

Series LLCs: Financial and Operational Flexibility Under New Delaware and Other State Laws

Advantages and Disadvantages; Formation and Governance; Drafting Strategies

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Advantages and Disadvantages; Formation and Governance; Drafting Strategies

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Outline

- I. Legal parameters of Series LLC
 - A. Description and definition
 - B. Available formation states
 - C. Available operation states
- II. Selection of entity considerations
 - A. Advantages
 - B. Disadvantages
- III. Operational considerations
- IV. Tax considerations
- V. Examples of Series LLC applications

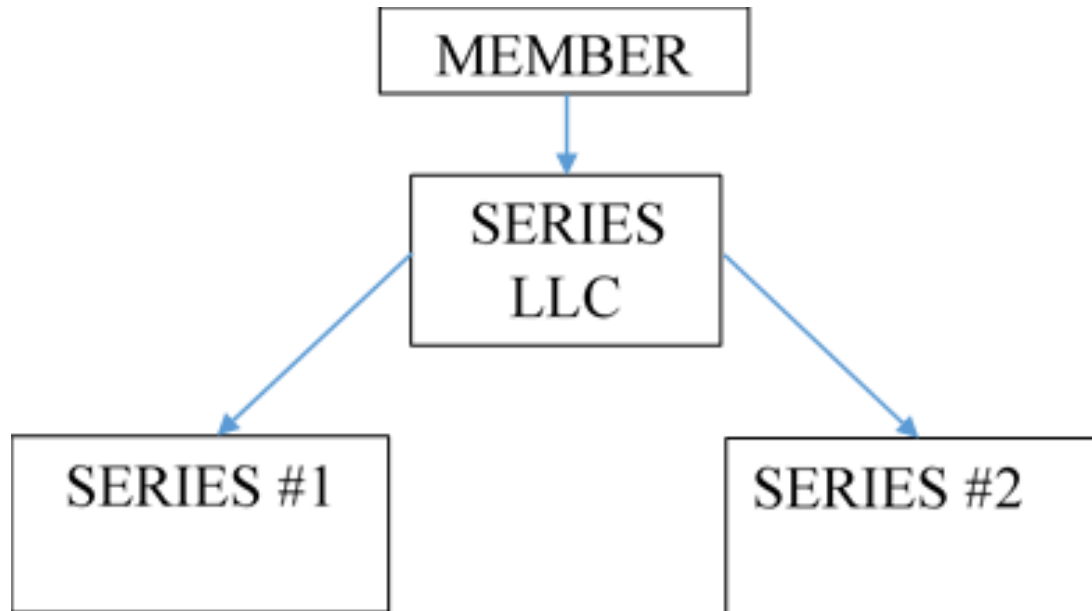
Legal parameters of Series LLC

Description and definition

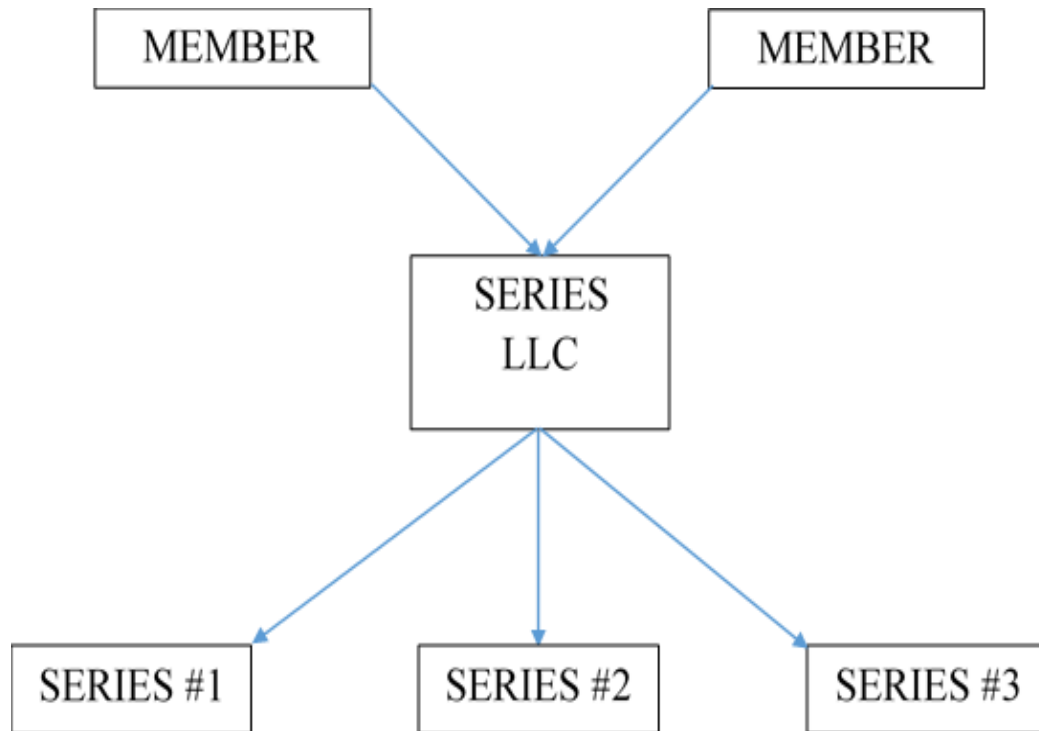
Overview

- Statutory unit or enterprise associated with an LLC (the “**Series LLC**”)
- Not a juridical (or legal) entity, or is it?
- Potentially provides unlimited flexibility in
 - Sharing or dividing managerial responsibilities
 - Sharing or dividing ownership and economic rights, including profits and losses
 - Compartmentalizing assets and liabilities

Two Simple Series LLC Examples



Two Simple Series LLC Examples (cont.)



Evolution

- 1909 – Statutory Trusts
- 1988 – Delaware Statutory Trust
 - Unincorporated association created to conduct business
 - Trustees and beneficiaries
 - Used in structured finance and for investment companies, such as mutual funds
 - Ability to segregate assets into subunits or series – a tracking interest
- 1996 – Delaware Series LLC and LP
- 2017 – National Conference of Commissioners on Uniform State Laws released the “Uniform Protected Series Act”

Key Terms

- Series LLC—an LLC that has at least one series
- Protected Series / Registered Series / Series—a series associated with a Series LLC and established under applicable law

Aspects of a series

An arrangement that allows for segregation of rights, powers, and duties:

- Separate rights, powers or duties with respect to specified assets
- Separate rights, powers or duties with respect to specified obligations
- Separate rights, powers or duties with respect to profits and losses associated with specified assets or obligations
- Separate business purposes
- Separate business investment objectives

Aspects of a series (cont.)

An arrangement that allows for segregation of management:

- Separate and distinct management and administrative structure

Aspects of a series (cont.)

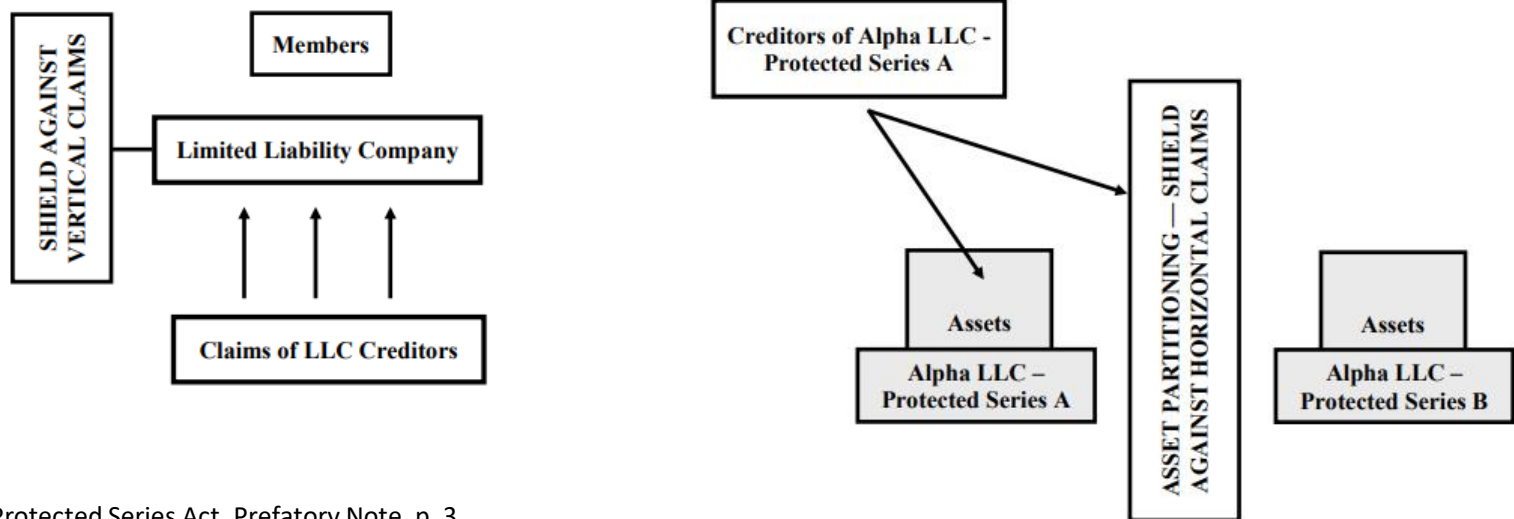
An arrangement that allows for segregation of profits, losses and distributions and ownership:

- Separate and distinct arrangement for the sharing of profits, losses, and distributions
- Ownership vs. association

Aspects of a series (cont.)

An arrangement that allows for segregation of liabilities:

- Statutorily sanctioned vertical and horizontal liability shields



Uniform Protected Series Act, Prefatory Note, p. 3

Aspects of a series (cont.)

§ 18-215 of the Delaware Limited Liability Company Act

Notwithstanding anything to the contrary set forth in this chapter or under other applicable law... then the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to such series **shall be enforceable against the assets of such series only, and not against the assets of the limited liability company generally or any other series thereof**, and, unless otherwise provided in the limited liability company agreement, **none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the limited liability company generally or any other series thereof shall be enforceable against the assets of such series.**

Aspects of a series (cont.)

An arrangement that allows for holding of assets:

- Assets of a series may be held directly or indirectly, including being held in the name of the series, in the name of the Series LLC, through a nominee, or otherwise

Example

XYZ COMPANY, a series of ABC, LLC, a Delaware series limited liability company, and established pursuant to § 18-215 of the Delaware Limited Liability Company Act

Aspects of a series (cont.)

An arrangement that allows for granting of broad powers and privileges:

- A series 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

Establishing a series

No Filing Statutes

- Certificate of formation notice
- Operating agreement provisions
 - Creation
 - Books and records
- Maintain separate books and records

Filing Statutes

- Certificate of formation notice
- Operating agreement provisions
 - Creation
 - Books and records
- Maintain separate books and records
- Registration filing

Legal parameters of Series LLC

Summary

Available operation state statutes

- Ala. Code § 10a-5a-11.01
- Ark. Code Ann §4-41-101
- Del. Code Ann. Tit. 6, § 18-215; 805
- D.C. Code § 29-802.06
- Ill. Comp. Stat. 180/37-40
- Ind. Code § 23-18.1
- Iowa Code § 489.1201
- Kan. Stat. Ann. § 17-76, 143
- Mo. Ann. Stat. §§ 347.039, 347.153, 347.186
- Mont. Code Ann. §§ 35-8-102, 35-8-107, 35-8-108, 35-8-202, 35-8-208, 35-8-304, 35-8-307, 35-8-503, 35-8-803, 35-8-804, 35-8-901, 35-8-902
- 2018 Neb. Laws L.B. 1121 (Effective January 1, 2021)
- Nev. Rev. Stat. § 86.296
- Okla. Stat. Tit. 18 § 2054.4
- P.R. Laws Ann. Tit. 14 § 3967
- Tenn. Code Ann. § 48-249-309
- Tex. Bus. Orgs. Code Ann. §§ 101.601, 101.622
- Utah Code Ann. § 48-3a-12.01
- 2019 Virginia Laws Ch. 636 (H.B. 2272) (effective July 1, 2020)
- Wyo. Stat. Ann. § 17-29-211

Legal parameters of Series LLC

Available formation states

Available formation states

No Filing Statutes

- Alabama
- Delaware
- Indiana
- Kansas
- Nevada
- Oklahoma
- Tennessee
- Texas
- Utah
- Wyoming

Filing Statutes

- Arkansas
- Delaware
- Illinois
- Iowa
- Missouri
- Montana
- Nebraska
- Virginia
- Uniform Protected Series Act

Available formation states (cont.)

- Enacted Uniform Protected Series Act
 - Arkansas
 - Iowa
 - Nebraska
 - Virginia
- Introduced Uniform Protected Series Act
 - Colorado
 - Tennessee

Legal parameters of Series LLC

Available operation states

Available operation states

While the following states do not have Series LLC legislation, they allow for the registration of a foreign Series LLC:

- California
- Maine
- Florida

Selection of entity considerations

Advantages

- Eligible entity for federal income tax purposes (discussed below)
- Less costly to form if the associated Series LLC operating agreement governs the operations of the series
- A series formed under a filing statute, secures some of the benefits of a juridical entity:
 - Ability to be a party to a state law merger or conversion
 - Ability to obtain a certificate of good standing or certificate of existence
- In some cases, using a Series LLC to incorporate new members/series cells can more easily facilitate consolidation without extensive “due diligence”.¹

¹ We have evaluated using this for independent practice associations (IPAs) and physician practice consolidations.

Disadvantages

- Inability to register to do business in a jurisdiction that does not have a series statute
- Concern about protections in a jurisdiction that does not have a series statute. *See Alphonse, Jr. v. Arch Bay Holdings, LLC*, 548 Fed.Appx. 979 (5th Cir. 2013).
- Cessation upon dissolution of sponsoring Series LLC
- A series formed under a non-filing statute can be problematic:
 - Inability to be a party to a state law merger or conversion
 - Inability to obtain a certificate of good standing or certificate of existence
 - Potential inability to file an assumed name certificate

Disadvantages (cont.)

Potential disadvantages due to uncertainty:

- Conceptual
- Bankruptcy
 - Is it a person under the Bankruptcy Code?
 - What is the property of the series?
 - Internal claims
 - External claims
- Efficacy of internal liability shield
- Taxation
- Securities laws

Tax considerations

Tax considerations

- Proposed Regulations issued September 14, 2010
 - Treated as an entity
 - Tax characterization determined under Reg. §301.7701-1 and general tax principles
 - Ownership of interests determined under general tax principles
 - Contemplates a stand-alone annual statement that must be filed by March 15
- California Franchise Tax Board takes the position that each series is a separate entity for franchise tax purposes
- Texas Comptroller takes the position that a Series LLC and all of its associated series are a unified company for franchise tax purposes

Examples of Series LLC applications

Private Equity Investments

Assume a family wishes to make multiple private equity investments. The family forms PEI, LLC, a Series LLC. In order to compartmentalize the obligations relating to each investment, a new series is established for each such investment.

Trust Company Hedge Fund Investment

A Trust company could create a Series LLC to allow its trust customers to invest in a hedge fund without each trust customer having to go through the qualification paperwork. That is, the Series LLC does the paperwork once and the trusts buy member interests in the Series LLC.

Real Estate Investments

Assume an entity owns numerous commercial, single-family residential and multi-family residential income producing properties. In lieu of creating a separate LLC to hold each property or each group of similarly situated properties, the entity could be converted into a Series LLC and a separate series could be established to hold each such property or each such group.

Mineral Investments

Assume an investor holds numerous multi-well leases. The owner could use a Series LLC model to put hazardous activities, such as gas gathering systems, into separate series.

Multiple Business Operations

Assume an entity operates through multiple locations, such as multiple restaurants. In lieu of creating a separate LLC to operate each location, the entity could be converted into a Series LLC and a separate series could be established to operate each location.

Transportation Companies

Assume a transportation company has 50 trucks. It can place each truck in a separate protected series. There will be liability protection for each protected series and only one legal entity will apply for the DOT license for all the protected series.

Platting Issues

Assume A, B, and C own Blackacre through ABC, LLC. A, D, and E wish to acquire Whiteacre, which is adjacent to Blackacre. Access to Whiteacre must be provided across Blackacre. Local authorities have refused to permit Whiteacre to be transferred to anyone except ABC, LLC unless Whiteacre is replatted. In this case ADE, LLC can be converted into a Series LLC and two series can be established: ABC Series and ADE Series. ABC, LLC will acquire Whiteacre. ABC, LLC will hold legal title to Blackacre and Whiteacre as nominee for ABC Series and ADE Series, respectively.

Succession Planning

Assume a family owns several limited partnerships that own a variety of operating businesses and investments. A single limited liability company, GP LLC, serves as general partner of each limited partnership. The patriarch desires to institute a different management and succession structures for each limited partnership. In this case, GP LLC could be converted into a Series LLC, where each series provides for a different management and/or ownership structure.

Partition Right

Assume a family owns three separate classes of investments: ranching, mineral interests, and multi-family housing. The oldest generation (G1) is not willing to split-up the holdings because of uncertainty in current values or future production or use, but the G1s recognize that their descendants, G2 and beyond, will likely not agree on future operations. To address the issue, a Series LLC is formed and three series are established: Farm Series, Mineral Series, and Housing Series. The Series LLC is the member associated with each series.

Partition Right (cont.)

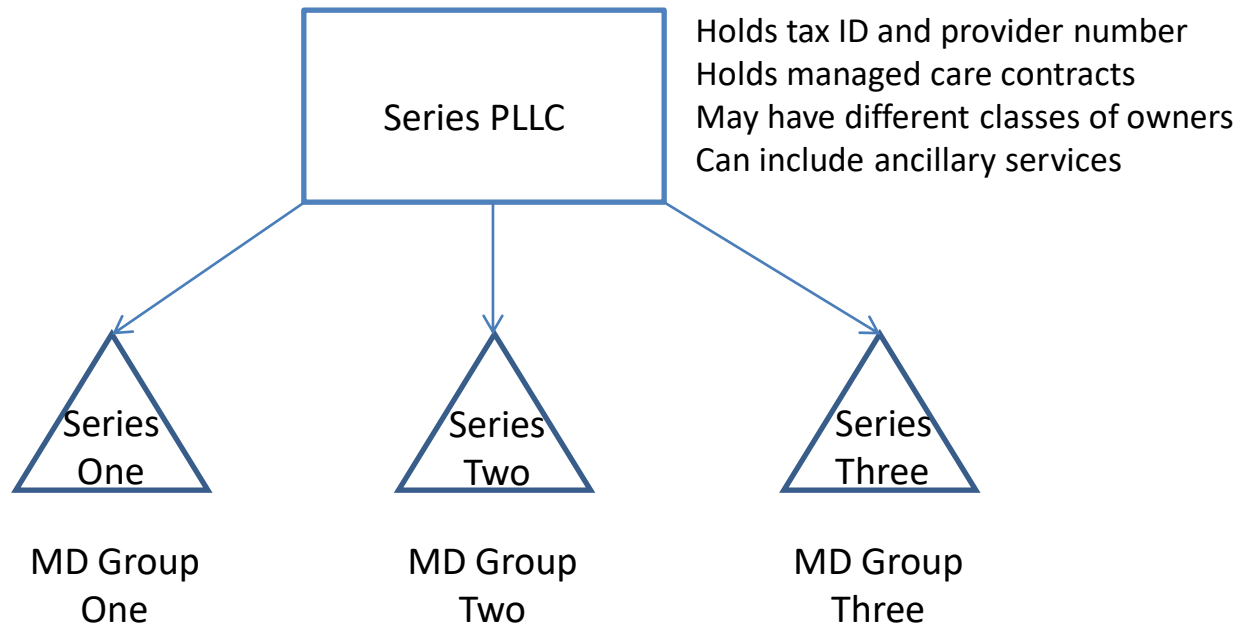
If a dispute arises, one of the options any family may initiate is a partition right detailed in the Series LLC operating agreement. The initiating family designates the appropriate assets that are allocated to the appropriate number of lots. The other families then select lots based on a random process detailed in the Series LLC operating agreement. The initiating family takes the last lot remaining. The families may either leave their lots in the Series LLC, at which time the ownership of that series becomes associated with that family, or that family may withdraw their lot from the Series LLC altogether.

Medical Business

The Multi-Specialty Integrated Practice Series Model Client Goals

- Enable primary care and specialty physicians to come together into a single professional medical entity (PLLC) to promote cross referral and sharing of ancillary revenue without high complexity of formal consolidation or merger
- Enable each group practice to maintain control over its own assets, operations and compensations structure with limitation of liability

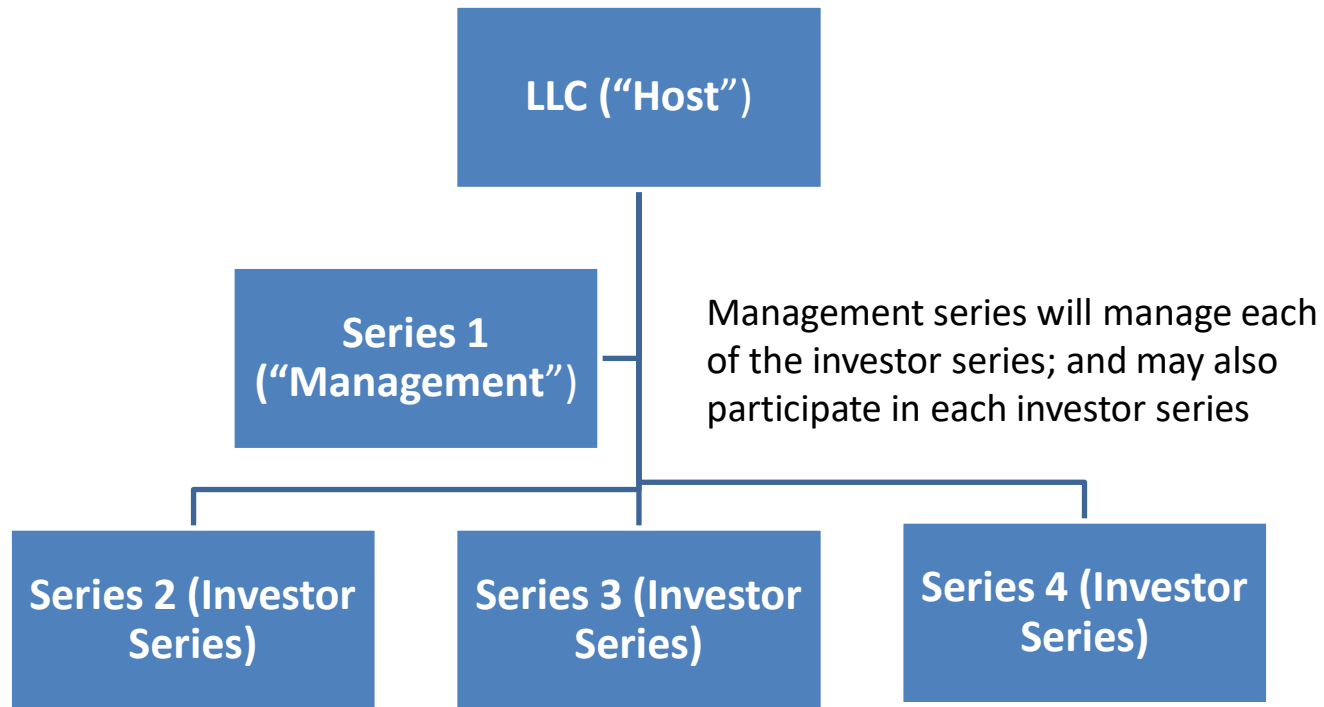
The Multi-Specialty Integrated Practice Series Model



The Series LLC Health Care Venture Investment Model

- Client Goals:
 - Enable physician participation as investors in ancillary ventures (lab, pharmacy, etc.)
 - Reduce risk of violating Anti-kickback and Stark laws based on potential referrals
 - Allow for controlled expansion of physician investment via use of series
 - Limit spill-over liability from non-compliant series physician investors

Investment Model (MSO)



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