

PRESENTED AT

25th Annual LLCs, LPs and Partnerships

July 14-15, 2016

Austin, Texas

Series LLCs: Pros and Cons

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This outline was completed March 15, 2016

TABLE OF CONTENTS

I.	Definitions.....	1
II.	Mutual Fund Origin of Concept.....	2
III.	“Alternative and Analogous Structures.	3
	A. Master LLC-Parent entity with subsidiaries.	3
	B. Schedular Allocation:.....	3
	C. Series Statutory/Business Trusts.....	4
	D. Protected Cell Companies (“PCC”).	4
IV.	Series LLC.	5
	A. Initial Series LLC.....	5
	B. Additional Series LLC Legislation.	6
	C. Legislative Developments.....	7
	D. Formation Statistics.	9
	E. Uses of Series.....	10
V.	Characteristics of Series LLC.	10
	A. Delaware.	10
	B. Entityness-Entity v. Person.....	13
	C. Comparison Chart.	18
VI.	Tax Treatment.....	18
	A. Federal Tax Treatment.....	18
	B. State Income Tax Treatment.....	27
VII.	Benefits and Risks of Series Compared to Multiple LLCs.....	30
	A. Benefits.	30
	B. Risks.....	30
	C. Foreign Recognition of Internal Shield.....	31
	D. Bankruptcy.....	34
	E. Secured Transactions - UCC Revised Article 9.....	37
	F. Fraudulent Transfer.....	37
	G. Securities Law.....	38
	H. Charging Order.	39
	I. HUD Projects.	39
VIII.	Use for Real Estate Projects.....	40
	A. How are assets of a series to be titled?	40
	B. Good Standing Certificates for a Series.....	41
IX.	Form a Series LLC.....	41
	A. Name.	41
	B. Registered Agent.....	41
	C. Formation, Organization, Establishment.	42
	D. Provision in Operating Agreement.	42
	E. Records.	43
	F. Registration of Foreign Series LLC.....	43
	G. Agreements.	44
	H. Multiple Real Estate Projects.....	45
	I. Operating Business.	45
	J. Legal Opinions.....	45

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March 18, 2016

SERIES LLCs

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“The series LLC may turn out to be a heaven-sent planning tool, or attractive nuisance that will lure clients and advisors to economic disaster. Anyone involved with series LLCs should proceed with caution.” Cuff, Delaware Series LLCs and Transactional Practice, (Part 2), 38 Real Estate Tax’n 170 (2011).

I. Definitions.

“Series LLC” is the term used to describe a form of entity with internal funds, portfolios, cells, or divisions, each of which may have separate members, managers, assets and liabilities, and business purpose or investment objectives. The principal distinguishing characteristic is the internal liability shield for each series of the Series LLC.

Other terms for the Series LLC are “series organization” (see federal tax regulations in Section VI.A.3.a.i); “master LLC” (see SEC Letter in Section VI.D and Cal. Tax News, p. 4 October 2011 and FTB 1123, Guide to Forms of Ownership, 17 (2013)). Other terms used are “umbrella,” and “mothership.”

“Series” is the term used to describe each of the separate components.

The Uniform Limited Liability Company Protected Series Act (formerly the Series of Unincorporated Business Entities Act) (“ULLCPSA”) uses “Protected Series,” because “(i) usage in the series/asset-partitioning realm requires that the act refer to ‘series’

while (ii) usage elsewhere makes the term confusing when standing alone.” Reporter’s Prefatory Note – Drafting Premises, 2014 Annual Meeting Draft.

“Members associated with a series,” rather than “member,” is the term typically used to describe the persons who own an interest in the equity of a series. The term is generally not defined. Compare the statement in the Preamble to the federal tax Proposed Regulations: “Although series of a Series LLC generally are not treated as separate entities for state law purposes, and thus, cannot have members, each series has ‘associated’ with it specified members, assets, rights, obligations, and investment objectives or business purpose. Members’ association with one or more particular series is comparable to direct ownership by the members in such series, in that their rights, duties, and powers with respect to the series are direct and specifically identified.” Preamble Section 1.

“Property assets associated with a series,” means property or assets specified and accounted for on record of the series organization as attributable to a particular series. “... associated property is the *sine qua non* for a functioning protected series.” March 20-21, 2015 Draft of ULLCPSA n.95.

II. Mutual Fund Origin of Concept.

“A series company or fund is an investment company composed of separate portfolios of investments organized under the umbrella of a single corporate or trust entity.... Each portfolio of a series company has distinct objectives and policies, and interests in each portfolio are represented by a separate class or series of shares. Shareholders of each series participate solely in the investment results of that series. In effect, each series operates as a separate investment company.” Gordon Altman et al., A Practical Guide to the Investment Company Act, 2-3 (1996).

“The series fund concept is useful because it permits the formation of only one legal entity. For example, a series mutual fund formed as a corporation under state law has only one board of directors, one set of officers, etc. It files a single registration under the Investment Company Act of 1940. The use of the series is thus designed to save expenses for the fund’s shareholders.” Humphreys, Limited Liability Companies § 1.04 (Revised 2012).

“Indeed, the purpose of the trust structure of Nominal Defendants [statutory trusts] is to serve as an ‘umbrella’ entity that registers as an investment company with the SEC so that each mutual fund within the trust can enjoy its trust’s registration and avoid the costs and burdens of separately registering.” *Hartsel v. Vanguard Group, Inc.*, 2011 WL 2421003 (Del. Ch. 2011), *aff’d*, 38 A.3d 1254 (unpublished), 2012 WL 171881 (Del. Ch. 2012).

But see Guidance Update, SEC, Div. of Investment Management, June 2014, No. 2014-06:

“Each series also is a separate investment company for purposes of the investor protections afforded by the Investment Company Act of 1940 (1940 Act).” Further, “In administering the 1940 Act, the Commission and the staff have applied its requirements to a series as a separate investment company in virtually all circumstances.” In a note, the Guidance states, “In registering under section 8 of the 1940 Act, however, the multiple series of a series

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First appeared as part of the conference materials for the
25th Annual LLCs, LPs and Partnerships session

"Series LLCs: Pros and Cons"