

AN AGRIBUSINESS APPLICATION FOR THE SERIES LIMITED LIABILITY COMPANY

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ABSTRACT

Growing out of the offshore tax shelters of the 1950s into the domestic statutory trusts of the 1970s that isolated groups of assets individually, the Series Limited Liability Company (SLLC) was enacted by Delaware in 1996. In the 15 years following this enactment, other jurisdictions enacted their own statutes of the SLLC entity in some capacity but there is obvious reticence of broad enactment until uncertainty is quelled. Without a “federal blessing” by a federal court or federal agency on a SLLC statute, the uncertainty will not disappear. One potential application is for family operated agribusiness firms. This article concludes with its exploration.

“Agribusiness: an industry engaged in the producing operations of a farm, the manufacture and distribution of farm equipment and supplies, and the processing, storage, and distribution of farm commodities.”

-Merriam-Webster Dictionary¹

I. INTRODUCTION

American agribusiness is a different type of industry. There are numerous exceptions in law and business which lead to many niche practices internationally, federally, and from state to state. The reasoning is quite apparent when assessed against how culturally central food is to a country and a people. Politically this is shown through the exceptions to the laws. This article explores a new type of business entity which was originally meant for taxation sheltering of assets, but is evolving into an easily managed alternative to a parent-subsidary relationship in a traditional corporation. No, this entity was not a legislative carve-out specifically for agribusiness purposes, but it does have considerable potential for agribusiness use for asset protection and business operations. This Article is meant to illuminate its potential.

The Series Limited Liability Company (SLLC) has incredible potential for business planning. The SLLC has been in existence since the Delaware enactment in 1996.² The entity offers the limited liability protections of an LLC spread amongst individual cells providing customizable options for the isolation of assets, fiduciary duties, ownership and control, distributions, and tax across the series' cells. The potential for multiple asset businesses, investment operations, professional malpractice purposes, or multiple business division creation is obviously not just for the possibility of economizing on transaction costs, but also for administrative clarity.³ The SLLC can be best thought of in the corporate analogy of parent-subsidary isolation of business purposes.⁴ But the SLLC offers the flexibility from the formality of the corporation, pass-through taxation, and IRC Subchapter K elections, making it a preferred option for a smaller business venture, in which corporate financing goals are not as prevalent.

In the fifteen years since the enactment, there has been little movement toward implementation; with little action on the part of states, federal agencies, or

1. Agribusiness, MERRIAM-WEBSTER DICTIONARY, <http://www.merriam-webster.com/dictionary/agribusiness> (last accessed Sept. 9, 2015).

2. See DEL. CODE ANN. tit. 6, § 18-215 (2015).

3. Sandra Mertens, *Series Limited Liability Companies: A Possible Solution to Multiple LLCs*, 84 CHI.-KENT L. REV. 271, 284, 287 (2009).

4. *Id.*

courts to affirm the SLLC. Affirmation may come from agency guidelines, a positive federal court opinion, or definitive state legislative clarifications for the rights and duties of a series. Lack of affirmation and guidance may come from the uncertainty which looms over the SLLC. This fear may motivate state legislatures' broad enactment of the SLLC. There are fears from the federal bankruptcy of substantive consolidation, fears as to federal and state taxation of respect of each series as a distinct entity, fears about creditor rights which may lead to a pierce from series to series thus frustrating its purpose, and fears for foreign jurisdiction regarding full faith and credit across sister jurisdictions.

Critics have attacked the SLLC fiercely, and questioned whether it is even needed because the options it provides are available through splicing other entities together without running the risks that the SLLC gives.⁵ However, it is the purpose of this paper to assume that the SLLC will survive, it will be affirmed, and it will achieve mass enactment and business planners can consider the entity without fear. It is foolish and unrealistic to assume that states would junk the SLLC for its defects as the critics want. No one junks a brand new car for dented fenders, broken headlights, or flat tires. States are fixing their statutes to improve clarity and avoid ambiguity. Illinois is the best example of these challenges.⁶

This Article will explore the SLCC as an entity with its origins in offshore tax shelters and its benefits for business planners. The detriments of an SLCC must be analyzed to expose its fears and uncertainty. Finally, an analysis of application for the SLLC will be given in the context of agribusiness operations.

II. ORIGINS AND EVOLUTION OF THE SLLC

An SLLC creates a group of series, or cells, that serve to shield the master.⁷ Think of it as a hub/spoke construction with the master series as the hub. The operating agreement is where control lies, assets are defined, and licenses are held.⁸ The spokes are the individual series which may have their own business purpose,

5. Dominick T. Gattuso, *Series LLCs: Let's Give the Frog a Little Love*, BUS. L. TODAY (July/Aug. 2008) available at <https://apps.americanbar.org/buslaw/blt/2008-07-08/gattuso.shtml>.

6. See 805 ILL. COMP. STAT. 180/37-40 (2014) (amending 805 ILL. COMP. STAT. 180/1-10; 805 ILL. COMP. STAT. 5/1.11 (2007)).

7. ILLINOIS SECRETARY OF STATE, 500-334.4, A GUIDE FOR ORGANIZING DOMESTIC LIMITED LIABILITY COMPANIES 7 (2014) available at http://www.cyberdriveillinois.com/publications/pdf_publications/c334.pdf.

8. See TEX. BUS. ORGS. CODE ANN. § 100.601 (2009); see Julie Alexander, *Using the 'Series LLC' for Real Estate Investing*, JKB REALTY, <http://www.jkbrealty.com/market-news>.

separate ownership, separate assets, tax distributions, and profit and capital interests.⁹ These are distinct from all other series. The theory is that if one series is liquidated or attacked by creditors, then there will be a shield from penetrating the assets of another series or the owners to satisfy a deficiency. This design seems intuitively designed for multiple asset businesses or investments.

A. Offshore Mutual Funds & Captive Insurance

The creation of the SLLC is disputed, but the inspiration came from the (now-forbidden) tax shelter, offshore captive insurance, and investment vehicles with mutual funds and hedge funds.¹⁰ In the 1960s, Bermuda ushered in captive insurance, which is a method for a company to create its own insurance fund for a specific division of a company.¹¹ Other structures in Guernsey supply Europe with the captive model,¹² mutual fund models in Mauritius, the Cayman Islands, the British Virgin Islands, Belize, and Bermuda also use the cell isolation structure.¹³

In the 1970s and into the 1980s, Vermont and Delaware aggressively competed for the captive insurance markets by enacting statutes which required low capital requirements, an annual audit, and self-regulation, but despite Delaware's amendments in the late 1980s, there was still not broad adoption or favored use over offshore alternatives.¹⁴ On the heels of the broad enactments of LLC acts, Delaware enacted the first series of LLC legislation in 1996 which was able to issue unlimited sub-series entities in which the debts, liabilities, and obligations of one series are only enforceable against the assets of that series and not against the assets of the LLC or another series.¹⁵

The Delaware SLLC was geared towards financial investments and insurance and the language revolved around the business trust or statutory trust. Massachusetts developed the business trust that created legislation for a trust to establish different series, and in 1984 the Tax Court upheld the separate series as a

9. See TEX. BUS. ORGS. CODE ANN. § 100.601; see Julie Alexander, *Using the 'Series LLC' for Real Estate Investing*, JKB REALTY, <http://www.jkbrealty.com/market-news>.

10. James Blake, *From the Offshore World of International Finance to Your Backyard: Structuring Series LLCs for Diverse Business Purposes*, 9 DEPAUL BUS. & COM. L.J. 1, 4 (2010).

11. *Id.* at 4-5.

12. *Id.* at 5.

13. Gattuso, *supra* note 5.

14. Blake, *supra* note 10, at 6.

15. *Id.*

distinct business entity.¹⁶ The 1988 Delaware Statutory Trust Act (DTSA)¹⁷ is the mirror of the SLLC without the business purpose of the LLC.¹⁸ Delaware amended its Limited Liability Company Act in 1996 to include the series provisions.¹⁹ What is interesting is that the SLLC was used for broader purposes than its original intent for financial investment and insurance as oil companies isolated their drilling operations, real estate developers isolated their properties, and, even a speed boat was isolated.²⁰ Other states have provided for the SLLC, but these states' statutes show a noticeable attribution to Delaware.²¹ It is further noticeable that broader business purposes are being embraced beyond the original purposes of investment and large asset protection. The real issue here is whether the Delaware SLLC and its statutory framework is equipped to handle the new purposes.

B. *The States' Attempt to Follow The SLLC*

As of 2013, eight states, the District of Columbia,²² and Puerto Rico²³ have adopted the SLLC: namely Delaware,²⁴ Illinois,²⁵ Texas,²⁶ Iowa,²⁷ Oklahoma,²⁸ Nevada,²⁹ Tennessee,³⁰ Utah,³¹ and now Kansas.³² Three other states, Minnesota,³³

16. IRS GCM 39211, IN RE: WHETHER THREE INVESTMENT FUNDS FORMED AS A SINGLE MASSACHUSETTS BUSINESS TRUST CONSIST OF ONE OF THREE SEPARATE INCORPORATED ASSOCIATIONS TAXABLE AS CORPORATION UNDER SECTION 7701 (a)(3). *See generally* Nat'l Sec. Series Indus. Stocks Series v. Comm'r, 13 T.C. 884 (1949).

17. DEL. CODE ANN. tit. 12, § 3806 (2015).

18. Ann E. Conaway, *A Business Review of the Delaware Series: Good Business for the Informed*, WIDENER LAW SCHOOL, LEGAL STUDIES RESEARCH PAPER SERIES NO. 8-19, 4-5 (2008).

19. DEL. CODE ANN. tit. 6, § 18-215.

20. Thomas E. Rutledge, *Again, For the want of a Theory: The Challenge of the "Series" to Business Organization Law*, 46 AM. BUS. L.J. 311, 314 (2009).

21. *Compare* OKLA. STAT. tit. 18, § 2054.4 (2007) *with* DEL. CODE ANN. tit. 6, § 18-215 (2012); Gattuso, *supra* note 6.

22. D.C. CODE § 29-802.06 (2014).

23. P.R. LAWS ANN. tit. 14, § 3426p (2008).

24. DEL. CODE ANN. tit. 6, § 18-215.

25. 805 ILL. COMP. STAT. 180/37-40 (2008).

26. TEX. BUS. ORGS. § 101.601 (2010).

27. IOWA CODE § 490A.305 (2008).

28. OKLA. STAT. tit. 18, § 2054.4 (2007).

29. NEV. REV. STAT. § 86.286 (2007).

30. TENN. CODE ANN. § 48-249-309 (2006).

31. UTAH CODE ANN. § 48-2c-606-616 (2007).

32. KAN. STAT. ANN. §§ 17-7663, 17-7682 (2012).

33. MINN. STAT. ANN. § 322B.03 (2008).

North Dakota,³⁴ and Wisconsin,³⁵ reference it. Most of those states model their statutes after the Delaware series LLC, with the exception of Illinois and Iowa.³⁶ But Delaware's construction showed to be flawed as the *GxG Management Limited Liability Company v. Young Brothers and Company* case proved.³⁷

The *GxG Management* case is the only case which has dealt with the SLLC.³⁸ It is an unpublished opinion of a Delaware organized SLLC entity which was operating in New York.³⁹ The case is about the construction of a speed boat.⁴⁰ The plaintiff lived on an island where the only means of getting to shore is by boat.⁴¹ He contracted with Young Brothers to construct a new larger boat to replace his older one.⁴² The boat builder, Young Brothers, missed the completion deadline, and when it was finally delivered, the boat did not run correctly.⁴³ The plaintiff sued for breach of contract and warranties and sought damages for the cost to fix the boat.⁴⁴ The plaintiff put the boat in Series B and the master series was maintained as Series A.⁴⁵ Series B brought the suit and there was a challenge to standing due to the boat and owner being in different series.⁴⁶ The court found that Series B had a traceable interest to the owner series and Series B was only nominal and could be readily ignored.⁴⁷

The effect of *GxG Management LLC* for the Delaware SLLC was humbling. This decision was unpublished and not controlling anywhere but Maine. However, it exposed notable cracks in the Delaware SLLC. The lessons were: (1) foreign jurisdiction recognition was good. Maine respected the series existence and did not collapse each series and treat it as a LLC out of a public policy argument; (2) the court traced the interest back to GxG Management; failing to preserve isolation; (3) and the court struggled to find standing because it was poorly defined in

34. N.D. CENT. CODE ANN. § 10-32-02 (2008).

35. WIS. STAT. ANN. § 183.0504 (2008).

36. Compare DEL. CODE ANN. § 18-215 (2015), with IOWA CODE § 490A.305 (2015); Wendell Gingerich, *Series LLCs: The Problem of the Chicken and the Egg*, 4 ENTREPRENEURIAL BUS. L.J. 185 (2009).

37. *GxG Mgmt. L.L.C. v. Young Bros. & Co.*, No. 05-162-B-K, 2007 WL 551761 at 1 (D. Me. Feb. 21, 2007).

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.* at 7.

46. *Id.*

47. *Id.* at 8.

the statute. These issues were dealt with immediately by Delaware's 2007 amendment to its LLC act, which held that a series can hold title to assets in its own name and it has the capacity to sue and be sued.⁴⁸ These clarifications may help in the future with other foreign jurisdiction recognition.

The issue of the other jurisdictions which have enacted the SLLC statutory provisions are all unique despite deriving from the Delaware model. Tennessee treats each series like a separate LLC,⁴⁹ Nevada weaves the series laws throughout its LLC act instead of a "series section" as other states have,⁵⁰ and Utah⁵¹ protects creditors by disallowing any allocation of tax or profits or transfer of property of a series that could harm creditors' rights to collect.⁵² The cacophony between jurisdictions may cause issues because all other jurisdictions are built on Delaware, save Illinois, and it has been Delaware that has shown to be too flexible. Seeking to get out in front of the issue, Illinois has taken the SLLC beyond Delaware, and has fought to define the SLLC and eliminate ambiguity.

C. Illinois Saving the SLLC

After the *GxG Management* decision there was a trend to model SLLC statutes on the Illinois statute.⁵³ The Illinois SLLC is distinguishable from Delaware's largely due to the breadth of formalities and the statutory explicit rights and duties of an SLLC.

Among the SLLC states, the Delaware model is attractive because there are fewer filing fees and substantial liability protection, but Illinois diverges by adding language to provide more notice to third parties and emphasizing the separation of the series from the master.⁵⁴ These added requirements supply a built-in protection against creditor challenges to inequitable notice.

As to notice, the master LLC must file a separate certification for each series, which will bolster the individual series in foreign jurisdiction which disfavor Delaware's method.⁵⁵ Delaware finds that sufficient notice is given by merely filing a SLLC with the Delaware Secretary of State's Office.⁵⁶ Furthermore, Illinois requires that the full name of the series and the full name of the SLLC be designated

48. DEL. CODE ANN. tit. 6 § 18-215(c) (2008).

49. TENN. CODE ANN. §§ 48-248-309 (e)-(f) (2006).

50. NEV. REV. STAT. ANN. §§ 86.291, 86.296 (2007).

51. UTAH CODE ANN. § 48-2c-606(6)(b) (2007).

52. Mertens, *supra* note 3 at 296-97.

53. Gingerich, *supra* note 36.

54. *Id.*

55. *Id.*

56. DEL. CODE ANN. tit. 6, § 18-215(b) (2012).

for notice to third parties as well as demarking the business purpose in the operating agreement of each of the series.⁵⁷ The fact that Illinois requires the certification may make it smoother to do business outside of Illinois. The Illinois Secretary of State has a record of each series of all SLLCs in the state, while Delaware only has a record of the master LLC series.⁵⁸ A non-series state may refuse a Delaware certification from the Delaware Secretary State which only attests to the master series and not give the individual certifications to each series, as Illinois does.⁵⁹

As to the statutorily defined rights of the SLLC, Illinois has sought to establish the independence of a series from its master. The language's purpose is such that a series' limited liability will be a separate entity according to the scope of the articles of organization.⁶⁰ Each series will have limited liability and may contract in its own name, hold title in its name, sue and be sued in its name, and conduct business in its own name.⁶¹ The entity may elect to consolidate operations into a single taxpayer or file jointly.⁶² Delaware took the step of defining the rights of a SLLC in its 2007 amendment to its LLC Act after *GxG Management*, but Illinois foresaw this trouble.

In the first three years of the adoption of the SLLC in Illinois, 2,342 SLLCs were created: 109 foreign and 2,166 domestic.⁶³ To form a SLLC in Illinois, an entity must file its articles of organization with the Secretary of State, pay \$750, provide language to the purpose of each series, denote ownership rights, distribution rights, capital interests, and profits interests, and each individual series formed must pay a \$50 fee for the series certification with Illinois.⁶⁴ All series will be dissolved upon dissolution of the master series LLC.⁶⁵ At first blush, Illinois seems to require more and cost more. The initial filing fee of \$750 is relatively steep and then there are fees associated with the series, in addition to the administrative assignments with the operating agreement. It seems cumbersome to the other states; however, the costs associated with formality benefits foreign jurisdictions as will be explained.

57. Gingerich, *supra* note 36.

58. *Id.*

59. *Id.*

60. *Id.*

61. 805 ILL. COMP. STAT. 180/37-40(b)(2014).

62. Gingerich, *supra* note 36.

63. Mertens, *supra* note 3 at 293.

64. ILLINOIS SECRETARY OF STATE, 500-334.4, A GUIDE FOR ORGANIZING DOMESTIC LIMITED LIABILITY COMPANIES, 7 (2014) http://www.cyberdriveillinois.com/publications/pdf_publications/c334.pdf (accessed Sept. 9, 2015).

65. Mertens, *supra* note 3 at 295.

III. THE BENEFITS

Through the evolution of the SLLC, one can appreciate that the original focus it orbited around was investments and the need to isolate assets while maintaining a thread of connection back to a master hub. This structure allows business planners possibilities for structure beyond investments. Anything with multiple assets or diverse business structures can seize on the limited liability and it is this potential which will not sunset the SLLC. The multiple uses, flexibility, and administrative efficiency will be elaborated on.

A. Costs & Administration

Costs may be seen as negligible on first impression due to the fact that many states have a low filing fee for entity creation. However, the willingness-to-pay for a single LLC filing may be elastic at first, it may quickly become very inelastic the more LLCs that are registered. An example in the traditional context of investments or mutual funds created in multiple LLCs would be an equation of the filing fee multiplied by the number of LLCs. For twenty investment LLCs in Delaware, the cost of each would be \$90.⁶⁶ Multiplied by twenty LLCs, it equals \$1,800 in filing fees alone. This would be ignoring incidental filing costs, annual report filings, and annual franchise taxes, which would kick up costs to over \$20,000 a year or higher.⁶⁷ In Illinois, this cost to file would be \$500⁶⁸ multiplied by twenty, which equals \$10,000 just to file.⁶⁹ A SLLC offers one price to file, one registered agent fee to maintain, one franchise tax to pay, one federal tax return to file, and one operating agreement to write. Even if Illinois does require paying for each series certification, a \$50 series fee is much more reasonable than a \$500 LLC fee. The SLLC is very alluring and it can literally save thousands of dollars over a period of years.

The paperwork would be drastically reduced because only one filing is required to encompass all series.⁷⁰ The contrast would be a virtual nightmare to handle filings, tax returns, and any amendment for multiple entities. The SLLC is

66. *State of Delaware Division of Corporations*, <http://www.corp.delaware.gov/llcform09.pdf> (last visited Sept. 9, 2015).

67. See generally James D. Blake, *From the Offshore World of International Finance to Your Backyard: Structuring Series LLCs for Diverse Business Purposes*, 9 DEPAUL BUS. & COM. L.J. 1, at 6-7 (2010) (describing the inspiration behind the SLLC); Mertens, *supra* note 3, at 285.

68. ILLINOIS SECRETARY OF STATE, 500-C334.4, A GUIDE FOR ORGANIZING DOMESTIC LIMITED LIABILITY COMPANIES, 7 (2014) available at http://www.cyberdriveillinois.com/publications/pdf_publications/c334.pdf.

69. Mertens, *supra* note 3 at 285.

70. Gingerich, *supra* note 36 at 197.

extremely useful for any multiple asset small business that has limitations of employees and budget.

B. Great Expectations in Planning

The SLLC is truly beneficial for a specific type of business structure and need. The aforementioned costs, administrative duties, and the forthcoming risks are a higher burden than the “run of the mill” LLC. A business which does not have the characteristics appropriate for an SLLC should stick with the time-tested LLC entity. The characteristics which bring the SLLC analysis into view revolve around multiple assets, multiple LLC members divided into areas of expertise, or multiple divisions of businesses that mean to harness individual attributes of ownership.⁷¹ Truly, the bottom line is whether there is a need for the shield, and unless a business has a clear need for liability protection between cells, the SLLC will likely not be worth the risks and hassle. So what are types of businesses that fit the SLLC?

There are numerous examples for the multiple asset need. A taxi cab owning multiple taxi cabs may place a vehicle in an individual series to isolate liability, depreciation, or ownership from other series.⁷² A similar thought is available for real estate allowing investors to isolate properties within one company, which has been previously done by forming multiple LLCs for each parcel.⁷³ Further, from the original offshore purposes, investment banks or venture capital funds would create multiple LLCs for mutual funds, hedge funds, capital funds, or location specific funds better through the internal shields of the SLLC.⁷⁴

An interesting aspect focused on the member benefits comes from estate planning. If the SLLC is being taxed as a partnership, a series can be used to avoid the gift tax for amounts up to \$24,000.⁷⁵ A partnership can then devise and transfer among related parties to avoid taxes.⁷⁶ This option has many qualifications, anti-tax abuse considerations, and substance-over-form issues, but it is an option in which it applies.

Another member-focused use is in tweaking aspects of the duties, rights, distributions, and tax benefits amongst members of a series. This may be a logical

71. Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. BAR J. 226, 227 (2009).

72. Mertens, *supra* note 4 at 190.

73. *Id.*

74. *Id.*

75. Gingerich, *supra* note 37 at 200 (quoting I.R.C. § 2503(b)(2009)).

76. *Id.*

conclusion in which many members of an LLC have different roles, and compensation can be divided according to a series-percentage in the operating agreement.

The area of most potential is in the business division aspect for a SLLC. Filing costs make this an option which it was too costly to engage before. An example may be in an auto repair company with many members and divisions in auto collision repair, auto towing services, custom restorations, and auto technical repair. The type insurance for each of these components vary from shop facility insurance, auto repair liability insurance, or commercial tow truck insurance. Further, states, such as Utah have business purpose limitations on auto shop licenses.⁷⁷ This means there is a limitation of one auto-related business restriction in a single auto-shop on that single license. A SLLC's isolation attributes can be ideal to isolate each business division's assets, license-rights, member fiduciary duties per division, distributions, and cordon off liability.⁷⁸

A further example of business divisions is professional malpractice in different jurisdictions.⁷⁹ Ethics rules may limit the use of LLCs as in the case of California,⁸⁰ but as long as it is permissible this option supplies a means of isolating divisions by jurisdiction and isolating malpractice liability.

The benefits can be considerable, but there is a balance to the analysis in the evaluation of the detriments of the SLLC.

IV. THE DETRIMENTS

The uncertainty which hovers over the SLLC is notable. Again, the *GxG Management* case is the only case to discuss the points of law of the SLLC, and they were not great proponents of the entity. But arguably this is the same path the LLC took. In 1977, Wyoming was the first state to adopt the LLC, and few businesses used the entity because of the uncertainty surrounding the tax classification, foreign jurisdiction liability protection, and bankruptcy court actions.⁸¹ It was not until 1988 that the Internal Revenue Service (IRS) gave a blessing with a Revenue Ruling,⁸² which provided the LLC with its partnership tax status and further as-

77. *Utah Motor Vehicle Enforcement Division Licensing Requirements*, <http://www.tax.utah.gov/forms/current/tc-301.pdf> (last accessed Sept. 9, 2015).

78. *E.g.*, Bernie R. Kray, *Respecting the Concept and Limited Liability of a Series LLC in Texas*, 42 ST. MARY'S L.J. 501, 523-24 (2011).

79. Gingerich, *supra* note 36.

80. CAL. CORP. CODE § 13410 (2015).

81. Shannon L. Dawson, *Series LLC and Bankruptcy: When the Series Finds Itself in Trouble, Will it Need its Parent to Bail it Out?*, 35 DEL. J. CORP. L. 515, 517 (2010).

82. Rev. Rul. 88-76, 1988-2 C.B. 360, 17; 26 C.F.R. pt. 301 (2015).

suaged states' anxiety enough for broad enactment of LLC legislations. The bankruptcy issues were resolved in the 1990s, and now the LLC entity is sound.⁸³ This is very similar to what is being witnessed with the SLLC.

There are federal uncertainties, and then there are state uncertainties. This article's focus is on the treatment of an SLLC in a foreign jurisdiction and preparing defenses. The federal agencies have their own precedents that move independent of the state law components. Again, the focus to prevent the LLC "pierce the veil" precedents with the operating agreement and these precedents will be explored.

A. Federal Recognition

To briefly touch on the federal issues, there are issues with taxation, securities, and bankruptcy. There is uncertainty with tax treatment of each series individually and whether a joint return can be filed. There is uncertainty with securities if each series is not registered properly with the Securities and Exchange Commission (SEC) when the series' members join for investing purposes. There is uncertainty with bankruptcy treatment with a federal bankruptcy court ignoring all state law adherences with creditor notification and deeming that the series is nothing more than an LLC and using the action of substantive-consolidation to combine all the series' assets for placement into the debtors' estate.

As for taxation, there are uncertainties as to who is actually the taxpayer: the master, the series, or a combination.⁸⁴ The IRS has not established how to treat the SLLC, but there is speculation that each series of the SLLC will be treated as a separate entity.⁸⁵ A private letter ruling issued in 2008 holds that each entity will be separate for federal tax purposes, and likely follow LLC classifications of disregarded entities for the single member, partnership election, or the corporation treatment.⁸⁶ The legal community feels this is the likely result, and that treatment will mirror that of a statutory trust citing the precedent of *National Securities Industries Stock Series v. Commissioner Internal Revenue*⁸⁷ and the Revenue Ruling⁸⁸ confirming it.

83. Dawson, *supra* note 81 at 517-18.

84. McLoon & Callaghan, *supra* note 71 at 230.

85. I.R.S. PRIV. LTR. RUL. 200803004 (Jan. 18, 2008).

86. Steven E. Grob & Norman J. Hannawa, *Federal Tax Status of a Series Limited Liability Company*, DYKEMA, http://www.dykema.com/media/site_files/47_FederalTaxStatus.pdf (last visited Sept. 15, 2015).

87. Nat'l Sec. Series-Indus. Stock Series v. C.I.R., 13 T.C. 884, 885 (1949).

88. REV. RUL. 55-416, 1955-1 C.B. 416.

The securities concern is whether a series transfer constitutes a security separate from the ownership of the master and whether this is governed by state Blue Sky or federal securities laws.⁸⁹ A series transfer is when a dissolution of a series investment fund and distribution meets the criteria of an investment contract under § 5 of the 1933 Securities Act.⁹⁰ Rule 12d1-1(d) of the Securities and Exchange Act of 1934 says that, “If a class of security is issuable in two or more series with different terms, each such series shall be deemed a separate class for the purposes of this section.”⁹¹ So this means that the series will not be covered in the master LLC registration if the rule would apply to the SLLC. However, compliance with Regulation D, which gives state exemption, may be a means around this issue if it truly becomes an issue.⁹²

As to the bankruptcy code, an LLC is a “person” and it may be a debtor under it.⁹³ The SLLC series will likely be given similar treatment, but this may depend on whether the series is treated as a separate entity under state law.⁹⁴ The real issue a bankruptcy court must rule on is whether a series is considered a “person” under the bankruptcy code, because there is a risk that the bankruptcy court will be dragging in the entire SLLC for an insolvent series.⁹⁵ But even if the bankruptcy court finds that a series is a “person” the court may use substantive consolidation in an action similar to veil-piercing.⁹⁶ Substantive consolidation is when courts combine assets and liabilities of affiliated debtors into one bankruptcy estate and eliminate inter company claims.⁹⁷ This option is available where creditors are in an inequitable situation, specifically where the creditor is deemed to have inadequate notice of an entity’s liability situation.⁹⁸ Again, a series in the Delaware-like statute state carries no duty to disclose the series as notice is deemed to be given to creditors in the secretary state office. Illinois and Iowa carry the notice requirement of the

89. McLoon & Callaghan, *supra* note 71 at 230.

90. *See* Sec. & Exch. Comm’n v. W. J. Howey Co., 328 U.S. 293, 298-99 (1946) (concluding an instrument qualifies as an “investment contract” for the purposes of the Securities Act where: 1) investment of money due to 2) an expectation of profits arising from 3) a common enterprise, 4) which depends solely on the efforts of a promoter or third party).

91. 17 C.F.R. § 240.12d1-1 (2015).

92. *See generally* 17 C.F.R. § 230.501 (2015) (providing definitions of terms used in Regulation D).

93. 11 U.S.C. § 101(41) (2006).

94. Gattuso, *supra* note 5 at 37.

95. *See* Amanda J. Bahena, *Series LLCs: The Asset Protection Dream Machine*, 35 J. CORP. L. 799, 820-21 (2010).

96. *Id.* at 811.

97. *Id.*

98. *See id.*

series to the public and this may be the best defense to substantive consolidation.⁹⁹

B. Foreign Jurisdiction Recognition

The full faith and credit provision of the U.S. Constitution puts a requirement that states are to recognize foreign jurisdiction SLLCs.¹⁰⁰ But as was demonstrated by the *GxG Management* case, a state may refuse to respect aspects which are against its own public policy.¹⁰¹ The court found that under the Delaware LLC Act, the series was a “series of interest” of the master SLLC and not a separate legal entity capable of independently pursuing its own legal claims, hence a standing issue.¹⁰² Again, this spawned the 2007 Delaware revision to its LLC Act to include language of rights to sue and be sued, but the issue may be duplicated if other states do not revise.

An interesting reticence has come from the Revised Uniform Limited Liability Companies Act (ReULLCA), which was approved for adoption by states in 2006, but does not expressly contain any SLLC provisions.¹⁰³ The drafting committee gave concerns that Delaware is a highly sophisticated jurisdiction relating to business entity law, and what is good for Delaware is not necessarily “good-medicine” for the LLC laws of other states.¹⁰⁴

Even with the ReULLCA rejection of the SLLC, there is still a choice of law option for the series jurisdictions. The public policy argument most likely to be used to attack the SLLC is creditors do not have proper notice.¹⁰⁵ This is the repeated refrain by critics and the ultimate place to look is how Illinois’ SLLC provisions are to be handled.

The ultimate examination of all treatment by states is whether the actual adherence to SLLC formalities, notice requirements, and statutory demands is seen as unreasonable by a foreign jurisdiction that veil-piercing is suited to attack. It is

99. See IOWA CODE § 490A.305(2)(d) (2014); 805 ILL. COMP. STAT. 180/37-40(b) (2014).

100. Bahena, *supra* note 95 (quoting Dem A. Hopkins, *Annual ALI-ABA Satellite Conference Looks at New Developments in Limited Liabilities*, (CCH Res. NetWork Newsl. No. 128, Apr. 2006)).

101. Bahena, *supra* note 95 at 804.

102. *GxG Mgmt. L.L.C. v. Young Bros. & Co.*, No. 05-162-B-K, 2007 WL 551761 at *1 (D. Me. Feb. 21, 2007).

103. REVISED UNIF. LT. LIAB. CO. ACT (Nat’l Conference of Comm’r on Unif. State Laws 2006).

104. Daniel S. Kleinberger & Carter G. Bishop, *The Next Generation: The Revised Uniform Limited Liability Company Act*, 62 BUS. L.J. 515, 541-42 (2007).

105. Gingerich, *supra* note 36 at 205.

very important to examine how the LLC has been treated with veil-piercing actions.

C. *The LLC Pierce & the SLLC*

The issue with SLLC and veil-piercing actions is with the formalities of independence between series, the amount of series capitalization, and the methods of accounting of the assets.¹⁰⁶ In SLLC jurisdictions, it is reasonably predictable that a series will be upheld to be separate but what will a foreign jurisdiction rule, especially one that views a SLLC as against its public policy? Since there is no precedent directly for the SLLC, the LLC pierce actions will be examined.

A state statutory provision ensuring limited liability of an entity may not be observed if a court finds it equitable to pierce the corporate veil.¹⁰⁷ There are over fifty flavors of LLC Acts from across the United States, and there is great variation in the standards of veil-piercing for the LLC. Some jurisdictions provide for an LLC pierce action expressly in a statute, like Colorado,¹⁰⁸ Minnesota,¹⁰⁹ North Dakota,¹¹⁰ and Washington.¹¹¹ Other states have an implied action like California,¹¹² Maine,¹¹³ and Wisconsin.¹¹⁴ Hawaii¹¹⁵ and New Mexico¹¹⁶ have statutes which apply corporate piercing statutes to LLCs. Focus on the lack of separateness of the entity, lack of adherence to formalities, and undercapitalization is common to any entity piercing statute.¹¹⁷ The empirical data, compiled by Professor Robert Thompson, indicates that comingling of accounts is the largest factor in veil piercing cases.¹¹⁸

The *Gallinger v. North Star Hospital Mutual Assurance, Limited*,¹¹⁹ case

106. McLoon & Callaghan, *supra* note 71 at 228.

107. Kray, *supra* note 78 at 541.

108. COLO. REV. STAT. § 7-80-107(1) (2014).

109. MINN. STAT. § 322B.303(2) (2015).

110. N.D. CENT. CODE § 10-32-29(3) (2013).

111. WASH. REV. CODE § 25.15.060 (2015).

112. CAL. CORP. CODE § 17101(b) (2014).

113. ME. REV. STAT. ANN. tit. 31 § 645(3) (2014).

114. WIS. STAT. ANN. § 183.0303(2) (West 2013).

115. HAW. REV. STAT. § 428-104(a) (2014).

116. N.M. STAT. ANN. § 53-19-65(b) (West 2014).

117. ZOLMAN CAVITCH, BUSINESS ORGANIZATIONS WITH TAX PLANNING § 33.06 [2] (Matthew Bender & Co. ed. 2015).

118. See John H. Matheson, *Why Courts Pierce: An Empirical Study of Piercing the Corporate Veil*, 7 BERKELEY BUS. L.J. 1, 52 (June 2010).

119. See *Gallinger v. N. Star Hosp. Mut. Assurance, Ltd.*, 64 F.3d 422, 427-28 (8th Cir. 1995).

gives the leading precedent for the LLC pierce action.¹²⁰ Here a group of hospitals formed a LLC in Bermuda to provide malpractice and workers compensation insurance to its members. A component of the insurer became insolvent, and an action in Minnesota was commenced by creditors against not only the LLC but against its sixty-seven members. The Eighth Circuit eventually upheld the limited liability shield by examining the factors of failing to follow corporate formalities, domination by an owner, and undercapitalization that may lead to inequity.¹²¹

The corporate veil-piercing application places greater emphasis on the adherence to corporate formalities like having boards of directors, holding annual meetings, designating officers, providing minimum notice for shareholder meetings, and establishing appraisal rights for shareholders who dissent from certain transactions.¹²² LLCs have self-imposed formalities, therefore a veil-piercing action may not treat this factor with as much weight as it is an inherent advantage of a LLC to have flexibility in controls. Capital accounts can be adjusted in an LLC, distributions and allocations of income can be tweaked, and member rights and duties can be curtailed. But adherence to the self-imposed formalities is still a factor. Aside from this formalities weight, the doctrine of veil-piercing will apply the same test for LLCs and corporations alike.¹²³

The origins of the veil-piercing theory comes from the idea that the corporation charter has the privilege of state protection as long as the legal entity is not used to defeat public convenience, justify wrong, protect fraud, or defend crime.¹²⁴ This “abuse of corporate privilege” is at the center of the contemporary three part test. First, the court must evaluate whether the controlling shareholder or member and the entity are “alter-egos” of each other or that the company and the control person has no division.¹²⁵ Second, the court must examine whether equity requires disregarding the entity because it has been used for perpetuate fraud or injustice.¹²⁶ Third, an evaluation of justice being performed by disregarding the entity is made.¹²⁷ This “privilege” theory is the dominant theory for veil-piercing.

The main concern for the SLLC and the privilege theory of veil-piercing is

120. Stephen B. Presser, *Piercing the Corporate Veil*, § 4.2 (West 2011).

121. *Id.*

122. Mark J. Loewenstein, *Veil Piercing to Non-Owners: A Practical and Theoretical Inquiry*, 41 SETON HALL L. REV. 839, 842 (2011).

123. *Id.* at 843.

124. *United States v. Milwaukee Refrigerator Transit Co.*, 142 F. 247, 255 (E.D. Wis. 1905).

125. Loewenstein, *supra* note 122 at 846.

126. *Id.*

127. *Id.*

under that of thin capitalization. Arguably, the SLLC may be a “perfect storm” for abuse if formalities adherence is not controlled by maintaining the records and following the operating agreement. A SLLC may back into a veil-pierce by not following the operating agreement or through inadequate capitalization of a series coupled with not isolating the series assets by comingling or engaging in fraudulent conveyances between series. For this reason the SLLC is a risky business entity, and should not be used by those that do not fully understand its mechanisms.

Careful business planning and construction of SLLC operating agreements will be the best offense for the defense against the risks.

V. AGRIBUSINESS APPLICATION WITH THE SLLC

The applications to agribusiness are arguably akin to those offered to the corporate parent-subsiary model, however the advantage for the SLLC is that it is an LLC with the IRC Subchapter K advantages of pass-through taxation, with an additional ease of management. A family farm could be easily divided among family members in a SLLC. In addition, business lines could isolate its seasonal products, real estate could be isolated, and heavy equipment could be isolated and maintained. The SLLC’s potential is strong in the agricultural context.

Again, the SLLC does have issues of sister sovereignty recognition, however, the SLLC’s defense to any attack is in its articles of organization and its operating agreement. The operating agreement is the most integral piece. Because it contains all the provisions that a veil-pierce action will attack. The key to survival of the SLLC in these uncertain times is a “belt and suspenders” approach to all elements of the SLLC.¹²⁸

A quick explanation of the articles of organization and the operating agreement will best illumine the recommendations.

A. *The Articles of Organization*

If an LLC’s operating agreement is the circulatory system of the LLC, then the articles of organization is the musculoskeletal system supplying the structure. State LLC statutes require the articles to contain certain basic facts for a notice function of identifying and describing the nature of the firm on which assets third parties must rely for satisfaction of liabilities.¹²⁹ Required facts include: (1) the

128. See Jennifer B. Poppe & Alithea Z. Sullivan, *Could the Supreme Court’s Enforcement of Arbitration in Concepcion Reverberate in the Securities Litigation Sphere?*, 8 NO. 8 SEC. LITIG. REP. 1 (2011) (“Corporations may want to take a belt-and-suspenders approach to avoid this problem and add their arbitration provisions to *both* the bylaws and the charter”).

129. LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED

unique, distinguishable name of the firm; (2) the address of the principal place of business or registered office; and (3) the name and address of the agent for service of process.¹³⁰ These items are generally required, but some jurisdictions require more or a LLC may disclose more if so desired such as: nature of management being either member or manager managed, names of initial managers, names and addresses of members, duration of entity, and members' rights after disassociation, limitations of agency powers, LLC company purpose, or amount of member contributions.¹³¹

The filing of the articles of organization with the state's secretary of state office is the start of the LLC.¹³² The purpose is to give creditors notice of the nature of the LLC, of its members, and of its structure.

B. The Operating Agreement

Again, the operating agreement is the heart of the LLC. It is the internal contract between members defining member roles, member fiduciary duties, and delineates the state default LLC act statutes to further tailor the LLC to the members' needs. The operating agreement generally controls except to the extent that it is inconsistent with mandatory statutory provisions.¹³³ Most states allow some fiduciary duties to be waived or redefined in the operating agreement except the duties of good faith and fair dealing.¹³⁴ The operating agreement generally specifies six areas of function for the LLC: (1) formation, (2) management, (3) membership, (4) economics, (5) dissolution and termination, and (6) inspection and record keeping requirements.¹³⁵ Items relating to tax and capital accounts, formalities with voting, indemnification, rights, notice, choice of law, etc. are discussed in detail in it.¹³⁶

The beginning point is structuring the operating agreement and the articles of organization. The operating agreement differs from the articles of organization in detail. The best way to think of the articles is as an executive summary of the broader operating agreement. Since the articles are public, the LLC may prefer to use a "bare-bones" summation approach to keep the flexibility to tweak business

LIABILITY COMPANIES § 4:6 (West 2014).

130. *Id.*

131. *Id.*

132. CAVITCH, *supra* note 117.

133. RIBSTEIN & KEATINGE, *supra* note 129.

134. CAVITCH, *supra* note 117.

135. *Id.*

136. See SCOTT ZESCH, BUSINESS ORGANIZATIONS WITH TAX PLANNING § 14.06 (2d ed. Matthew Bender & Co.) (Lexis 2015).

operations without filing amendments. But the point is that the articles of organization relate the core and the operating agreement relate full details and formalities of the LLC.

C. Drafting the SLLC with Clarity

The attack to SLLC can come from many fronts, including bankruptcy, federal or state tax, foreign jurisdiction veil-piercing actions, or even domestic jurisdiction veil-piercing. However, whether a federal bankruptcy, tax, state common law, or statutory veil-piercing action, the common defense is in the operating agreement and articles of organization.

Again, the veil pierce tests look to entities' degree of separateness, capitalization, and adherence to formalities.¹³⁷ An SLLC which is ignorant of formalities or blithely, assumes the states default LLC statutes. An SLLC that assumes the states default LLC statutes may run the company as they wish. However, an SLLC taking this approach is in serious risk of liability. Further, an SLLC that does not follow notice formalities in providing the series and LLC name in all business transactions with creditors, escalates the risk of a pierce. The proper drafting hinges on formalities and series, the proper notice hinges on the equitable creditor notice.

Following the Illinois Act is the best recommendation.¹³⁸ At minimum, following the Illinois statutory example will give creditor notice and support good record keeping. Illinois requires each series to be certified with the state and requires public notice of the series.¹³⁹ This will certainly give creditors notice. Even in the bankruptcy example, a bankruptcy court will need to rule on the "person" status of a series however. Again, public notice can be given in an Illinois-like disclosure of a series opposed to the Delaware model. An SLLC may reduce the risks associated with substantive consolidation by maintaining separate books and records, properly documenting asset transfers, keep actions independent within a series, never comingling assets between series, not preparing consolidated financial statements, not obtaining joint financing, or entering loan guarantees with other series.¹⁴⁰ Implementing all of these measures is likely unreasonable due to cost and administrative constraints but implementation would lower risks for sub-

137. CAVITCH, *supra* note 111.

138. See Michael E. Fink, *The Series LLC: Suggestions for Surviving Some Serious Uncertainties*, 72 U. PITT. L. REV. 597, 598, 608 (2011) (the Illinois Statute regards series as separate business entities).

139. 805 ILL. COMP. STAT. ANN. 180/37-40(b) (2014).

140. Gattuso, *supra* note 5 at 37.

stantive consolidation and veil-piercing. Again, adherence to self-imposed formalities and creditor notice give the best protection to an SLLC in a foreign jurisdiction.

As to tax, based on the Private Letter Ruling 200803004,¹⁴¹ *National Securities*¹⁴² and Rev. Ruling 55-416,¹⁴³ if an operating agreement defines each series as a separate entity and maintains separate books, each series should be treated as a separate entity under federal tax law, just like statutory trusts.¹⁴⁴

The following provisions should be included in the operating agreement. These provisions were imagined for tax purposes, but their application is much broader:

1. Separation: separation of each “series will consist of a separate pool of assets, liabilities, and streams of earnings.”¹⁴⁵

2. “Ownership: [t]he members of each series may share in the income only of that series” that member has an interest in and “will be limited to the assets of that series upon redemption, liquidation, or termination of” that series.¹⁴⁶

3. “Liabilities: [t]he payment of the expenses, charges, and liabilities of a series is limited to that series’ assets and the creditors of each series are limited to the assets of that series for recovery of expenses, charges, and liabilities.”¹⁴⁷

4. Separate Business: one or more business purposes may be designated for series in the SLLC with members having separate interests in a series, powers or duties with respect to specified property or obligation of the SLLC “or profits and losses associated with specified property or obligations, and any such series may have a *separate business purpose* or investment objective.”¹⁴⁸

5. Voting: votes of members may be conducted by each series separately with respect to the matters affecting that particular series weighted according to interest proportion.¹⁴⁹

Every method of defense for the SLLC is in separateness. The uncertainty

141. Grob & Hannawa, *supra* note 86 at 29.

142. *See id.*

143. *See* Grob & Hannawa, *supra* note 86 at 29; *see also* National Sec. Series-Indus. Stock Series v. Comm., 13 T.C. 884 (1949).

144. *See* Grob & Hannawa, *supra* note 86 at 29.

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

surrounding the SLLC regards series piercing, thus treating each series with diligent respect will deflect attack. This may be easier to accomplish administratively in the traditional method of tucking large assets into a single series opposed to the newer business division purpose where there are many facets of business to keep straight. But to seize the benefits, one must pay the costs or assess not to partake.

VI. CONCLUSION

The SLLC has enormous potential in agribusiness. There will very likely be a federal “blessing” of the SLLC in bankruptcy courts and federal tax. When this does happen expect the mirror of broad enactment similar to the LLC in the 1990s. But until better days, an attentive and deliberate approach must be given to all that form SLLCs. The key to this protection is drafting a clear operating agreement, filing clear articles of organization to give notice of series’ purposes, and publicly name the series in all business transactions. Illinois has been the most proactive and innovative with the SLLC and either following or filing in Illinois is the best practice in waiting for more solid times.