Series Limited Liability Companies and New York Real Property Transactions

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The Series LLC was first developed in Delaware in 1996[1], and the power to create them has been added into the limited liability company laws of several states since. However that number still does not include New York. Nevertheless, New Yorkers and New York businesses are increasingly aware of, and interacting with, Series LLCs. There is a fair amount of confusion about the use of Series LLCs in states like New York which have not adopted the structure. While the Full Faith and Credit Clause of the United States Constitution has generally led states to reciprocally respect the limited liability company laws of sister states, the core innovative feature of Series LLCs is not merely some further streamlining of company bookkeeping, or additional flexibility in management structure. The powers only available to and through Series LLC go to the heart of how states regulate their business entities.

This is the first of a series (no pun intended) of articles about Series LLCs and their use in transactions insured by title insurance. We will examine the use of the Series LLC both in terms of real property transactions, such as the purchase and sale of a building, and personal property transactions, such as in the case of mezzanine financing.[2] In this first article, we will review the nature of the Series LLC itself, and what it means to be transacting with a "series" of that Series LLC.

What exactly is a Series?

A Series of a "Series LLC" is a construct of the organizational documents of a limited liability company (an "LLC") created pursuant to powers enumerated in a state's limited liability company law. Series LLCs were introduced in order reduce filing and administrative costs incidental to maintaining multiple legal entities.

Businesses, or their creditors, oftentimes find it advantageous to hold assets in separate legal entities, and due to their flexibility in structure, LLCs are the usual entity of choice. The Series LLC makes it theoretically unnecessary for a company to maintain several separate LLCs, and yet still receive the same limitation of liability and tax advantage that maintaining separate legal entities can provide. For example, a printing company might find it useful to have one LLC which owns the business itself, another LLC to own the building where the business is located, and yet another LLC to own the printing press inside the building. Such a printing company might normally have organized three separate LLCs such as: Acme Printing 1, LLC (the business), Acme Printing 2, LLC (the building owner), and Acme Printing 3, LLC (the printing press owner). These three entities may be commonly owned, or they may be subsidiaries of each other, such as the following illustrations depict:

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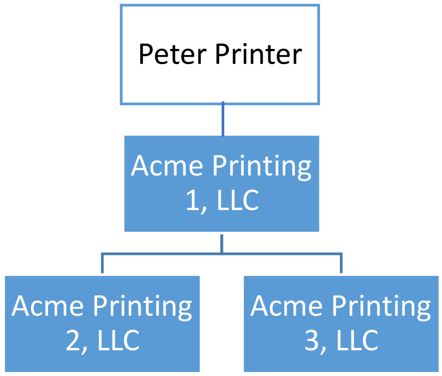
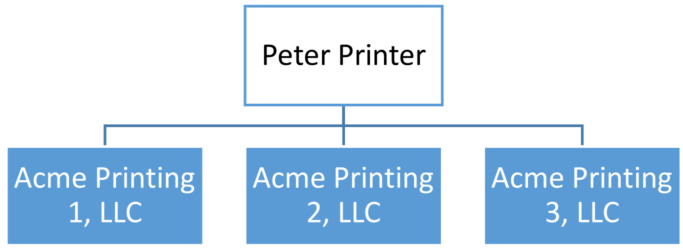
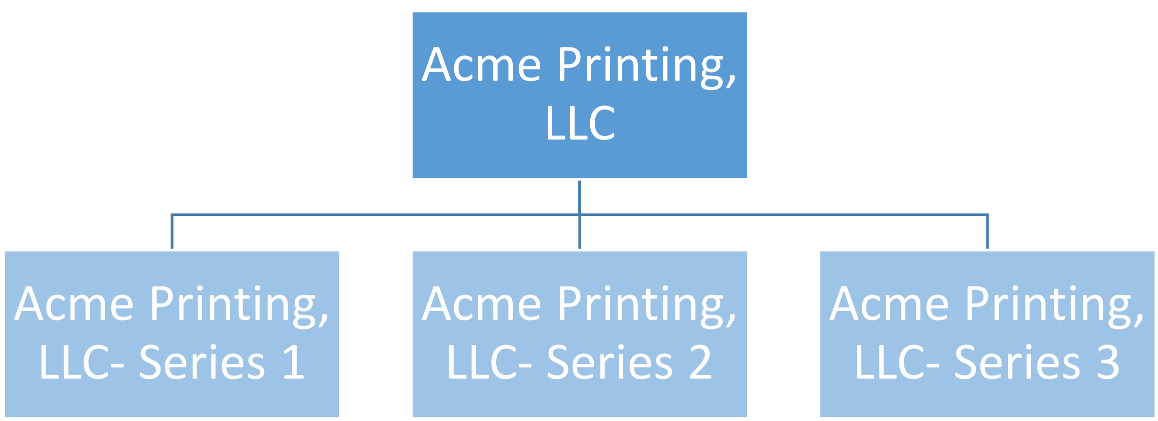
[1] The Series LLC: A New Planning Tool, 45-FALL Tex. J. Bus. L. 57, page 58
[2] Mezzanine Financing involves the pledging of personal property represented by the membership interest (shares) of a business entity which owns real property.





With a Series LLC, however, one could simply organize a single entity such as Acme Printing, LLC. A “Series” within Acme Printing, LLC, could own the building, and another Series could own the printing press. Each such “Series”, including all its assets and liabilities, would be regarded as separate; separate from other Series created within the Series LLC, and separate from the Series LLC itself. For all intents, and *most* purposes, a “Series” is equivalent in legal rights to the Series LLC which contains it.



Members, Managers, and Assets

To understand what a Series is, it is useful to review what the core elements of an LLC are in the first place. After all, since the Series LLC was invented in order to obviate the need to form multiple independent LLCs, it stands to reason that a Series will have many of the same characteristics of the LLC which acts as its container.

Foundationally, every LLC must have an owner, known as a "member" in the New York LLCL. A "member" in New York LLC parlance is, "a person who has been admitted as a member of a limited liability company in accordance with the terms and provisions of this chapter and the operating agreement and has a membership interest in a limited liability company with the rights, obligations, preferences and limitations specified under this chapter and the operating agreement."[3] Even though someone other than the owner may actually form the entity, "At the time of its formation, a limited liability company must have at least one member."[4]

Additionally, an LLC *may* also have one or more "managers". An LLC manager is defined as, "a person designated by the members to manage the limited liability company as provided in the operating agreement."[5] Just as an LLC's members would be analogous to a corporation's shareholders, an LLC's managers are analogous (perhaps a bit more roughly) to a corporation's directors and officers. At their discretion, LLC members and managers can delegate their duties to create elaborate hierarchies of officers and other employees, to the effect of mimicking all the structural aspects of corporations, though this is not commonly done.

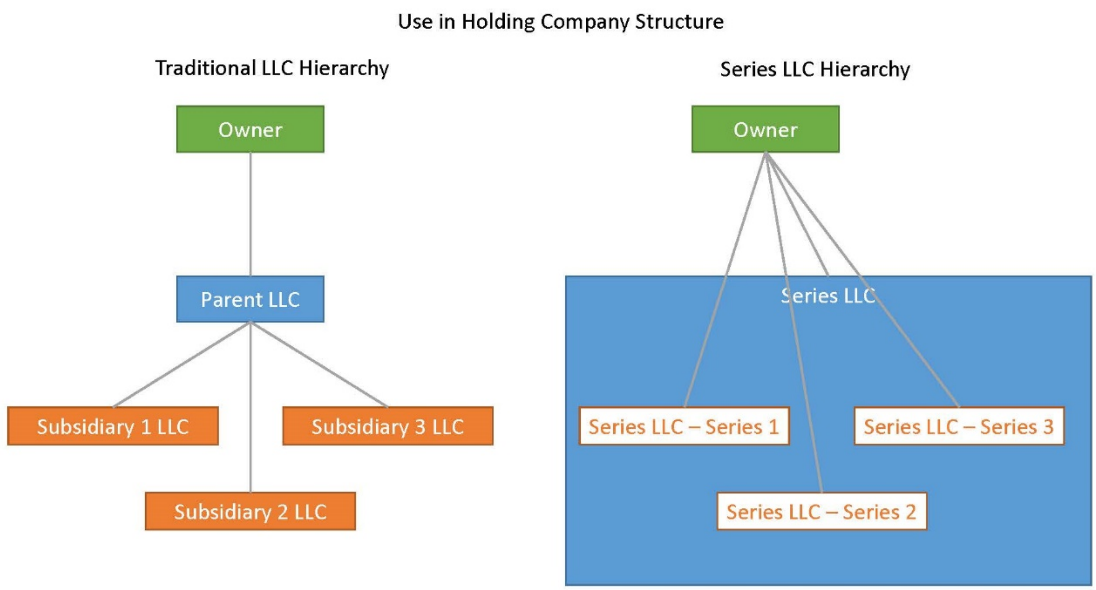
Lastly, an LLC would not be of much use if it did not have any assets upon which to act.

So the core minimum components of an LLC can be generally stated as a collection of members, managers, and assets. These are also the core components of a Series.

Hierarchy of Series

Another important concept about Series is how they relate to each other and to the Series LLC they are a component of. While a Series LLC may, in fact, be the owner of all its component Series, it need not be. Since the Series may have completely separate ownership, the Series LLC may instead act as a container, rather than as an owner, for its component Series. A holding company Series LLC could mimic the "Traditional LLC Hierarchy" shown in the illustration below through the indirect ownership of Series, or it could instead be structured to provide the ultimate beneficial owner with direct ownership of the Series as shown in the "Series LLC Hierarchy".

[3] NYLLCL §102(q)
[4] NYLLCL §203(c)
[5] NYLLCL §102(p)



The Series LLC

The "Series LLC" which contains the Series shown above, is merely an otherwise-traditional LLC whose operating agreement includes the power to create one or more Series within it of members, managers, and assets, which Series act as a sort of "sub" LLC. The Delaware Limited Liability Company Act offers a useful exposition of the requirements of a Series:

> *A limited liability company agreement may establish or provide for the establishment of 1 or more designated series of members, managers, limited liability company interests or assets. Any such series may have 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, and any such series may have a separate business purpose or investment objective.*
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> Delaware Limited Liability Company Act, 6 Del.C. §18-215

Types of Series

Those familiar with drafting operating agreements for LLCs can confirm that the LLC business entity structure allows for a great deal of flexibility in ownership and management. An LLC's membership interests or management powers, can be tailored in innumerable ways. That same flexibility trickles down to Series, but it is generally the case that Series fall into three basic types: (1) "Basic Series" which have their own designated business purposes, but are not liability-remote from the Series LLC or the other Series within it, (2) "Protected Series" which are liability remote from the Series LLC and the other Series, and (3) "Registered Series" which are both liability remote and publicly registered. In our next article, we will review the above three types of Series, and their use.

As we have seen, the Series LLC offers an innovative and streamlined approach to the use of the limited liability company. In theory it makes unnecessary a great deal of costly business filings for the organization and maintenance of multiple independent limited liability companies. As we will see in the next article however, the special requirements of real and personal property transactions complicate the implementation of that theory somewhat, and have caused the creation of Series which, by design, require some of the same independent filings which motivated the creation of Series LLCs in the first place.