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2018 LLC Act, LP Act and UCC Amendments

Executive Summary

The Corporate Law Section of the Delaware State Bar Association has proposed its annual amendments to the Delaware Limited Liability Company Act (the "LLC Act"), the Delaware Revised Uniform Limited Partnership Act (the "LP Act") and the Delaware Revised Uniform Partnership Act ("DRUPA"). In addition, the Corporate Law Section has proposed clarifying amendments to Delaware's Uniform Commercial Code (the "UCC") which are intended to work in conjunction with the series amendments to the LLC Act as discussed below.

The following is a summary of the most noteworthy amendments impacting the operation of Delaware limited liability companies ("LLCs"), limited partnerships ("LPs") and partnerships. As is set forth in more detail below, this year's amendments to the LLC Act significantly modify statutory provisions to: (i) create a new type of series of LLCs, (ii) permit "divisional mergers," (iii) permit the use of "blockchain" and "distributed ledger" technologies to maintain records for LLCs and for certain "electronic transmissions" and (iv) provide for the creation of public benefit LLCs. The amendments to the LP Act and DRUPA (i) allow for the use of blockchain and distributed ledger technologies in the maintenance of the records of LPs and (ii) provide rules for distinguishing the names of LPs and partnerships from series of LLCs.

If the proposed amendments are approved by the Delaware legislature, Governor John C. Carney, Jr. could sign the amendments into law as of August 1, 2018. However, while most of the amendments described herein would be effective as of the date they are signed by Governor Carney, the series amendments to the LLC Act and the amendments to the UCC would not go into effect until August 1, 2019. The delayed effectiveness will allow the Delaware Secretary of State to implement the necessary changes to its filing system and records.

Series Amendments to the LLC Act

Three Types of Series

The proposed series amendments to the LLC Act may be the most significant series-related amendments since series LLCs were first introduced in Delaware in 1996. As a result of these amendments, there are now three distinct types of series. The first type of series is created by contract (i.e. an LLC Agreement) and does not benefit from any statutorily-granted separateness from other series. This contract-based series can be a series of members, managers or assets, but as most commonly used, is a series of interests in LLCs (i.e. Series A Interests, Series B Interests, etc.). The second type of series is what most practitioners currently refer to as a limited liability company series and will be, as a result of the amendments, denominated a "protected series." Established under Section 18-215(b), protected series enjoy statutorily granted limitations on liability between the series and the LLC and among the other series. The

third type of series is newly created under the proposed addition of Section 18-218 and is deemed a "registered series." As is the case for protected series, the amendments provide for inter-series limitations of liability for registered series. However, unlike protected series, the formation of registered series is accomplished by a filing with the Delaware Secretary of State. In addition, the proposed amendments permit: (i) the conversion of a protected series into a registered series, (ii) the conversion of a registered series into a protected series and (iii) the merger of registered series with and into other registered series.

Registered Series and the UCC

Each individual registered series is required to file a 'certificate of registered series' and to pay an annual franchise tax. As a result, the Delaware Secretary of State will be able to provide a certificate of good standing for a registered series. The proposed LLC Act amendments provide specific requirements for the names of registered series. Further, the proposed amendments to the LLC Act, LP Act and DRUPA require that the names of registered series be distinguishable from the names of LLCs, LPs and partnerships.

The proposed amendments to the UCC explicitly include series in the definition of "person" and include registered series in the definition of "registered organization."

Some Thoughts on Series LLCs and the UCC

Under the current law, the formation and operation of series are highly technical matters, and practitioners face many thorny issues related to the use of series in secured financing transactions, including issues concerning the status of series under the UCC. The proposed amendments may add to the complexity of forming and operating series, but they are intended to facilitate the use of series in secured transactions. For example, by including series in the definition of "person" under the UCC, a series can be a "debtor." In addition, the inclusion of registered series in the definition of "registered organization" provides clarity regarding other UCC matters, including perfecting security interests against a registered series. Lastly, it is important to note that while these UCC amendments are non-uniform (i.e. they have not been adopted in the uniform version of the Uniform Commercial Codes or in other states), certain of the proposed LLC Act amendments should permit Delaware series to be included in definition of "person" in other states' versions of the Uniform Commercial Code.

Whether the use of registered series in secured financing transactions increases as a result of these amendments remains to be seen, but practitioners should be aware that registered series could become increasingly viable vehicles for financings beginning on August 1, 2019.

Divisional Mergers

Another notable proposed amendment to the LLC Act would add Section 18-217 to permit an LLC to divide into one or more newly formed LLCs. The pre-merger LLC can either survive the division or terminate as a result. The proposed amendment has specific requirements governing the division process, including the creation and implementation of a 'plan of division' to govern (i) the conversion or exchange of interests in the pre-division LLCs, and (ii) the allocation of assets of the pre-division LLCs among the resulting newly-created LLC(s). This

process is termed a "divisional merger," but divisional mergers are unlike typical mergers and might, in certain situations, be better thought of as spin-off transactions. It should be noted that the divisional merger amendment includes provisions to protect the creditors of pre-division LLCs and permits LLCs to prohibit divisional mergers in their LLC Agreements. It should also be noted that, under the current law, the effects and results of divisional mergers may be accomplished by other means, and it is unclear at this point how this new process will be utilized. However, this amendment is an effort to provide maximum flexibility in the use of Delaware LLCs and adds another potentially useful tool for practitioners.

Blockchain and Distributed Ledger Technology

In an effort to keep pace with changing technological capabilities, the Delaware General Corporation Law was amended last year to provide specific statutory authority to use blockchain and distributed ledger technologies for corporate records. This year's proposed amendments to the LLC Act and the LP Act make similar updates for use of these technologies in LLCs and LPs. Specifically, the amendments permit the use of networks of electronic databases (which are intended to mean databases currently known as "blockchain" and "distributed ledger" technologies) to maintain records for entities and for certain electronic transmissions.

Public Benefit LLCs

The proposed amendments would add a new Subchapter XII to the LLC Act to provide for the formation of, and requirements pertaining to, statutory public benefit limited liability companies. The new subchapter includes, among other things, requirements for biennial reports to members of statutory public benefit LLCs and specific limitations with respect to derivative suits against such LLCs.

Other Amendments

In addition to the above-described legislative proposals, there are a number of other proposed amendments touching on the following topics: (i) the authority of the Delaware Attorney General to seek cancellation of the certificate of formation of LLCs and certificates limited partnership for LPs for abuse or misuse of their power, privileges or existence and (ii) fees payable to the Delaware Secretary of State in connection with the filing of a certificate of correction for LLCs and LPs.

Berger Harris is a nationally-recognized law firm located in Wilmington, Delaware. A business law boutique firm, Berger Harris transactional attorneys specialize in a wide range of sophisticated financing transactions, including real estate financing, structured finance, investment fund transactions and securitizations. Our transactional attorneys have extensive experience rendering third-party legal opinions and advice as to matters of Delaware law relating to entity formation, business acquisitions, partnership matters and issues involving limited liability companies and corporations. Our litigation attorneys have in-depth experience representing plaintiffs and defendants in a broad range of high-stakes disputes in both state and federal courts, particularly in the Delaware Court of Chancery.

Chris Messa is a partner in the Corporate/Business Entity Counseling practice group of Berger Harris with significant expertise in Articles 8 and 9 of the Delaware Uniform Commercial Code. His practice focuses primarily on rendering advice and legal opinions relating to commercial transactions, including securitizations, structured finance, asset sale and purchase, cross-border transactions and secured transactions. Chris has extensive experience counseling clients with respect to the formation and operation of Delaware corporations, trusts, partnerships and limited liability companies.

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