CORPORATE MATTERS: SERIES LIMITED LIABILITY COMPANIES

Author
Simon Prisk

Tags
Corporate
Delaware
L.L.C.
Series L.L.C.

Clients frequently tell us they have heard of series limited liability companies but are unsure what they are and when they should be used. In this issue we will briefly explain the series limited liability company ("Series L.L.C.") and outline some of the pros and cons, with respect to its formation and use.

SERIES L.L.C. ESSENTIALS

Delaware and a handful of other states have allowed the formation of Series L.L.C.'s since the mid-1990's. A Series L.L.C. is a limited liability company ("L.L.C.") composed of an individual series of membership interests where the L.L.C. is essentially subdivided into many separate series, each series holds distinct assets, and obligations with respect to the assets designated as being in a series. The creation of the series must be included in the Certificate of Formation[54] and the management and operation of each series must be set forth in the Series L.L.C. agreement. The Delaware statute provides that "a limited liability company agreement may establish or provide for the establishment of one or more designated series of members, managers, limited liability company interests or assets"[55] and that each series may have a separate business purpose or investment objective.[56] This allows, in theory, for each series to have its own management structure and distinct business purpose.

The feature that most piques the interest of our clients is the ability of the assets of each separate series to be protected from the creditors of another. An owner of an L.L.C. that holds real estate assets, for example, that comprises both ownership and management could hold each business in a separate series of the same L.L.C., and a suit against the ownership series could not attack the assets of the management series.

54 DEL. CODE ANN tit. 6. §18-215(b).
55 DEL. CODE ANN tit. 6. §18-215(a).
56 *Id*.

ADVANTAGES OF A SERIES L.L.C.

A very tangible benefit of a Series L.L.C. is the low cost to form the entity relative to alternative structures. Typically a real estate holding company will have many subsidiaries, each holding a different asset in order to segregate assets and liabilities. Each entity has its own formation cost and annual costs associated with keeping the entity in good standing. With a Series L.L.C., only one entity need be formed, and that entity could hold multiple assets. The owner would only need to file one certificate of formation and, in terms of annual costs, pay only one Delaware Franchise Tax and one registered agent's fee.

As mentioned above, the overriding advantage of a Series L.L.C. is its ability to segregate assets by the creation of a series within a single entity and protect the assets of a particular series from the creditors of another.

DISADVANTAGES OF A SERIES L.L.C.

There is uncertainty around treatment of Series L.L.C.'s in states that do not recognize them. If a Delaware Series L.L.C. owns property in another state, it is really not known how that state's courts would react to a law suit against the L.L.C. as a whole, as opposed to a suit against a series within the L.L.C. There is no case law on the point, and it must also be pointed out that a court in another state could choose not to recognize legal separation. If registered as a foreign L.L.C. in California, for example, the Series L.L.C. is charged a franchise tax for *each* series.

It is a different take on piercing the corporate veil, and it is still somewhat of an unknown quantity. As with other types of entities, one can improve the likelihood of the legal separation being recognized by keeping books and records in a way that clearly shows the distinction. The Delaware statute provides that the records for each series must "account for the assets associated with such series separately from the other assets of the limited liability company, or any other series thereof."[57] More specifically, the section goes further with respect to the standard required to protect the limited liability:

> Records maintained for a series that reasonably identify its assets, including by specific listing, category, type, quantity, computational or allocational formula or procedure (including a percentage or share of any asset or assets) or by any other method where the identity of such assets is objectively determinable, will be deemed to account for the assets associated with such series separately from the other assets of the limited liability company, or any other series thereof.[58]

Again, there is no case law on the point, and although the above provides some guidance, without case law it is hard to advise what would or would not suffice in terms of record keeping. It should be remembered at all times each series in a

---

57 DEL. CODE ANN tit. 6. § 18-215(b).
58 *Id*.

Series L.L.C. is supposed to be treated as a separate entity. This means that each series should have separate meetings, minutes, and resolutions of action. Each series should maintain distinct financial books of accounts. Failure to segregate the books and records of each series may give a creditor grounds to pierce the veil of the particular series or the entire Series L.L.C.

There are other areas of uncertainty relating to Series L.L.C.'s, including broader questions relating to creditors rights and bankruptcy – how would the Uniform Commercial Code apply and how would an individual series be treated in bankruptcy?

Each series in a Series L.L.C. would need its own bank account, and some banks have trouble with the concept.

One reason why Series L.L.C.'s are not widely used is the uncertainty that exists as to how they will be treated for federal and state tax purposes. Proposed federal regulations addressing series and series organizations were formulated in 2010 but as yet have not been finalized.[59]

CONCLUSION

When L.L.C.'s were first introduced there was a general reluctance to use them for many of the same reasons that people are now reluctant to use Series L.L.C.'s. Over time banks, investors, title companies, and other institutions became comfortable with L.L.C.'s. When more clarity exists as to how Series L.L.C.'s will be treated for federal and state tax purposes, we think they will become more popular for businesses looking for limited liability for distinct activities and assets without the expense of forming and maintaining multiple entities.

---

[59] Prop. Reg, §301.7701-1(a)(5).