assignment or transfer of, or creation,  
120       attachment, or perfection of a security interest in, the  
121       promissory note, health-care-insurance receivable, or  
122       general intangible, is ineffective to the extent that the  
123       term:

124       (a) Would impair the creation, attachment, or perfection of  
125       a security interest; or

126       (b) Provides that the assignment or transfer or the  
127       creation, attachment, or perfection of the security  
128       interest may give rise to a default, breach, right of  
129       recoupment, claim, defense, termination, right of  
130       termination, or remedy under the promissory note, health-  
131       care-insurance receivable, or general intangible.

132       (2) Subsection (1) applies to a security interest in a  
133       payment intangible or promissory note only if the security

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134 interest arises out of a sale of the payment intangible or  
135 promissory note, other than a sale pursuant to a  
136 disposition under s. 679.610 or an acceptance of collateral  
137 under s. 679.620.

138 (3) ~~A~~Except as otherwise provided in subsection (8), a  
139 rule of law, statute, or regulation that prohibits,  
140 restricts, or requires the consent of a government,  
141 governmental body or official, person obligated on a  
142 promissory note, or account debtor to the assignment or  
143 transfer of, or creation of a security interest in, a  
144 promissory note, health-care-insurance receivable, or  
145 general intangible, including a contract, permit, license,  
146 or franchise between an account debtor and a debtor, is  
147 ineffective to the extent that the rule of law, statute, or  
148 regulation:

149 (a) Would impair the creation, attachment, or perfection of  
150 a security interest; or

151 (b) Provides that the assignment or transfer or the  
152 creation, attachment, or perfection of the security  
153 interest may give rise to a default, breach, right of  
154 recoupment, claim, defense, termination, right of  
155 termination, or remedy under the promissory note, health-  
156 care-insurance receivable, or general intangible.

157 (4) To the extent that a term in a promissory note or in an  
158 agreement between an account debtor and a debtor which

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159 | relates to a health-care-insurance receivable or general  
160 | intangible or a rule of law, statute, or regulation  
161 | described in subsection (3) would be effective under law  
162 | other than this chapter but is ineffective under subsection  
163 | (1) or subsection (3), the creation, attachment, or  
164 | perfection of a security interest in the promissory note,  
165 | health-care-insurance receivable, or general intangible:  
166 | (a) Is not enforceable against the person obligated on the  
167 | promissory note or the account debtor;  
168 | (b) Does not impose a duty or obligation on the person  
169 | obligated on the promissory note or the account debtor;  
170 | (c) Does not require the person obligated on the promissory  
171 | note or the account debtor to recognize the security  
172 | interest, pay or render performance to the secured party,  
173 | or accept payment or performance from the secured party;  
174 | (d) Does not entitle the secured party to use or assign the  
175 | debtor's rights under the promissory note, health-care-  
176 | insurance receivable, or general intangible, including any  
177 | related information or materials furnished to the debtor in  
178 | the transaction giving rise to the promissory note, health-  
179 | care-insurance receivable, or general intangible;  
180 | (e) Does not entitle the secured party to use, assign,  
181 | possess, or have access to any trade secrets or  
182 | confidential information of the person obligated on the  
183 | promissory note or the account debtor; and

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184 (f) Does not entitle the secured party to enforce the  
185 security interest in the promissory note, health-care-  
186 insurance receivable, or general intangible.

187 (5) This section prevails over any inconsistent statute,  
188 rule, or regulation.

189 (6) Subsections (1) and (3) do not apply to the creation,  
190 attachment, perfection, or enforcement of a security  
191 interest in:

192 (a) A claim or right to receive compensation for injuries  
193 or sickness as described in 26 U.S.C. s. 104(a)(1) or (2).

194 (b) A claim or right to receive benefits under a special  
195 needs trust as described in 42 U.S.C. s. 1396p(d)(4).

196 (c) The interest of a debtor who is a natural person in  
197 reemployment assistance or unemployment, alimony,  
198 disability, pension, or retirement benefits or victim  
199 compensation funds.

200 (d) The interest of a debtor who is a natural person in  
201 other benefits which are designated solely for his or her  
202 maintenance, support, or education, the assignability of  
203 which is expressly prohibited or restricted by statute.

204 (7) Subsections (1), (3), and (6) apply only to a security  
205 interest created after January 1, 2002.

206 (8) This section does not apply to a security interest in  
207 an ownership interest in a general partnership, limited  
208 partnership, or limited liability company.

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# LLC and Partnership Transfer Restrictions Excluded From UCC Article 9 Overrides

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The organizational law of limited liability companies (LLCs) and partnerships has always fundamentally embraced an idea known as the “pick-your-partner principle,” under which transfers of a member’s or partner’s ownership interest are restricted by statute, and those restrictions may be tightened or loosened by agreement. In recent years the pick-your-partner principle has interacted in complex and not always practical ways with Article 9 of the Uniform Commercial Code (UCC). Since 2001, UCC §§ 9-406 and 9-408 have overridden a broad range of statutory and agreement-based anti-assignment provisions, subject to complex exceptions that have tended to protect the pick-your-partner principle in many significant respects, while also proving analytically very difficult to handle. Recently, however, in an important step forward, Article 9’s overrides of anti-assignment provisions have recently been amended to make them simply inapplicable to LLC and partnership interests.

One hopes that these amendments to Article 9’s overrides (hereinafter the “2018 amendments” because they were approved last year) will soon be enacted by the states, but in the meantime, the current overrides will remain on the books in various jurisdictions with all of their existing complexities. Accordingly, this article focuses not only on the 2018 amendments, but also on an analysis of the overrides as they now stand, as applied to LLC and partnership interests. The amendments themselves are quite simple, but the article discusses them only after analyzing the overrides because the amendments are more easily understood against that background.

## I. Background on Unincorporated Organization Law and UCC Article 9

Any co-owner of a privately held business organization may have a substantial stake in determining who the other co-owners are. If a second co-owner has the power to transfer its interest to a stranger, then the second co-owner can, in effect, force the first co-owner into a venture with the stranger/transferee without the first co-owner’s consent. The policy and effect of the pick-your-partner principle under LLC and partnership law is to prevent such an outcome.

UCC Article 9, by contrast, has the very different policy orientation of facilitating voluntary transfers of personal property. Article 9’s most familiar application is to transfers of property as security for the repayment of loans, but Article 9 also applies to outright sales of certain types of personal property. Some of these transfers and outright sales are precisely those that the pick-your-partner principle seeks to prevent, and as a result, for personal property consisting of LLC or partnership interests, the interaction of the pick-your-partner principle with Article 9 has been complex and thorny. Some have even called it *recondite*.

Ownership interests in a business organization, particularly one that is unincorporated, can be formally or informally bifurcated into governance rights and economic (or financial) rights. Governance rights consist of the owner's right to vote on, consent to, or otherwise make decisions about the organization's activities, and the right to receive information about the organization. Economic rights consist of the owner's entitlement to receive monetary distributions from the organization, whether from its profits or from an eventual dissolution and winding up. A complete ownership interest typically comprises both governance rights and economic rights. A good example of purely economic rights is a transferable interest in an LLC or limited partnership. See, e.g., Uniform Limited Liability Company Act (ULLCA) § 102(24) (2013).

Article 9 broadly covers ordinary security interests in both of the above aspects of ownership rights as well as in virtually all other personal property, plus the outright sales of some types of personal property, to be explained below. In light of this vast coverage, and in order to provide appropriately tailored rules for particular patterns of transaction, Article 9 subdivides personal property into an array of statutorily defined "types," or classifications. The most important classification for purposes of this article is general intangibles, which is Article 9's residual or catch-all classification, meaning that it includes any personal property that does not fall within the other Article 9 classifications. Hence, an asset is a general intangible only if it is not, for example, inventory or other goods, accounts, instruments, chattel paper, or securities or other investment property. See UCC § 9-102(a)(42). Examples of general intangibles range from trademarks to taxicab medallions, and centrally for purposes of this article, the category includes most LLC and partnership interests. (LLC or partnership interests may alternatively be classified as securities, using an opt-in process discussed in Part II.C.)

The other key type of property for purposes of this article is payment intangibles, which is a subset of general intangibles. The distinction between a general intangible that is also a payment intangible on one hand, and a general intangible that is not a payment intangible on the other, is that the former includes only general intangibles under which the "principal obligation" of the "account debtor" is "a monetary obligation." § 9-102(a)(62). In this article, the important term "account debtor" may be understood simply as the entity that is obligated on a payment intangible or other general intangible, i.e., the LLC or partnership itself as opposed to its members or partners. To determine whether the "principal obligation" is "monetary," one must weigh the relative importance of a member's or partner's governance and economic rights: if the LLC's or partnership's principal obligation in respect of the ownership interest is economic and thus "monetary," then the ownership interest is a general intangible that is also a payment intangible (or simply "payment intangible" for short). Otherwise, the ownership interest is a general intangible that is not a payment intangible. In general, if a member or partner has governance rights that the LLC or partnership is obligated to respect, the ownership interest is likely a general intangible that is not a payment intangible.

This distinction between payment intangibles and other general intangibles affects Article 9's scope, which is crucial to understanding the overrides because of course the overrides apply only within that scope. Article 9's scope includes two principal types of transactions relevant to this article: interests in either payment intangibles or other general intangibles that secure a loan or another obligation (referred to in this article as ordinary security interests), and outright sales of

payment intangibles. In fact, outright sales of payment intangibles are statutorily defined in Article 9 as “security interests,” purely as a matter of terminological convenience, because many (though not all) of Article 9’s rules for ordinary security interests also apply directly to sales of payment intangibles. By contrast, Article 9’s scope does not include outright sales of general intangibles that are not payment intangibles, because most of such sales have little enough in common with ordinary security interests that inclusion would not be sensible. (The boundary between an outright sale of property and an ordinary security interest in the property is not always self-evident, but that topic is beyond the scope of this article. See, e.g., § 9-109 cmt. 4.) One final note on Article 9’s scope is that transfers by gift or, generally, transfers by operation of law are not covered.

Bringing these strands together, Article 9 typically does not apply at all to the most common kind of transfer in this area—namely, outright sales of a member’s or partner’s complete ownership interest—because such a transaction is typically the sale of a general intangible that is not a payment intangible. By the same token, Article 9 does not apply to outright sales of a member’s or partner’s governance rights alone. But Article 9 does apply, and hence its overrides discussed below might apply, to ordinary security interests in complete ownership interests; to ordinary security interests in economic rights alone; and to outright sales of economic rights alone.

The fact that Article 9 applies to a particular transaction, though, does not necessarily mean that there is a practical conflict between an Article 9 override and the pick-your-partner principle. Whether a practical conflict exists depends on three elements. First, do the applicable statutes governing the organization directly restrict transfers? Such restrictions are universal or nearly so in the case of governance rights and complete ownership interests (e.g., ULLCA § 407(b)(2) (2013)), but they are nonexistent or nearly so in the case of economic rights (e.g., *id.* § 502(a)). Second, do the LLC’s or partnership’s own organic documents alter (or perhaps track) the statutory law just mentioned, for example by restricting transfers of economic rights? Organizations may indeed adopt restrictions on the transfer of economic rights, in order to ensure that all owners retain their economic stake in the organization and, as a result, have reasonably well-aligned governance incentives. And finally, if a restriction on transfer is imposed by either of the foregoing sources, does one of the Article 9 overrides invalidate or limit the restriction?

## **II. Navigating Unamended §§ 9-406 and 9-408**

Part of what makes Article 9’s overrides of anti-assignment provisions difficult is that they appear in two separate sections that are phrased quite similarly, but have subtle distinctions, and do not overlap. The first override, in § 9-406, is relatively strong and simple in its effects, but it applies to only a narrow set of transactions. The second override, in § 9-408, applies more broadly and is more complex in its provisions that apply to LLC and partnership interests, but it has only relatively weak effects on the transactions to which it applies. Taking into account the narrowness of the first and the weakness of the second, plus the availability of the opt-in process discussed in Part II.C, the overrides have generally not posed substantial problems for those who seek the protection of the pick-your-partner principle. On the other hand, general conclusions only take one so far in particular transactions.

## **A. Section 9-406**

Article 9’s first override, beginning at § 9-406(d), invalidates any “term in an agreement between an account debtor and an assignor” to the extent that that term “prohibits, restricts, or requires the consent of . . . the account debtor” to “the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in . . . the payment intangible.” The simplicity of this provision is evident from its shortness, and the strength of this provision is that it overrides restrictions on all aspects of security interests, including “enforcement,” as further discussed below.

The § 9-406 override is narrow, however, in three important ways. First, it applies only to payment intangibles (leaving aside its application to other types of property not relevant to this article), and only to ordinary security interests in them. See § 9-406(e). In other words, the override does not apply to transfers of governance rights, in either an outright sale or an ordinary security interest; and it does not apply to transfers of a complete ownership interest in either an outright sale or an ordinary security interest, assuming that the complete ownership interest is a general intangible that is not a payment intangible. Nor does the override apply to an outright sale of a payment intangible (other than a foreclosure sale or a secured party’s acceptance of the payment intangible in satisfaction of the obligation it secures). See the discussion of § 9-408 in Part II.B. The narrowness of the § 9-406 override is important as a practical matter because when an LLC’s or partnership’s organic documents impose restrictions on transfer, the restrictions sometimes apply by their own terms only to governance rights or complete ownership interests, not to purely economic rights (classified as payment intangibles) in the first place.

Second, the § 9-406 override has no effect on an anti-assignment clause in an agreement among the organization’s members or partners *inter se*, as opposed to terms in an agreement with the organization itself. This is because the override applies only to terms in an agreement with “an account debtor” and the assignor/transferor, and as noted in Part I, the LLC or partnership itself, rather than the other members or partners, is the account debtor in this context. Moreover, there may be substantial grounds to question whether the override applies even to an anti-assignment clause that is set forth directly in the organization’s operating agreement, partnership agreement or other organic documents, because as a formal matter, an LLC or partnership is usually not a party to these agreements. On the other hand, substance-over-form arguments should be borne in mind on this point.

Third and relatedly, if the term of the agreement imposes a consent requirement, the override applies only if the consent required is that of the LLC or partnership itself, as opposed to one or more members or partners. For example, if an LLC is member-managed, the agreement will almost certainly require the consent of the members, and accordingly, the override will not apply to that requirement.

## **B. Section 9-408**

Article 9’s other override, beginning at § 9-408(a), invalidates any term in “an agreement between an account debtor and a debtor which relates to . . . a general intangible” that “prohibits, restricts, or requires the consent of . . . the account debtor” to “the assignment or transfer of, or

creation, attachment, or perfection of a security interest in . . . the . . . general intangible.” It also invalidates any provision of a statute or other rule of law that similarly “prohibits, restricts, or requires the consent of . . . [an] account debtor” to “the assignment or transfer of, or creation of a security interest in, a . . . general intangible.” Thus § 9-408 is more complex than § 9-406 as applied to LLC and partnership interests, because it overrides not only terms of agreements, but also statutes or other rules of law. (Although § 9-406 also overrides some statutes or other rules of law, it does so only for classifications of collateral that are not relevant to this article.)

Section 9-408 is also broader than § 9-406 in two additional ways. First, it applies to a broader range of transactions, namely outright sales of payment intangibles (statutorily included in Article 9’s term “security interest,” as noted in Part I) and ordinary security interests in general intangibles that are not payment intangibles. Outright sales of economic rights, covered here, perhaps are more common than ordinary security interests in them, covered in §9-406; and certainly general intangibles that are not payment intangibles is the most common classification of an LLC or partnership interest.

Second, the statutes that § 9-408 overrides are of broad applicability because they are restrictions on the transfer of general intangibles that are not payment intangibles, i.e., virtually all complete ownership interests, plus all governance rights taken alone. As a practical matter, such statutory restrictions are nearly universal in this area, though a particular organization’s organic documents may sometimes alter the statutory default rules.

On the other hand, just as for § 9-406 above, § 9-408 does not apply to an anti-assignment clause in an agreement among the organization’s members or partners *inter se*, as opposed to an agreement with the organization itself. Similarly, and again just as for § 9-406, if the term of the agreement imposes a consent requirement, § 9-408 applies only if the consent required is that of the organization itself, as opposed to one or more members or partners. This override of consent requirements, in § 9-408 unlike § 9-406, extends to statutes as well as terms in an agreement, but nonetheless only if the consent required is that of the organization itself as opposed to one or more members or partners—but this is not how the LLC and partnership statutes work. Instead, the statutes place the power to give or withhold consent in the hands of the members or partners themselves.

The feature of this override that makes its effects relatively weak, and thereby substantially accommodates parties seeking the protection of the pick-your-partner principle, is that § 9-408 invalidates restrictions only on the “creation, attachment, or perfection” of security interests. It does not, unlike § 9-406, invalidate restrictions on “enforcement” of security interests. Subsection 9-408(d) amplifies on this point by specifying among other things that, even giving effect to the § 9-408 override, a security interest that is subject to an otherwise enforceable restriction is “not enforceable” against the “account debtor” (i.e., the LLC or partnership itself), and “does not entitle the secured party to enforce the security interest.” In other words, under § 9-408, a security interest (including an outright sale of a payment intangible) may go forward as between the transferor and transferee, but not as between the transferee and the LLC or partnership. The secured party acquires property rights (an ordinary security interest or an ownership interest) to the transferring member’s or partner’s ownership interest, and the value of these rights would be respected, for example in a bankruptcy of the transferor, or as applied to



proceeds from a transfer not affected by a restriction. See UCC § 9-408 cmt. 7. But the secured party is nonetheless without power of its own to step into the transferor's shoes and exercise the transferor's governance or economic rights.

Summarizing the substance of the two overrides, it is useful to think in terms of four permutations, based on the two classifications of collateral and the two forms of transaction. First, an outright sale of a general intangible that is not a payment intangible is not within the scope of Article 9, so neither override applies. Second, with an ordinary security interest in a general intangible that is not a payment intangible, the relatively weak override in § 9-408 applies, so that the secured party cannot enforce the transferred governance or economic rights against the organization. Third, with an outright sale of a payment intangible, again the relatively weak override in § 9-408 applies, so that the secured party cannot enforce the transferred rights against the organization. And fourth, with an ordinary security interest in a payment intangible, the relatively strong override in § 9-406 applies, so that the secured party can enforce the transferred rights against the organization. The Permanent Editorial Board for the Uniform Commercial Code (P.E.B.) is considering issuing a report that would further detail the application of both overrides to LLC and partnership interests.

### **C. Opting into Article 8**

Neither of the Article 9 overrides applies to property that is a security as defined in UCC Article 8. This is because securities are classified by Article 9 as "investment property" rather than as general intangibles or, *a fortiori*, payment intangibles.

The term "security" generally does not include ownership interests in LLCs and partnerships, but it does include them if the "terms" of the ownership interest "expressly provide that it is a security" governed by Article 8. See §§ 8-102(a)(15), 8-103(c). Hence, one established way for transactional lawyers to avoid the overrides altogether is to have the organization "opt in" to Article 8 by adopting appropriate provisions in its organic documents. Related measures include providing for the security to be certificated or uncertificated, and preventing the organization from opting back out of Article 8 without the consent of the parties concerned.

## **III. The 2018 Amendments, Non-Uniform Amendments, and Choice of Law**

Compared to the complex analysis in Part II, enactment of the 2018 amendments will markedly simplify the law in this area, eliminating the possible conflicts with the pick-your-partner principle that can remain despite the exceptions in §§ 9-406 and 9-408, and without the need for an Article 8 opt-in.

The 2018 amendments statutorily provide that Article 9's overrides do not apply to "a security interest in an ownership interest in a general partnership, limited partnership, or limited liability company." (In § 9-406, this language appears in a new subsection (k), which explicitly applies to subsections (d), (f), and (j). In § 9-408, the same language appears in a new subsection (f), which explicitly applies to the entire section.) A new comment to § 9-408 reads:

This section does not apply to an ownership interest in a limited liability company, limited partnership, or general partnership, regardless of the name of the interest and whether the interest: (i) pertains to economic rights, governance rights, or both; (ii) arises under: (a) an operating agreement, the applicable limited liability company act, or both; or (b) a partnership agreement, the applicable partnership act, or both; or (iii) is owned by: (a) a member of a company or transferee or assignee of a member; or (b) a partner or a transferee or assignee of a partner; or (iv) comprises contractual, property, other rights, or some combination thereof.

A new comment to § 9-406 provides that the § 9-408 comment applies to § 9-406 as well.

By excluding from the overrides “a security interest” in an ownership interest, the 2018 amendments permit outright sales of payment intangibles to go forward, as well as ordinary security interests in payment intangibles, and ordinary security interests in general intangibles that are not payment intangibles. The overrides remain in effect for general intangibles that are not LLC or partnership interests and for other classifications of personal property that are not relevant to this article.

The 2018 amendments were initially recommended by the P.E.B. in conjunction with representatives from the Joint Editorial Board on Uniform Unincorporated Organization Acts. They were then approved in accordance with the respective procedures of the UCC’s two sponsoring organizations, the American Law Institute and the Uniform Law Commission. As a result, they are now a part of the UCC’s official text.

At the time of this writing, it is too early for the 2018 amendments to have been enacted in any jurisdiction. On the other hand, in recent years a number of states, led by Delaware, have enacted non-uniform provisions having the same thrust. Some of the non-uniform provisions appear in the enacting states’ UCC; others appear in their LLC and partnership organizational statutes; and others appear in both spots, as belt and suspenders and to ensure they will be found.

An important conflict-of-laws question can arise if a transaction involves elements from more than one jurisdiction, one of which has the unamended Article 9 overrides, and another of which has an eventual enactment of the 2018 amendments (or an existing, comparable non-uniform provision). Article 9’s conflicts rule for perfection and priority of security interests in general intangibles does not apply to the treatment of transfer restrictions, because this issue is neither “perfection,” “the effect of perfection or nonperfection,” nor “priority.” See § 9-301(1). Article 1’s main catch-all conflicts rule, which leaves some conflicts questions to the agreement of the parties, would also generally be inappropriate here because transfer restrictions inherently present a three-party question that is not amenable to treatment by two-party agreement. See § 1-301(a). Accordingly, a choice-of-law clause in the security agreement or other agreement between transferor and transferee does not control, as Comment 3 to § 9-401 makes clear. Instead, one would hope that a court would apply the version of the overrides enacted by the jurisdiction in which the entity is organized, as the same Comment assumes. (The “internal affairs” doctrine in business entity law would also be consistent with such an outcome, although of course, restrictions on transfers to nonmembers or nonpartners are not strictly internal affairs issues.) In any case, the bottom line is that real certainty in this area will most promisingly have

to come from broad enactment of the 2018 amendments. The members of each state's Uniform Law Commission delegation can often be of direct help in those enactment efforts.

## **IV. Conclusion**

The 2018 amendments will protect the pick-your-partner principle while also greatly simplifying and clarifying its interactions with Article 9. By the same token, as is often true of simple rules, the 2018 amendments may also sometimes reach more broadly than really needed, for example by preventing simple attachment and perfection, without enforcement, of a security interest in a complete ownership interest. However, those transactions can continue to go forward despite the 2018 amendments by means of, for example, the Article 8 opt-in, or other amendment or waiver of the organization's organic documents. On balance, the gains in this area from simplicity and clarity should clearly outweigh the losses from the occasional extra burden to an Article 9 transaction.

**State Overrides of UCC Sections 9-406 and 9-408**

*Last Updated 12/11/19*

State	Amend §9-406	Comments	Amend §9-408	Comments	Amend LLC Act	Comments	Amend LP Act	Comments	Amend Partnership Act	Comments
Alabama	No		No		Yes. Ala. Code § 10A-5A-1.06	“(e) Sections 7-9A-406 and 7-9A-408 of the Uniform Commercial Code, and all successor statutes thereto, do not apply to any interest in a limited liability company, including all rights, powers, and interests arising under a limited liability company agreement or this chapter. This provision prevails over Sections 7-9A-406 and 7-9A-408 of the Uniform Commercial Code, and all successor statutes thereto, and is expressly intended to permit the enforcement of the provisions of a limited liability company agreement that would otherwise be ineffective under sections 7-9A-406 and 7-9A-408 of the Uniform Commercial Code, and all successor statutes thereto.	Yes Ala. Code § 10A-9-7.02 (2015)	“(h) Limitations on the transfer of transferable interests set forth in Sections 10A-9-7.01 to 10A-9-7.04 and limitations on the transfer of transferable interests set forth in the partnership agreement are enforceable notwithstanding Sections 7-9A-406 and 7-9A-408.”	No	
Alaska	No		No		No		No		No	
Arizona	No		No		No		No		No	
Arkansas	No		No		No		No		No	
California	No		No		No		No		No	
Colorado	Yes Colo. Rev. Stat. § 4-9-406	“(l) As specified in section 7-90-104, C.R.S., subsections (d) to (f) of this section do not apply to the assignment or the transfer of, or the creation of a security interest in, an owner’s interest as defined in section 7-90-102(44), C.R.S.”	Yes Colo. Rev. Stat. § 4-9-408	“(g) As specified in section 7-90-104, C.R.S., this section does not apply to the assignment or the transfer of, or the creation of a security interest in, an owner’s interest as defined in section 7-90-102(44), C.R.S.”	Yes Colo. Rev. Stat. § 7-90-104 (2015)	“Sections 4-9-406 and 4-9-408, C.R.S., shall not apply to an owner’s interest.”	Yes Colo. Rev. Stat. § 7-90-104 (2015)	“Sections 4-9-406 and 4-9-408, C.R.S., shall not apply to an owner’s interest.”	Yes Colo. Rev. Stat. § 7-90-104 (2015)	“Sections 4-9-406 and 4-9-408, C.R.S., shall not apply to an owner’s interest.”
Connecticut	No		No		No		No		No	

**State Overrides of UCC Sections 9-406 and 9-408**

*Last Updated 12/11/19*

State	Amend §9-406	Comments	Amend §9-408	Comments	Amend LLC Act	Comments	Amend LP Act	Comments	Amend Partnership Act	Comments
Delaware	Yes De. Code. Ann. Tit. 6, § 9-406 (West 2015)	Specific provision subsection (i)(5)	Yes De. Code. Ann. tit. 6, § 9-408 (West 2015)	Specific provision subsection (e)	Yes Del. Code. Ann. tit. 6, § 18-1101 (West 2015)	“(g) Sections 9-406 and 9-408 of this title do not apply to any interest in a limited liability company, including all rights, powers and interests arising under a limited liability agreement or this chapter. This provision prevails over §§ 9-406 and 9-408 of this title.”	Yes Del. Code Ann. tit. 6, § 17-1101 (West 2015)	“(g) Sections 9-406 and 9-408 of this title do not apply to any interest in a limited partnership, including all rights, powers and interests arising under a partnership agreement or this chapter. This provision prevails over §§ 9-406 and 9-408 of this title.”	Yes Del. Code Ann. tit. 6, § 15-104 (West 2015)	“(c) Sections 9-406 and 9-408 of this title do not apply to any interest in a domestic partnership, including all rights, powers and interests arising under a partnership agreement or this chapter. This provision prevails over §§ 9-406 and 9-408 of this title.”
DC	No		No		No		No		No	
Florida	No		No		No		No		No	
Georgia	No		No		No		No		No	
Hawaii	No		No		No		No		No	
Idaho	No		No		No		No		No	
Illinois	No		No		No		No		No	
Indiana	No		No		No		No		No	
Iowa	No		No		No		No		No	
Kansas	No		No		Yes K.S.A. § 17-76, 134	“(g) K.S.A. 84-9-406 and 84-9-408, and amendments thereto, do not apply to any interest in a limited liability company, including all rights, powers and interests arising under an operating agreement or this act. This provision prevails over K.S.A. 84-9-406 and 84-9-408, and amendments thereto.”	No		No	
Kentucky	No		No		Yes Ky. Rev. Stat. Ann. § 275.255	“(4) Limitations upon the assignment or pledge of a membership interest set forth or adopted in accordance with this section shall be enforced notwithstanding KRS 355.9-406 and 355.9-408.”	Yes Ky. Rev. Stat. Ann. § 362.2-702 (West 2015)	“(8) Limitations upon transfer set forth in KRS 362.2-701 to 362.2-704 or adopted by the partners in accordance with this subchapter are enforceable notwithstanding KRS 355.9-406 and 355.9-408.”	Yes Ky. Rev. Stat. Ann. § 362.1-503 (West 2015)	“(7) Limitations upon transfer set forth in KRS 362.1-501 to 362.1-504 or adopted by the partners in accordance with this subchapter are enforceable notwithstanding KRS 355.9-406 and 355.9-408.”
Louisiana	No		No		No		No		No	

**State Overrides of UCC Sections 9-406 and 9-408**

*Last Updated 12/11/19*

State	Amend §9-406	Comments	Amend §9-408	Comments	Amend LLC Act	Comments	Amend LP Act	Comments	Amend Partnership Act	Comments
Maine	No		No		Yes Maine Stat. tit. 31 § 1507	“5. Assignments. Title 11, sections 9-1406 and 9-1408 do not apply to any interest in a limited liability company, including all rights, powers and interests arising under a limited liability company agreement or this chapter. This subsection prevails over Title 11, sections 9-1406 and 9-1408 and is intended to permit the enforcement of the provisions of a limited liability company agreement that would otherwise be ineffective under Title 11, sections 9-1406 and 9-1408.”	No		No	
Maryland	No		No		No		No		No	
Massachusetts	No	Mass. HB 57 (2019) – Introduced Feb. 25, 2019  Pending, no movement currently	No	Mass. HB 57 (2019) – Introduced Feb. 25, 2019  Pending, no movement currently	No		No		No	
Michigan	No		No		No		No		No	
Minnesota	No		No		No		No		No	

**State Overrides of UCC Sections 9-406 and 9-408**

*Last Updated 12/11/19*

State	Amend §9-406	Comments	Amend §9-408	Comments	Amend LLC Act	Comments	Amend LP Act	Comments	Amend Partnership Act	Comments
Mississippi	No		No		Yes Miss. Code Ann. § 79-29-711 (West 2015)	“Sections 75-9-406 and 75-9-408 do not apply to a member’s financial interest in a domestic limited liability company, including the rights, powers and interests arising under the limited liability company’s certificate of formation or operating agreement or under this chapter. To the extent of any conflict or inconsistency between this section and Sections 75-9-406 and 75-9-408, this section prevails. It is the express intent of this section to permit the enforcement, as an agreement among the members of a limited liability company, of any provision of an operating agreement that would otherwise be ineffective under Sections 75-9-406 and 75-9-408.”	Yes Miss. Code Ann. § 79-14-706 (West 2015)	“Sections 75-9-406 and 75-9-408 do not apply to a limited partnership interest in a limited partnership formed under the laws of Mississippi, including the rights, powers and interests arising under the certificate of limited partnership or limited partnership agreement or under this chapter. To the extent of any conflict or inconsistency between this section and Sections 75-9-406 and 75-9-408, this section prevails. It is the express intent of this section to permit the enforcement, as a contract among the partners of a limited partnership, of any provision of a limited partnership agreement that would otherwise be ineffective under Sections 75-9-406 and 75-9-408.”	Yes Miss. Code Ann. § 79-13-505 (West 2015)	“Sections 75-9-406 and 75-9-408 do not apply to a partnership interest in a partnership formed under the laws of Mississippi, including the rights, powers and interests arising under the certificate of partnership or partnership agreement or under this chapter. To the extent of any conflict or inconsistency between this section and Sections 75-9-406 and 75-9-408, this section prevails. It is the express intent of this section to permit the enforcement, as a contract among the partners of a partnership, of any provision of a partnership agreement that would otherwise be ineffective under Sections 75-9-406 and 75-9-408.”
Missouri	No		No		No		No		No	
Montana	No		No		No		No		No	
Nebraska	No		No		No		No		No	
Nevada	No		No		No		No		No	
New Hampshire	No		No		Yes N.H. Rev. Stat. Ann. § 304-C:202 (2015)	“The provisions of RSA 382-A:9-406 and RSA 382-A:9-408 shall not apply to any interest in a limited liability company, including all rights, powers, and interests arising under an operating agreement or under this act. The provisions of this section shall prevail over the provisions of RSA 382-A:9-406 and RSA 382-A:9-408.”	No		No	
New Jersey	No		No		No		No		No	
New Mexico	No		No		No		No		No	
New York	No		No		No		No		No	

**State Overrides of UCC Sections 9-406 and 9-408**

*Last Updated 12/11/19*

State	Amend §9-406	Comments	Amend §9-408	Comments	Amend LLC Act	Comments	Amend LP Act	Comments	Amend Partnership Act	Comments
North Carolina	Yes N.C. Gen. Stat. Ann. § 25-9-406 (West 2014)	“This section does not apply to an assignment of a health-care-insurance receivable or an interest in a partnership or limited liability company.”	Yes N.C. Gen. Stat. Ann. § 25-9-408 (West 2014)	“This section does not apply to an assignment of an interest in a partnership or limited liability company.”	Yes N.C. Gen. Stat. Ann. § 57D-10-02 (West 2015)	“(d) 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.”	No		No	
North Dakota	No		No		No		No		No	
Ohio	No		No		No		No		Yes Ohio Rev. Code Ann. § 1776.49 (2015)	“(G) Sections 1309.406 and 1309.408 of the Revised Code do not apply to any partnership interest in a partnership formed under this chapter.”
Oklahoma	No		No		No		No		No	
Oregon	No		No		No		No		No	
Pennsylvania	No		No		No		No		No	
Puerto Rico	No		No		No		No		No	
Rhode Island	No		No		No		No		No	
South Carolina	No		No		No		No		No	
South Dakota	No		No		No		No		No	
Tennessee	No		No		No		No		No	



**State Overrides of UCC Sections 9-406 and 9-408**

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State	Amend §9-406	Comments	Amend §9-408	Comments	Amend LLC Act	Comments	Amend LP Act	Comments	Amend Partnership Act	Comments
Texas	Yes Tex. Bus. & Com. Code Ann. § 9.406 (Vernon 2013)	“(j) This section does not apply to an interest in a partnership or limited liability company.”	Yes. Tex. Bus. & Com. Code Ann. § 9.408 (Vernon 2013)	“(e) This section does not apply to an interest in a partnership or limited liability company.”	Yes Tex. Bus. Orgs. Code Ann. § 101.106 (Vernon 2013)	“(c) Sections 9.406 and 9.408, Business & Commerce Code, do not apply to a membership interest in a limited liability company, including the rights, powers, and interests arising under the company’s certificate of formation or company agreement under this code. To the extent of any conflict between this subsection and Section 9.406 or 9.408, Business & Commerce Code, this subsection controls. It is the express intent of this subsection to permit the enforcement, as a contract among the members of a limited liability company, of any provision of a company agreement that would otherwise be ineffective under Section 9.406 or 9.408, Business & Commerce Code.”	Yes Tex. Bus. Orgs. Code Ann. § 154.001 (Vernon 2013)	“(d) Sections 9.406 and 9.408, Business & Commerce Code, do not apply to a partnership interest in a partnership, including the rights, powers, and interests arising under the governing documents of the partnership or under this code. To the extent of any conflict between this subsection and Section 9.406 or 9.408, Business & Commerce Code, this subsection controls. It is the express intent of this subsection to permit the enforcement, as a contract among the partners of a partnership, of any provision of a partnership agreement that would otherwise be ineffective under Section 9.406 or 9.408, Business & Commerce Code.”	Yes Tex. Bus. Orgs. Code Ann. § 154.001 (Vernon 2013)	“(d) Sections 9.406 and 9.408, Business & Commerce Code, do not apply to a partnership interest in a partnership, including the rights, powers, and interests arising under the governing documents of the partnership or under this code. To the extent of any conflict between this subsection and Section 9.406 or 9.408, Business & Commerce Code, this subsection controls. It is the express intent of this subsection to permit the enforcement, as a contract among the partners of a partnership, of any provision of a partnership agreement that would otherwise be ineffective under Section 9.406 or 9.408, Business & Commerce Code.”
Utah	No		No		No		No		No	
USVI	No		No		No		No		No	
Vermont	No		No		No		No		No	

**State Overrides of UCC Sections 9-406 and 9-408**

*Last Updated 12/11/19*

State	Amend §9-406	Comments	Amend §9-408	Comments	Amend LLC Act	Comments	Amend LP Act	Comments	Amend Partnership Act	Comments
Virginia	Yes Va. Code Ann. § 8.9A-406 (West)	“(k) Inapplicability to partnership and limited liability company interests. This section does not apply to an interest in a partnership or limited liability company.”	Yes Va. Code Ann. § 8.9A-408 (West)	“(g) Inapplicability to partnership and limited liability company interests. This section does not apply to an interest in a partnership or limited liability company.”	Yes Va. Code Ann. § 13.1-1001.1 (West 2015)	“B. Sections 9-406 and 9-408 of the Uniform Commercial Code, including §§ 8.9A-406 and 8.9A-408, do not apply to any interest in a limited liability company, including all rights, powers and interests arising under the articles of organization or operating agreement of a limited liability company or this chapter. This provision prevails over §§ 8.9A-406 and 8.9A-408, and is expressly intended to permit the enforcement as a fundamental matter of contract among the members of a limited liability company of any provision of an operating agreement that would otherwise be ineffective under § 9-406 or § 9-408 of the Uniform Commercial Code.”	Yes Va. Code Ann. § 50-73.84 (West 2015)	“C. Sections 9-406 and 9-408 of the Uniform Commercial Code, including §§ 8.9A-406 and 8.9A-408, do not apply to any interest in a partnership, including all rights, powers and interests arising under the partnership agreement of a partnership, Chapter 2.1 (§ 50-73.1 et seq.) of this title, or this chapter. This provision prevails over §§ 8.9A-406 and 8.9A-408, and is expressly intended to permit the enforcement as a fundamental matter of contract among the partners of a partnership of any provision of a partnership agreement that would otherwise be ineffective under § 9-406 or § 9-408 of the Uniform Commercial Code.”	Yes Va. Code Ann. § 50-73.84 (West 2015)	“C. Sections 9-406 and 9-408 of the Uniform Commercial Code, including §§ 8.9A-406 and 8.9A-408, do not apply to any interest in a partnership, including all rights, powers and interests arising under the partnership agreement of a partnership, Chapter 2.1 (§ 50-73.1 et seq.) of this title, or this chapter. This provision prevails over §§ 8.9A-406 and 8.9A-408, and is expressly intended to permit the enforcement as a fundamental matter of contract among the partners of a partnership of any provision of a partnership agreement that would otherwise be ineffective under § 9-406 or § 9-408 of the Uniform Commercial Code.”
Washington	No		No		No		No		No	
West Virginia	No		No		No		No		No	
Wisconsin	No		No		No		No		No	
Wyoming	No		No		No		No		No	