

## Fund Finance Friday



### Divide and Conquer: New Delaware 'Division' Law Creates Potential Issues for Fund Finance Lenders

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The State of Delaware recently amended the Delaware Limited Liability Company Act (the “Act”) to create a new form of transaction called a “Division.” Newly enacted Section 18-217 of the Act (the “Amendments”) allows an existing limited liability company (a “Dividing LLC”) to divide into two or more separate and distinct LLCs (each, a “Resulting LLC”), with a Dividing LLC allocating its assets, rights and liabilities among the two or more Resulting LLCs, with the further option of either terminating or continuing its own existence. The Amendments allow a Dividing LLC to separate pools of assets among Resulting LLCs without the procedural burden of a traditional asset transfer or other familiar form of reorganization.

It is important to distinguish a Dividing LLC from a Delaware Series LLC. A Series LLC is treated as a single “umbrella” LLC with a collection of individual series operating under the same umbrella LLC. Resulting LLCs, on the other hand, are separate and distinct entities from the Dividing LLC. Each series in a Series LLC is formed under a single Certificate of Formation, while Resulting LLCs each file individual Certificates of Formation. Additionally, a Series LLC survives after the creation of individual series, while (as mentioned above) a Dividing LLC can choose to terminate or continue its existence after a Division.

From an organizational document perspective, a Dividing LLC’s operating agreement drives whether or not such LLC can be divided. If the operating agreement is silent, under the Amendments, a Division is permitted to the extent a Plan of Division is approved by the Dividing LLC’s members owning 50 percent or more of the Dividing LLC. If the operating agreement contemplates a Division, it would be adopted as specified in the operating agreement.

#### Implications for Fund Finance

The impact of Divisions presents lenders making loans to Delaware LLCs with several new challenges. First, loan documents generally restrict or condition mergers, consolidations, transfers and other similar transactions, but most do not contemplate a Division. As a result, credit parties that are Delaware LLCs could, theoretically, divide and allocate assets and liabilities to Resulting LLCs that are not party to the loan documents without violating restrictive covenants or triggering any mandatory prepayments thereunder. Fortunately, the Amendments contain a safe harbor for loan documents with Delaware LLCs that were in effect prior to the August 1, 2018 effective date, which provides that any restrictions on mergers, consolidations, transfers and other similar transactions in agreements entered into before August 1, 2018 will be deemed to also apply to any Division.

Further, while the Amendments provide for the preservation of liens against the Dividing LLC, the language is not explicit as to whether such liens apply to the Resulting LLCs (“all liens upon any property of the dividing company shall be preserved unimpaired, and all debts, liabilities and duties of the dividing company shall remain attached to the division company to which such debts, liabilities and duties have been allocated in the plan of division, and may be enforced against such division company to the same extent as if said debts, liabilities and duties had originally been incurred or contracted by it in its capacity as a domestic limited liability company.” Section 18-217(l)(4)). Thus, while the lien against a Dividing LLC remains intact, if the assets securing that lien are allocated to a Resulting LLC, the lender will not have a security interest in the Resulting LLC’s assets unless the lender obtains a security interest from the Resulting LLC.

## **Considerations for Loan Documents**

The impact of the Amendments on Delaware LLCs deserve attention from practitioners, credit parties, banks and other lenders in the fund finance space. On the front end, practitioners should carefully review the operating agreements of credit parties that are Delaware LLCs to (i) determine whether a Division is contemplated and, if necessary, address the concerns at that stage and (ii) restrict Divisions in the operating agreements if not contemplated (“A limited liability company agreement may provide that a domestic limited liability company shall not have the power to divide as set forth in this section.” Section 18-217(k)). Further, in conjunction with such restriction, loan documents entered into on or after August 1, 2018 should expand negative covenants relating to mergers and transfers to restrict a Division unless the Resulting LLC(s) that are allocated the assets/collateral become a party to the loan documents. Finally, the affirmative covenants should be expanded to require the credit parties to procure the pledge of the assets of any Resulting LLC in the same manner as a Dividing LLC.

## **Limited Partnership Agreements**

The majority of U.S. fund finance transactions involve Delaware limited partnerships. They are not impacted – there is no corresponding legislation with respect to partnerships. This issue only impacts those fund credit parties formed as Delaware limited liability companies. But this could evolve – so stay tuned.

## **Conclusion**

The Amendments create some interesting but solvable considerations for parties entering into loan facilities that include (or have the potential to include) Delaware LLCs as credit parties. Lenders should consider incorporating language addressing a Division in all new facilities in which a Delaware LLC is a loan party (or likely to become a loan party), or adding such language at any time such loan documents are being amended or renewed.

[Link to the Amendments:](#)