Equity Pledge Agreements – A Valuable and Flexible Secured Creditor Tool

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An equity pledge can provide secured lenders greater protection and leverage in case of borrower default, making it a crucial consideration for Israeli investors in US secured lending transactions.

Israeli investors looking to engage in secured lending transactions in the United States should seriously consider requiring equity pledges from the borrower's equity holders in addition to receiving a general security interest in all of the borrower's assets. A properly documented and executed equity pledge provides secured creditors with multiple remedies: (1) exercising voting rights with respect to the pledged equity and (2) foreclosing on the pledged equity through a Uniform Commercial Code ("UCC") Article 9 sale. Which remedy is appropriate depends on the secured creditor's objectives and the specific circumstances of the default. This article examines the core components of a well-drafted equity pledge agreement and analyzes the remedies available to a secured creditor holding a pledge of equity interests, with a focus on practical guidance for Israeli lenders engaged in US secured lending transactions.

What Is an Equity Pledge?

An equity pledge agreement is a security arrangement in which a "pledgor" (i.e., the holder of the equity rights) grants a secured lender a security interest in the pledgor's equity holdings as collateral for debt or other obligations owed to the secured lender. The pledgor may be the borrower itself, pledging the equity interests in its subsidiaries, or the borrower's equity holders, pledging their ownership interests in the borrower itself. In either case, the pledge agreement creates a lien on the specified equity interests and related rights in favor of the secured party.

Equity pledge agreements typically provide the creditor with two main forms of protection upon default: (1) voting and proxy rights with respect to the pledged equity (i.e., the right to vote the pledged equity upon the occurrence of an event of default), and (2) a security interest in and lien on the equity shares themselves, governed by the UCC. The scope of pledged collateral can extend beyond the equity interests themselves to include economic rights (rights to receive profit allocations and distributions) and governance or control rights (rights to vote, access company information, and participate in management).

Due Diligence Is Key. As with any secured lending transaction, thorough due diligence should be conducted before entering into an equity pledge. Due diligence considerations include reviewing the organizational documents of the pledgor and the pledged entity and any senior loan agreements, identifying any transfer or third-party consent requirements that could impede enforcement, and ensuring that the pledge agreement contains all provisions necessary to effectuate the secured creditor's remedies.

Drafting Considerations. When drafting the pledge agreement, the definition of pledged equity interests should be drafted broadly to capture all forms of ownership interests in an entity, including the ancillary benefits flowing from ownership of the pledged equity (the "Equity Related Rights"). Equity Related Rights should include all rights to receive assets, money, or rights of any kind due from time to time in respect of the pledged equity, as well as any dividends and rights to proceeds received; all rights and interests in and to the pledged companies under the operating agreements of the pledged companies; and all voting rights attached to the pledged equity. Secured creditors should ensure that the organizational documents clearly set forth the procedures for electing and removing directors or managers, and the authority required to take significant corporate actions.

The pledge agreement should also include covenants restricting the pledgor's ability to take actions that could impair the secured party's interests. A prohibition on amendments to organizational documents without the secured party's consent is particularly important, as it prevents the pledgor from unilaterally modifying governance provisions that the secured party may need to rely upon when exercising remedies.

Understand the Governing Law. Equity pledge agreements are often governed by the laws of the jurisdiction where the pledged entity is organized, even if the underlying loan agreement may be governed by a jurisdiction outside the US For example, a loan agreement may be governed by Israeli law with

exclusive jurisdiction in Israel, while the related pledge agreement may be governed by US state law where, in the event of a dispute, US state law would be applied.

Perfecting the Equity Lien. The method for perfecting a security interest in pledged equity depends on how that equity is classified under the UCC:

» **Certificated Securities**. Where the pledged equity is evidenced by a physical certificate, perfection may be achieved by either: (a) filing a UCC-1 financing statement, or (b) taking "control" of the certificates by taking possession of the certificates together with signed, undated stock powers (for shares) or assignments (for LLC or LP interests) in blank. Security interests perfected by control have priority over those perfected solely by filing.

» **Uncertificated Securities.** Where the pledged equity is evidenced only on the issuer's books and not certificated, perfection may be achieved by filing a UCC-1 financing statement.

Regardless of classification, secured lenders should use all available perfection methods to maximize protection.

Filing Location. A UCC-1 financing statement must be filed with the central filing office (typically the Secretary of State) in the jurisdiction where the **pledgor** is organized—not where the pledged entity is organized. If the pledgor is a foreign entity organized outside the United States in a jurisdiction that does not maintain a public filing system comparable to the UCC, the UCC-1 financing statement should be filed with the District of Columbia. Because Israel does not maintain a system comparable to the UCC, UCC-1 financing statements for Israeli pledgors should be filed with the District of Columbia.

Remedy 1: Exercise of Voting Rights

The first—and more immediate—remedy available to secured creditors is the ability to exercise voting rights with respect to the pledged equity interests. To effectuate this remedy, the pledge agreement must clearly provide for the transfer of voting rights from the pledgor to the secured party. If so drafted, upon the occurrence of an event of default, voting and other consensual rights will vest in the secured creditor and the pledgor will cease to have the ability or right to vote the pledged shares. Importantly, this transfer of voting power to the secured creditor is accomplished without any requirement of judicial proceedings or notice beyond what is stipulated in the pledge agreement, offering creditors a very flexible tool to protect their collateral.

Once voting rights vest in the secured creditor, the secured creditor can: (1) vote to remove existing directors (for a corporation) or managers (for a limited liability company); (2) appoint an independent director or manager to replace prior management; and (3) amend organizational documents as needed to effectuate these governance changes (assuming the applicable organizational documents permit the pledged equity holder to make such changes).

Appointment of an Independent Director or Manager

The ability to remove and replace management is among the most valuable aspects of the voting rights remedy. By appointing an independent director or manager, the secured creditor places the company under the control of a fiduciary who will act in the best interests of the company, including its creditors. Existing equity holders lose authority to take significant corporate actions without the consent of the newly installed independent director or manager. These blocked actions include initiating bankruptcy proceedings, disposing of or transferring assets (including transferring cash from the borrower's bank accounts), granting additional security interests, and otherwise subjecting the company's assets to liens or encumbrances.

Blocking Power Is Critical. This blocking power prevents former equity holders from taking adverse corporate actions and allows the secured creditor to preserve the value of its collateral while determining the appropriate path forward.

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The independent director or manager can also: (1) effectuate asset sales to satisfy the secured debt; (2) consent to an Article 9 foreclosure of the company's assets; and (3) consent to or authorize a bankruptcy filing where appropriate for the protection of creditors' interests. As recent case law confirms, courts will enforce these bargained-for terms of pledge agreements, rewarding secured creditors who invest in strong documentation with correspondingly robust creditor protection.

It is important to note that exercising voting rights, as described above, does not affect ownership of the pledged equity—the pledgor retains economic ownership, and repayment of the secured obligations reinstates the pledgor's voting rights and economic entitlements. In order to transfer the actual ownership, the secured creditor will need to exercise its rights to foreclose under Article 9 of the UCC. This remedy is discussed below.

Remedy 2: Article 9 Foreclosure

The second principal remedy found in equity pledges is the ability to foreclose under Article 9 of the UCC. Upon default, a secured creditor may dispose of or sell the collateral and apply the proceeds to satisfy the debt. This foreclosure process is governed by UCC Article 9, which provides two main paths for enforcement: UCC Section 9-610 disposition or UCC Section 9-620 strict foreclosure.

UCC Section 9-610 Disposition

Under UCC Section 9-610, a secured creditor may dispose of collateral through either a private or public sale. The process requires:

- **Reasonable authenticated notice** of intent to sell, which must be provided to the debtor, any secondary obligors, and any other interested parties that held a perfected security interest in the pledged equity within ten days before the notification date;
- **Sale of collateral** in a commercially reasonable manner with respect to method, manner, time, place, and other terms; and
- **Proper disposition of sale proceeds** in accordance with UCC priority rules.

Timing Matters. For public sales, the secured party must advertise or provide public notice and ensure the public has had a meaningful opportunity for competitive bidding. Although notice must be reasonable regarding manner, content, and time, the UCC provides that ten days' notice is generally deemed reasonable for non-consumer transactions. However, because the UCC requires a commercially reasonable sale, the actual timing for a Section 9-610 disposition typically ranges from 10 to 90 days, depending on the specific facts and whether the underlying company owns real estate.

In the context of foreclosing on the equity of distressed real estate companies, secured lenders pursuing their remedy of foreclosure will need to market the foreclosed equity with an appropriate broker and publish notice to potential purchasers containing a description of the equity or underlying property, the applicable debt securing the equity and/or the property, the bidding procedures, and any other terms governing the sale, including the time and place of any auction to be held and how interested parties become qualified to attend and bid at the auction. Secured lenders are entitled to "credit bid" (i.e., bid the cancellation of all or a portion of the outstanding debt as opposed to cash), meaning that any third party looking to purchase the collateral must bid in excess of what the lender is owed unless the lender agrees to accept less than its entire debt.

At a public sale, the lender has the right to purchase the collateral (UCC § 9-610(c)(1)), whereas at a private sale, the lender may only purchase collateral of the type that is customarily sold on a recognized market or that is the subject of widely distributed standard price quotations (UCC § 9-610(c)(2)). When the secured creditor or a related party purchases the collateral at its own foreclosure sale, UCC Section 9-615(f) provides that any deficiency must be calculated based on the amount of proceeds that would have been realized through a proper disposition to an unrelated purchaser.

UCC Section 9-620 Strict Foreclosure

An alternative to the public or private sale disposition is strict foreclosure under UCC Section 9-620, whereby the secured creditor accepts collateral in full or partial satisfaction of the debt. This is often the most attractive method of foreclosure when available because it typically involves lower transaction costs and is less likely to result in a dispute. Two requirements must be met: (1) the debtor must consent, and (2) the secured party must not receive a timely notification of objection from any party entitled to object, including any person from whom the secured party received authenticated notice of a claim of interest in the collateral and any secured party or lienholder that perfected its interest within ten days before the debtor consented.

Strict foreclosure may be particularly attractive when the secured creditor wishes to acquire the pledged equity directly rather than conducting a sale process. However, the consent requirement limits the availability of this remedy in adversarial situations where the debtor is unwilling to cooperate.

Case Studies in Enforcement

How do these remedies work in practice? Two recent cases illustrate the importance of strong documentation and the willingness of courts to enforce properly drafted pledge agreements and organizational documents.

Yanai v. Keinan, No. 2584CV00565-BLS2 (Mass. Super. Ct. 2025)

Yanai v. Keinan provides a compelling example of successful enforcement of voting rights under a pledge agreement. In *Yanai*, Scintilla Fund, L.P., an Israeli lender ("Scintilla"), made $38.2 million in loans to a Massachusetts limited liability company. The members of the borrower, who were Israeli citizens, pledged their membership interests as collateral to Scintilla. The pledge agreements provided that "upon the occurrence and during the continuance of an Event of Default … all rights of any Pledgor to exercise or refrain from exercising the voting … shall cease and all such rights shall thereupon become vested in [Scintilla]." After multiple defaults, Scintilla exercised its voting rights, removed the managing member, and appointed an independent replacement manager. The members of the borrower challenged these actions, seeking to bar Scintilla from exercising their voting rights.

The Massachusetts court upheld Scintilla's exercise of voting rights, concluding that Scintilla "was entirely within its rights under the Pledge Agreements" to exercise the members' voting rights and that the pledges granted Scintilla the "sole right to exercise such voting and other consensual rights" upon an Event of Default. The court observed that "each and every action Scintilla undertook was expressly provided for within the plain language of the Pledge Agreement[s]." The court also rejected the members' argument that the independent manager could not serve because he was not a member, noting that Massachusetts law permits non-member managers. The *Yanai* decision demonstrates that courts will enforce clear pledge language transferring voting rights upon default. It underscores the importance of incorporating such provisions in pledge agreements and ensuring compliance with applicable law regarding entity governance[1].

In re Ashley Stewart, Inc., No. 25-23314 (Bankr. D.N.J. Dec. 23, 2025)

In re Ashley Stewart, Inc. provides a complementary perspective on the importance of organizational documents. Courts evaluating disputes over corporate authority will look closely at corporate organizational documents to determine who has the power to authorize corporate actions. A well-drafted pledge agreement must work in conjunction with appropriate provisions in the company's organizational documents in order to ensure that the secured creditor can seamlessly step into the shoes of the equity holder upon default. The organizational documents should provide for proper governance control and clearly delineate the voting rights, the mechanisms for electing or removing directors or managers, and the authority required to take significant corporate actions.

In *Ashley Stewart*, shortly after a secured creditor conducted an Article 9 foreclosure sale of Ashley Stewart, Inc., two former board members purported to "reconstitute" the company's board and filed a Chapter 11 bankruptcy petition. The company's duly authorized board moved to dismiss the bankruptcy case, arguing that the petition was filed without the requisite corporate authority and that the alleged reconstitution violated the company's bylaws and related governance documents. No unanimous consent of the board was obtained, as required for corporate actions pursuant to a New Jersey state court consent order, and the sole independent director did not authorize or receive notice of the bankruptcy filing. The court granted the motion to dismiss, finding that cause existed to dismiss the case for lack of proper corporate authorization.

Strong Documentation Pays Dividends. The *Yanai* and *Ashley Stewart* decisions demonstrate how well-drafted pledge agreements and organizational documents provide the foundation for successful enforcement and powerful creditor protection.

Key Rules for Secured Creditors

Pledge Agreements are Valuable Tools for Secured Creditors. Equity pledges remain a cornerstone of secured lending transactions, providing creditors with

1. Chapman and Cutler LLP represented the secured lender Scintilla Fund L.P. in this matter.

flexible and powerful remedies upon default. The ability to exercise voting rights immediately upon default—installing independent governance and blocking adverse actions—offers secured creditors a valuable tool for protecting their interests without the delay inherent in foreclosure proceedings.

Drafting and Due Diligence are Critical. The key to successful enforcement lies in careful documentation at the outset of the transaction, thorough due diligence regarding organizational documents and potential consent requirements, and clear contractual provisions that will withstand judicial scrutiny.

Comply with UCC Requirements. When ownership transfer is the objective, Article 9 provides well-established procedures for disposition. Secured creditors must comply with the UCC's requirements for good faith and commercially reasonable conduct. Noncompliance may result in equitable remedies being ordered against the creditor, liability for damages, and, under the "rebuttable presumption" framework of UCC Section 9-626, the potential forfeiture of the creditor's right to pursue any deficiency against the debtor.

Seek Specialized Expertise. Drafting and enforcement of pledge agreements introduces both challenges and opportunities that require specialized expertise. For Israeli investors and lenders engaged in US secured financing transactions, understanding these mechanisms and ensuring they are carefully and properly documented is essential to protecting investment interests when borrowers fail to perform.

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