# A New Breed of Borrower: Series LLCs

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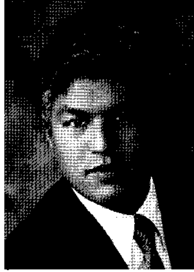
When limited liability companies were rising to prominence two decades ago, banks and other creditors were concerned about the legal status of an LLC and the extent of liability protection that might be afforded to this new type of business entity. Banks had no choice but to accept a certain degree of risk inherent to lending to an LLC, a risk that was exacerbated by a lack of guidance from the courts.



Although LLCs are now a widely utilized and advantageous structure for many businesses, the cost of organizing a new LLC for each of the business' endeavors can be prohibitively high. To address this issue, some states have begun approving a new type of LLC – the "series LLC."

This is a legal entity organized under state law and comprised of internally created "cells," each of which may have its own assets, members, and managers. In essence, the series LLC is an umbrella entity that can partition its assets and liabilities among cells in the same way that a corporation operates its subsidiaries. The profits, losses, assets, and liabilities of one cell can be legally separated from all of the other cells under the LLC without the expense and administrative burden of creating individual LLCs. This can be an attractive structure for businesses, particularly real estate development entities that would otherwise incorporate a new LLC for each development.

However, not all series LLCs are alike. The characteristics of a series LLC depend on the laws of the state in which it was organized. This lack of uniformity comes at a price: Creditors are faced with the challenge of determining the legal validity of a series LLC, as well as the breadth of liability protection afforded to an individual cell. Compounding this challenge is the lack of case law addressing the extent to which cells are truly insulated from the liabilities of other cells under the same LLC.

Delaware, which authorized the creation of series LLCs in 1996, continues to serve as a model for other states. Delaware's series LLC statute permits each cell within a series LLC to have a "separate business purpose or investment objective." A series LLC must (1) provide for the creation of one or more cells within the LLC in its operating agreement; (2) maintain separate financial records for each cell and separately account for the assets and liabilities of each cell; and (3) provide notice of each cell's limited liability by setting forth such limitation on the LLC's certificate of organization.

Only a handful of states have followed Delaware's lead in authorizing series LLCs — Illinois, Iowa, Nevada, Oklahoma, Tennessee, Utah, and Wisconsin. Critical variations among these states' laws have created significant confusion for creditors.

Under Delaware law, the internal liability shield for a cell is available only if notice of the entire series' limited liability is included on the umbrella LLC's certificate of organization. In contrast, Illinois' LLC statute treats each cell as a "separate entity to the extent set forth in the articles of organization." Illinois law also requires that a cell's legal name contain the name of the entire series LLC, despite that each cell may contract in its own right, grant security interests limited to its own assets, and be sued individually.

Unlike Delaware and Illinois, a cell in a Wisconsin series LLC is not a distinct legal entity even though it may have special voting and distribution rights. Wisconsin statutes permit a LLC to establish a "designated series or classes of members, managers, or limited liability company interests that have separate or different preferences, limitations, rights, or duties, with respect to profits, losses, distributions, voting, property, or other incidents associated with the limited liability company." Nonetheless, a Wisconsin series LLC (including its individual cells) remains a single legal entity even if its cells have compartmentalized assets and liabilities.

Because the legal concept of a series LLC is relatively untested in the courts, uncertainty arises as to how liens and valid security interests are created against the entire series LLC or a particular cell. Lending to a series LLC or its cells requires a careful analysis of the LLC's and the cells' articles of organization, operating agreements, certificates of designation, meeting minutes, financial statements, and other documents.

The precise scope of creditors' and debtors' rights is unclear as it relates to series LLCs. Bankruptcy law has not yet recognized cells as separate legal entities. Will the entire series LLC become part of a bankruptcy proceeding if a single cell becomes insolvent? Can a bankruptcy court consolidate the assets and liabilities of all of the cells to satisfy the creditors of the parent series? It is similarly unclear how state courts will treat series LLCs because not all states authorize the creation of series LLCs and because, to the extent that a state does authorize their creation, it might be unclear whether the series LLC is more akin to that authorized in Delaware and Illinois or that authorized in Wisconsin.

In Illinois, this uncertainty has led to varying treatment of series LLCs by creditors and title companies. At least one title company in Chicago will not insure title to property in the name of a particular cell; rather, it requires that property be titled in the name of the series LLC, even if the property has been allocated to the cell. But another Chicago company will insure title in the sole name of a particular cell.

Until courts have an opportunity to address these uncertainties, creditors should be aware of the inherent risks involved with lending to a series LLC. Given the complexity of the legal issues that arise, creditors should consult an attorney before engaging in any transaction that involves this new breed of borrower.

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