

Del. Series LLC Changes Bring Clarity for Secured Lenders

Article

08.23.2018

Law360

Delaware recently passed amendments to the Delaware Limited Liability Company Act that enable a new type of series of an LLC known as a “registered series.” The changes address historical uncertainty among lenders seeking to perfect a security interest with respect to a secured lending transaction involving a series of a Delaware limited liability company as a borrower.

Taking effect on Aug. 1, 2019, the amendments provide a statutory basis for characterizing a registered series as a registered organization located in the state of Delaware for purposes of Article 9 of the Uniform Commercial Code. Delaware also adopted related amendments to the Delaware Uniform Commercial Code.

BACKGROUND ON DELAWARE SERIES LLCs

Delaware law permits a limited liability company to have multiple series, and each series may have characteristics similar to that of a separate limited liability company, including separate members, interests, managers, assets, business purpose and, if certain requirements are met under Delaware law, debts and liabilities. In 2007, the Delaware Limited Liability Company Act was amended to expressly provide that a series of an LLC may hold assets and grant liens and security interests in its own name. However, lenders making loans to a series of an LLC that owns its own assets and grants a security interest in its own name have dealt with uncertainty when seeking to properly perfect their security interest by filing a UCC-1 financing statement.

As a result of both the 2007 Delaware amendments and the recently passed amendments, a secured lender would file a UCC-1 financing statement in the state of Delaware to perfect its security interest against a registered series in collateral as to which a security interest can be perfected by filing in the state in which the borrower is organized. For purposes of this article, we refer to this type of collateral as “filing collateral.”

The Uniform Commercial Code provides choice-of-law rules that govern where a financing statement should be filed to perfect a security interest in certain assets. Where to file a financing statement first depends on the threshold question of whether the borrower is a “debtor” and/or an “organization” - a definition that turns on whether a borrower is a “person” under Section 1-201 of the UCC. This seemingly simple question is more complicated for a series of an LLC because of the

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unique characteristics of a series, given that a series is neither expressly identified in this definition nor a separate legal entity.

Assuming that a series of an LLC is a “debtor” and an “organization” for UCC purposes, the next question is whether it would be considered a “registered organization” under Article 9 of the UCC, which generally requires that the organization be formed by the filing of a record in its state of organization. Although such a filing is required to form the LLC of which a series forms a part, there has been no requirement under the Delaware LLC Act that a filing be made to form any individual series. If a series is a registered organization, then a lender could perfect its security interest in filing collateral by filing in the state of Delaware. If it is not, the lender may be required to file in some other jurisdiction, such as the principal place of business or the chief executive office of the series. After sorting through those matters, the final issue is how to name the debtor in the UCC-1 financing statement and, specifically, whether the LLC itself or the series itself should be named, or both.

Given the flexibility in naming series of a Delaware LLC, there could be many series that have the same name. For example, there could be many LLCs that have a “Series A.” Because of these issues, as a prophylactic matter, it was not uncommon for secured lenders to file UCC-1 financing statements in multiple jurisdictions, including the state of organization (Delaware) and the principal place of business of the series, and to also identify both the LLC and the series as debtors. As an alternative, some lenders have required that the LLC itself hold the assets of a series as nominee, with the LLC then serving as the debtor and grantor.

FUNDAMENTALS OF NEW “REGISTERED SERIES” LLCs

To address these concerns, among others, Delaware adopted the recently passed amendments, which were signed into law by Delaware Gov. John Carney on July 23, 2018. The amendments create a new type of series known as a “registered series,” which will be governed by a new Section 18-218 of the Delaware LLC Act, whereas a series with limited liability formed under the presently existing Section 18-215(b) of the Delaware LLC Act will be known as a “protected series.”

Registered series will have several characteristics designed to facilitate secured lending transactions. First, a registered series is expressly identified as an “association” in Section 18-218 of the Delaware Act. This is presumably intended to clarify that a registered series constitutes a person for purposes of the UCC, and thus would be an organization and could be the debtor under the UCC. For purposes of Delaware law, Article 1 of the Delaware UCC was also amended commensurate with the effectiveness of the LLC amendments - Aug. 1, 2019 - to expressly include a series as a person. In addition, to form a registered series, a certificate of registered series will be required to be filed with the Delaware secretary of state (the “Delaware state office”). Consequently, a registered series should be a registered organization under Article 9 of the UCC because its formation is conditioned on such a public filing.

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This was also clarified in Article 9 of the Delaware UCC, which was amended to confirm that a series of a registered organization (e.g., an LLC) will itself constitute a registered organization if the series is formed under the laws of a state that requires a public filing for its formation. It is important to note that the amendments to the Delaware UCC that relate to the amendments to the Delaware LLC Act were intended to add clarity under the Delaware UCC, but the analysis discussed herein should apply equally to the UCC when dealing with a Delaware registered series. Additionally, the Delaware LLC Act amendments require that the name of a registered series begin with the name of the LLC and be distinguishable both from other Delaware business entities and business entities qualified or registered to do business in Delaware. This name would be set forth in the UCC-1 financing statement.

ADDITIONAL ADVANTAGES FOR LENDERS

Lenders may also benefit from a few of the other matters that distinguish a registered series from other types of series. For example, the Delaware secretary of state will be able to provide certificates of good standing and certificates of existence for registered series of a Delaware LLC. However, lenders should also be mindful that a registered series will have the ability to merge or consolidate with or into one or more other registered series of the same LLC. In addition, there will be an annual franchise tax for each registered series. To the extent an LLC has series existing at the time the amendments will be effective, the amendments enable a series to convert to a registered series.

CONCLUSION

This new Delaware registered series should give secured lenders comfort that they can properly perfect a security interest granted by a registered series in filing collateral by filing a UCC-1 financing statement in the Delaware state office.

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R. Jason Russell, Sean M. Sullivan, "Del. Series LLC Changes Bring Clarity For Secured Lenders," *Law360* (August 23, 2018)

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