

SERIES LLCs: THE PROBLEM OF THE CHICKEN AND THE EGG

WENDELL GINGERICH*

I. INTRODUCTION

A Series Limited Liability Company (series LLC) is the future of the unincorporated form. Acting essentially as an umbrella corporation, the series LLC allows a company to place a series of properties or operations with separate business purposes or investment objectives in one entity. Though a similar effect could be accomplished using a typical limited liability company (LLC) as a holding company, Delaware introduced the series LLC to the rest of the country primarily as a vehicle to provide more planning flexibility in business formation while also reducing administrative and filing costs associated with the use of multiple “ordinary” LLCs. Each series of the “master” LLC may have different assets, liabilities, duties, members, managers, and rights.¹ As a result of the separation of assets and liabilities between series, a shield or firewall is created between each series, protecting the assets of one series from lawsuits that are filed against any of the other series.²

After its introduction in Delaware in 1996,³ the series LLC has not seen a dramatic increase in popularity, largely because of the glaring lack of case law interpreting the series LLC statutes.⁴ Nevertheless, its current lack of mainstream use as an unincorporated entity could change quickly with more court cases decided in favor of the series LLC or more states adopting the series LLC. Conversely, if more series LLCs are used in practice, more court cases will follow and provide direction to the current speculation on whether courts will allow a series to have its assets protected from another series’ liabilities.

A total of seven states now provide for series LLCs by statute: Delaware,⁵ Illinois,⁶ Iowa,⁷ Oklahoma,⁸ Nevada,⁹ Tennessee,¹⁰ and Utah.¹¹

* J.D. Candidate, The Ohio State University Michael E. Moritz College of Law, expected May 2009.

¹ Larry E. Ribstein, *An Analysis of the Revised Uniform Limited Liability Company Act*, 3 VA. L. & BUS. REV. 35, 42 (2008).

² *Id.*

³ DEL. CODE ANN. tit. 6, § 18-215 (2008).

⁴ John C. Murray, *A Real Estate Practitioner’s Guide to Delaware Series LLCs* (2007), available at: <http://www.firstam.com> (enter “series LLC” in the search box then click the aforementioned title hyperlink) (last visited Apr. 3, 2009).

⁵ DEL. CODE ANN. tit. 6, § 18-215.

⁶ 805 ILL. COMP. STAT. 180/37-40 (2008).

⁷ IOWA CODE § 490A.305 (2008).

Most of those states model their statutes after the Delaware series LLC, with the notable exception of Illinois.¹² Several other states, namely Minnesota,¹³ North Dakota,¹⁴ and Wisconsin,¹⁵ make brief reference to the series or class in their statutes, but they do not establish the special characteristics of the series LLCs (e.g., separate liabilities and assets for each series) in the fashion seen in the statutory laws of Delaware or Illinois.¹⁶

This article advocates for increased use of the series LLC by juxtaposing current criticisms of the series LLC with an analysis of how courts should interpret the current series LLC statutes. The benefits of the series LLC in tandem with the likelihood of courts interpreting a series LLC statute favorably should allay fears about the current lack of litigation regarding the use of the series LLC. The lack of litigation thus far may be due to the conservative manner in which the series has been utilized. Part I of this Article provides a brief historical background of the series LLC. In Part II, this Article will explore the differences between the pioneering Delaware series LLC and the Illinois series LLC statutes, because Illinois diverges from the Delaware model more than any other state with a series LLC statute. Part III evaluates the benefits and pitfalls of the series LLCs, in particular the criticisms given by the National Conference of Commissioners on Uniform State Laws in July 2006, when the series LLC was excluded from the Revised

⁸ OKLA. STAT. tit. 18, § 2054.4 (2007).

⁹ NEV. REV. STAT. § 86.286 (2007).

¹⁰ TENN. CODE ANN. § 48-249-309 (2006).

¹¹ UTAH CODE ANN. § 48-2c-606-616 (2007).

¹² LARRY E. RIBSTEIN & ROBERT R. KEATINGE, 1 RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES, § 4:17, n. 10 (Thompson/West 2004).

¹³ The Minnesota LLC statute states: “‘Class,’ when used with reference to membership interests, means a category of membership interests that differs in one or more rights or preferences from another category of membership interests of the limited liability company.” MINN. STAT. § 322B.03 (2008).

¹⁴ The North Dakota LLC statute states: “‘Series’ means a category of membership interests, within a class of membership interests, that has some of the same rights and preferences as other membership interests within the same class, but that differ in one or more rights and preferences from another category of membership interests within that class.” N.D. CENT. CODE § 10-32-02 (2008).

¹⁵ The relevant portion of the Wisconsin LLC statute states:

An operating agreement may establish, or provide for the establishment of, designated series or classes of members, managers, or limited liability company interests that have separate or different preferences, limitations, rights, or duties, with respect to profits, losses, distributions, voting, property, or other incidents associated with the limited liability company.

WIS. STAT. § 183.0504 (2008).

¹⁶ Vicki R Harding, *Series LLCs: A Wave of the Future—Or Not?*, 27 MICH. BUS. L.J., 19, 21 (Spring 2007) (noting that vague references to a class or series made in passing will not grant the rights of a Delaware series LLC for example). This is also available at <http://www.michbar.org/business/BLJ/Spring2007/harding.pdf>.

Uniform Limited Liability Company Act (RULLCA). Part IV examines how the statutes will likely be interpreted given the litigation history and recently updated series LLC statutes. Part V concludes, arguing that if state legislatures begin to adopt statutes resembling the language in the Illinois series LLC statute, many of the risks associated with the series LLC would likely be mitigated.

Apprehension regarding the use of the series LLC stems largely from its uncertain tax treatment and the fear that courts will not uphold its liability shield in a non-series state.¹⁷ However, until more series LLCs are used in practice, the likelihood of cases interpreting these provisions and creating strong case precedent remains low.¹⁸ Thus, the series LLC suffers from the problem of the age-old chicken and the egg.

What must come first for the series LLC to gain popularity: greater use of the series LLC in practice,¹⁹ or widespread adoption of a series LLC statute by states? This article advocates that the problem should be solved by having more legislatures implement the series LLC by statute, based on the reasonable likelihood that the courts will favor a relatively broad interpretation of the statutes. As more states adopt the series LLC, the series will likely gain exposure and popularity.²⁰ It would eventually eliminate the question of whether courts will uphold foreign LLC statutes.²¹ As a result of increased

¹⁷ Nick Marsico, *Current Status of the Series LLC: Illinois Series LLC Improves Upon Delaware Series LLC but Many Open Issues Remain*, 9 J. PASSTHROUGH ENTITIES 35, 35 (Nov.-Dec. 2006).

¹⁸ Presumably as more series LLCs enter into commerce, litigation involving the series LLC will follow. However, one potential explanation for the lack of series LLC case law to date is the conservative and cautious manner in which the series has been used. Attorneys who have steered their clients toward using a series LLC have likely advised them to keep separate records for each series and to ensure that potential creditors know when they are dealing with a series that has limited liability.

¹⁹ This assumes that more series LLCs will generate more case law, and that the case law generated by the series LLC will answer the current uncertainties, such as to how a series will be treated in a foreign state, for tax purposes, or in bankruptcy.

²⁰ This assumes that the adoption of the series LLC by state statutes would mirror, if not lead to, the increased use of the series LLC in practice. The LLC rose to popularity with state statutes leading the way, as borne out by the numbers. By the end of 1992, eighteen states had the LLC, and there were 7000 new LLC filings. By the end of 1993, thirty-six states had an LLC statute, and the number of LLC filings rose to 23,000. At the close of 1994, all but three states had an LLC statute, and there were 64,000 new filings. The new filing growth continued to explode to 115,000 filings in 1995, which demonstrates a small lag between the adoption of a state LLC statute and the increased use of the LLC form. Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1475-77 (1998).

²¹ The problem of foreign recognition of the series LLC would disappear if all states had statutes that recognized the series LLC. While this may seem unrealistic to occur in the near future, the LLC was adopted in forty states over just three years (ten in 1992, eighteen in 1993, and twelve in 1994). *Id.*

popularity in practice, more case law will settle the tax and liability issues and regulators will be pressured to provide input, creating even greater security for businesses to continue the rise of the series LLC.

II. HISTORY OF THE SERIES LLC

Imagine yourself as an entrepreneur with a small business or two, or as an investor with several parcels of real estate. In order to protect your assets and eliminate potential personal liabilities, you decide to form an LLC for each property and each business. Because courts have generally upheld the LLC as a legitimate entity for limiting liability to an owner's investment in that entity (absent fraud),²² you (and any other investor) would be justified in thinking that you were reasonably safe. But at the end of the year, when doing taxes and paying fees for each LLC, you realize that forming all those separate LLCs requires a large amount of paperwork, taxes, and state filing fees.²³

Fortunately, lawmakers in some states have created a solution to help fix these problems: the Series LLC. Insight into the history and beginning of the series LLC lends itself to a more thoughtful analysis of the potential pitfalls and benefits of using this new corporate form.

There are differing opinions on the particular type of business responsible for the development of the series LLC conceptually. The series LLC may have originated from the need in investment banking to maintain separate investment portfolios under one entity.²⁴ Other scholars cite offshore mutual funds and the insurance industry as the catalysts.²⁵ The most obvious use for a series LLC is in the context of real property,²⁶ because many people or businesses have multiple properties that should be separated for liability purposes (requiring a new series or corporation), yet in effect have one owner. The series LLC allows one owner to have all of his holdings under one umbrella, while also having each series separate from the others for liability

²² See, e.g., Unif. Ltd. Liab. Co. Act § 303(a), 6A U.L.A. 590 (2003).

²³ Filing the articles of organization, an operating agreement, and in some states, filing your intention to form a business in a newspaper are some of the mechanics of business formation, before franchise and filing fees are even considered. These fees vary by state, but it is intuitive that filing one series LLC entity would be much cheaper than filing numerous LLCs. (It would make little sense for the state to enact a series LLC statute only to eliminate one of its primary advantages.) That said, it may not necessarily always be cheaper to form a series LLC depending on which state you want to form a regular LLC in. See Carol R. Goforth, *The Series LLC, and a Series of Difficult Questions*, 60 ARK. L. REV. 385, 395 (2007).

²⁴ Harding, *supra* note 16, at 22.

²⁵ Dominick T. Gattuso, *Series LLCs: Let's Give the Frog a Little Love*, 17 BUS. L. TODAY, Jul.-Aug. 2008, at 33, 33. It should be noted that this article will focus only on series LLCs as they are used in the United States, even though other countries such as Puerto Rico have also adopted them.

²⁶ Marisco, *supra* note 17, at 35.

purposes.²⁷ Even if one property operates at a net financial loss, none of the properties that were placed in other series would be affected. Likewise, taxi companies, hedge funds, oil and gas deals,²⁸ and any other business with disparate functions subject to tort liability should consider the series LLC. Each of those businesses with a segment particularly prone to tort liability would benefit from the series LLC by keeping that segment in its own series, under the same master LLC but separate from the other series, and thus free from liability for debts of other series.

The series LLC was designed by legislatures to give companies flexibility by allowing each series to have its own separate assets, and only the corresponding liabilities from those assets.²⁹ Each series is to be independent, with different duties and rights. This means that liabilities incurred by a series are enforceable only against that series; a loss in one series cannot roll over to consume the gains from another series.³⁰ With proper planning though, ownership and assets could be shifted among series.³¹ In other words, companies may now segregate assets to avoid potential liability issues by using different series under the umbrella of one corporation instead of creating many distinct corporations or shell corporations in a parent-subsiary relationship.

Delaware was the first state to create the series LLC,³² introducing it in 1996 by adding the series provision to the Delaware Limited Liability Company Act (DLLCA).³³ Since then, five states have adopted a series LLC provision very similar to that of Delaware.³⁴ Notably, the drafters of the 2006

²⁷ See e.g., DEL. CODE ANN. tit. 6, § 18-215(b) (2008).

²⁸ LimitedLiabilityCompanyCenter.com, What is a Series LLC?, http://www.limitedliabilitycompanycenter.com/series_llc.html (last visited Feb. 26, 2009).

²⁹ See e.g., DEL. CODE ANN. tit. 6, § 18-215(b).

³⁰ *Id.*

³¹ Goforth, *supra* note 23, at 387.

³² *Id.*

³³ See DEL. CODE ANN. tit. 6, § 18-215 (2008).

³⁴ These states are Iowa, Nevada, Oklahoma, Tennessee, and Utah. Gattuso, *supra* note 25, at 33. *But see* Ribstein & Keatinge, *supra* note 12, at § 4.17 n. 10, (placing Tennessee closer to the Illinois statute). Delaware's statute is not as explicit as Tennessee's regarding the effect of the termination of a series LLC. The Delaware statute simply states that "a series may be terminated and its affairs wound up without causing the dissolution of the limited liability company." DEL. CODE ANN. tit 6, § 18-215(k) (2008). However, Tennessee's statute goes further, stating "A series of an LLC may be terminated and its affairs wound up without causing the dissolution of the LLC or the termination of any other series of the LLC and without affecting the limitation on liability of the terminated series or any other series of the LLC." TENN. CODE ANN. § 48-249-309(g) (2006) (emphasis added). The Tennessee statute, like the Illinois' statute, more explicitly treats each series as a separate LLC with regard to management, voting rights, and termination of the series. TENN. CODE ANN. § 48-249-309 (e)-(g) (2006) (treating the series "as if the series were a separate LLC.").

Revised Uniform Limited Liability Company Act (RULLCA) did not include a series LLC provision, thinking its function was not novel and that its legal standing was uncertain. These issues will be explored in Part III.³⁵

Illinois added the series LLC in 2005, and stands alone in its departure from the Delaware model, containing several significant differences that could help the series LLC appear more deserving of protection in the eyes of judges. Because the future of the series LLC may depend upon whether states adopt the Delaware version or the Illinois version, their differences require further analysis.

III. DIFFERENCES BETWEEN THE SERIES LLC PROVISIONS IN DELAWARE AND ILLINOIS

Skepticism of the series LLC may spring, in part, from a belief that the Delaware model seems “too good to be true.” The Delaware model requires seemingly few filing fees and the promise of less burdensome procedures, while also offering substantial and flexible liability protection.³⁶ Despite this skepticism, the legislatures in Iowa, Oklahoma, Nevada and Utah added series LLC statutes that mirror the Delaware model.³⁷ In addition, the Tennessee provisions largely follow the Delaware statute.³⁸

The Illinois legislature introduced some important changes to the Delaware statute when it enacted its own series LLC statute.³⁹ The Illinois statute has added several provisions bolstering the likelihood that a court will uphold the liability shield of an individual series. The Illinois statute diverges from the Delaware provision by adding language: 1) that requires a series to provide more notice of its form to third parties; and 2) that further emphasizes the separation of each series from every other series within the master LLC.⁴⁰

First, the Illinois statute requires more notice of the series LLC to third parties.⁴¹ For example, to form a series, the master LLC must file a separate form specific to the series LLC in order to create a new series.⁴² This could be

³⁵ Harding, *supra* note 16, at 21.

³⁶ See Julia Gold, *Series Limited Liability Companies—Too Good to Be True?*, NEV. LAWYER, July 2004, at 18, 19 (arguing that Nevada should adopt the Series LLC despite the uncertainty associated with it because the series would promote Nevada’s reputation as a business friendly state and because the series would be beneficial as a fee-reducing business planning tool).

³⁷ Marsico, *supra* note 17, at 35.

³⁸ Gattuso, *supra* note 25, at 33.

³⁹ See generally 805 ILL. COMP. STAT. 180/37-40 (2008).

⁴⁰ Marsico, *supra* note 17, at 35-36.

⁴¹ 805 ILL. COMP. STAT. 180/37-40(b) requires a master LLC to file a Certificate of Designation to create a new series, and 805 ILL. COMP. STAT. 180/37-40(c) requires the name of each series to include the name of the master LLC and also to be distinguishable from every other series within the master LLC.

⁴² 805 ILL. COMP. STAT. 180/37-40(b).

important to courts when a series LLC conducts business in a state that does not have a series LLC statute, because that state may choose not to recognize a foreign series LLC if no additional notice was provided.⁴³

The potential problem with the original Delaware statute and its progeny is that someone who does business with a series LLC needs sufficient notice that he or she is only dealing with a particular series, and thus the liabilities of that series are limited to those liabilities arising from that series' assets.⁴⁴ But in order to discover he or she was dealing with a series, a person must obtain the Articles of Organization of the LLC, and then obtain the operating agreement in order to find the particular series in question.⁴⁵ Courts in states without a series LLC statute might not look favorably on requiring someone to go to that length to discover that it is dealing with a particular series LLC (with potentially much more limited liability than it would appear to have).

The Illinois statute would allow someone to find this information simply by the name of the series itself. The name of an individual series is required to include the master LLC name and be different from the other series.⁴⁶ The series name could also be found by searching the Certificates of Designation for the name of the business in question. For example, the name "Small Company XYZ LLC, Series C" is easily identifiable as a series LLC.⁴⁷ Potential creditors of the company with access to this information would only need to question the series as to its limitations on liability to have full notice. Thus, the Illinois statute would likely be looked upon favorably by courts. In addition, creditors could access filings of the series LLC regardless of the differences with the parent company, and even the names of a series' management team would be available to creditors.⁴⁸ Courts should find that type of notice sufficient, regardless of the state in which the series is operating, because it becomes easy for potential creditors to know whether they are dealing with a series LLC.

⁴³ The choice of law issues in non-series states are discussed below, but to date there is no case law on the most current versions of the statute. The only relevant case questioned the ability of a series to bring suit in its own name, but the Delaware statute at issue has since clarified that an individual series can bring a suit. *GxG Management LLC v. Young Bros. & Co., Inc.*, No. 05-162-B-K, 2007 WL 551761 at *2 (D. Me. Feb. 21, 2007).

⁴⁴ Marsico, *supra* note 17, at 50.

⁴⁵ *Id.*

⁴⁶ 805 ILL. COMP. STAT. 180/37-40(c).

⁴⁷ If a company includes the company name with the particular series behind it, a potential creditor performing reasonable due diligence should be on notice to inquire about a series, and what makes a series different or separate from the main company name.

⁴⁸ A Certificate of Designation must include "names of the members if the series is member managed or the names of the managers if the series is manager managed." 805 ILL. COMP. STAT. 180/37-40(d) (2008).

In contrast, all other states⁴⁹ with a series LLC statute require the series LLC to be formed by filing a Certificate of Formation or Articles of Organization with the Secretary of State.⁵⁰ Each of those states either allows the same form to be used for series LLCs as for regular LLCs, or requires no separate form at all.⁵¹ In the states without a form specific to the series LLC, a series is created by simply including in the Articles of Organization the language specified in the series statute.⁵² Conversion of a regular LLC to a series LLC, however, can be done simply by adding the requisite language to the Articles of Organization, as specified in the statute, in each of the states, Illinois included.⁵³

Another distinction in the formation process is that Illinois requires a Certificate of Designation for any series *operating* within the state, to ensure that the liabilities of a series are enforceable only against the assets of that particular series.⁵⁴ This means that along with series LLCs formed in Illinois, foreign series LLCs that qualify to do business in Illinois are required to file a Certificate of Designation.⁵⁵ This acts to provide notice to those dealing with the series LLC in the future.⁵⁶ Courts in non-series states, which may not be willing to uphold the liability shield to the disadvantage of their own citizens, especially will want evidence that a third party had notice that the series with which it dealt was limited in its liability, in order to ensure justice.

In contrast, notice to third parties in states that have a series LLC statute (except Illinois) is accomplished by limiting the liabilities of a series in the Certificate of Formation alone.⁵⁷ The Delaware statute states that:

Notice in a certificate of formation of the limitation on liabilities of a series as referenced in this subsection shall be sufficient for all purposes of this subsection whether or not

⁴⁹ DEL. CODE ANN. tit. 6, § 18-215 (2008); IOWA CODE § 490A.305 (2008); 18 OKLA. STAT. tit. 18, § 2054.4 (2007); NEV. REV. STAT. § 86.286 (2007); TENN. CODE ANN. § 48-249-309 (2006); UTAH CODE ANN. § 48-2c-606-616 (2007).

⁵⁰ Marsico, *supra* note 17, at 36.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ Only “if the operating agreement so provides, and notice of the limitation on liabilities of a series as referenced in this subsection is set forth in the articles of organization of the limited liability company *and if the limited liability company has filed a certificate of designation for each series . . .*” may the series have an internal liability shield. 805 ILL. COMP. STAT. 180/37-40(b) (2008) (emphasis added).

⁵⁵ “The limitation of liability shall be so stated on the application for admission as a foreign limited liability company and a certificate of designation shall be filed for each series being registered to do business in the State by the limited liability company.” 805 ILL. COMP. STAT. § 180/37-40(o) (2008). *See also* Harding, *supra* note 16, at 20.

⁵⁶ Gattuso, *supra* note 25, at 34. The other states simply allow the Articles of Organization to serve as notice to those dealing with the series LLC. *Id.*

⁵⁷ *See, e.g.*, DEL. CODE ANN. tit. 6 § 18-215(b).

the limited liability company has established any series when such notice is included in the certificate of formation, and there shall be no requirement that any specific series of the limited liability company be referenced in such notice. *The fact that a certificate of formation that contains the foregoing notice of the limitation on liabilities of a series is on file in the office of the Secretary of State shall constitute notice of such limitation on liabilities of a series.*⁵⁸

Illinois requires a series to have a different name than any other series, and the Certificate of Designation for each series must include the full name of the LLC.⁵⁹ This provides further notice to third parties dealing with an Illinois series LLC.⁶⁰ Finally, those forming a series LLC in Illinois must specify the business purpose of a series in the operating agreement, if that purpose differs from the purpose of the master LLC.⁶¹ Each of these Illinois provisions is consistent with the concern for adequate notice to third parties.

Because of the Certificate of Designation requirement, any single Illinois series will likely be more able to do business in a non-series state than a Delaware series would. This is true because to qualify to do business in a state other than the state of formation, a series must (in at least some states) produce a certificate of good standing.⁶² In Illinois, the Secretary of State has record of each individual series, and can simply issue the certificate for a particular series. However, in Delaware, the Secretary of State would only have information about the master LLC, not each individual series.⁶³ Even though a certificate of good standing can identify the LLC as a series LLC, the certificate would only refer to the master LLC in general, and not the

⁵⁸ DEL. CODE ANN. tit. 6 § 18-215(b) (emphasis added).

⁵⁹ 805 ILL. COMP. STAT. 180/37-40(b).

⁶⁰ Gattuso, *supra* note 25, at 34.

⁶¹ *Id.* at 33-34.

⁶² Harding, *supra* note 16, at 22.

⁶³ DEL. CODE ANN. tit. 6 § 18-215(b) states:

Notice in a certificate of formation of the limitation on liabilities of a series as referenced in this subsection shall be sufficient for all purposes of this subsection whether or not the limited liability company has established any series when such notice is included in the certificate of formation, and *there shall be no requirement that any specific series of the limited liability company be referenced in such notice.* The fact that a certificate of formation that contains the foregoing notice of the limitation on liabilities of a series is on file in the office of the Secretary of State shall constitute notice of such limitation on liabilities of a series.

Id. (emphasis added).

particular series.⁶⁴ If a non-series state fails to recognize the series LLC, then it may reject a good standing certificate that only referred to a master LLC.⁶⁵

Second, the Illinois statute is theoretically stronger in protecting the assets of one series from being exposed to the liabilities of other series.⁶⁶ It is different from and stronger than other states' statutes in that it explicitly includes provisions with the sole purpose of establishing the separateness of a series from the master LLC.⁶⁷ For example, the Illinois statute provides that:

A series with limited liability shall be treated as a separate entity to the extent set forth in the articles of organization. *Each series* with limited liability may, *in its own name*, contract, hold title to assets, grant security interests, *sue and be sued* and otherwise conduct business and exercise the powers of a limited liability company under this Act. The limited liability company and any of its series may elect to consolidate their operations as a single taxpayer to the extent permitted under applicable law, elect to work cooperatively, elect to contract jointly or elect to be treated as a single business for purposes of qualification to do business in this or any other state. Such elections shall not affect the limitation of liability set forth in this Section except to the extent that the series have specifically accepted joint liability by contract.⁶⁸

This language separates Illinois from the previous Delaware statute, because Delaware did not provide that each series is its own legal entity that is distinct from the original LLC.⁶⁹ The Illinois legislature, foreseeing potential difficulties with foreign state courts, decided to endow each series with its own legal entity.⁷⁰ The Illinois statute explicitly provides that each series is "treated as a separate entity to the extent set forth in the articles of organization"⁷¹ and

⁶⁴ *Id.*

⁶⁵ *Id.* For example, many state statutes allow a foreign entity no more rights than a domestic entity would be allowed. If the series is not authorized in a state, then the series LLC could be said to have more rights than the typical LLC, and thus be disregarded to the extent of the additional benefits. *Id.*

⁶⁶ Marsico, *supra* note 17, at 50.

⁶⁷ *Id.*

⁶⁸ 805 ILL. COMP. STAT. 180/37-40(b) (2008) (emphasis added).

⁶⁹ Goforth, *supra* note 23, at 388-89.

⁷⁰ 805 ILL. COMP. STAT. 180/37-40(b) states explicitly that each series should be "treated as a separate entity to the extent set forth in the articles of incorporation."

⁷¹ 805 ILL. COMP. STAT. 180/37-40(b).

should be treated as a single entity for the purpose of qualifying to do business in other states.⁷²

In addition, “the provisions of this [LLC] Act which are generally applicable to limited liability companies, their managers, members and transferees *shall be applicable to each particular series . . .*”⁷³ Though Tennessee is the only other state to include this provision in its original series statute, the phrase is significant. A court in a state without a series LLC statute would probably be more apt to treat the series like a simple LLC where the statute explicitly commands it.⁷⁴ But without treating the series as its own entity, there is neither statutory nor court direction to clarify the issue for courts in foreign states.⁷⁵ Recognizing this, Delaware amended its statute to say: “Assets associated with a series may be held directly or indirectly, *including in the name of such series*, in the name of the limited liability company, through a nominee or otherwise . . .”⁷⁶

The Illinois statute is also stronger because it provides that each series is to be treated as a separate entity that may “contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company . . .”⁷⁷ The glaring omission of a similar provision in the original Delaware statute and its progeny led one commentator to believe that the statute simply provides a way to segregate assets, not to separately own them.⁷⁸ If a court were to find that thinking persuasive, then a series would not be capable of owning assets in its own name. Indeed, a United States District Court in Maine has said that the “relationship between a Delaware LLC and its series does not create a truly separate legal entity capable of independently pursuing its own legal claims . . . but merely [creates] a ‘series of interest’ maintained by the LLC . . .”⁷⁹ However, the original Delaware statute stated that debts of a series are

⁷² *Id.*

⁷³ 805 ILL. COMP. STAT. 180/37-40(j) (2008) (emphasis added). Tennessee includes a similar provision in its series LLC statute. TENN. CODE ANN. § 48-249-309(f) (2006).

⁷⁴ States without a series LLC statute are still subject to the Full Faith and Credit clause of the Constitution, which would require them to give some deference to the state in which the series was formed. U.S. CONST. art. IV, § 1.

⁷⁵ Until the series LLC is litigated in states without a series statute, or until a majority of states enact series LLC statutes, the treatment of the series in foreign states will remain an open question.

⁷⁶ DEL. CODE ANN. tit. 6 § 18-215(b) (2008) (emphasis added).

⁷⁷ 805 ILL. COMP. STAT. 180/37-40(b).

⁷⁸ John C. Murray, *A Real Estate Practitioner’s Guide to Delaware Series LLCs* (2007), available at: <http://www.firstam.com> (enter “series LLC” in the search box then click the aforementioned title hyperlink) (last visited Apr. 3, 2009).

⁷⁹ *GxG Management, LLC v. Young Bros. & Co., Inc.*, Civil No. 05-162-B-K, 2007 WL 1702872, *1 (D. Me. June 11, 2007).

enforceable “against the assets of such series only,”⁸⁰ which presumes that a series owns assets and it is not merely a “series of interest.”⁸¹

Following *GxG Management LLC v. Young Bros. & Co., Inc.*, the Delaware LLC statute⁸² was amended in 2007 to rectify the belief that a series LLC only has an *interest* in its assets. The new provision explicitly states that a series can hold title to assets in its own name.⁸³ The capacity to sue and be sued, questioned by the District Court in Maine and other commentators,⁸⁴ was clearly granted in the amended Delaware statute.⁸⁵

The amendment of the Delaware statute may be the beginning of a trend toward modeling the series LLC after the Illinois statute, which leaves less ambiguity and will likely offer companies more protection in court. While the original Delaware legislature undoubtedly intended to create the most flexible and useful quasi-corporation possible, it may have overshot the bounds of legal reality.⁸⁶ If more states follow the Illinois model, requiring additional notice and clearly stating that the assets are owned by each series separately, certainly courts in those states, if not those in foreign states, will follow that clear legislative direction.

IV. BENEFITS AND PITFALLS OF THE SERIES LLC

Commentators and practitioners have cited numerous beneficial applications of the series LLC ever since series LLCs were introduced, ranging from use as a property management tool to use as an intra-family wealth

⁸⁰ DEL. CODE ANN. tit. 6 § 18-215(b).

⁸¹ A series must have assets for the phrase “assets of such series” to make sense.

⁸² The series LLC provisions come within the LLC statute; there have not been stand-alone series LLC statutes to date.

⁸³ § 18-215(b) of the DLLC Act states: “Assets associated with a series may be held directly or indirectly, including in the name of such series, in the name of the limited liability company, through a nominee or otherwise.” DEL. CODE ANN. tit. 6 § 18-215(b). This demonstrates the foresight of the Illinois statute, which made the point explicit in its original statute.

⁸⁴ *GxG Management LLC*, 2007 WL 551761, at *7. See also Craig A. Gerson, *Taxing Series LLCs*, 45 Tax Mgmt. Mem. (BNA) No. 4, at 76 (Mar. 8, 2004).

⁸⁵ § 18-215(c) of the DLLC Act now states that: “Unless otherwise provided in a limited liability company agreement, a series established in accordance with subsection (b) of this section shall have the power and capacity to, in its own name, contract, hold title to assets (including real, personal and intangible property), grant liens and security interests, *and sue and be sued.*” DEL. CODE ANN. tit. 6 § 18-215(c) (2008) (emphasis added).

⁸⁶ As the first state to introduce the series LLC, Delaware was bound to need clarifying amendments when courts began interpreting it. By using somewhat vague language as to whether the series could own assets or sue, the Delaware legislature could allow courts leeway in guiding the development of the series LLC. However, this ambiguity left the court in Maine with significant questions and a hesitation to rule on them. See generally *GxG Management, LLC*, 2007 WL 1702872.

transfer vehicle.⁸⁷ But the series LLC has also fallen under scrutiny because of the associated uncertainty arising from minimal case law and lack of IRS direction on its tax effects.⁸⁸ After examining some benefits of the series LLC, this section responds to the criticisms mentioned by the National Conference of Commissioners on Uniform State Laws, which was excluded the series LLC from the Revised Uniform Limited Liability Company Act (RULLCA) of 2006.⁸⁹

A. *Potential Benefits of the Series LLC*

The hallmark of the series LLC is the ability of a company to separate its assets and liabilities favorably among its different series, which operate independently but are under one umbrella.⁹⁰ Why not just create separate corporations within a holding company? Some potential applications of the series LLC provide insight into that question.

For example, suppose a company wanted to start its New York City taxi cab service as a Delaware corporate entity. Given the aggressive nature of driving there, accidents are bound to happen, some of which will probably be the fault of the company's cab driver. Under the legal doctrine of *respondeat superior*, the owner of the taxi cab company can be liable for the actions of the taxi cab driver that occur within the scope of his employment.⁹¹ A company would want to take action to protect its owners from having their personal assets confiscated to cover the liability.⁹² Indeed, tort liability could potentially be large enough to put the company out of business. Because of this risk, a businessman might form a holding company, with each subsidiary owning only some of the vehicles. In this way, the risk to the entire holding company could be mitigated to some extent. A series LLC allows the businessman to do the same thing without paying a full LLC filing fee for each subsidiary.⁹³

⁸⁷ Jared L. Peterson, *Unlimited Potential or Uncertain Future: Series LLCs and Intra-Family Wealth Transfers*, 9 J.L. & FAM. STUD. 385, 392-393 (2007).

⁸⁸ *Id.* at 399-400.

⁸⁹ REVISED UNIFORM LIMITED LIABILITY COMPANY ACT (RULLCA), § 107 (2006), available at http://www.law.upenn.edu/bll/archives/ulc/ullca/2006act_final.htm (last visited Mar. 15, 2009).

⁹⁰ Michael E. Kearney & Andrew J. Glendon, *Limited Liability Company Update in Nevada: Introduction to Limited Liability Companies*, at 6 (Nat'l Bus. Inst. July 26, 2005), available at: www.westlaw.com (citation 28673 NBI-CLE 1).

⁹¹ See 17 N.Y. JUR. 2d *Carriers* § 9 (2009).

⁹² See Gail Petravick & Coleen Troutman, *Does the LLC Make the Illinois Close Corporation With S Election Obsolete?*, 95 ILL. B.J. 532, 534-35 (Oct. 2007) (discussing the doctrine of piercing the veil with regard to unincorporated entities like the LLC). See e.g., 805 ILL. COMP. STAT. 5/3.10(b) and (h) (2008) (showing the corporation alone to be liable for its debts).

⁹³ This assumes that the businessman is comparing costs in a state with a series statute. It may be cheaper to form multiple regular LLCs in a non-series state than to form a

Perhaps a more useful example is that of a real estate investor with ten properties. To prevent loss of personal assets, an investor may want to form a separate LLC for each of those properties. Now, with the introduction of the series LLC, the investor could include all of the properties under one master LLC, with each individual property given its own series. The concrete advantage to this is the savings in filing fees and paperwork.⁹⁴ Each series within a master LLC is cheaper to file and maintain, and each is under the master LLC.

The filing savings could be relatively large for any situation involving numerous series.⁹⁵ In the property example, if the investor had a series LLC in Illinois the initial filing fee would be \$750, and each separate LLC would cost an additional \$250 each year.⁹⁶ The cost of setting up all ten properties under separate LLCs and paying the yearly fee would be \$5000 for the initial filing fees and an additional \$2500 each year thereafter.⁹⁷ On the other hand, it costs \$750 to set up a master series LLC in Illinois, and an additional \$50 for each series (to get the Certificate of Designation).⁹⁸ The annual franchise fee is \$250 for the master and \$50 for each series. That means the initial filing fees would be \$1250 (\$750 + \$50*10) and the yearly franchise fees would be \$750 (\$250 + \$50*10). In Illinois, forming as a series LLC would result in a savings of \$5500 initially, and \$1750 each year thereafter; the savings may be far greater in other states.⁹⁹ Even if an investor had just two properties, the initial fees would be \$150 less (\$850 vs. \$1000) for a series LLC, and would also save \$150 in annual franchise fees. (See Table 1). Consequently, even in the least likely scenario—using just two series—in Illinois the filing fees

single series LLC in a state that has a series statute. *See* Goforth, *supra* note 23, at 395.

⁹⁴ Marsico, *supra* note 17, at 48.

⁹⁵ As shown in Table 1, entrepreneurs in Illinois using ten series rather than ten separate LLCs would save \$5500 after the first year, and \$1750 each year thereafter in filing and franchise fees. Other states, Delaware included, have different structures for calculating franchise taxes, such as using the number of authorized shares or calculating them using the assumed par value capital method. *See* State of Del. Dep't of State, How to Calculate Franchise Taxes, <http://corp.delaware.gov/frtaxcalc.shtml> (last visited Apr. 3, 2009). This makes those states less amenable to analysis of savings using the series LLC. There is much speculation as to how states will treat each series for franchise tax purposes.

⁹⁶ It is \$500 for each LLC initial filing along with an additional \$250 annual LLC franchise fee. 805 ILL. COMP. STAT. 180/50-10 (2008).

⁹⁷ *See* Table 1. This does not consider attorney drafting fees and other incidental costs that go along with starting a business.

⁹⁸ 805 ILL. COMP. STAT. 180/50-10.

⁹⁹ In California, the fee for each LLC is \$800, and there is no separate series fee. Jacob Stein, *Advanced Asset Protection and Tax Planning with LLCs*, LOS ANGELES LAWYER, June 9, 2006, at 20-21.

would be cheaper to use a series LLC than to use two separate “regular” LLCs.¹⁰⁰

There are several other reasons why the creation of an LLC is advantageous. For example, the creation of a series LLC requires less paperwork because it requires only one filing encompassing a number of series. This contrasts with the formation of several corporations, which would each require individual documentation.¹⁰¹ While some may argue that consolidating all the statements into a single statement for the master LLC actually requires more work,¹⁰² an umbrella company with multiple LLCs would also have to get this information when it filed. Practitioners can and usually do choose to file only one tax return for the entire series LLC, which effectively limits the paperwork involved.¹⁰³ Further, in Illinois, only one annual report must be filed by the master LLC on behalf of all its series, and each series remains in good standing with the Secretary of State as long as the master LLC is also in good standing.¹⁰⁴

Also, in Illinois, a series need only appoint one registered agent, who serves as the agent for both the master LLC and each series.¹⁰⁵ Registered agents typically charge the same fee to represent both series and standard LLCs.¹⁰⁶ While agents may begin charging more for series representation in the future, their current fees also reduce costs associated with registration and filing.

In Delaware, there are no additional fees for each series because the master LLC and all its series are treated as one.¹⁰⁷ The entire series LLC is only required to have one registered agent, and file one annual report, which can save time and money.¹⁰⁸

¹⁰⁰ There would be little or no use for a series LLC if you needed only one entity.

¹⁰¹ On its face, it seems intuitive that less paperwork would be required because one master LLC takes the place of multiple regular LLCs. However, it should be noted that the series adds a record-keeping requirement that the typical LLC does not have. Because the statute in Illinois, for example, does not specify the content or format of the records, or how to record assets owned by the master for the benefit of the entire series, companies would be well-advised to keep careful records. *See Goforth, supra* note 23, at 400-401.

¹⁰² Goforth, *supra* note 23, at 396.

¹⁰³ This is true even if the capital accounts are separated for each member's interest in different series. Brian R. Fons, *Serious About Series LLCs*, CBA RECORD, Apr. 21, 2007, at 47, available at 21-APR CBAR 46 (Westlaw).

¹⁰⁴ 805 ILL. COMP. STAT. 180/37-40(e) (2007).

¹⁰⁵ 805 ILL. COMP. STAT. 180/37-40(f) (2007).

¹⁰⁶ Marsico, *supra* note 17, at 49. *See e.g.*, Delaware Registered Agent, http://www.incnow.com/registered_agent.shtml (last visited April 14, 2009) (registered agent service is the same price for both the series LLC and the typical LLC in Delaware).

¹⁰⁷ DEL. CODE ANN. tit. 6 § 18-1105(a)(3) (2008).

¹⁰⁸ Fons, *supra* note 103, at 47.

Table 1: Illinois Filing Savings Using the Series LLC

	<u>Formation Fees</u>		<u>Annual Franchise Fees</u>	
Separate LLC	\$500		\$250	
Series LLC	\$750 master LLC + \$50/series		\$250 master LLC + \$50/series	
<u>10 Property Hypothetical</u>			<u>Total For Year</u>	<u>Cost/year after Year</u>
			<u>1</u>	<u>1</u>
Separate LLCs	\$5,000	\$2,500	\$7,500	\$2,500
Series LLCs	\$1,250	\$750	\$2,000	\$750
Series Savings	0	0	\$5,500	\$1,750
<u>2 Property Hypothetical</u>				
Separate LLCs	\$1,000	\$500	\$1,500	\$500
Series LLCs	\$850	\$350	\$1,200	\$350
Series Savings	\$150	\$150	\$300	\$150

The series LLC may also be beneficial in regard to its potential use in the context of estate planning.¹⁰⁹ The series has been touted as a tool for transferring wealth from parent to child with fewer tax consequences.¹¹⁰ Transferring wealth through an LLC is a more effective way to get around the gift tax, because a couple could transfer up to \$24,000 tax free to any number of individuals¹¹¹ as opposed to lower tax-free gift limits with means such as educational savings plans.¹¹² Transferring a series LLC, however, must be done with caution, making sure that no restrictions are placed on the future sale of the gift and vesting “dominion and control of the partnership interest in

¹⁰⁹ Peterson, *supra* note 87, at 394.

¹¹⁰ *Id.* at 394-97.

¹¹¹ I.R.C. § 2503(b) (2009). There is no limit on how many people you can give these smaller amounts to. “For calendar year 2008, the first \$12,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under § 2503 made during that year.” Rev. Proc. 07-66, 2007-45 I.R.B. 956, available at http://www.irs.gov/irb/2007-45_IRB/ar19.html. Also, this is assuming you do not want to transfer the wealth posthumously (estate tax exemptions are disregarded) and that the LLC is being taxed as a partnership.

¹¹² Peterson, *supra* note 87, at 397.

the transferee.”¹¹³ A donee can provide evidence of dominion or control of an LLC by becoming involved in management, receiving his or her share of the profits, and being held out by other interested members as a partner.¹¹⁴ A wealthy client would also have the benefit of dealing with a single document rather than several, and could perhaps save in legal fees because the attorney would not need to draft as many documents.¹¹⁵

Venture capital funds with investments in many different companies could also benefit by placing each investment in a separate series, with all of the investments under one master LLC umbrella. This would allow them to limit their liability to their investment in that particular series in the event it goes bankrupt. Additionally, using a series in the venture capital context could significantly expedite the licensing process. For example, a bank wanted to do a series of \$25 million funds, with incentives tied to each separate fund.¹¹⁶ It needed to use a business entity licensed by the United States Small Business Association (SBA) to form a small business investment company (SBIC).¹¹⁷ At the time the bank was deciding on its best course of action, the SBA took about nine months to issue an SBIC license.¹¹⁸ Using a single series limited partnership with a series LLC as a general partnership, the bank would have the ability to make each fund its own series, while only having to get one license and wait once (then about nine months) to get that license for all of the series.¹¹⁹ The ability to create all the funds after only waiting about nine months significantly speeds up the time it would take for numerous series to be started.¹²⁰ It also gives them the advantage of having simplified documentation for any subsequent funds.¹²¹

Other business entities that would benefit from using a series LLC include large-scale professional services businesses that operate in multiple jurisdictions. These entities could create a series for each jurisdiction, allowing

¹¹³ Treas. Reg. § 1.704-1(e)(iii) (as amended in 2008).

¹¹⁴ Treas. Reg. § 1.704-1(e)(v)(2)(iv)-(vi) (2008).

¹¹⁵ Goforth, *supra* note 23, at 394. An attorney would otherwise have to draft a document (i.e. Articles of Organization or Operating Agreement) for each separate company. Rather he or she could draft one (probably more complicated) document that is sufficient for the master LLC as well as each individual series.

¹¹⁶ This example is taken directly from Harding, *supra* note 16, at 22.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ If the bank wanted to start four funds, for example, it would have had to wait about three years before the last fund would be approved (assuming approximately a nine month wait for each SBIC license). That would slow the bank by more than two years compared to needing just one approval using a series partnership or LLC.

¹²¹ Harding, *supra* note 16, at 22. This is possible because each fund was easily created with a short supplement identifying the members, management, and their capital commitments. The same supplement would be sufficient for creating future series (funds).

the malpractice liability of a professional to be limited to the area in which they actually practice.¹²²

Finally, any business with a variety of activities may benefit from using a series LLC. For example, a company that does research, manufacturing, distribution, and retail sales may benefit from separating each function into its own company. Previously this could be accomplished with an umbrella corporation and numerous subsidiaries within that umbrella, or with separate LLCs. Now it can also be accomplished with a single series LLC using a series for each type of activity, which would consolidate the number of documents necessary and reduce franchise fees.¹²³

A. *Risks of the Series LLC*

Despite the numerous advantages of the series LLC, the biggest disadvantages are the uncertainties concerning the tax implications and whether non-series states will actually uphold the liability shield provided by series LLC statutes.¹²⁴ In July 2006, the series LLC was excluded from the Revised Uniform Limited Liability Company Act (RULLCA) for numerous reasons. The drafters noted conceptual concerns, bankruptcy issues, series treatment in states without series LLCs, tax treatment, and securities law issues. RULLCA wanted these questions answered before endorsing the series LLC.¹²⁵ Other commentators have questioned whether the series LLC really reduces companies' filing fees and paperwork, is fair to creditors, or provides opportunity for potentially fraudulent uses.¹²⁶

This section will address each of these questions from the perspective of an entrepreneur or firm that wants to make a decision on whether to use a series LLC based on a reasonable probability that courts will uphold the statute, rather than the typical non-evaluation analysis (i.e. nobody knows its outcome, so avoid using the series). To be clear, this section does not purport to predict how courts will rule on the many complicated and difficult issues left to be determined. Rather, it attempts to provide entrepreneurs and attorneys with an examination of whether there is a reasonable likelihood that the series LLC will be upheld as intended by state legislatures for each

¹²² Goforth, *supra* note 23, at 394-95. This is assuming that the series LLC statutes will be interpreted as the state legislatures intended.

¹²³ Since less than 10 states have adopted the series LLC, the filing fees and tax issues are still undetermined in many areas. In the states that currently have the series LLC however, the filing fees are cheaper. This only makes sense since there would be much less incentive for businesses to use a series LLC if one of the only concrete advantages – lower filing fees than the LLC – were essentially removed by the legislature. See Marsico, *supra* note 17, at 48.

¹²⁴ Goforth, *supra* note 23, at 397; LIMITED LIABILITY COMPANY HANDBOOK *Series LLCs* § 3:84 (2008).

¹²⁵ RULLCA, *supra* note 89, at 5 (Prefatory Notes).

¹²⁶ See generally Goforth, *supra* note 23.

particular issue, based on past treatment of the LLC and the logical arguments on both sides of the issues.

The drafters of the RULLCA produced two rationales for not proposing a model series LLC statute.¹²⁷ First, the drafters cited “difficult and substantial questions” as to how series LLCs should be treated for choice of law, tax, and bankruptcy purposes, and to what extent it should or would be treated as a separate legal entity.¹²⁸ Second, “[g]iven the availability of well-established alternate structures (e.g., multiple single member LLCs, an LLC ‘holding company’ with LLC subsidiaries), it made no sense for the Act to endorse the complexities and risks of a series approach.”¹²⁹ But neither of these reasons is particularly persuasive as to why a model series statute could not have been proposed, for the reasons explained below. Therefore, states should not be reticent to adopt the series LLC.

With regard to the “difficult and substantial questions,” one commentator has noted the “NCCUSL’s mission should be to clarify the law of LLCs as it is, rather than to wish away questions it would prefer did not exist.”¹³⁰ Whether or not the answers to its legitimate questions will be a boon or bane to the series, the exclusion of the series by the drafters of the RULLCA should not signify rejection of the series. Questions about federal or tax law should not prevent a model (state law) series statute from being proposed, because federal law can morph to match state law.¹³¹ Indeed, if the history of the LLC is a reasonable indicator of what could happen in courts for the series LLC, there is little reason for practitioners to wait for federal and tax law to catch up with the current series LLC legislation. For example, Wyoming and Florida had already enacted LLC statutes before the Internal Revenue Service (IRS) made its 1988 tax classification ruling.¹³² After the IRS studied the form and allowed the LLC to be taxed as a partnership, the other states quickly followed suit.¹³³

¹²⁷ See Ribstein, *supra* note 1, at 43, 44 (commenting on each of the NCCUSL concerns about the series LLC and why those concerns should have led them to propose a rule instead of refraining from doing so).

¹²⁸ *Id.*

¹²⁹ RULLCA, *supra* note 89, at 6.

¹³⁰ Ribstein, *supra* note 1, at 43, 44. The NCCUSL is the National Conference of Commissioners on Uniform State Laws.

¹³¹ The tax classification problems that were restraining the widespread adoption of the LLC eventually were resolved, as the IRS adapted. Ribstein, *supra* note 1, at 44. See also Hamill, *supra* note 20, at 1469-73 (delving into more detail on specific IRS rulings that allowed the LLC to grow quickly).

¹³² Hamill, *supra* note 20, at 1468.

¹³³ *Id.* The tax issue was the springboard for the LLC. While the IRS determination was crucial to the widespread growth of the LLC, Florida and Wyoming prompted that IRS action by enacting the LLC statutes. Similarly, the series LLC was not commented on by the IRS until the numerous states had enacted the series LLC statutes.

With regard to the second rationale—the availability of well-established alternatives—the drafters of the RULLCA were also unpersuasive. A company may have good business reasons for separating related parts of its business, but it will still run the risk of a court considering them to be part of the same firm.¹³⁴ A series LLC would be the only legal machinery available to accomplish the separation of the related parts that a court would respect, even though it is housed under a master LLC.¹³⁵ Where a series is used fraudulently, courts will likely combine different parts of a business regardless of what legal form is used. A model statute would help firms discover what practices are acceptable or unacceptable in a series LLC. Since neither of the rationales for refusing to propose a model statute is compelling, states and attorneys should not view the exclusion of a series LLC statute in the RULLCA as an indicator of the value or the future of the series LLC.

1. *Choice of Law Issues in Non-series States*

While a model statute was not proposed in the RULLCA, companies may still want to know the reasonable likelihood of a court upholding the liability shield created by a series. In particular, because just seven states have adopted it to this point, they need to assess the risk of potential litigation in a state that does not expressly recognize the series LLC. Without a measure of confidence that foreign states will recognize and protect a series, a business operating in those jurisdictions would be foolish to utilize a series LLC.

All of the states that have enacted series LLC statutes explicitly state that the liability “firewall” or shield of foreign series LLCs will be respected in their state.¹³⁶ As more states adopt the series LLC, and presumably adopt that provision, the choice of law issue will disappear.¹³⁷ But because only a minority of states have series LLC statutes,¹³⁸ the treatment of series LLCs in non-series states is a legitimate concern that should be addressed.

¹³⁴ *Id.* Some courts have taken the power in equity to pierce the veil of the LLC, and in those cases it would likely not matter whether an entity was formed as an LLC holding company with LLCs under it, or as a series LLC with multiple series. *See e.g., Kaycee Land & Livestock v. Flahive*, 46 P.3d 323, 327 (Wyo. 2002) (stating “We can discern no reason, in either law or policy, to treat LLCs differently than we treat corporations.”).

¹³⁵ *Id.* This of course does not include creating completely separate LLCs or corporations in the place of each series that would have been created.

¹³⁶ Marsico, *supra* note 17, at 49. *See, e.g.,* DEL. CODE ANN. tit. 6, § 18-215(m) (2005).

¹³⁷ Goforth, *supra* note 23, at 397.

¹³⁸ DEL. CODE ANN. tit. 6, § 18-215 (2009); 805 ILL. COMP. STAT. 180/37-40 (2009); IOWA CODE § 490A.305 (2009); OKLA. STAT. tit. 18, § 2054.4 (2009); NEV. REV. STAT. § 86.286 (2009); TENN. CODE ANN. § 48-249-309 (2009); UTAH CODE ANN. § 48-2c-606 to § 48-2c-616 (2009).

The majority of LLC statutes across the nation provide that the law of the state of formation controls the liability of members of a foreign LLC.¹³⁹ This likely solves the choice of law question for any *internal* issues,¹⁴⁰ but in many instances the issue will arise between members of a series LLC and a third party foreign creditor, such as an out of state bank or supplier.¹⁴¹ Under the Full Faith and Credit clause of the U.S. Constitution, states must generally respect the law of another state governing a particular transaction.¹⁴² It does not need to do so, however, if there are public policy reasons to reject the foreign state law.¹⁴³ A foreign state may argue that a series is against public policy because it reduces the fees it owes to that state, for example.¹⁴⁴ It could also argue that the series LLC violates public policy because it does not provide sufficient notice to foreign creditors. A state could easily remedy the policy issue by requiring qualification and a registered agent for each foreign series.¹⁴⁵ The likely diminutive increase in money generated by requiring an agent for each series would not appear to be an extremely strong public policy rationale. Even if a state does not provide a policy reason, most states have a provision in their LLC statute that a foreign LLC with a certificate of authority has no greater rights or privileges than a domestic LLC.¹⁴⁶ While defendants could argue that a particular series has no more rights than a typical LLC because they basically function as separate LLC entities, a non-series state may counter by noting that the master LLC has more privileges than a typical LLC because it requires less fees and paperwork, assuming there are several series.

Contracts between a third party and the master LLC could also prompt choice of law questions in a foreign state. The Illinois series LLC statute explicitly allows a series to accept joint liability by contract.¹⁴⁷ But if a contract were formed between a third party creditor and the master LLC in a non-series state, and each series benefits without expressly agreeing to the contract, can each series be held liable? For example, what if an accountant or

¹³⁹ Marsico, *supra* note 17, at 52. See, e.g., DEL. CODE ANN. tit. 6, §18-901(a)(1)(2009); 805 ILL. COMP. STAT. 180/45-1(a) (2007).

¹⁴⁰ Harding, *supra* note 16, at 22 (emphasis added). Internal refers to disputes between members of the series LLC. By third party foreign creditor, I mean a creditor who is not a member of the series LLC and that is domiciled in a non-series state.

¹⁴¹ *Id.* A third party foreign creditor as referenced here is a creditor in a state without a series LLC statute that is not a member of a series in question.

¹⁴² U.S. CONST. ART. IV, § 1.

¹⁴³ Marsico, *supra* note 17, at 52.

¹⁴⁴ *Id.* It could also be against public policy because a series LLC would allow a business to limit its liability to a particular series, which would provide greater advantage than the state's citizens would have without the ability to create a series.

¹⁴⁵ A state could acknowledge foreign series LLCs by requiring them to register to do business separately like any other corporate form, with a caveat that each series LLC will have no greater rights than those granted to a typical LLC.

¹⁴⁶ Harding, *supra* note 16, at 22. See, e.g., MICH. COMP. LAWS 450.5001 (2008).

¹⁴⁷ Marsico, *supra* note 17, at 52.

auditor was hired by the master LLC to prepare statements for the master LLC and each of the series? In Illinois, each series is not liable for the master LLC or any of the other series unless it has contracted otherwise.¹⁴⁸ Therefore, in a state like Illinois, a particular series may not be liable to the accounting firm without being a party to the contract. In non-series states this result may seem troubling, which may prompt a state to find policy reasons for using its own law (perhaps lack of adequate notice to the creditor) rather than applying the Full Faith and Credit clause. On the other hand, potential creditors ought to eliminate a court's need for legal gymnastics by requiring each series to sign as a party to the contract.

It seems unlikely that a court would find in favor of the creditor and against the series on the basis that the series has privileges (lower filing fees perhaps) which have little or nothing to do with the transaction in question. Justice would be offended if the form of entity alone, rather than the actual transaction or the parties themselves, dominates a policy-based result.

Consider a hypothetical scenario in which a court in a non-series state decides that a series LLC must refrain from performing an otherwise legitimate LLC action solely because it had not paid as many filing fees. The difference in filing fees generated would probably not be a sufficient policy reason to override the Full Faith and Credit clause of our Constitution.¹⁴⁹ At a time when LLC statutes had not been enacted in all states, the U.S. Supreme Court in *Allstate Ins. Co. v. Hague*¹⁵⁰ upheld the application of Minnesota law in a Minnesota court for an accident occurring in Wisconsin because the decision to apply Minnesota law “was neither arbitrary nor fundamentally unfair.” The Court also stated that “[d]ifferent considerations are of course at issue when full faith and credit is to be accorded to acts, records, and proceedings outside the choice-of-law area, such as in the case of sister state-court judgments.”¹⁵¹ This could mean that the U.S. Supreme Court would implement a stricter standard balancing the forum state interests against the

¹⁴⁸ *Id.*

¹⁴⁹ See e.g., *Hall v. Woods*, 156 N.E. 258 (Ill. 1927) (“It is voluntary with the state and not obligatory, though in the absence of a positive rule affirming, denying, or restraining the operation of foreign laws, courts of justice presume the tacit adoption of them by their own government, unless they are repugnant to its policy or prejudicial to its interest. A state, however, has the right to prohibit a foreign corporation from exercising any part or all of its charter powers within its borders.”) But see *Means v. Limpia Royalties*, 115 S.W.2d 468, 475 (Tex. Civ. App. 1938) (stating “[t]he established public policy of the forum is supreme, and will not be relaxed upon the ground of comity to enforce contracts which contravene such policy, even though such contracts are valid where made.”) It has typically been said that the policy must be expressed or established by the state.

¹⁵⁰ *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 320 (1981) (plurality opinion).

¹⁵¹ *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 308 n.10 (1981) (plurality opinion).

interests of the other states.¹⁵² A series LLC member has a vested interest in limiting liability to the series, and could argue that the state of incorporation has an established law that must be balanced against the slight decrease in revenue by the non-series state.

On the other hand, if the creditor could show some privilege or right granted the series that would not be given to a traditional LLC, and that right or privilege was used to the detriment of the creditor, then justice would not be offended by ruling against the series. While it is impossible to foresee all possible cases that may be brought against a series, most would probably not fall within the latter category, when the creditor can show connection between the privilege of the series LLC and the detriment of the creditor. Companies considering a series should be aware of this possibility in evaluating whether a series is the proper entity choice.

Finally, by analogy to regular LLCs, a series LLC will likely be upheld if it is only pursuing activities that a domestic LLC in that jurisdiction would be able to do.¹⁵³ In other words, if an activity is prohibited in the domestic jurisdiction, a foreign series LLC should not expect to be able to perform that activity, even if the same action is permissible under its own LLC statute.

2. Taxation Questions

The taxation of the series LLC has been the subject of much debate, but to date only two relevant decisions have been made. The first decision was made by the Franchise Tax Board in California, which found that each series should be treated as a distinct entity for California tax purposes.¹⁵⁴ At the time of the California tax decision, no IRS ruling had been made. Typically,

¹⁵² Jim Hyde, *Constitutionally Mandated Fairness And The Limited Liability Company: An Argument For The Extra-territorial Application Of Limited Liability Company Statutes*, 1 GEO. MASON INDEP. L. REV. 83, 90 (1992).

¹⁵³ Thomas E. Rutledge, *To Boldly Go Where You Have Not Been Told You May Go: LLCs, LLPs, and LLLPs in Interstate Transactions*, 58 BAYLOR L. REV. 205, 209 (2006).

¹⁵⁴ See Franchise Tax Board, TAX NEWS, Mar.-Apr. 2006, http://www.ftb.ca.gov/professionals/taxnews/tn_06/03_04.shtml (last visited Mar. 15, 2009); 2005 Limited Liability Company Tax Booklet (instructions to California Form 568, Limited Liability Company Return of Income). The California Franchise Tax Board said that each entity must file its own tax form and pay its own separate LLC annual tax if it is registered or doing business in California. Franchise Tax Board, *supra*. See also Michael W. McLoughlin & Bruce P. Ely, *The Series LLC Raises Serious State Tax Questions But Few Answers Are Yet Available*, J. MULTISTATE TAX'N AND INCENTIVES, Jan. 2007, at 7. This may be a case of California wanting extra tax revenue, rather than its recognition of the series as a separate entity. There is no statute or case law in California establishing and recognizing the series LLC as its own entity with liability protection. To be consistent with its tax ruling, it ought to recognize the series LLC for asset protection and liability purposes.

federal tax classification depends on federal tax law, not on whether the entity is recognized as an entity under state law.¹⁵⁵

In January of 2008, the IRS issued a private letter ruling allowing the series to use the “check-the-box” rules, allowing each series to decide whether it will be taxed as a partnership or corporation.¹⁵⁶ Because each individual series can choose whether to be taxed as partnership or corporation, this ruling also seems to indicate that each series is its own entity for tax purposes. The series LLC, however, introduces another level of complexity into tax laws. One commentator has suggested that the specific facts or circumstances of each case will guide each IRS analysis of a series LLC.¹⁵⁷

Businesses should note that the Illinois series LLC offers more clarity than the Delaware-type statutes in the taxation analysis under the most recent Treasury classifications,¹⁵⁸ and would very likely be considered separate entities. Businesses should take this into consideration because if (or when) the series is considered separate for tax purposes, each series would have to obtain its own tax identification number, file its own tax return, and distribute Schedule K-1’s to each of the members of the series.¹⁵⁹ In addition, it could mean that there would be tax consequences to a transfer between series and that each series could reorganize itself.¹⁶⁰ Despite the greater clarity of the Illinois statute with respect to each series being independent and treated as its own entity, it is likely that even a Delaware series would be classified as a separate entity for tax purposes. The IRS ruling referred only to the Delaware statute, yet the IRS still allows each Delaware series to choose its classification separately for tax purposes.¹⁶¹ This further illustrates that the initial federal tax ruling combined with California’s tax ruling may be forming a trend toward the recognition of each series as a separate entity.¹⁶²

¹⁵⁵ Treas. Reg. § 301.7701-1(a) (as amended in 2009).

¹⁵⁶ I.R.S. Priv. Ltr. Rul. 200803004 (Jan. 18, 2008).

¹⁵⁷ Marsico, *supra* note 17, at 53. This was written prior to the IRS private statement.

¹⁵⁸ Charles T. Terry & Derek D. Samz, *An Initial Inquiry Into the Federal Tax Classification of Series Limited Liability Companies*, 110 TAX NOTES 1093, 1098 (2006), available at http://taxprof.typepad.com/taxprof_blog/files/2006-3770-1.pdf.

¹⁵⁹ Marsico, *supra* note 17, at 53. A Schedule K-1 is the form for a partnership to report a partner’s share of income, credits, deductions, etc.

¹⁶⁰ *Id.*

¹⁶¹ It should be noted that this is a *private* letter ruling, not to be relied on as precedent for anyone other than the taxpayer to whom it was issued. In addition, the facts upon which the decision rested were that the assets of each series were completely separate, with separate records and earnings. The IRS may rule differently if the assets were mixed between series. Ezra Dyckman & Seth Hagen, *Series LLCs Ruling Clarifies IRS View, but Leaves Uncertainty*, 240 N.Y. L.J., Aug. 27, 2008, at 5.

¹⁶² While tax law certainly is not conclusive, it could be early evidence that the internal liability shield of the series will stand.

3. Bankruptcy/Fairness to Creditors

Our society has agreed by social contract to protect business risk-taking. For example, it allows bankruptcy.¹⁶³ Creditors potentially may not recover their investment when a debtor is declared bankrupt if there are not sufficient assets to satisfy all debts.¹⁶⁴ However, creditors have the ability to recoup their losses by factoring that reality into their cost of business or negotiating contractually to secure their potential claims.

Similarly, the series LLC allows companies to limit or rearrange risks in an increasingly litigious climate.¹⁶⁵ If sufficient notice is required by statute and provided before a creditor begins a transaction, that creditor should have no more problem with the series LLC statute than it does with bankruptcy law. Rather, it should build in the cost of any additional risk it assumed by dealing with a particular series or negotiate differently to mitigate that risk.

Concerns about fairness to creditors underscore the importance of the Illinois' statute notice requirements. If a third party is unaware of the fact that it is dealing with a series rather than a typical LLC, and discovering that fact would be difficult, courts in non-series states will be reticent to uphold the series.¹⁶⁶

Because bankruptcy courts are not subject to the Full Faith and Credit clause,¹⁶⁷ and none have ruled on series LLC, the status of the series in bankruptcy is largely unknown. However, if bankruptcy courts hold that a series is a legal "person," with the corresponding ability to be a debtor, then an individual series may file for bankruptcy.¹⁶⁸ If an individual series is not considered a person, however, then the whole series LLC could be treated as one entity and ultimately held liable.¹⁶⁹ If bankruptcy courts follow state and tax law and find the series to be its own entity,¹⁷⁰ then each series will probably be able to file for bankruptcy without affecting the master LLC or the other series.

¹⁶³ Title 11 of the United States Code contains the bankruptcy provisions.

¹⁶⁴ See generally Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23 (2005) for the limitations on previous bankruptcy law provided so that debtors do not abuse the ability to satisfy their obligations repeatedly.

¹⁶⁵ Goforth, *supra* note 23, at 387.

¹⁶⁶ As a matter of public policy, notice is very important. The public policy implications bear strongly in choice of law matters, as mentioned previously.

¹⁶⁷ Marsico, *supra* note 17, at 52.

¹⁶⁸ Goforth, *supra* note 23, at 398.

¹⁶⁹ Marsico, *supra* note 17, at 54.

¹⁷⁰ *Id.* (Bankruptcy courts are not obligated or required to follow state statutes.)

IV. EVALUATION OF RISKS

Currently, the primary drawback to the series LLC is uncertainty.¹⁷¹ The uncertainty associated with the series LLC should serve as a caution to those currently using the series to treat each series separately and maintain separate records. This could require a shift in mindset from the typical LLC which does not have many formal recording requirements. With all the uncertainty, it is curious that most of the issues raised here have never appeared in court. The lack of litigation may stem from businessmen following the conservative advice of legal practitioners.

Despite the lack of litigation, however, there appears to be increasing certainty upholding the series as its own entity. The early trend in every available series LLC decision indicates that the individual series will likely be treated as its own entity. The Illinois series statute explicitly treats the series as its own entity.¹⁷² The recent amendment to the Delaware series statute implies that the series should be treated as its own entity.¹⁷³ The tax ruling of the California Franchise Tax Board treats each series separately for tax purposes.¹⁷⁴ And the IRS allows each series to choose whether it will be taxed as a partnership in its private letter ruling.¹⁷⁵ With few cases, statutes, or regulations serving as guides, practitioners must also rely on analogy to similar entities (like the LLC) in order to analyze the likely results. If governmental actors treat the series as its own entity with liability corresponding only to the assets it owns, then many tax issues become clearer, and bankruptcy courts could follow that trend.¹⁷⁶

Those considering using a series LLC should choose the Illinois series for its strong notice requirements and clear status as a separate entity. As a good business practice, a series entering a transaction should provide notice to each potential creditor that it is a series LLC and its liabilities are limited to the assets it owns. Businesses that wish to use the series LLC should also consult an attorney familiar with the series to organize in a way that does not appear to evade taxes or perpetrate fraud.

State legislators may be the answer for increasing the use the series LLC, as well as eliminating problems of uncertainty. History shows us that the IRS will likely follow the trend of the states in this area.¹⁷⁷ As more states

¹⁷¹ Peterson, *supra* note 87, at 399.

¹⁷² 805 ILL. COMP. STAT. 180/37-40(b) (2007) (stating that “A series with limited liability shall be treated as a separate entity to the extent set forth in the articles of organization.”).

¹⁷³ DEL. CODE. ANN. tit. 6 § 18-215(c) (2008) (giving a series the ability to sue in its own name). The Delaware statute also refers to the assets *of the series* throughout the statute, which presumes that the series owns the assets.

¹⁷⁴ See Franchise Tax Board, *supra* note 154.

¹⁷⁵ I.R.S. Priv. Ltr. Rul., *supra* note 156.

¹⁷⁶ Marsico, *supra* note 17, at 54.

¹⁷⁷ Hamill, *supra* note 20, at 1475-77.

adopt the series, more tax issues will be solved, and the uncertainty surrounding series LLCs will diminish. In addition, the choice-of-law issues disappear when all states enact series LLC statutes.¹⁷⁸

Federal actors such as the IRS and state tax boards may not make the series LLC questions a priority until they gain widespread use. Because those actors may not make series LLC decisions a priority, they are not necessarily the answer to the conundrum proposed by the series LLC.

V. CONCLUSION

For the series LLC to gain popularity, more states must adopt a series LLC statute. As more legislators implement the series LLC by statute, based on the reasonable likelihood that the courts should favor a relatively broad interpretation of the statutes creating the series, the series will likely gain exposure and popularity.¹⁷⁹ It would eventually eliminate the question of whether courts will uphold foreign LLC statutes.¹⁸⁰ As a result, more case law will settle the tax and liability issues and regulators will be pressured to provide input, creating even greater security for businesses to continue the rise of the series LLC.

As more states adopt series statutes, they should ensure stronger notice as required in Illinois so that courts in non-series states will have less reason to void the series form. States should also include explicit recognition that the series is its own entity with the ability to sue and be sued. If statutes are explicit with regard to the scope, function, and operation of the series, there is no reason that the series should not withstand judicial scrutiny.¹⁸¹ The decision to exclude a model series statute in the RULLCA should not significantly influence the states as they consider series LLC legislation, because that decision was not a denunciation of the series, but rather an opinion on the current lack of clarity.¹⁸² As more states will follow the lead of

¹⁷⁸ Goforth, *supra* note 23, at 397. This assumes that just as each state eventually recognized the validity of foreign LLCs, each state will also include provisions recognizing the validity of foreign series LLCs. Courts would not need to address choice-of-law issues with respect to the validity of the series LLC itself unless a series LLC in one state was much different than that of another state.

¹⁷⁹ Again, this assumes that the adoption of the series LLC by state statutes would mirror, if not lead to, the increased use of the series LLC in practice. As noted previously, the LLC rose to popularity with state statutes leading the way, as borne out by the numbers. Hamill, *supra* note 20, at 1475-77.

¹⁸⁰ Goforth, *supra* note 23, at 397. The problem of foreign recognition of the series LLC would disappear if all states had statutes that recognize the series LLC. While this may seem unlikely to occur in the near future, the LLC was adopted in forty states over just three years (ten in 1992, eighteen in 1993, and twelve in 1994).

¹⁸¹ *Id.* at 400.

¹⁸² See Ribstein, *supra* note 1, at 43-44.

Illinois, and people continue to use the series correctly, the series will gain more popularity and clarity from federal agencies.