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THE SERIES LLC IN TEXAS: A NEW PLANNING TOOL

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I. The Series LLC in Texas

Texas adopted new provisions permitting the creation and operation of series limited liability companies (the "Series LLC") under Texas law in 2009.¹ This paper discusses the state of law on Series LLCs under the Texas Business Organizations Code ("TBOC") with some consideration of other jurisdictions' laws and practice pointers for resolving the issues presented by the statutory formulation for the Series LLC. After discussing what Series LLCs are and can do, the paper will analyze points of ambiguity and development where the results of the use of the Series structure may not be perfectly clear. This vehicle for formation is still under development, but, in the right circumstances, presents an elegant solution to ownership and management of closely related, but not identical, groups of assets.

II. What is a Series LLC?

The Series LLC was first created in Delaware in 1996,² but has only recently gained traction in legislation in other states.³ Like all new formation vehicles, it is an idea that is in process, and the several statutory formulations are not uniform. In fact, the American Bar Association and the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), the organizations that usually draft and distribute model and uniform laws, have only recently weighed in with draft legislation, in the Uniform Statutory Trust Entity Act. NCCUSL does now have a project underway to draft uniform series provisions for its uniform acts. Texas is one of the most recent thoughts on drafting, and tends to follow the Delaware formulations (and rejects those state formulations that have strayed from Delaware). The kernel legal concept of the Series LLC is the internal segregation of assets. The TBOC states the following: "A company agreement may establish...one or more designated series...that: (1) has separate rights, powers or duties with respect to specified property or obligations of the limited liability company or profits and losses associated with specified property or obligations, or (2) has a separate business purpose or investment objective."⁴

If you consider the concept of internal asset segregation that means that two other issues have to necessarily complement that idea: first, if assets are segregated, the primary reason for such segregation is to allocate the economic rights to those assets differently among the owners. That may mean (i) an economic segregation of income, or allocations among different owners with the same management, or (ii) an economic segregation of liabilities with the same owners and management, or the liabilities of the operating assets of each project separated from the assets of the other projects. Second, if the segregation is internal, and the purpose for the segregation is economic, then there must be some commonality within the entity. The commonality might be with the management of the enterprise, where groups of assets segregated within separate series (which might have different equity owners) have common management. Alternatively, the assets that are segregated in different series might also be separated in other ways that would suggest the desirability of separate management for the different series. For example, the Buffalo Series of a Texas Series LLC might own a high-rise office building in Houston, the Big Tex Series, an apartment complex in Dallas, and the Sooner Series, a large block of raw land outside Oklahoma City. Although this Series LLC would no doubt have common overall management at the Mothership level,⁵ each separate

¹ TEX. BUS. ORGS. CODE ANN. § 101.601 (West 2011).

² DEL. CODE ANN. tit. 6, § 18-215 (2005).

³ As of April 1, 2014, the jurisdictions that have enacted series legislation are Alabama (H. B. 2, Ala. Reg. Sess. 2014, amending Title 10A, Code of Ala. 1975, effective January 1, 2015), Delaware (6 Del. C. § 18-215), the District of Columbia (D. C. Code § 29-802.6), Kansas (2012 ALS 50(amending K. S. § 17-7663), Illinois (805 ILCS 180/37-40), Iowa (Iowa Code Ann. 8489.1201), Nevada (N. R. S. 86.296), Oklahoma (Okla. Stat. § 18-2054), Puerto Rico (14 L. P. R. § 3967), Tennessee (Tenn. Code § 48-249-309), Texas (Tex. Bus. Org. Code § 101.601), and Utah (Utah Code § 48-3-1201 - 1201). In addition, three states have legislation providing for entities known as series LLCs, but the statutes in these states do not provide for internal liability shields: Minnesota (Minn. Stat. § 322B.03), North Dakota (N. D. C. C. § 10-32-02.55), and Wisconsin (Wis. Stat. § 183.0504). Delaware law also provides for series limited partnerships. 6 Del. C. § 17-218.

⁴ TEX. BUS. ORGS. CODE ANN. § 101.601.

⁵ The authors use the term "Mothership" to refer to the totality of the LLC of which a Series within the LLC is a segregated part. Other commentators state that the term that should be used is "juridical entity." The authors find this term, although technically accurate, to be insufficiently descriptive and find the "Mothership" metaphor helpful for conceptualizing the formation process. At least in part, the commentators who prefer "juridical entity" do so because, as discussed later in this paper, the preamble to the proposed income tax regulations

series, because of the geographic separation as well as the different types of assets, likely would need at least a general manager type on location. While the Texas statute affords significant flexibility around the issues of ownership and operation of the assets in the series, this flexibility should not confuse the basic nature and use of the vehicle: segregation of assets with common management structures. Business lawyers have always split up and recombined management structures and economic allocations of the enterprise, and the Series LLC is a permutation of that concept.

In this connection, you will see as we go through this discussion that the statute would permit a Series LLC to be one where all the members were associated with one or more Series, and all assets and liabilities are in the name of one or more Series. That is, there are no assets titled in the name of the Series LLC, it has no liabilities, and there are no members who are just members of the Series LLC and not associated with one or more Series. Alternatively, the Series LLC could be where, in addition to having members associated with one or more Series and having some assets and liabilities in the name of one or more Series, there were also assets and liabilities in the name of the Series LLC and members of the LLC who were not associated with a Series but who were entitled to the economic benefits and burdens of the activities at the Series LLC level. Colleagues with whom we are working on an ABA project have suggested that it is more likely that the internal liability shields of a LLC (Mothership) will be respected if all the assets and liabilities are at the individual Series level with the LLC (Mothership) itself conducts no business,

Since the Texas statute is based on "commonality" among the Series LLC, that definitional concept has been embedded in the statutory formulation. The entity for state law purposes is the LLC itself and not the Series within the LLC. Stated positively, the Series within the LLC (Mothership) is not a separate entity under the TBOC. Although an individual series of a Texas LLC (Mothership) has 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, a Series may not enter into a merger or conversion.⁶ The TBOC permits a "domestic entity" to enter into a merger or conversion.⁷ Further, the TBOC defines a "domestic entity" as "an organization formed under or the internal affairs of which are governed by this code."⁸ In the case of a Series LLC, only the Mothership is formed under the TBOC, and the individual Series are formed pursuant to the LLC Agreement of the Mothership, which also governs their internal affairs. Because of controversy that arose over this issue, the Texas Legislature amended the TBOC in 2013 to state expressly that "for purposes of this chapter and Title 1, a series has the rights, powers, and duties provided by this subchapter to the series, but is not a separate domestic entity or organization."⁹ This basic concept has repercussions throughout the formation of a Series LLC, the drafting of the LLC Agreement, the operation of the LLC and the Series within the LLC, and the exit strategies for the Series within the LLC. Some states, namely Kansas, Illinois, Iowa, and the District of Columbia, have considered this issue and have permitted (but not required) a Series within a Series LLC to be a separate entity. The majority of the statutory formulations, however, including Texas and Delaware, follow the model in which a Series within a Series LLC is not a separate entity. This is *the* core issue that creates the ambiguity and mystery of forming and using this vehicle and will be a theme throughout this paper. While many discuss (and complain about) this issue, this paper will suggest treatments available to provide certainty for the use of the Series LLC.

III. How Do You Create a Series LLC?

The TBOC states express requirements for the filing of a Series LLC, including requirements for the contents of the certificate of formation, requirements for the terms and conditions of the LLC Agreement, and requirements for specific record keeping. Section 101.602(b) of the TBOC sets forth these three express statutory requirements. Upon formation, or by amendment, the Certificate of Formation must contain a notice of the limitations (internal) caused by the segregation of the assets in the Series LLC, as specified in Section 101.602(a). Those Series LLC limitations are as follows:

applicable to series organizations discusses the possibility that the Mothership may be completely ignored for federal tax purposes if all of the assets and business operations are in one or more individual series and none are at the Mothership level. Even if totally ignored for federal tax purposes, however, the Mothership will be an entity for state law purposes.

⁶ TEX. BUS. ORGS. CODE ANN. § 101.605.

⁷ *Id.* § 10.001.

⁸ *Id.* § 1.002(18).

⁹ TEX. BUS. ORGS. CODE ANN. § 101.622 (added by Acts 2013, 83rd Leg., R. S., Ch.9 (S. B. 847), Sec. 9, eff. September 1, 2013).

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