

NEW KID ON THE BLOCK: BERMUDA LLCS, TRUSTS

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Like an emerging artist following a breakthrough hit, much has been made of the arrival of Bermuda's new limited liability company (LLC) since its introduction in 2016. This new vehicle has already "gone platinum" in Bermuda's corporate and funds space. What has perhaps been overlooked is the unique value that LLCs can provide within a trust structure.

As a hybrid vehicle, the LLC - modelled closely on that offered by Delaware - offers many of the features of a partnership within an incorporated entity.

In a trust context, it is usual for a trustee to hold shares in one or more "underlying" companies limited by shares (CLS). Each underlying CLS may form part of a wider group structure or be used as a silo for distinct asset classes to prevent cross contamination or co-mingling. This may be so where one or more sub-trusts have been established for the benefit of distinct groups of family members. Such structure may also minimise the trustee's liability where the underlying CLS, as opposed to the trustee, enters into transactions with, and has exposure to, counterparties.

The directors of an underlying CLS often are employed (and provided) by a licensed trustee who may also be acting as trustee of the trust. This potentially creates an additional layer of risks, complexity and costs to the structure because such a director has a range of fiduciary duties that could conceivably conflict with the trustee's duties.

This may create issues where, for example, a trustee would like the directors of an underlying CLS to take into account competing interests of trust beneficiaries when considering a transaction. However, those directors are required to act in the best interests of the company and not of the trust beneficiaries. Even if an underlying CLS

issued multiple share classes which, for instance, effectively allocated income and gains to certain beneficiaries, the directors would nevertheless be extremely limited as to the extent that they could consider the specific interests of a given class when managing the CLS.

LLCs undoubtedly offer more flexibility. Bermuda's Limited Liability Company Act 2016 (LLC Law) specifically provides that "It is the intent of this Act to give the maximum effect to the principle of freedom of contract and to the enforceability of LLC agreements".

The LLC Law provides that to the extent duties may be owed (at law or in equity) to another person (e.g. by a manager of an LLC to the member(s)), such duties may be expanded, restricted or eliminated by provisions in the LLC agreement; except that no such provisions shall permit fraud or dishonesty. Consequently, the governance of the LLC and the interests that should be considered when managing its affairs can be closely aligned with those applicable to the trustee that holds the LLC interests as part of the trust property.

Taking a step further, the trustee could be both the manager and member of an LLC. This offers the above-mentioned advantages of holding property in an underlying corporate vehicle but in a structure where, unlike in the case of the CLS, the management is streamlined as the trustee as managing member would not be subject to the potentially inconsistent fiduciary duties described above.

Further, prescriptive legal processes need to be followed to flow funds into and out of a CLS, whether this is done by reduction of share capital, share purchase, cancellation, dividend or other form of distribution. Contrast this to the flexibility provided by LLCs. If, on the date of the distribution, the LLC's managers have reasonable grounds for believing that after payment thereof the LLC would be able to pay its liabilities as they become due, the LLC Law permits LLCs to make distributions to the extent and at the times or upon the happening of the events specified in an LLC agreement. This is very close to the traditional partnership model where partners can share their profits and losses as they decide. In a trust context, distributions under the LLC agreement could complement trust distributions that are contemplated by the trust deed.

Most jurisdictions in the United States (US) have LLC laws. US advisors frequently utilise LLCs for their flexibility and flow-through tax treatment. US advisors with international clients may find the familiarity of the Bermuda LLC appealing and utilise them for asset holding purposes, or as regulated or private fund vehicles.

US advisors have indicated that they would welcome the ability to legally segregate assets within an LLC, and Bermuda plans to provide these benefits by adapting our existing segregated accounts concept. Trustees may be attracted by the prospect of combining the existing advantages of the LLC with the ability to further segregate and protect assets and minimise annual regulatory fees made possible by using one "series" LLC as opposed to maintaining several separate underlying entities.

Step by step Bermuda LLCs are proving they are no one hit wonder and have the right stuff for enduring appeal.

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