2018 AMENDMENTS AFFECTING DELAWARE ALTERNATIVE ENTITIES

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Important amendments to Delaware's alternative business entity statutes, namely, the Delaware Revised Uniform Partnership Act, 6 *Del. C.* § 15-101, *et seq*. ("DRUPA"), the Delaware Revised Uniform Limited Partnership Act, 6 *Del. C.* § 17-101, *et seq*. ("DRULPA"), the Delaware Limited Liability Company Act, 6 *Del. C.* § 18-101, *et seq.* ("DLLCA"), and the Delaware Statutory Trust Act, 12 *Del. C.* § 3801, *et seq.* ("DSTA" and, collectively with DRUPA, DRULPA, and DLLCA, the "Alternative Entity Statutes"), have just been signed into law by the Governor (the "2018 Amendments"). This article briefly summarizes the more significant of those amendments.

BLOCKCHAIN AND DISTRIBUTED LEDGERS

The 2018 Amendments provide specific authority for Delaware limited liability companies ("LLCs"), limited partnerships ("LPs") and statutory trusts ("DSTs") to use networks of electronic databases, such as blockchain and distributed ledgers, for the creation and maintenance of entity records and for certain electronic transmissions. While the Alternative Entity Statutes were believed to provide sufficient flexibility for the use of such networks of electronic databases even without the 2018 Amendments, providing explicit authority was deemed beneficial given the increased frequency with which such mechanisms are anticipated to be used in the future.

More particularly, the 2018 Amendments specifically authorize the use of such networks of electronic databases to facilitate voting by members, partners or beneficial owners, in each case as long as the organizational documents of the LLC, LP or DST do not otherwise provide. In addition, the 2018 Amendments expressly authorize LLCs, LPs and DSTs to maintain their books and records in the form of information storage devices or on one or more networks of electronic databases, provided that such books and records remain capable of being converted into written form within a reasonable time.

The blockchain and distributed ledger amendments become effective on August 1, 2018.

PROTECTED SERIES AND REGISTERED SERIES

Section 18-215 of the DLLCA currently permits an LLC in its limited liability company agreement ("LLC Agreement") to establish one or more designated series of members, managers, limited liability company interests or assets. Section 18-215 of the DLLCA further provides that if records are maintained that account for the assets associated with such series separately from the assets associated with the LLC generally or any other series thereof, and if a general notice of the limitation on liabilities of such series under Section 18-215 of the DLLCA is set forth in the certificate of formation of the LLC filed with the Delaware Secretary of State, then, unless otherwise provided in the LLC Agreement, (i) the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series

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only, and not against the assets of the LLC generally or any other series thereof, and (ii) none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the LLC generally or any other series thereof shall be enforceable against the assets of such series (the concepts in (i) and (ii) being referred to herein as the "interseries limitation on liability"). The 2018 Amendments to the DLLCA entirely retain this concept, however, any series established under Section 18-215 of the DLLCA (whether established before or after the effective date of such 2018 Amendments) will now be referred to as "protected series".

In addition, the 2018 Amendments add a new Section 18-218 to the DLLCA to provide for the formation of a new type of designated statutory series of members, managers, limited liability company interests or assets of an LLC known as a "registered series". Registered series, and the provisions of the DLLCA related thereto, are similar to those for protected series under Section 18-215 of the DLLCA, including with respect to the interseries limitation on liability. However, the statutory provisions relating to registered series differ from protected series in several significant respects. First, in order to form a registered series, a separate certificate of registered series must be filed with the Delaware Secretary of State. The name of such registered series contained in its certificate of registered series must begin with the name of the LLC itself and must also be distinguishable from the name of other business entities formed or organized, registered, or qualified to do business in Delaware. Second, the Delaware Secretary of State will charge an annual franchise tax on each registered series in the amount of $75. Finally, the Delaware Secretary of State will have the ability to issue a certificate of good standing and certificate of existence with respect to each registered series.

The 2018 Amendments also add new Sections 18-219, 18-220 and 18-221 to the DLLCA which, respectively, provide for (i) the conversion of a protected series of an LLC to a registered series of such LLC, (ii) the conversion of a registered series of an LLC to a protected series of such LLC, and (iii) the merger or consolidation of one or more registered series of an LLC with or into one or more other registered series of the same LLC.

A primary purpose for the enactment of the new statutory provisions relating to registered series is to more easily facilitate the use of statutory series of Delaware LLCs in certain commercial financing transactions, particularly where the assets of such series are being pledged as security. Importantly, the requirement that a filing be made in order to form a registered series is intended to, among other things, enable a registered series to qualify as a "registered organization" under Article 9 of the Uniform Commercial Code. To this end, the Delaware Uniform Commercial Code is also being amended to expressly confirm that a registered series of an LLC is within the meaning of the term "registered organization". In this manner, the intention is to clarify that to the extent that a security interest in relevant collateral granted by a registered series can be perfected by the filing of a financing statement, the appropriate jurisdiction in which to file would be Delaware since it is the jurisdiction of organization of such "registered organization". However, note that the law governing the applicable security agreement initially applies to determine where a perfection filing must be made. Accordingly, to the extent that the law governing the security agreement is not Delaware and the Uniform Commercial Code in such jurisdiction does not contain similar language to the Delaware Uniform Commercial Code with respect to registered series, consideration will need to be given as to whether a registered series nonetheless qualifies as a registered organization under the Uniform Commercial Code as in effect in such other jurisdiction.

As a result of the time needed to implement the new provisions relating to registered series, including the related filings with, and the issuance of the related certificates by, the Delaware Secretary of State, the amendments to

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each of the Delaware statutes relating to registered series, as well as the amendments to the DLLCA relating to protected series, will not be effective until August 1, 2019.

DIVISIONS

The 2018 Amendments add a new Section 18-217 to the DLLCA to authorize LLCs to divide into one or more newly formed LLCs (a "division company" or the "division companies") with the dividing LLC either continuing in existence or terminating its existence in connection with the division. In order to approve a division, an LLC must adopt a plan of division and file a certificate of division with the Delaware Secretary of State along with a certificate of formation for each division company being created in connection with the division. If the LLC Agreement of the dividing LLC provides for the manner of adopting a plan of division, the plan of division must be adopted in that manner. Otherwise, a plan of division must be adopted in the same manner as the LLC Agreement provides for the adoption of a merger or, failing a provision addressing mergers, by members who own more than 50 percent of the then current percentage or other interests in profits of the dividing LLC.

The division amendments contain a variety of concepts analogous to those in the merger provision of the DLLCA, including those relating to the conversion or exchange of rights, securities or interests in the dividing LLC, the amendment or adoption of a new LLC Agreement for the dividing LLC and the contents of a certificate of division. The division amendments also require that the plan of division effect the adoption of a new LLC Agreement for each division company.

A division does not affect the personal liability of any person incurred prior to the division nor does it affect the validity or enforceability of any obligations or liabilities of the dividing LLC incurred prior to a division, however, so long as the plan of division does not constitute a fraudulent transfer under applicable law, the pre-division obligations and liabilities are valid and enforceable after the division only against the division company to which they have been allocated in the plan of division. All of the division companies are jointly and severally liable for any debts and liabilities that are either not allocated pursuant to the plan of division to one or more division companies or those as to which a court of competent jurisdiction determines a fraudulent transfer pursuant to the plan of division has occurred. In order to preserve records relating to obligations and liabilities of the dividing LLC, a "division contact" is required to be set forth in the certificate of division and to serve for a period of six years, during which period the division contact will provide to any creditor upon written request the name and address of the division company to which such creditor's claim was allocated pursuant to the plan of division.

The new provision on divisions is effective on August 1, 2018 and is available to any LLC, however, for any LLC formed prior to August 1, 2018, if such LLC is a party to any written contract or agreement entered into prior to August 1, 2018 that, by its terms, restricts, conditions or prohibits mergers, consolidations or transfers of assets, then those restrictions, conditions or prohibitions shall apply to a division to the same extent as they apply to mergers, consolidations or transfers of assets.

STATUTORY PUBLIC BENEFIT LIMITED LIABILITY COMPANIES

In light of the increased desire to utilize public benefit entities, and in an effort to include statutory provisions in the DLLCA corresponding to similar new statutory provisions being adopted with respect to Delaware corporations under the Delaware General Corporation Law, the 2018 Amendments add a new subchapter XII to the DLLCA specifically authorizing the formation of a "statutory public benefit limited liability company" (an "SPBLLC"). An

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SPBLLC is a for-profit LLC that is formed with the intention to produce a public benefit (as defined in the new subchapter) and operate in a responsible and sustainable manner. While there is no doubt that, prior to the adoption of new subchapter XII, the provisions of the DLLCA offered enough flexibility to allow the formation of an LLC that, through the provisions of its LLC Agreement, could be operated for a public benefit and in a similar manner, which is not changing, the intention behind expressly providing for the formation of an SPBLLC is to allow for the efficient creation of a “standard” public benefit LLC, to which certain restrictions and requirements automatically apply by statute.

In order to form an SPBLLC, the certificate of formation filed with the Delaware Secretary of State must (i) state in its heading that it is an SPBLLC and (ii) set forth one or more specific public benefits to be promoted by it. Once such a filing is made, certain provisions of the new subchapter XII automatically will apply to the SPBLLC and cannot be modified or overridden in its LLC Agreement. These provisions include the vote of members required for the taking of actions that would cause the SPBLLC to cease to be such an entity or would cause the members to become associated with another entity that is not for a similar public benefit. The SPBLLC is also required by the new subchapter to provide its members no less than biennially a statement as to the SPBLLC's promotion of the public benefit or benefits set forth in its certificate of formation and as to the best interests of those materially affected by the SPBLLC's conduct.

In addition, the management of an SPBLLC (whether members, managers or others) are required by the new subchapter to manage the SPBLLC in a manner that balances the member's pecuniary interests, the best interests of those materially affected by the SPBLLC's conduct, and the specific public benefit or benefits set forth in its certificate of formation. This balancing requirement statutorily replaces any related modification or elimination of fiduciary duties that might otherwise have been permitted or provided for in the LLC Agreement of the SPBLLC, although the provisions of new subchapter XII also provide that a person will be deemed to satisfy its fiduciary duties to the SPBLLC and its members with respect to a decision implicating such balancing requirement if “such person's decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve.”

In this regard, it is important to note the differences between an LLC and a Delaware corporation (that are not statutory public benefit entities) with respect to the default fiduciary duties of management and the ability to modify those duties. By default, and if not otherwise modified in an LLC Agreement, management of an LLC will have a full duty of loyalty and care similar to that of a director of a Delaware corporation. However, unlike with respect to a Delaware corporation, the DLLCA expressly permits the duties (including fiduciary duties) of members and managers to be restricted or even eliminated in an LLC Agreement.

A director of a Delaware corporation that is not a statutory public benefit corporation, in satisfying its fiduciary duties to stockholders, may only consider the best interests of the corporation and its stockholders. A Delaware corporation's becoming a statutory public benefit corporation has the effect of allowing (and in fact requiring) management, in satisfying its fiduciary duties to stockholders, to consider interests related to such public benefit in addition to the interests of the corporation and its stockholders. In contrast, through a properly drafted LLC Agreement, an LLC that is to be operated for a public benefit but does not specifically become an SPBLLC may already modify the default fiduciary duties of management and specify such persons and interests that management may consider (or not consider) when making determinations. Accordingly, an LLC's becoming an SPBLLC may well have the adverse effect of increasing the persons and interests that management is required to

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consider when acting, to the extent that the fiduciary duties of management would have otherwise been further modified or eliminated in the LLC Agreement given that new subchapter XII of the DLLCA expressly provides that the LLC Agreement of an SPBLLC may not contain any provisions inconsistent with subchapter XII.

For this reason, among others, new subchapter XII of the DLLCA expressly confirms that, even if not being formed as an SPBLLC, an LLC may still be formed or operated for a public benefit and be designated as a public benefit limited liability company. While doing so may, in practice, require careful drafting of the LLC Agreement, it also affords the ability therein to modify the restrictions and requirements that would otherwise apply under subchapter XII of the DLLCA, including with respect to relevant fiduciary duties and voting and reporting requirements. Consideration should, therefore, be given as to whether forming as an SPBLLC is appropriate in all circumstances, even when the intention is for the LLC to be operated for the promotion of a public benefit.

The SPBLLC amendments become effective on August 1, 2018.

CONCLUSION

By clarifying existing law where clarifications were deemed beneficial, and by creating more flexibility where additional statutory or contractual freedoms were viewed as advantageous, the 2018 Amendments continue Delaware's leadership as the jurisdiction of choice for the formation and utilization of all types of business entities.

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