

# JOHN CUNNINGHAM'S LLC NEWSLETTER FOR TAX AND LEGAL PROFESSIONALS

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## WHAT NEW HAMPSHIRE CPAs AND EAs SHOULD KNOW ABOUT DELAWARE LLCs

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EXECUTIVE SUMMARY. New Hampshire CPAs and EAs should advise their New Hampshire clients who are forming LLCs to seriously consider using the Delaware Limited Liability Company Act (the "Delaware Act") rather than the New Hampshire Limited Liability Company Act (the "New Hampshire Act") in the following three situations:

- High financial stakes. The financial stakes in the LLC deal in question are (or are likely to become) substantial.
- Members from two or more states. The LLC will have members from different states and if any members from one state don't want the LLC to be formed under the laws of the state of other members.
- The LLC's organizers want to obtain investment in the LLC from sophisticated investors or loans from sophisticated lenders.

### DISCUSSION

- 1) Similarities between the New Hampshire and Delaware Acts. The New Hampshire Act and the Delaware Act are generally similar on most legal issues important to LLC organizers, and on all of these issues, both Delaware and New Hampshire LLCs are better for most clients than corporations.
  - a) Entity status. Like corporations, LLCs are entities that exist independently of their members.
  - b) Liability shield. LLC members have strong liability shields that protect members' personal assets from claims against their LLCs. For smaller businesses, the LLC liability shield under both the Delaware and New Hampshire acts is stronger than the corporate shield.
  - c) Management structure. The members may choose either of two management structures—namely, the member management structure and the manager management structure. For most privately held businesses, these structures are much more user-friendly than the corporate management structure.
  - d) Contractual freedom. LLCs provide members with substantial contractual freedom in forming their LLCs. Corporations provide far less contractual freedom.

- e) Charging order protections. LLCs provide their members with “charging order protections,” which prevent creditors from obtaining ownership of member-debtors’ membership rights and from forcing sales of LLC assets. Corporations don’t provide these protections.
- 2) Legal advantages of the Delaware Act over the New Hampshire Act. From a purely legal viewpoint, the Delaware Act has the following principal advantages over the New Hampshire Act:
- a) Charging order protection advantages. The charging order provisions of the Delaware Act provide stronger and more comprehensive charging order protections than those of the New Hampshire Act. For many companies, this is the most important difference between the two acts.
  - b) “Bells and whistles.” The Delaware Act has various statutory “bells and whistles” that the New Hampshire Act does not have. The most important are these:
    - i) Statutory conversions. The Delaware Act permits any type of entity to make a statutory conversion into any other type of entity. New Hampshire statutory conversion law is more limited.
    - ii) Delegations. The Delaware Act makes it clear that members and managers of Delaware LLCs may delegate their authority to third parties. This delegation authority is arguably less clear under the New Hampshire Act.
    - iii) Fiduciary duties and liabilities. The Delaware Act permits LLC members to eliminate the fiduciary duties and liabilities of those with LLC management responsibilities. For at least a few LLCs, this may be a useful capability.
  - c) Case law. There is already an extensive body of LLC case law under the Delaware Act, and this body of case law is developing rapidly. There are no reported cases under the New Hampshire Act and it is likely to take many years before New Hampshire has even a few significant LLC cases.
- 3) The financial factor. Because of the above legal advantages of the Delaware Act over the New Hampshire Act, and particularly because of the superiority of the charging order provisions of the Delaware Act, LLC organizers and members whose LLC deals do or eventually may involve high financial stakes should generally form their LLCs as Delaware LLCs.
- 4) Legal disadvantages of Delaware LLCs. The main legal disadvantage for New Hampshire business people in forming LLCs under the Delaware Act is that in order to do so, they must appoint a Delaware resident agent for their LLC. This may facilitate lawsuits against the LLC in Delaware for which Delaware jurisdiction might otherwise be unavailable.
- 5) Costs for New Hampshire business people in forming and maintain Delaware LLCs.
- a) Delaware state LLC formation fees. The State of Delaware charges a basic fee of \$90 to form an LLC. Fees for expedited formations are higher. The fee for a certified copy of the certificate of formation (which it is always a good idea to obtain) is \$30.

- b) Delaware state LLC maintenance fees. The State of Delaware charges an annual LLC tax of \$200 to maintain the registration of Delaware LLCs, payable beginning on June 1 in the year after formation.
  - c) Fees charged by private companies. There are many companies located in Delaware that assist out-of-state individuals and entities to form LLCs and that serve as registered agents for them. Fees charged by these companies vary widely, but a fairly typical formation fee would be around \$180 for formation services; while a fairly typical annual fee for service as a registered agent would be \$160 (beginning in the year after the year of formation).
  - d) New Hampshire fees. The State of New Hampshire charges an annual fee of \$100 to register “foreign” (i.e., non-New Hampshire) LLCs.
- 6) Many investors favor the Delaware Act. The Delaware Act is by far the most prestigious of all U.S. LLC acts, and it is the LLC act preferred by many sophisticated venture capital partnerships and other sophisticated private equity providers.
- 7) Lenders. Certain sophisticated lenders prefer (and sometimes even require) that LLCs with which they deal be formed under the Delaware Act.