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The Bermuda LLC: a Cost-Effective and Flexible Vehicle for Private Equity

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Bermuda Limited Liability Companies (LLCs) are flexible offshore vehicles that can replicate many of the same features as Bermuda exempted companies, at a cheaper cost and without some of the corporate governance restrictions of an exempted company. Nevertheless, the LLC is occasionally overlooked as a structuring option. One application of a Bermuda LLC that has increased in popularity is for private equity structures, particularly as a general partner of a limited partnership.

Bermuda's LLC legislation, introduced in 2016, was closely modelled on Delaware's LLC statute. This ensures a high level of familiarity for those who have used Delaware LLCs before. Concepts and documentation need not change very much. An LLC, like an exempted company, has legal personality separate from its members who, like the members of a limited company, are liable up to the amounts they have agreed to contribute to the LLC, but no more. Existing benefits of a Bermuda corporate structure are extended to LLCs with no loss of limited liability protection.

In common with a partnership, however, the affairs of a Bermuda LLC are governed by an agreement rather than by statutorily mandated constitutional documents. This affords greater flexibility, as the Bermuda LLC Act, like the Delaware legislation, expressly provides that maximum effect be given to the principle of freedom of contract in relation to LLC agreements. This ability to tailor the constitution and the corresponding simplified corporate governance of Bermuda LLCs make them ideal for complex financial structures.

Streamlined governance

Using an LLC, an entity is not required to appoint a separate board (although a board of managers may be appointed if the structure requires). This may be advantageous for an LLC that acts as a general partner entity. Allowing for management of the LLC by its members avoids duplication of governance committees across tiered holding entities.

As the Bermuda LLC statute gives maximum effect to the principle of freedom of contract, the LLC agreement may exclude fiduciary duties. Where an LLC acts as the private equity vehicle, this affords the ability to relax the duties owed by managers or members to the LLC, so that, for example, they can pursue other corporate opportunities. Directors of exempted companies and general partners of exempted limited partnerships are subject to minimum fiduciary and statutory duties to act in good faith towards the exempted company/exempted limited partnership; but for an LLC, short of fraud and dishonesty, the fiduciary wind-back permits an even more flexible approach.

Specified penalties or consequences against any non-performing member can be written into the LLC agreement. These may include the subordination, reduction, forced sale or forfeiture of the defaulting member's LLC interest, which the Act expressly states are enforceable.

Furthermore, any security interest granted over the assets of a Bermuda LLC can be registered in Bermuda, and the registration will ensure priority under Bermuda law over any unregistered and any subsequently registered security interests. This provides important certainty to lenders and investors.

LLCs, in common with exempted companies, are subject to the requirement to prepare audited financial statements; for LLCs, this requirement may be excluded in the LLC agreement, while for exempted companies it is necessary to obtain waivers from all members and directors. Distributions by an LLC to its members are subject only to a cash flow solvency test, contrasting with the cash flow solvency and balance sheet solvency tests that apply to exempted companies.

Tax status

Bermuda levies no taxes on income, profits or capital gains. Like an exempted company, an LLC is eligible for the same assurance that, if Bermuda introduces a tax on profits or income or on any capital asset, gain or appreciation, then the imposition of any such tax shall not be applicable to the LLC or to any of its operations. The potential tax status of a Bermuda LLC can also be a positive feature in terms of whether an LLC will be tax transparent or tax opaque. However, the actual tax treatment received by the LLC will be determined by the relevant onshore jurisdiction.

Ease of merger and amalgamation

When it comes to making fundamental changes to a Bermuda LLC is again very flexible. Like an exempted company, the LLC can continue to merge or amalgamate with foreign entities, redomicile from Bermuda to another jurisdiction, or convert to another corporate entity, such as an exempted company or exempted limited partnership which has elected to have legal personality.

Commercially-friendly

From a private equity perspective, the LLC belongs to the same stable of commercially-friendly regulation as the 2015 amendments to Bermuda's partnerships legislation. A limited partner or its representative may serve on boards or committees of the limited partnership, its general partner, or any entity in which the limited partnership has an interest, without concern that this activity is management of the limited partnership and would lose the limited partner its limited liability. A Bermuda LLC offers the same freedom of activity without loss of limited liability.

Quick and cost-effective

A Bermuda LLC can be formed with relative ease, just like a Bermuda company. The LLC will require a registered office with a licensed Corporate Service Provider, or if not using a corporate service provider, a registered office with a resident representative. Instead of a Memorandum of Association, a Certificate of Formation is filed with the Registrar of Companies. Consent to formation from the regulator – the Bermuda Monetary Authority – is waived if the Certificate of Formation is filed by a licensed Corporate Service Provider. The underlying LLC agreement, which covers the structure and operation of the business, can follow after incorporation, which saves delays. Government fees for LLCs are set competitively at less than half the minimum annual government fee for an exempted company. Moreover, the government fees for LLCs do not vary depending on the capitalization of the LLC. With corporate service provider fees being priced competitively also, the LLC may be a cost-effective option.

Efficient liquidation

Finally, the procedure for winding up and dissolving Bermuda LLCs follows closely the well understood corresponding regime for Bermuda corporations. This provides a sophisticated structure and certainty when dealing with the liquidation of complex businesses.

High compliance standards

Bermuda's internationally recognised standing as a reputable financial centre and its sound legal system based on English common law are attractive to clients seeking to structure cross-border investment and asset-pooling. Recent advances that secure Bermuda's status as a leader in compliance, such as enhanced money-laundering checks, have been extended to LLCs to ensure that an organisation using an LLC will have the assurance of the same high standards, which meet or exceed the requirements of the OECD and FATCA.

Other benefits of Bermuda include its stable, tax-neutral platform and its deep pool of intellectual capital and business support services.

Three years in

LLCs have been available in Bermuda now for three years and their popularity as a structuring vehicle has increased over time as sponsors become familiar with their operation and flexibility. Adoption was immediate by US-based clients who are familiar with the Delaware equivalent. For example, when two major reinsurance groups teamed up to launch a third-party capital backed life and annuity reinsurance start-up a couple of years ago, they chose Bermuda LLCs as both general partners and holding company for the structure. The new entity secured over US\$750 million of equity capital commitments. However, we are increasingly seeing LLCs feature in transactions originating from Europe where clients are less used to the vehicle.

Although Bermuda exempted companies will continue to be used in the public equity and debt markets, an LLC can make a lot of sense in private equity, offering a cheaper alternative and greater flexibility around governance.

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