

# Expert Q&A on the Delaware Law Amendments Relating to Registered Series of Limited Liability Companies

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## An expert Q&A with Tarik J. Haskins, Morris, Nichols, Arsht & Tunnell LLP on the Delaware Law Amendments Relating to Registered Series of Limited Liability Companies.

### WHAT WERE THE AMENDMENTS TO THE DELAWARE LIMITED LIABILITY COMPANY ACT RELATING TO REGISTERED SERIES OF LIMITED LIABILITY COMPANIES?

The Delaware Limited Liability Company Act (Act) has permitted a limited liability company agreement to provide for the establishment of one or more designated series of members, managers, limited liability company interests, or assets since 1996. Assets associated with a series may be able to be shielded from creditors' claims against the limited liability company or other series of the limited liability company. Series limited liability companies are used in many different transactions, including without limitation for investment funds and in real estate transactions.

The Act was amended in 2018 to provide, among other things, for the creation of "registered series" (Amendments). A registered series is defined as "a designated series of members, managers, limited liability company interests or assets that is formed in accordance with Section 18-218" of the Act. The Amendments are effective on August 1, 2019.

A series in a limited liability company that was established before the Amendments under Section 18-215 of the Act continues to exist and is now referred to as a "protected series." One of the key differences between a registered series and a protected series is that under Section 18-218(d) of the Act, a registered series must file a certificate of registered series in accordance with Section 18-218(d) of the Act. Therefore, the formation of a registered series requires a filing with the Office of the Secretary of State of the State of Delaware (Secretary of State), while the establishment of a protected series does not require any filing with the Secretary of State.

According to the Amendments, each of Section 18-215 of the Act and Section 18-218(c) of the Act state that a protected series or registered

series, as applicable, is considered an "association" for all purposes of Delaware law. Designating both protected series and registered series as associations means that either type of series can be considered a "person" for purposes of the Uniform Commercial Code of the State of Delaware (UCC) and therefore, each type of series can be considered a "debtor" for purposes of Article 9 of the UCC.

In addition to the Amendments, conforming amendments were added to Article 1 and Article 9 of the UCC. Section 1-201(b)(27) of the UCC was amended to make clear that any series of an entity is a "person" as defined in the UCC. Also, Section 9-102(a)(71) of the UCC was amended to make clear that a "registered organization" "includes a series of a registered organization if the series is an organization formed or organized under the laws of a single State and the statute of the state governing the series requires that the public organic record of the series be filed with the State."

The Amendments also enable registered series of the same limited liability company to merge with one another as provided in Section 18-221 of the Act. Section 18-221 of the Act permits a registered series to merge or consolidate with one or more series of the same limited liability company by complying with the terms of Section 18-221 of the Act. The mechanics of a merger among registered series and the effect of this merger under Section 18-221 of the Act are similar to the mechanics of a merger among limited liability companies and other entities and the effect of that merger under Section 18-209 of the Act (which governs mergers of limited liability companies with other entities).

The Act was also amended by the Amendments to enable a protected series to convert into a registered series, and for a registered series to convert into a protected series. Section 18-219 of the Act and Section 18-220 of the Act, respectively, permit conversion from a protected series to a registered series and vice versa. Each of the conversion provisions functions similar to Section 18-216 of the Act (which governs conversion of limited liability companies into other entities).

The Amendments also provide that franchise fees will be payable to the Secretary of State for each registered series. Therefore, under

Section 18-1107(b) of the Act, a franchise tax in the amount of \$75 is payable to the Secretary of State with respect to each registered series.

### WHAT WAS THE PURPOSE OF THE AMENDMENTS?

A primary criticism in the past of the series limited liability company form related to uncertainty around using series in secured lending transactions. The Amendments were designed to enhance the use of series limited liability companies by practitioners and business planners.

Prior to the Amendments it was unclear:

- With respect to assets associated with a series, is the series itself a debtor for Article 9 purposes?
- Related to the first question, where does a secured party file a financing statement with respect to a series in a related secured financing?

To address this uncertainty, the Amendments attempted to clarify the nature of a series for UCC purposes and how a security interest in assets associated with a series can be perfected. Conforming amendments were also made to Article 1 and Article 9 of the UCC to add clarity on the use of series in secured transactions.

The Amendments created a new type of series called “registered series” to clarify, together with the other amendments to the Act and Article 9 of the UCC, that either type of series can be a debtor for Article 9 purposes. The Amendments and the conforming changes to the UCC, particularly with respect to registered series, should now provide a clear road map for how to obtain a perfected security interest in the assets associated with a registered series.

The Amendments make it clear that a series formed under Section 18-215 of the Act (now called a protected series) is an association. Section 1-201(b)(27) of the UCC was amended to provide that a series of a limited liability company is a person for purposes of the UCC. Consequently, a series formed under Section 18-215 of the Act can be a debtor as defined in Section 9-102(a)(28) of the UCC (assuming it has an interest in the relevant collateral), and a secured party can perfect a security interest in assets associated with a series.

A protected series, however, does not fall within the definition of a registered organization under the UCC. Therefore, the location of a protected series for purposes of filing a financing statement is governed by Section 9-307(b)(2) or (b)(3) of the UCC. Those sections provide that a debtor’s location for UCC purposes is determined by its place of business or its chief executive office.

A registered series, however, is required to file a certificate of registered series with the Secretary of State in order to be formed. Therefore, a registered series should be considered a registered organization for purposes of the UCC. Consequently, the location of a registered series for purposes of filing a financing statement under the UCC is governed by Section 9-307(e), and a registered series is located in Delaware.

### WHAT ARE THE REQUIREMENTS TO FORM A REGISTERED SERIES?

Section 18-218(d) of the Act governs the formation of a registered series. To form a registered series a certificate of registered series

must be filed with the Secretary of State. Section 18-218(d) of the Act requires that the certificate of registered series must set out the name of the limited liability company forming the registered series and the name of the registered series. The certificate of registered series may set out any other matter as determined by the members of the limited liability company.

Section 18-218(c) of the Act sets out two specific requirements for the name of a registered series. First, the name of the registered series must begin with the name of the limited liability company. Second, the name of the registered series must be distinguishable from both:

- The name on the records of the Secretary of State of any business entity that has reserved or registered that name, or any business entity that has been formed under the laws of Delaware.
- The name on the records of the Secretary of State of any person qualified to do business and registered as a foreign entity in the State of Delaware.

### WHAT ARE THE REQUIREMENTS FOR ASSET SHIELDING BY A REGISTERED SERIES?

Section 18-218(c) of the Act describes the requirements to shield assets associated with a series from another series or a limited liability company. Under Section 18-218(c) of the Act, to the extent the records maintained for a registered series account for the assets associated with that series separately from the assets of the limited liability company, or any other series of the limited liability company, then the debts, liabilities, obligations, and expenses incurred for or otherwise existing with respect to that series, are enforceable against that series only, and not any other series of the limited liability company.

The Act also provides guidance as to how records can be maintained by a limited liability company to comply with these requirements. Section 18-218(c) of the Act states that if records are maintained in a manner that reasonably identifies its assets, including by a specific listing, category, type, computational, or other formula or any other method where the identity of the assets is objectively determinable, then the records will be deemed to account for the assets associated with that series separately from the other assets of the limited liability company, or any series of the limited liability company.

For asset-shielding, the limited liability company agreement needs to provide the limited liability company with the ability to establish or provide for series of members, managers, limited liability company interests or assets. Also, the certificate of formation of the limited liability company must include a notice of the limitation on liabilities of a registered series. The notice of the limitation on liabilities set out in the certificate of formation constitutes notice of such limitation on liabilities of the registered series which is required for asset shielding.

### CAN A PROTECTED SERIES CONVERT INTO A REGISTERED SERIES?

Yes. Section 18-219 of the Act permits a protected series to convert into a registered series. In order to effect a conversion, a protected series must file with the Secretary of State:

- A certificate of conversion of protected series to registered series.
- A certificate of registered series that complies with Section 18-218(d) of the Act.

Section 18-218(d) of the Act requires that each of the certificates described in the preceding sentence must be filed simultaneously with the Secretary of State.

Before filing the requisite certificates, the conversion must be authorized either:

- As provided in the limited liability company agreement of the limited liability company.
- If the limited liability company agreement does not specify the manner of authorizing a conversion, the conversion should be authorized by members of the protected series who own more than 50% of the then current percentage or other interest in the profits of the protected series owned by all of the members of the protected series.

Under Section 18-219(c) of the Act, on the effectiveness of the conversion, for all purposes of the laws of Delaware, the registered series is deemed to be the same series as the converting protected series and the conversion constitutes a continuation of the existence of the protected series in the form of the registered series.

### **WILL THE SEPARATENESS OF THE REGISTERED SERIES BE RESPECTED BY COURTS OUTSIDE OF DELAWARE?**

The intent of the Delaware legislature is that the liability shield provided by each registered series and the separateness of each registered series will be respected outside of Delaware. However, whether the separateness of the registered series will be respected outside of Delaware remains an open question.

There is very little case law addressing this issue, however, we believe the answer probably will be determined by the choice of law analysis. In *Alphonse v. Arch Bay Holdings, LLC*, 2013 WL 6490229 (5th Cir. Dec. 11, 2013) the Fifth Circuit declined to affirm the district court's conclusion that the applicable series limited liability company was a separate juridical entity from its limited liability company and did not respect the separateness of the applicable series. Further, the Fifth Circuit declined to follow the district court's decision to apply Delaware law to determine issues related to the liability of a series limited liability company to a third-party plaintiff.

We believe that if Delaware law is applied by courts outside of Delaware or if courts apply the law of a state that provides for the series limited liability company form in its entity laws, then these courts will be more likely to respect the separateness of registered series. Series LLC legislation is increasingly being adopted in additional states, and we believe this phenomenon will increase the likelihood of courts outside of Delaware respecting the separateness of registered series and the liability shield provided by each registered series.

### **WHAT IS THE IMPACT OF THE AMENDMENTS ON LOAN TRANSACTIONS, LOAN DOCUMENTS AND OPINIONS?**

The Amendments do not have any direct impact on existing loan transactions or loan documents. As noted above, the Amendments add a new type of series limited liability company, the registered series, but the existing series (now referred to as protected series) still exists. It is not necessary for lenders to make any changes to loan documents for protected series as a result of the Amendments.

Due to the uncertainty regarding the perfection of a security interest in assets associated with a series, a number of creative methods were used to ensure lenders were comfortable using these assets as collateral. These methods included the process of vesting title to assets associated with a series in the limited liability company itself and then filing a financing statement with respect to that limited liability company as nominee. If practitioners would like to use a more direct method to perfect a secured party's security interest in the assets associated with a series, practitioners could cause an existing series to convert from a protected series to a registered series and file a financing statement against the registered series directly. We do not, however, believe this action is necessary.

The Amendments will not have a material effect on the delivery of legal opinions; provided, however, opinion givers will now be able to deliver good standing opinions regarding the registered series.

### **WHAT ARE THE BENEFITS UNDER THE UCC OF A REGISTERED SERIES?**

As noted above, the Amendments were enacted to provide clarity as to the nature of a registered series under the UCC and whether it can be a debtor under the UCC. Therefore, the primary benefit of the registered series form under the UCC is that the attributes of a registered series allow for it to be considered a registered organization under the UCC. As a registered organization, the location of the registered series will be governed by Section 9-307(e) of the UCC and therefore it is clear that a financing statement covering the assets associated with a registered series of a Delaware limited liability company should be filed in Delaware. Further, the financing statement may be filed with the name of the registered series as debtor.

We believe that secured parties will be more comfortable lending to series as a result of the Amendments and the clarification as to the nature of registered series under the UCC.

### **CAN A REGISTERED SERIES OPT IN TO UCC ARTICLE 8?**

Yes. Under Section 8-103 of the UCC, an interest in a limited liability company can be considered a "security" for UCC purposes if the limited liability company "opts in" to Article 8. A limited liability company interest with respect to a series of a limited liability company represents an interest in the limited liability company. Therefore, we believe that the issuer of limited liability company interests in a series can opt in to Article 8 so that the limited liability company interests with respect to the series would be considered "securities" as described in Section 8-103(c) of the UCC.

### **CAN A REGISTERED SERIES OBTAIN A CERTIFICATE OF GOOD STANDING?**

Yes. A certificate of good standing for a registered series can be issued by the Secretary of State, if the series is, in fact, in good standing. This new feature will allow counsel to opine on whether a registered series is in good standing in the State of Delaware.

## HOW WILL A SEARCHER OF RECORDS IN THE DELAWARE SECRETARY OF STATE KNOW THAT ITS BORROWER IS A REGISTERED SERIES?

A lender will need to diligence the relevant records of its loan party to determine whether it is a protected series or a registered series. A lender should ask the borrower to confirm the series type and provide the exact name of the series. Once the lender knows the exact name of the applicable series, the lender can run a search of the records of the Secretary of State under that name to determine if a certificate of registered series has been filed. If a certificate of registered series is not on file with the Secretary of State, then it is likely that the series is not a registered series but it is probably a protected series formed under Section 18-215 of the Act.

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