

## Focus | M&A/Corporate Counsel

# When and When Not to Consider Choosing a Series LLC

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Effective September 1, 2009, the Texas legislature enacted its series LLC statute with the addition of Subchapter M to Chapter 101 of the Texas Business Organizations Code. Unlike traditional LLCs, series LLCs have the ability to partition assets and liabilities from those held within each of the other series. Each series may also have a different business purpose, members, and management, and the liabilities incurred by each series are, in theory, enforceable only against that series. Furthermore, the formation of a series LLC requires only one filing fee and one certificate of formation for the “primary” series—each series created thereafter within the series LLC will not require an additional fee.

Beyond the formation stage, legal counsel should advise the client of “best practices” in operating such business entity to maintain the critically important liability shield or “veil” between each of the series. Statutorily, a series LLC gains these internal veils by including a statement noticing the limitations on liability between each series in the certificate of formation and the company agreement, as well as by maintaining separate books for each individual series. Because of these internal veils, the question arises of whether a potential creditor can internally pierce the corporate veil. Unfortunately, there is essentially no case law currently guiding the analysis of corporate veil piercing in the context of a Texas series LLC.

Not long after the series LLC statute was enacted, the Texas Comptroller

issued a private letter ruling providing that each series is not taxed as a separate entity, which means that all profit and expenses among all of the series must be aggregated. In late 2010, the IRS issued proposed regulations that treat each series LLC formed under state law as a separate legal entity for federal income tax purposes, regardless of whether the state at issue classifies each of the series as a separate juridical entity. Although the IRS issued guidance contrary to the Comptroller’s position a mere four months later, Texas has not modified its position on the aggregation of all series within a series LLC.

Only 14 states, the District of Columbia, and the Commonwealth of Puerto Rico have enacted series LLC statutes. Characterization of the business entity in states that have neither enacted series LLC statutes nor allowed registration as a foreign entity is an unanswered question. In a Texas lawsuit, each series within a series LLC will

likely be considered distinct from the other series and the “primary” series. However, perhaps the most pressing question is whether courts in states that have not enacted series LLC statutes will respect the internal liability protections provided by the Texas statute should litigation involving a Texas series LLC arise in an out-of-state court.

If a court were to consider such a case and determine that piercing the corporate veil is warranted, it is possible that a judgment against one of the series could attach to the assets of one or more of the other series, including the primary, or against the owners of any of the series. It is critical to respect the corporate formalities and keep separate books and records for each series to limit available assets in the event of a judgment.

It is important to remember that the lack of case law is itself a risk. Even if courts across the country ultimately find that series LLCs hold greater liability protections than traditional LLCs, the

pioneers in using series LLCs will disproportionately bear the costs of arguing those protections in litigation and any ensuing appeals. In Texas, therefore, it is understandable if legal counsel is extremely hesitant to recommend that clients choose a series LLC as the entity of choice unless the potential cost savings of a single formation fee far outweigh the risks associated with operating a business in such form. Certain industries may find that benefits of the series LLC outweigh the risks, such as those in the real estate industry where it is advisable to hold each property within a separate and distinct entity. The increased risk in using the series LLC format must be balanced against the convenience and potential cost savings to the business. **HN**

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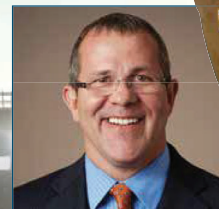
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