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Is a Series LLC Right for Your Business?

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The Series limited liability company (the “Series LLC”) is more nuanced than an ordinary limited liability company, and for the right user, it provides flexibility that will streamline administration better than other alternative entities. Although there are some risks and uncertainties relating to the Series LLC, as discussed further below, the Series LLC is a useful tool to create a series of limited liability companies in a single vehicle, preserving limited liability and reducing the administrative expenses necessary to organize different lines of business or manage different properties.

What is a Series LLC?

The Series LLC is equivalent to a series of separate limited liability companies housed within a single limited liability company entity; it possesses internal mechanisms in its articles of formation and operating agreement to segregate equity interests, assets, liabilities, and profits and losses within any number of independent series (the “Series” or “Protected Series”). Because the Series LLC is a single legal entity, no additional state formation filings are generally required to establish a new series. This structure has been analogized to a honeycomb (the Series LLC) that is owned by all of the bees in the hive, but each bee, or several bees together, can own their own hex (an individual Series) in the honeycomb.[1] Alternatively, it may also be useful to visualize an egg carton filled with a dozen eggs, where the egg carton is the Series LLC itself and each individual egg is a Protected Series within the Series LLC that can be owned separately by one or more members. Each Protected Series functions as a completely separate entity with a unique name, bank account, set of books and records, and the ability to enter into contracts, sue or be sued. The primary benefit of a Series LLC is that a business owner can operate multiple businesses with multiple owners within a single legal entity, and yet still shield the liability of one Series from another, as well as of each Series from the Series LLC itself.

Common Uses of a Series LLC

Two common uses supported by the unique structure of the Series LLC are (1) for regulatory convenience, allowing a business to hold a single license or make a single filing on behalf of all of its Protected Series, and (2) as an off-the-shelf template for establishing similar or related affiliated businesses. The Series LLC structure is particularly attractive for companies that want to simultaneously explore and finance several potential lines of business and shield those individual profit centers from other ventures. It is also attractive to venture capital funds and mutual funds that want to segregate assets with varying risk profiles from each other. Similarly, real estate investors are able to keep the liabilities of various properties separate within a single legal entity.

Risks and Uncertainties of Series LLCs

Although tens of thousands of Series LLCs are already operating in the United States, only 13 states, the District of Columbia, and Puerto Rico have formally adopted their own Series LLC legislation.[2] This lack of legislative guidance in many states has resulted in many attorneys and clients being wary of utilizing the Series LLC structure. Furthermore, as a relatively unexplored area of law, there are few decisions from regulators or judges regarding Series LLCs, which can result in a lack of clarity around various legal issues, such as:

- Will jurisdictions respect the Series' "internal" liability shields in the event of litigation in a jurisdiction that has not yet adopted its own Series LLC laws?
- What is the tax status of each individual Series? In some states, including Delaware, Series LLCs only have to pay a single state franchise tax for a single entity rather than having to pay separate fees for each Series.
- The IRS takes the position, however, that each Series is taxed as a separate entity for federal tax purposes.
- Even routine tasks, like filing a Form D to notify the Securities and Exchange Commission (the "SEC") that a firm or company has raised capital, are uncertain because there is no official guidance on whether each Series must file a Form D as a separate entity.

Even though a business may save time and money as it creates various Series over time, bank accounts, books and records, and other formalities must be established and respected to ensure that the entities are treated separately and the "internal" liability shield remains effective. These uncertainties may overshadow the intended efficiencies of the statute.

The Uniform Protected Series Act

In order to address the uncertainties surrounding the treatment of Series LLCs, in July 2017 the National Conference of Commissioners on Uniform State Laws (the "NCCUSL") finally approved the Uniform Protected Series Act (the "Act").[3] In the next few months, the Act will start to make its way to the states for passage which may encourage even more attorneys and clients to leverage the Series LLC structure and thereby reduce the uncertainties that currently bedevil the entity structure.

Assuming that state legislatures adopt the Act as drafted (particularly Delaware and states with large economies such as California and New York), there may be greater certainty as to the operation and liabilities of the Series LLC. For example, the Act defines the Protected Series as a separate legal person from the Series LLC itself or the other Protected Series, codifying the "internal" liability shield. However, the Act reduces some of the flexibility permitted under most jurisdictions which have authorized Series LLCs by requiring each individual Series to make a separate public filing (thereby undercutting one of the administrative advantages noted above). The Act includes specific rules to address the concerns voiced by creditors and provide greater security in lending to a particular Protected Series by providing a process for disregarding the "internal" shields that protect the assets of one Protected Series from the creditor of another Protected Series. The statute also addresses how provisions of the existing limited liability company statutes apply at the Protected Series level, formally applying the plain vanilla limited liability company laws to Protected Series in addition to all the specific provisions created by the Act. Lastly, the Act provides for registering particular Protected Series (rather than the whole Series LLC) as foreign entities to permit them to do business in a state without exposing all Protected Series to that state's laws.

Surprising Popularity of Series LLCs

What is interesting about the Series LLC structure is that the relationships established through Protected Series are not unique, and can be established with various structures involving several limited liability companies (such as a traditional holding company and subsidiary structure). Despite the risks created by the uncertainties outlined above and despite alternative entity structures, many venture capital funds, companies with multiple subsidiaries and others are choosing to employ the Series LLC structure.

Endnotes

1 *See* Jay Adkisson, Uniform Limited Liability Company Protected Series Act (ULLCPSA) Adopted by Uniform Law Commission, FORBES.COM, July 22, 2017, here.

2 Alabama, Delaware, Illinois, Indiana, Iowa, Kansas, Minnesota, Missouri, Montana, North Dakota, Nevada, Oklahoma, Tennessee, Texas and Utah. The District of Columbia and Puerto Rico also have provisions for Series LLCs. While California has not authorized Series LLCs by statute, it does allow Series LLCs that were formed in other states to register as a foreign entity and do business in California.

3 Uniform Protected Series Act, National Conference of Commissioners on Uniform State Laws, Meeting in its 126th Year, San Diego, California, July 14 – July 20, 2017 here.

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