THE SERIES LLC: A NEW PLANNING TOOL

Presented by:

ADRIENNE RANDLE BOND, *Houston*
The Bond Law Firm, PLLC

STEVEN D. MOORE, *Austin*
Jackson Walker L.L.P.

Written by:

ADRIENNE RANDLE BOND
The Bond Law Firm, PLLC
5505 Jackson
Houston, Texas 77004
abond@abondlaw.com
713-524-4200 voice
www.abondlaw.com

ALLEN SPARKMAN
Of Counsel
The Bond Law Firm, PLLC
5505 Jackson
Houston, Texas 77004
sparkman@abondlaw.com
713-524-4200 voice

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CHAPTER 9

Adrienne Randle Bond

**Adrienne Randle Bond** specializes in energy and energy finance law, including E&P acquisitions, and related equity and debt financing, and representation of oilfield service companies. Skills include the formation of limited liability companies, corporations and partnerships, SEC compliance issues, private placements, corporate compliance, and acquisitions or sales of assets, routine contract issues for E&P and oilfield service companies, including farmout or participation agreements, joint operating agreements, master service agreements, and gas purchase agreements. She is licensed in Texas and Colorado.

EDUCATION

Ms. Bond is a *magna cum laude* graduate of Rice University (B.A. 1980) and graduated Columbia University Law School (JD, 1980) as a Harlan Fiske Stone Scholar.

ADMITTED

- Texas
- Colorado

PROFESSIONAL MEMBERSHPS

- Texas Bar Association
  - *Business Law Section and Oil, Gas, and Energy Resources Section*
- Houston Bar Association
  - *Mergers and Acquisitions Section*
- Colorado Bar Association
- American Bar Association
  - *Business Law Section and Environment, Energy and Resources Section*
  - *Distressed M&A Committee*
  - *International Use of U.S. Business Entities Committee*
  - *LLC, Partnership and Unincorporated Entities Committee*
  - *Mergers and Acquisitions Committee*
  - *Private Entity and Venture Capital Committee*

PROFESSIONAL ACTIVITIES

She is a frequent author and lecturer on corporate and securities law issues, and has served as Adjunct Professor of Corporate Law and Securities Law at the University of Houston Law Center. Ms. Bond is a past President of the Women's Finance Exchange and has been a member of the State Bar of Texas' Corporation Law, Continuing Education and Venture Capital Committees. She services on the Board of Directors of the Neuhaus Education Center.

REPRESENTATIVE TRANSACTIONS

- Representation of E&P companies in the purchase and sale of oil and gas properties, from purchases in the $1-$15 million range, to significant acquisitions and divestures in the $300 million to $500 million range.

- Representation of owners of oil field service companies in the preparation and sale of their businesses.
- Preparation and execution of company and tax structures to efficiently operate the business or prepare it for marketing and sale
- Negotiation on behalf of family owned businesses of private equity and debt funding for the purchase of significant domestic assets from a major oil and gas companies.
- Preparation and sale of a privately held oil and gas business to a publicly traded company.
- Negotiation of private equity and related debt financing for oil and gas assets in financial distress.
- Representation of clients in leasing, exploration, participation, farmout and seismic acquisition agreements.
- Preparation of confidentiality agreements, employee confidentiality agreements, employment agreements and related compensation through equity ownership in exchange for services (sweat equity).
- Preparation of master service agreement and related agreements for providing or purchasing oilfield services.
- Planning and executing business and tax structures for newly formed or growing businesses.
- Preparation of employment agreements, and related compensation arrangements through equity such as carried interests, stock options and restricted stock or equity plans.

PERSONAL:

She speaks Spanish, French, and Portuguese. In her leisure time, she enjoys wildlife photography and her dog.

Steven D. Moore - *Partner*

Tax

Education
- B.B.A., *with high honors*,
- J.D., *with honors*, The University of Texas School of Law
  - Order of the Coif - Top 10%

Court Admissions
- 1989, Texas

Steven D. Moore is a state tax lawyer whose practice includes planning and controversy work emphasizing sales tax, Texas franchise (aka "margin") tax, and insurance premium tax. Mr. Moore is dedicated, from a value driven perspective, to helping his clients fully comply with and control their tax exposure.

Mr. Moore has extensive experience in state tax planning for multi-state business models, and regularly provides tax strategy advice relating to business acquisitions and divestitures.

An effective negotiator, Mr. Moore works to reach successful and economically viable resolutions to Texas sales, franchise, and insurance premium tax audits. To this end, Mr. Moore handles administrative hearings before the Texas Comptroller of Public Accounts and works with the firm's litigation group to prosecute judicial resolution of Texas tax cases.

Recognized for his depth of expertise in state tax matters, Mr. Moore is one of the state's leading attorneys for guidance on the new Texas margin tax and he frequently speaks on this topic, with ongoing commitments for presentations to Texas State Bar and University of Texas CLE programs.

Representative Matters

- Renewable energy project acquisition and development advice to maximize benefits from state and local tax incentives including Chapter 312 and Chapter 313 abatement work

- Frontier legal project design for new solar electricity business models to reconcile complex regulatory and corporate restrictions with state tax incentives

- Aircraft acquisitions, sales, and ongoing operations modeled to achieve best-available state tax treatment

- In-depth experience helping life insurance companies and P&C insurance companies successfully resolve Texas premium tax and retaliatory tax audits

- SALT work in large business acquisitions to navigate (i) Texas franchise tax results, (ii) preservation of state and local incentives, (iii) nexus concerns, (iv) transfer taxes, (v) occasional sale exemptions, and (vi) successor liability

- Planning and compliance with respect to Texas sales tax on services, including bundled "data processing" transactions

- Non-lobby monitoring and advising on pending and proposed Texas tax legislation and policy

Memberships

Mr. Moore is a past Chair of the State Bar of Texas State and Local Tax Committee. He is a member of the American Bar Association Committee on State and Local Tax. Mr. Moore serves on the board of directors for the Austin Technology Council Community Foundation.

Community Involvement

Mr. Moore has a passion for classical music and dedicates a large part of his time to the arts in Austin. He serves as Chairman of the Board of Trustees of KMFA Radio and is actively involved in fundraisers and other community events to help sustain this non-profit service. Mr. Moore is also a past President and Board member of Austin Community Nursery Schools and has served as an Elder and a Finance Chair with the Central Presbyterian Church.

Publications & Speaking Engagements

Mr. Moore has made numerous speaking presentations to major CLE programs across Texas dealing with various state tax and corporate topics, including "The New Texas Margin Tax."

- Nexus and State Tax Due Diligence
- Texas Margin Tax: Emerging Issues in Texas State Taxation
- Legislative Changes Affecting Business Entities
- TGS-NOPEC Victory in Franchise Tax Case has Broad Implications for Texas Businesses
- Franchise Taxpayers Should Check Account Status Online
- On the Margin: The Impact of the Margin Tax on Landlords and Tenants
- Texas Margin Tax: Planning, Strategies, and More
- Margin Tax: Comptroller Expands Definition of Uncompensated Care
- Planning and Choice of Entity After the New Texas Franchise (Margin) Tax
- The New Margin Tax: Unintended Consequences for Healthcare Providers
- New Texas Law Penalizes Failure to Render Business Personal Property
- Aircraft Taxes: Texas State and Local Tax Enforcement on the Rise
- Texas Taxation of Electronic Commerce

News

- Steve Moore Named to Austin Technology Council Community Foundation's Board of Directors

- Steve Moore Speaks on Nexus and State Tax Due Diligence in M&A Transactions and Multistate Business Models
- Byron Egan and Steve Moore Speak on Legislative Changes Affecting Business Entities
- Jackson Walker Wins Texas Supreme Court Victory for Client in Franchise Tax Case
- Byron Egan, Willie Hornberger and Steve Moore Speak on Choices of Entity and M&A
- Steve Moore Speaks on Understanding Property, Sales & Franchise Tax
- Willie Hornberger and Steve Moore Speak on Margin Tax
- Byron Egan, Willie Hornberger and Steve Moore Speak on Choices of Entity
- Jackson Walker Sponsors State Bar of Texas Annual Meeting
- Byron Egan, Tom Groves, Willie Hornberger, Steve Moore, and Bob Richardson Speak at Choice of Entity Conference

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I. THE SERIES LLC IN TEXAS.

Texas adopted new provisions permitting the creation and operation of series limited liability companies (the "Series LLC") under Texas law in 2009. This paper discusses the state of law on series under the Texas statute, with some consideration of other jurisdictions and laws and practice pointers for resolving the issues presented by the statutory formulation for the Series LLC. After discussing what series are and can do, the paper will analyze points of ambiguity and development where the results of the use of the series structure may not be perfectly clear. This vehicle for formation is still under development, but, in the right circumstances, presents an elegant solution to ownership and management of closely related, but not identical, groups of assets.

II. WHAT IS A SERIES LLC?

The Series LLC was first created in Delaware in 1996, but has only recently gained traction in legislation in other states. Like all new formation vehicles, it is an idea that is in process, and the several statutory formulations are not uniform. In fact, the American Bar Association and the National Conference of Commissioners on Uniform State Laws, the organizations that usually draft and distribute model and uniform laws, have only recently weighed in with draft legislation, in the Uniform Statutory Trust Entity Act. Texas is one of the most recent thoughts on drafting, and tends to follow the Delaware formulations (and reject those state formulations that have strayed from Delaware). The kernel legal concept of the Series LLC is the internal segregation of assets. The TBOC states the following: "A company agreement may establish . . . one or more designated series . . . that (a) has 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, or (b) has a separate business purpose or investment objective."

If you consider the concept of internal asset segregation that means that two other issues have to necessarily complement that idea: first if assets are segregated, the primary reason for such segregation is to allocate the economic rights to those assets differently among the owners. That may mean (i) an economic segregation of income, or allocations among different owners, with the same management, or (ii) an economic segregation of liabilities, with the same owners and management, but the liabilities of the operating assets of each project can be separated from the other projects. Second, if the segregation is internal, and the purpose for the segregation is economic, then there must be some commonality within the entity. The commonality might be with the management of the enterprise, where groups of assets segregated within separate series (which might have different equity owners) have common management. Alternatively, the assets that are segregated in different series might also be separated in other ways that would suggest the desirability of separate management for the different series. For example, the Buffalo Series of a series LLC might own a high rise office building in Houston, the Big Tex Series an apartment complex in Dallas, and the Sooner Series a large block of raw land outside Oklahoma City. Although this series LLC would no doubt have common overall management at the Mothership, each separate series, because of the geographic separation as well as the different types of assets, likely would need at least a general manager type on location.. While the Texas statute affords significant flexibility around the issues of ownership and operation of the assets in the series, this flexibility should not confuse the basic nature and use of the vehicle: segregation of assets with common management structures. Business lawyers have always split up and recombined management structures and economic allocations of the enterprise, and the Series LLC is a permutation of that concept.

Since the Texas statute is based on "commonality" among the Series LLC, that definitional concept has been imbedded in the statutory formulation. Commentators have labeled the totality of the LLC (of which the Series within the LLC is a segregated part) the "Mothership."[1] The entity for state law purposes is the LLC itself and not the Series within the LLC. Stated positively, the Series within the LLC is not a separate entity under the laws of the state of Texas. Although an individual series of a Texas Series LLC 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," a series may not enter into a merger or conversion. The Texas Business Organizations Code ("TBOC") permits a

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[1] Other commentators state that the term that should be used is "juridical entity." The authors find this term, although technically accurate, to be clunky and see no harm in using Mothership. At least in part, the commentators who prefer "juridical entity" do so because, as discussed later in this paper, the preamble to the proposed income tax regulations applicable to series organizations discusses the possibility that the Mothership may be completely ignored for federal tax purposes if all of the assets and business operations are in one or more individual series and none are at the Mothership level. However, even if totally ignored for federal tax purposes, the Mothership will be an entity for state law purposes.

"domestic entity" to enter into a merger or conversion. TBOC, Chapter 10. Further, the TBOC defines a "domestic entity" as an organization formed under or the internal affairs of which are governed by this code." TBOC §1.002(18). In the case of a Series LLC, only the Mothership is formed under the TBOC, and the individual series are formed pursuant to, and their internal affairs are governed by, the LLC Agreement of the Mothership. This basic concept has effects throughout the formation of a Series LLC, the drafting of the LLC Agreement, the operation of the LLC and the Series within the LLC and the exit strategies for the Series within the LLC. Some states, namely Kansas, Illinois and Iowa, have considered this issue and have permitted (but not required) that a Series within a Series LLC to be a separate entity. Most of the statutory formulations, however, are like Texas, in which a Series within a Series LLC is not a separate entity. This is *the* core issue that creates the ambiguity and mystery of forming and using this vehicle, and will be a theme throughout this paper. While many discuss (and complain about) this issue, this paper will suggest treatments when it arises to provide certainty for the use of the Series LLC.

III. HOW DO YOU CREATE A SERIES LLC?

The TBOC states express requirements for the filing requirements for a Series LLC, including requirements for the contents of the certificate of formation, requirements for the terms and conditions of the LLC Agreement and requirements for specific record keeping. Section 101.602(b) of the TBOC sets forth these three express statutory requirements. Upon formation, or by amendment, the Certificate of Formation must contain a notice of the limitations (internal) caused by the segregation of the assets in the Series LLC, as specified in Section 101.602(a). Those Series LLC limitations are as follows:

(1) The debts, liabilities, obligations and expenses incurred, contracted for, or otherwise existing with respect to a particular series shall be enforceable against the assets of that series only and shall not be enforceable against the assets of the limited liability company generally or any other series; and

(2) 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 shall be enforceable against the assets of a particular series.

The notice of limitations is effective whether or not a series has been established at the time is placed in the certificate of formation and whether or not it refers to a specific series. TBOC §101.604.[2]

The Secretary of State of the State of Texas has not promulgated a separate form for filing a Texas Series LLC, although there is a form to qualify a foreign series LLC. We recommend that you expressly state that the LLC is a Series LLC within the meaning of Subchapter M, Sections 101.601 et seq, and then quote the language of Section 101.602(a), set out above, out of caution. Stated directly, follow the statutory directions and diction slavishly.

The remaining provisions of Subchapter M impose indirect or implied requirements for the Certificate of Formation in addition to the express requirements of Section 101.602(a). Looking at the Secretary of State's Form 305, the first question about how Series LLCs function is presented by the issue of the name of the entity. If the LLC is the entity, and the Series within the LLC is not an entity, then in the Certificate of Formation, the name will be the name of the limited liability company, or the LLC (Mothership), and there is not an express location to name a Series within the LLC. This feature impacts the requirements for the segregation of the assets within the Series within the LLC, namely, if a Series within the LLC does not have a name that separately identifies it, how can the LLC, internally or externally identify or label the asset that is segregated in that Series within the LLC? How can a Series within the LLC enter into a contract if it does not have a name? How can it be sued or sue, if it does not have a name? Obviously, a Series within the LLC must have a name that must be set out, at a minimum, in the LLC Agreement. As the paper discusses in more detail below in the section concerning UCC issues, the authors suggest that in the Supplemental Provisions of the Form 305, initially or by amendment, you state that the Series within the LLC has a name and create a public record of that name. This does not solve all of the legal issues, but it certainly goes a long way towards solving the contract and related identification problems that could forestall the legal issues. A separate name on record in the Certificate of Formation will establish a focal point for the separation of the assets. We also suggest that you do not have to use the mundane "Series A" or "Series I." If the point of the name is to help segregate assets, name the Series LLC after the assets to help the identification and notice process.

Next, you need to expressly deal with who the governing persons of the LLC and any Series within the LLC are or will be. Because the LLC (Mothership) is the entity, the usual places in the Form 305 must set out governing persons for the entity, not for any Series

[2] This is also the rule in Delaware for a series LLC.

within the LLC. Again, this is where you need to be thoughtful about the issue of the entity being the LLC and not the Series. Therefore, on the Form 305, you must list the governing persons of the LLC (Mothership). That means an initial determination of whether the LLC is manager managed or member managed. The important point here is that the persons that you name in the Certificate of Formation will be the governing persons of the LLC, and not necessarily the governing persons of any particular Series within the LLC. Please hold this thought until the discussion below concerning the provisions on governing persons in Subchapter M on Series LLCs. If, however, you know at formation that the LLC will have managers or managing members that are unique to a particular Series LLC, the authors believe that best practice requires adding that information to the Supplemental Provisions of the Form 305 Certificate of Formation.

Even though a Series within the LLC is not a separate entity, if you determine to have governing persons associated with a Series within the LLC, make sure that the Certificate of Formation designates the managers or members associated with each specific series. In fact, the authors recommend that you amend your Certificate of Formation upon the creation of each series to publicly file this information. We believe that this could support maintaining the integrity of the Series within the LLC in a debtor/creditor controversy, as the paper will discuss below. Because the Secretary of State's form does not have a space to designate members or managers associated with a series within the LLC, you will have to use the "catch all box" of the Supplemental Provisions in the form to put in that information.

The authors do not believe that the issues of addresses, registered offices or registered agent present any significant difficulties, as long as you recognize that the only entity is the LLC. Therefore, a Series within the LLC cannot have a separate address or separate registered agents or offices from the LLC (Mothership) itself.

Next, in the formation process, the LLC Agreement must contain provisions creating the series structure. Hold this thought, because we will discuss it more fully after we have had the opportunity to look at and think about the remaining provisions of Subchapter M on Series LLCs, and how those must interact with the Chapter on LLCs and the remainder of the TBOC, and its hubs and spokes.

To be entitled to the internal liability shields offered by the series structure, a Series LLC must also create internal records that "account for the assets associated with that series separately from the other assets of the company or any other series." Section 601(b)(1). Contemporaneous records are best, and the authors believe this needs to include an identifying list of the assets, and a related balance sheet, income statement and cash flow statements that flow from the segregated assets, whatever the precise nature of the internal asset allocation may be. As discussed later, the IRS has issued rules that will require each Series within a Series LLC to report separately for federal tax purposes, so there will be a direct pressure to maintain these segregated records. The nature of the segregation of the assets in the series does not change the requirement to keep records, so if you are creative in your series structure and accomplish matters other than asset segregation, you must still keep these internal records. With these issues, we have covered how to file a Certificate of Formation for a Series LLC and summarized the other formation requirements. Once you have a Series LLC, what can you do with it?

IV. IF YOU CREATE A SERIES LLC, WHAT ARE ITS POWERS?

Texas drafters had the benefit of reviewing the history of drafts of Series LLC legislation in other jurisdictions, and the general powers provisions contained in Section 101.605 of the TBOC are well thought out. There are four specific powers set out for an individual Series within a Series LLC as follows:

(1) To sue and be sued;
(2) To contract;
(3) To hold title to assets of the series, including real property, personal property and intangible property; and
(4) To grant liens and security interests in assets of the series.

This enumeration of powers is illustrative of the basic premise that a Series LLC is a vehicle to segregate assets within an entity. These powers comprise the basic functions required to acquire, own, operate, convey or dispose of assets. This express grant of powers to an individual Series of a Series LLC is a helpful start in sorting out its status for statutory regimes, such as the UCC, that will affect the operations of a Series LLC. For example, if a Series within the LLC has the specific power to contract and to grant liens, then that Series should be able to execute and deliver a security agreement, and a creditor should be permitted under the UCC to file an effective financing statement.

This express grant of specific powers to an individual Series of a Series LLC is further evidence that the Texas legislature did not intend that an individual Series be treated as a separate entity for purposes of the TBOC generally. Otherwise, why would it have been necessary to set forth these specific powers for an individual Series? That is, if an individual Series were a separate entity under the TBOC, it would have all these powers, as well as others, without a specific enumeration in Subchapter M.

V. WHAT POWERS ARE DENIED TO AN INDIVIDUAL SERIES WITHIN A SERIES LLC?

Because of the structure of Subchapter M, there are a number of transactions that are not permitted to a Series within the LLC. Briefly, a Series within the LLC, alone, may not merge, convert, conduct an interest exchange, or sell substantially all of its assets under the terms and conditions of Chapter 10 of the TBOC. Thus, while a Series within the LLC may sell its assets, it may not use the provisions for approval of a sale of substantially all of its assets in the TBOC outside of Chapter 101 on LLCs. The TBOC reserves these transactions to the LLC, or the Mothership, itself through the structure of Chapter 101 and Subchapter M by the fact that an individual Series within a Series LLC is not within the definition of a "Domestic Entity."

VI. WHO MANAGES AN INDIVIDUAL SERIES WITHIN A SERIES LLC?

The express rules on management provisions of a Series LLC are contained in four provisions, Section 101.606, which contains provisions limiting the liability of members and managers associated with a series, and permits the duties of the members and managers to be expanded or restricted, Section 101.607, which contains the affirmative rules on how one may establish members and managers of a series, Section 101.608, which contains the default provisions, so that there will be governing persons if the draftsman makes a mistake, and Section 101.610, which concerns the termination of the relationship between a governing person and the Series LLC.

Section 101.606, concerning liability limitation is not remarkable. It simply makes express that any members and managers associated with a Series LLC are not liable for "a debt, obligation or liability of a series, including a debt, obligation or liability under a judgment, decree or court order." One may safely assume that an individual Series within a Series LLC will be subject to the same theories of veil piercing that are applicable to LLCs in general. Section 101.606 also contains the statutory authorization to expand or restrict duties of members or managers, but the paper discusses that issue and related practice pointers in more detail below.

Section 101.607 affords great flexibility for designating members and managers, and allocating their respective voting rights. Section 101.607 states:

(a) The company agreement may:

(1) establish classes or groups of one or more members or managers associated with a series each of which has certain express relative rights, powers, and duties, including voting rights; and
(2) provide for the manner of establishing additional classes or groups of one or more members or managers associated with the series each of which has certain express rights, powers, and duties, including providing for voting rights and rights, powers, and duties senior to existing classes and groups of members or managers associated with the series.

(b) The company agreement may provide for the taking of an action, including the amendment of the company agreement, without the vote or approval of any member or manager or class or group of members or managers, to create under the provisions of the company agreement a class or group of the series of membership interests that was not previously outstanding.

(c) The company agreement may provide that:

(1) all or certain identified members or managers or a specified class or group of the members or managers associated with a series have the right to vote on any matter separately or with all or any class or group of the members or managers associated with the series;
(2) any member or class or group of members associated with a series has no voting rights; and
(3) voting by members or managers associated with a series is on a per capita, number, financial interest, class, group, or any other basis.[3]

Key words in the statutory formulation include "group" and "associated." The authors believe the significance of the use of the term "group" can be analyzed by noting that the TBOC provisions applicable to LLCs that are not Series LLCs uses the same statutory language, but only with respect to members. Thus, TBOC section 101.104 states that the company agreement may "establish within the company classes or groups of one or more members or membership interests each of which has certain expressed rights, powers, and duties, including voting rights", may provide for the manner of establishing

[3] Added by Acts 2009, 81st Leg., R.S., Ch. 84, Sec. 45, eff. September 1, 2009.

additional such classes or groups, and may provide that the rights, powers, or duties of any class or group may be senior to the rights, powers, or duties of any other class or group. In the authors' experience, in traditional, non-Series LLCs, it is common to have different classes of membership, but very uncommon to have managers whose authority as managers is limited to particular aspects of the LLC's operations. Series LLCs, however, contemplate there may be different management for different individual Series. Accordingly, the statute needed to extend the concept that a team or set of people may be involved with respect to an individual Series but not otherwise. The word "associated" is significant, because that denotes a subset of rights under the TBOC. Because a Series within a Series LLCs is not a separate entity, the drafters of the Series LLC statutes have used the word "associated" because a person under the TBOC may have a membership interest only in the Series LLC (Mothership) itself, not in an individual Series and, likewise, a person named in the Certificate of Formation as a manager is a manger of the Series LLC (Mothership) itself, the persons who have the economic benefits and burdens of a particular Series, or who have the right to make management decisions with respect to that Series had to be identifies in some other way. Being "associated" with a Series within the LLC gives the members or managers the rights to deal with the Series within the LLC under the specific powers set forth in Subchapter M, but not necessarily the full rights of members and managers generally for the LLC (Mothership).

Section 101.608 contains the express back up provisions concerning the governing authority. The first rule is that the provisions of the company agreement concerning the governing authority for a Series will trump the materials on file publicly with the Certificate of Formation. The ability to determine the persons authorized and able to enter into contracts for an LLC continue to be difficult for a Series within the LLC also, requiring that the company agreement always be produced. Next, if the company agreement does not provide for governing persons, they will be the managers or members associated with the series in the Certificate of Formation. Hence, as set forth earlier, if possible, it is best to have in the Certificate of Formation an express statement of the members or managers associated with each Series within the LLC. Of course, there is no back up rule for the event that the Certificate of Formation is silent on the Series within the LLC. It is likely to take a lawsuit to figure out if the managers or members designated for the LLC (Mothership) will be those associated with a Series within the LLC in absence of a designation.

Finally Section 101.610 provides rules that permit a manager or a member to "cease to be a manager with respect to a series" [NOTE and see below – why does this not say "cease to be a manager associated with a series"??] or "cease to be a member associated with a series," and the termination of the relationship does not terminate the Series within the LLC or cause either the manager or member to terminate the relationship with the LLC (Mothership) or another series in an LLC. With respect to the member, the fact that there is not any member of a series will not require the series to terminate. This means that the members of the LLC (Mothership) are the members of the Series within the LLC. The difference in the two statutory formulations, i.e. the use of the word "associated" with respect to members may be important. Under this formulation, the statute uses the word "associated" with a series with respect to members to indicate that the members are members of the LLC (Mothership) itself, not just the Series within the LLC, while managers may belong solely to a Series within the LLC, if that is intended.

What does all this mean for the governance of a Series within the LLC? First, the information in the Certificate of Formation will be critical to the analysis, because if there is not a public filing, and the LLC Agreement is not clear, one must look to the backup rule contained in §101.608. This rule indicates that the governing persons for a Series within the LLC will be (1) the managers associated with the series, if its LLC (Mothership) is a manager-managed LLC or (2) those members associated with the Series, if the LLC (Mothership) is a member-managed LLC. Second §101.608 provides that the Company Agreement may set out the governing persons of the Series. By this provision "notwithstanding any conflicting provisions of the Certificate of Formation of a limited liability company", the statue permits the Series to have governing persons different from the LLC (Mothership), thus a manager-managed LLC may have a member-managed series. A member-managed LLC may have a manager-managed series also. Remember that the statue only requires that this be set forth in the Company Agreement. The authors suggest that it would be wise to consider using the Certificate of Formation to give public notice of the governing persons to establish a public record of the actual authority.

A Series within the LLC may also designate officers of the Series LLC by availing itself of the authority to create and use officers in Section 101.254, though the mechanism of Section 101.609 (as discussed in detail below). Also, remember that under the TBOC, if the LLC (Mothership) or a Series within the LLC is a manager managed LLC, each manager has express agency authority for the LLC (Mothership) and any the Series within the LLC, so that if you wish the Managers to act as a group, and not individually, you must specifically provide for that in your LLC Agreement, and this particular authorization may differ between the LLC (Mothership) and the Series within the LLC, since it is also based in contract, and not statute.

VII. THE MAGIC PROVISION – SECTION 101.609.

This is a key provision to the Texas statute that grants the powers or activities permitted to the Series LLCs, as opposed to LLCs in general that are not contained in Subchapter M specifically. This is the provision that permits the Series LLC to avail itself of the rules applicable to LLCs in general. Section 101.609 does NOT permit the Series LLC to avail itself of other provisions of the TBOC (such as the merger sections). Section 101.609(a) states that the general rules on LLCs apply to Series LLCs "to the extent not inconsistent" [good question – what is or is not consistent?]. Section 101.609(b) contains the converse rule, so that if a provision specific to Series within the LLCs is affected by the rest of the Chapter on LLCs, the rest of the Chapter may be applied to the Series within the LLC. Through this Section 101.609, all of the backup rules on voting requirements, election or appointment of managers and officers, assignment of interests and related rights of assignees and general record keeping requirements are neatly placed into the Series within the LLC. Of course, the backup rules of LLCs in general are very sparse (in comparison to the statutory rules available for corporations) and those back up rules are generally unpleasant, requiring unanimous approvals per capita, so Section 101.609 perpetuates the contractual nature of LLCs and the requirement for specific drafting.

Examples of provisions that are imported into Series within the LLCs include (1) amendment of the company agreement (requires a unanimous vote of the members), Section 101.053, (2) the prohibitions on waiver or amendment of specific statutory provisions, Section 101.054, (3) the nature of a membership interest as personal property (important in the UCC discussion below) Section 101.106, (4) prohibitions on withdrawal or expulsion of members, Section 101.107, assignment of interests, Section 101.108, (5) rights of the assignees, Section 101.110, enforceability of contribution obligations, Section 101.151, (6) rules prohibiting distribution in kind, Section 101.202, (7) transactions with interested persons, Section 101.255, (7) rules concerning the appointment, term, removal, vacancy and so forth applicable to managers, Section 101.301, et seq., and (8) general rules on meetings and voting, Section 101.351 et seq.

As an incorporation by reference section, Section 101.609 is very valuable, but like all incorporation by reference sections, a carefully drafted LLC Agreement that will include Series within the LLC will need to check each of the default rules and consider how the default rule needs to apply to the Series within the LLC and how the default rule will affect the relationship among each Series within the LLC and the LLC (Mothership).

VIII. WHAT ARE THE RULES ON DISTRIBUTIONS FROM THE SERIES LLC DURING OPERATIONS?

If a Series within the LLC segregates rights to assets within an LLC, it makes sense that there are particular rules on the distributions to the economic owners of those segregated assets. Briefly, the statute uses the time honored statutory rules and formulations on distributions with revisions to make the concepts work for the Series LLC concept. This particular set of rules could not be incorporated by reference because of the many possible contractual permutations of a Series within the LLC, so the drafters tackled this issue as a sui generis issue. The statute makes its way through distribution provisions generally applicable to LLCs to ensure that within the Series within the LLC, distributions are only made with respect to the assets contained within the Series within the LLC.

The distribution rules of Series within an LLC seek to isolate the liabilities of distributions of the assets of the Series within the LLC. The rules first protect a distribution to "a member associated with a series" by expressly granting that member the rights as a creditor to the Series within the LLC (<u>not</u> the LLC (Mothership)), Section 101.611, in parallel to the general provision for LLCs found in Section 101.207. The important detail, however, is that the member associated with the series is a creditor of that series and not the entire entity.

More importantly, rules on distributions thread through the separateness of the assets in the series. First, distributions from the series are expressly authorized, Section 101.613(a). Second, distributions do NOT have to only be made to members associated with the Series within the LLC. Section 101.613(b) provides that the rules on distributions apply to all members, not just to members associated with the series, by the deletion of the qualifier "associated with a series" in the express authorization of the persons to whom distributions may be made. Presumably, a member that is not associated with a series may be protected by the general provision in section 101.207. In determining the appropriateness of a distribution, that is, when you will be liable for a distribution, the tests of the liabilities and fair value of the assets are based on the liabilities and fair value of the assets of the series within the LLC, with the same exceptions from the tests as set forth in Section 101.207, except limited to the series. As a result, Section 101.206 is excluded and not incorporated by reference, so that the distribution rules in the case of a series within an LLC are limited to the assets and liabilities of that series. The distribution rules for series do not have the exception found in Section 101.206 for distributions made in liquidation of the LLC (Mothership), which makes perfect sense because the Series may be terminated while the LLC (Mothership) is continuing.

IX. DISSOLUTION OF A SERIES.

Series within an LLC may be terminated and wound up without terminating the LLC (Mothership). The converse is not true, and if the LLC (Mothership) is terminated, all series within it must be terminated. Of course, the Company Agreement may specify the events or the time that will require the Series within the LLC to terminate and wind up, Section 101.616(A) and (B). The members of the LLC (Mothership), not simply those members associated with the Series within the LLC, also have the right, by majority vote under the statute, to terminate the Series within the LLC. Members associated with the Series, and if there are no such members, then the managers associated with the Series within the LLC may, again by majority vote, terminate the Series within the LLC and wind it up. These statutory provisions on the events requiring the termination and winding up of the Series within the LLC may be varied by the Company Agreement. The issues of the percentage vote required to authorize the termination, and the issue of who may vote are likely to be matters that are routinely varied. Since Series within LLCs are likely to encompass one portion of a project, it is also likely that the completion of the project will be a typical event in a Series LLC that causes the termination of the Series. Because there may be classes or groups within a Series, the issues of termination and related distributions will also likely to be common issues in the drafting of Company Agreements.

Once the event requiring the winding up is triggered, the statutory provisions on series incorporate by reference the general provisions – the “HUB” provisions of the TBOC -- to establish the procedures for the winding up of the Series. Thus, the procedures of Chapter 11 of the TBOC directly apply to Series within LLCs, with simple definitional changes in Section 101.617 to make the HUB provisions work for the specific features of the Series within the LLC. A winding up of a Series within an LLC may be revoked voluntarily, but oddly enough, not by the members of the LLC (Mothership). The voluntary revocation may be accomplished by the majority vote of the members associated with the Series with the LLC, or if there are no such members, then the managers associated with the Series within the LLC. Presumably, all of this may be varied by the Company Agreement.

X. WHAT IS NOT EXPRESSLY STATED IN THE STATUTE ABOUT SERIES LLCS?

A. Questions about Management Structures.

Now that we have explored the express statutory provisions governing the Series LLC in Texas, let’s turn to what is not expressly discussed, and what you have to arrive at by analysis and implication. First and foremost, and the source of much controversy about Series LLCs, the statute does not really contain clear rules on the exact relationship between the LLC (Mothership) and the Series within the LLC. While the statute tells you what is possible to do and creates many alternatives and permutations, it is difficult to discern exactly what you should do Because of the relative newness of this vehicle, and because the myriad of choices in the statute are confusing, you must consider your precise structure in the context of your business transaction before you indulge in the potential flexibilities offered by the statute. As set out in the beginning of the paper, the Series LLC is a mechanism to segregate assets within an existing structure (a management team or contract, a license or permit, a physical location, a project, etc.). If you begin with the concept that the Series within the LLC is not wholly separate (or a separate entity, if you will), then some of the many choices become less overwhelming, and can begin to make some sense.

If the LLC (Mothership) is the entity, and a Series within the LLC is not a separate entity, management and ownership structures begin to fall into place. On the issues of ownership, if you parse the Texas statutory provisions, the statute provides that the members are members of the LLC (Mothership), not actually members of the Series within the LLC. If you study the statute, this must be the case, because a Series within the LLC can have no members, and not be required to dissolve, while an LLC without members must dissolve, ergo, the Series within the LLC does not actually have the members. That being said, one of the main features of a Series within the LLC is the ability to segregate assets, and therefore segregate the economic benefits of those assets, such as allocations and distributions (and, heaven help us, losses). This must mean that members “associated with” a Series must receive the economic rights/obligations associated with the assets in that Series within the LLC. Such members must be able to contribute to that Series within the LLC, and receive allocations of income, gain, loss deduction and credit and distribution of cash with respect thereto. This needs to happen with respect to regular operations and upon dissolution or sale of the underlying assets.

Next, you must consider the actual management of the LLC (Mothership) and the Series within it. There are many choices, and the particular fact situation will be an important factor. If, however, the Series within the LLC is an asset segregation device, by definition, there must be some common thread among the assets to suggest the efficacy of the use of a Series, and one frequent commonalty is management. It may make more sense to have the managers at the LLC (Mothership) than at the Series, although one can easily think of cases where there is a person unique to one part of an entire project. Both Member managed and Manager managed LLCs may have officers. If your entity is manager-managed, you may have separate managers for the Series within the LLC or provide for member management of one or more Series, or conversely, use the managers from the LLC (Mothership) as the Managers for the Series within the LLC. A member-managed series LLC may in its LLC Agreement provide that one or more series will be manager-managed, TBOC §101.608. This is an area where the facts and the structure of the deal will guide your choices.

If management is divided by each Series and there is also management at the Series LLC (Mothership) level, in addition to thinking about who will manage and how, you must also think about and provide for expenses, fees and/or compensation. All veil piercing arguments scrutinize very carefully the financial arrangements between the various parts where the piercing is being attempted. Series LLCs are not likely to escape this long standing case law. It would be wise to set out express provisions for allocation and payment of fees and expenses, including especially common or shared charges. Common or shared charges will likely include overhead, but there may be some costs, such as expenses for maintaining a common license, that would go beyond normal overhead allocation provisions, due to the nature of the Series within the LLC. Clean and crisp financial separation of each Series within the LLC and of each Series from the Mothership is going to be an important fact in respecting the separation of the assets. Records of common or shared charges and allocations of fees and expenses should be maintained as part of the internal records accounting for the assets of each series separately that are required to be maintained if the entity is to be entitled to the internal liability shield afforded by the series statute.

Finally, do not forget the long standing case law about liability of agents for entities, and the requirement that you identify the capacity in which an agent is serving. Once you determine your ownership and management structure, make sure that the documents correctly describe the precise authority of any agents.

Once the overall structure is established, you will need to set out the two main transactions that occur with respect to an "ownership interest"—voting it and selling it. Again, the flexibility of the statute is confusing at inception. Turning to voting, the first question is at what layer do you want the votes to count. If the Members are all members of the LLC (Mothership), are the voting rights at that level, and/or are there matters that belong to the Series within the LLC that need to be handled at the Series level? On voting at the LLC (Mothership) level, you must provide for voting on the LLC (Mothership) level because there are certain transactions that require member vote that cannot be approved by the Series within the within the LLC, such as mergers, conversions and interest exchanges, so all of the equity holders need a vote, and you will need to figure out if "class-like" vetoes (i.e. requiring approval series by series, or approval by all of the members without distinction) is appropriate for those "extra-series" transactions.

Next, you must think about whether there are matters with respect to the assets in the Series within the LLC that should be controlled by the members associated with that Series, for example, the sale of all or substantially all of the assets in the Series within the LLC. Then, are there transactions, such as budgets, borrowings, capital expenditures and management of lawsuits, where you must decide whether they are best handled centrally or in the Series within the LLC. Remember also, that as you get further into details of management, the approval process could move from the equity holders to the managers (who may or may not be centralized). Then after you decide on who you want to vote on the transactions, you need to figure out by how much. Again, the statute is flexible, which means that you have to think through your percentage of voting structures with care. Turning to default rules, you are once again governed by Section 101.609, which will direct you to the main LLC statutory provisions. The Series rules say that you can establish voting regimes, but the default rules for voting are in the main LLC statute.

B. Amendment of the Series LLC Agreement.

Amendment of the LLC Agreement is a particular subset of voting that needs to be covered. Again, the ability to amend the Series within the LLC itself is not contained in the Series LLC provisions. Therefore, if there are members associated with the Series within the LLC, those members may not unilaterally amend the provisions regarding that Series under the authority of the statute. This harkens back to the fact that the members are members of the LLC (Mothership), not the Series within the LLC. Again, you will need to determine what you want to do, since Section 101.609 throws you back to the general amendment provision, Section 101.053, which requires the unanimous vote of the members (the LLC Agreement is a contract). You may vary the amendment provisions by agreement, and you will need to decide if the members associated with the Series within the LLC will be able to amend the Series provisions, or whether all members (at some percentage) will need to be involved, or some combination of the two possibilities that is in between. The authors can easily imagine some amendments that should remain at the level of the Series within the LLC, and some that should involve all of the members because all would be affected. This determination will also depend on the deal and facts.

C. Assignment of the Interests in the Series LLC.

Assignment of interests is another matter that is not contained in the specific provisions applicable to Series within the LLC, so Section 101.609 would point you to the main provisions of the LLC statute, which provisions start in Section 101.108. Once again, the idiosyncratic provisions of the Series within the LLC must be thought through in connection with assignments of interests. First, you must consider the specific facts of the business deal, and whether or not the interests associated with the Series LLC may be assigned separately. Also, you must always remember that there is a linkage between the membership interests associated with the Series within the LLC and the LLC (Mothership). You must define in more detail what exactly is being assigned, and the approvals to assign these new rights. Will you be able to assign just the rights associated with the Series in the LLC (even Section 101.108 expressly permits an assignment in part)?? and if so, would you permit the member to assign the rights to allocations and distributions from the Series within the LLC, but not the rights to vote or otherwise participate in the LLC (Mothership) in connection with the assignment? Just as in a situation with classes of interests, will there be rights of the other members of the LLC (Mothership) – that means members associated with other series, also, to purchase or acquire the interest associated with the Series before any other outside party could enter into the Series within the LLC, at whatever level?

The provisions of Section 101.108 et seq, would require you to focus on several statutory issues, after you had thought through the business transaction. The statute expressly states that an assignment of any part of an interest in an LLC does not entitle the assignee to become a member of the LLC, absent approval of all the members (that pesky unanimous vote again!). Would you want that rule, which would mean that all of the members at the LLC (Mothership) would have to vote, or would you want something less? If all of the other members of the Series within the LLC must vote on the admittance of an assignee, that would mean that any member associated with another Series within the LLC would have the right to vote on the admission of an assignee in a Series in which that Member is not associated. Contribution obligations also need to be clarified. Section 101.108 states that assignees that are admitted as members take on the contribution obligations of the assignor. While it is likely that the assignor's liability for contributions is going to be specific to the Series within the LLC, any assignment must be clear on the ongoing liabilities. The assignment provisions also state that the assignee has rights to require "reasonable inspections or a reasonable account of the transactions of the company." Would this mean that the assignee would only have rights to the information about the Series within the LLC itself, or would the assignee have rights to the rest of the LLC (Mothership) or other Series within that LLC? Finally, the assignor remains liable under the statute after the assignment, so you will need to consider how appropriate it would be to leave that liability in place in connection with any full or partial assignment of interests associated with a Series within the LLC.

D. Withdrawal and Rights to Cash Distributions.

The right of a member to withdraw, and consequences of withdrawal is another set of provisions incorporated into the Series LLC provisions by Section 101.609. The basic statutory provision, set forth in Section 101.107, states that members cannot withdraw or be expelled. This provision affects Series LLCs in much the same manner as in a traditional LLC, in that you must consider how to have an appropriate exit for the members, both on a friendly basis, and on a not so friendly basis. The existence of a Series within the LLC raises issues on exits similar to assignments, and those issues are how separate are the rights of the members associated with the Series from the LLC (Mothership) as a whole. One unique question of a Series LLC is whether if a member is associated with a Series within the LLC, does that member withdraw only with respect to that Series within the LLC, or also with respect to the LLC (Mothership)? The answer to that question is also likely to be based on the deal terms (such as whether the member has any economic interest in the Series LLC apart from that one Series), but there is again a linkage between the two that must be documented, since the Series within the LLC is not a separate entity.

On the issue of friendly exits, you must consider how rights of first refusal, preemptive rights, drag along rights and tag along rights would apply to an individual Series as well as the LLC (Mothership), considering the complexities of the legal restrictions on what transactions the Series within the LLC is authorized to transact within its parameters (e.g. sale of assets) and those transactions that must be approved at the level of the LLC (Mothership). For example, concepts like drag alongs and tag alongs of membership interests would necessarily have to be drafted at the level of the LLC (Mothership) in order to operate effectively, but rights to sell the assets of a series (a drag-along or tag-along with respect to the assets of the series) could be placed at the series level.

The withdrawal provisions of the LLC statute also prohibit distributions in kind, Section 101.202. Because the Series within the LLC is associated with specific assets in an LLC, this particular basic rule may need to be analyzed, because in the context of the

Series within the LLC, it may make perfect sense to permit a distribution in kind of a portion of the asset held in the Series within the LLC to a departing member, rather than a cash distribution, and the structure of the Series within the LLC could facilitate the resolution of that conflict or transaction, as the case may be.

E. Books and Records.

The books and records provisions of the main LLC statute are another section incorporated into the Series provisions by Section 101.609. This is the first area, however, where there has been litigation over rights of members associated with a Series within the LLC to information from the LLC. Specifically, if you are a member associated with the Series within the LLC, do you have rights to the books and records of the LLC (Mothership) or the other Series within the LLC? Not surprisingly, the holdings in the cases conflict, but the authors submit that the specific facts are as influential as the theoretical underpinnings of the law on Series LLC. We would assert that if a Series within the LLC must look to the LLC (Mothership) for certain authorizations and related transactions, then it would be perfectly appropriate for the members associated with that Series to have access to the LLC (Mothership) with respect to matters that are not within the authority of the Series but that must be decided at the LLC (Mothership) level. The judges did not analyze the facts under that approach, however. The learning from the cases is that your LLC Agreement should spell out the rules applicable to the members associated with the Series within the LLC, so that a judge may enforce your agreement and not interpret the application of Section 101.609 to the books and records provisions of the LLC statute.

Turning to the books and records provisions themselves, parsing through the information that a member has a right to receive, Section 101.501, there are records applicable to the LLC (Mothership) that would necessarily affect each series, as for example, a copy of the Certificate of Formation and the LLC Agreement. The more difficult question is whether a member associated with a Series within the LLC should have access to the financial information about the other Series within the LLC. On first thought, you might conclude that if Series within the LLC are supposed to be asset "silos" then the information about the assets and their operations should also be maintained separately. On the other hand, any competent auditor will tell you that you cannot determine the extent of separation or segregation without access to the records to the entities related to the separate entity, to check all of the interparty transactions. Currently, the proposed federal tax rules treat each Series within the LLC as a separate entity, so disputes over access to federal income tax records may be minimized. After the issues of actual ownership and management of the Series LLC, the issues of the books and records access presents a significant area of controversy and thought as the law and practice on the Series LLC matures.

F. Duties, including Fiduciary Duties.

A larger question, but similar analysis, is the issue of the application of duties, including fiduciary duties, among and between the officers, managers and members of the Series LLC, as their rights and powers may be specifically delineated. Once again, a precise analysis of the problem will be dictated by the precise management structure, and due to the flexibility in that structure, a precise analysis will have to be made on a case by case basis. Several generalizations, however, may be helpful in this area. Because the LLC Agreement may reduce or increase the duties applicable to the officers, members or managers, the LLC Agreement needs to address this issue overtly, and not rely on the statute. Next, if the Series LLC is truly going to function as a liability limiting vehicle, the LLC Agreement needs to address the liabilities for the management team (in whatever structure or format you ultimately choose) across the LLC and its Series. Once again, if you have a Series LLC, it only makes sense that the LLC Mothership will have more than one Series, since you would not need the segregation if there was only one asset. If there is more than one Series, and there is "management" specifically assigned to a Series, it makes good sense to limit their liability to the members associated with the other Series. Conversely, if there is "management" that is common among all of the Series (which in fact, will be likely), then it makes sense that the common management is liable to all of the Series that they can affect (or relieved of liability with respect to all such Series if that is the deal).

This is an area where there is both a specific rule in the provisions on Series LLCs, and where Section 101.609 incorporates general rules on duties in LLCs by reference, so you will have to start the analysis and drafting based on the Series provisions, Section 101.606, and then also consider the general rules on duties in LLC. An additional consideration would be any type of drafting that would address the issues of management stepping out of the bounds of the LLC agreement, and exercising authority, especially as a manager or officer of the LLC (Mothership) that indirectly affects a Series in the LLC. Specifically, a governing person may not be directly a governing person of a Series within an LLC, but through the interrelationship, may make decisions that affect the Series within the LLC for which that governing person does not have direct responsibility. The long reach of fiduciary duty principles makes the effort to delineate duties in the LLC Agreement rather complicated.

XI. STATUTORY ISSUES OTHER THAN THE LLC STATUTE – UCC, BANKRUPTCY AND TAX

A. UCC

If the Series LLC is a vehicle for asset segregation, and a Series within the LLC may expressly enter into contracts (e.g. security agreements) and place liens on the assets of the Series, how does the Series LLC fit into the existing rules of the UCC and Bankruptcy Statutes? The short answer is that the fit is not perfect, but there are current answers that are workable and hopefully statutory clarifications will come. While the express provisions of the TBOC are clear that an individual Series within a Series LLC can place a lien on the assets placed into the Series, the relationship with the Texas UCC is not as seamless. Under Section 9.102(28), the definition of "Debtor" for purposes of the UCC is a "person having an interest, other than a security interest or other lien, in the collateral whether or not the person is an obligor." So far so good. "Person" is defined in Section 1.201(b) (27) as "an individual, corporation, business trust, estate, trust, partnership limited liability company, associate, joint venture, government, governmental subdivisions, agency or instrumentality, public corporation or any other legal or commercial entity. So "Series LLC" is not specifically in this definition, but it is reasonable to cover it under "any other legal or commercial entity," since that is precisely what the catch all provision is for. Turning to the next definition, Section 9.102(71), a "Registered Organization" is defined as "an organization organized solely under the law of a single state or the United States and as to which the state or the United States must maintain a public record showing the organization to be have been organized."

The going gets tougher as you turn to the specific section on financing statements. Under Section 9.503, there are rules for the name of the debtor that are divided into rules for "Registered Organizations" and "other cases." Thus, the critical issue becomes whether the Series LLC is a "Registered Organization" under the UCC definition. The negative view is that since the Series LLC provisions do not make mandatory (i.e. "MUST") the public record about the formation of the Series within the LLC, it does not qualify as a Registered Organization. The TBOC provision permits a notice to be filed, but there are no absolute requirements of a public record about the organization of a Series within the LLC itself. The counter argument is that the fact that there is a filing and a notice is sufficient to meet the mandatory requirements of the UCC, and that this argument over the definition of a Registered Organization is a tempest in a teapot. The uncertainty will be with us until the UCC, or the TBOC is clarified, or a case points to the correct direction.

There are several solutions to this problem. First, under the express provisions of the UCC, the LLC (Mothership) definitely qualifies as a "Registered Organization" and the filings may be made in its name, with a precise description of the assets. While not a perfect recognition of a Series within the LLC, this procedure works. Creditors have a long track record of limiting their security interests in specific assets, and the relative newness of Series LLCs should not change a long established UCC practice. Second, if you want to include a Series within the LLC as your debtor, then we would suggest that precise information about the Series within the LLC be placed into the Certificate of Formation, and that such information must contain a distinct name and listing of the purpose and governing persons, if not the management structure. If you do not have the Series within the LLC established on the date of formation, then the Certificate of Formation should be amended to add the information to facilitate the UCC perfection process. If these two methods are not satisfactory, and perhaps in addition to simply naming the Series within the LLC, you may rely on the alternate provisions of the UCC, i.e. Section 9.503(b)(5)(A). This provision states that in "other cases," . . . "if the debtor has a name, only if the financing statement provides the individual name or organizational name of the debtor," or under 9.503(a)(5)(B), "if the debtor does not have a name, only if the financing statement provides the names of the partners, members, associates or other persons comprising the debtor." Thus, in the worst case, you may properly perfect by providing the names of the Members (and, to be safe, that would mean all of the members of the LLC (Mothership)) of the Series LLC.

While the UCC provisions are not perfectly clear, they certainly have provisions that may be used to properly perfect under the circumstances. Until the UCC law is clarified, compliance with filing under UCC 9.503(a)(1) with the LLC (Mothership) as the named debtor seems the most straightforward choice, but one could use UCC 9.503(a)(1) with the name of the Series within the LLC, and perhaps also comply with (a)(5). If you want to use the name of the Series, another possibility is to file an assumed name certificate for the name of the Series within the LLC, which is an alternate to directly using the name of the LLC (Mothership) as the name of the debtor. Notwithstanding the criticisms of the lack of UCC clarity, there is definitely a mechanism for proper perfection under the Texas UCC provisions.

There is one other point to consider with the perfection process. The UCC requires that the collateral be described, and this part of the perfection process is not adversely affected by the TBOC Series provisions. It would be bad, however, if the descriptions of the assets that are required to be maintained in the Series LLC records are markedly (or even a teeny bit) different from the UCC filings. The descriptions of the assets in the internal records and external records need to match as closely as possible.

B. Bankruptcy

The issues about bankruptcy of a Series in an LLC are also rather unclear. There are two major concerns about Series LLCs: (1) Who and how do you actually file bankruptcy for a Series in an LLC, and (2) will the Series LLC separation of assets be respected by the Bankruptcy Code. On the first issue, we all know that the Bankruptcy Code is not clear on who is authorized to file bankruptcy for an LLC, and after a series of contested cases, rules on the issue became clearer. Lawyers drafting LLC Agreements became more careful about expressly stating who in the management structure of the LLC was actually authorized to file for protection under Chapter 11. The lesson for the Series LLC is to expressly state who and by what procedure (i.e. vote) may authorize the filing of a bankruptcy proceeding. Total caution would dictate that the approval be made at the LLC (Mothership) level, since the express provisions of the Series LLC rules do not mention bankruptcy. This problem, however, can be largely solved through careful drafting.

The larger question of the Bankruptcy courts respecting the Series LLC is more difficult. It would be wise to carefully review the statutory and case law on substantive consolidation in bankruptcy court. While drafting can create a format that helps maintain legal separation of assets, the fact remains that the actual practice of the managers and owners of the assets is critical to any analysis of substantive consolidation. While a bankruptcy judge does not have the authority to rewrite or unilaterally revise the express provisions of the TBOC, that judge can examine how the parties behaved in connection with their respective rights and obligations, and make a determination concerning the relative rights of creditors to the assets of the debtor and persons related thereto. This is an area where careful records and concepts of "veil piercing" need to be applied to the Series LLC operations to prevent consolidation.

In the preparation of documentation for Series LLCs, other traditional concepts applied among potential joint obligors need to be considered. In the LLC Agreement for a Series LLC that has any debt at the level of the Series within the LLC, indemnification provisions for that debt among and between the other Series and the LLC (Mothership) would be highly advisable. In Texas, we currently have a practice of placing an indemnification provision in our LLC agreements for liabilities relating to Texas franchise taxes. This concept can be modified for obligations among and between the various parts of the Series LLC. Similarly, there may be occasion to enter into provisions of an intercreditor agreement with outside creditors in connection with the various layers or levels of debt within the Series LLC. If the LLC (Mothership), for example, has obligations of record with respect to its several series, it would be best that the creditors of the Series contractually recognize those relationships, much as we do now for obligations across subsidiaries.

C. Federal and State Taxation

1. Proposed federal tax regulations would treat each Series within a Series LLC as a separate entity for federal income tax purposes. Proposed Reg. §30.7701-1, 75 Fed. Reg. 55,699 (2010) (the "Proposed Regulations"). Each Series would be classified as a partnership, disregarded, or as an association taxable as a corporation. The Proposed Regulations apply to Series created by "Series Organizations."

a. Proposed Reg. §301.7701-1(a)(5)(viii)(A) states:

> A series organization is a juridical entity that establishes and maintains, or under which is established and maintained, a series (as defined in paragraph (a)(5)(viii)(C) of this section). A series organization includes a series limited liability company, series partnership, series trust, protected cell company, segregated cell company, segregated portfolio company, or segregated account company.
>
> "Juridical entity" is the clunky formal term for what is referred to elsewhere in this paper as the "Mothership."

b. Proposed Reg. §301.7701-(a)(5)(viii)(C) defines a "series" as follows:

> A series is a segregated group of assets and liabilities that is established pursuant to a series statute (as defined in paragraph (a)(5)(viii)(B) of this section) by agreement of a series organization (as defined in paragraph (a)(5)(viii)(A) of this section). A series includes a series, cell, segregated account, or segregated portfolio, including a cell, segregated account, or segregated portfolio that is formed under the insurance code of a jurisdiction or

is engaged in an insurance business. However, the term series does not include a segregated asset account of a life insurance company. See section 817(d)(1); §1.817-5(e). An election, agreement, or other arrangement that permits debts and liabilities of other series or the series organization to be enforceable against the assets of a particular series, or a failure to comply with the record keeping requirements for the limitation on liability available under the relevant series statute, will be disregarded for purposes of this paragraph (a)(5)(viii)(C).

c. Proposed Reg. §301.7701-(a)(5)(viii)(B) defines "series statute:

> A series statute is a statute of a State or foreign jurisdiction that explicitly provides for the organization or establishment of a series of a juridical person and explicitly permits—
>
> (1) Members or participants of a series organization to have rights, powers, or duties with respect to the series;
> (2) A series to have separate rights, powers, or duties with respect to specified property or obligations; and
> (3) The segregation of assets and liabilities such that none of the debts and liabilities of the series organization (other than liabilities to the State or foreign jurisdiction related to the organization or operation of the series organization, such as franchise fees or administrative costs) or of any other series of the series organization are enforceable against the assets of a particular series of the series organization."

d. The preamble to the Proposed Regulations states:

> The proposed regulations do not address the entity status for Federal tax purposes of a series organization. Specifically, the proposed regulations do not address whether a series organization is recognized as a separate entity for Federal tax purposes if it has no assets and engages in no activities independent of its series.

An entity formed under local law is not always recognized as a separate entity for Federal tax purposes. Treas. Regs. §30.7701-1(a)(4). Moreover, classification of an organization as an entity separate from its owners is a matter of Federal tax law, not local law. Treas. Regs. §301.7701-1(a)(1).

(1) Some state limited liability company statutes provide that the sole member may have no economic interest on the company. For example, 6 Del. Code § 8-301(d) states that "a person may be admitted as the sole member of a limited liability company without making a contribution to the limited liability company or without acquiring a limited liability company interest in the limited liability company." If the juridical limited liability company were such an entity, it would be treated as a nonentity for Federal tax purposes. *See* PLR 200201024, holding that a limited liability company that had one member who owned all of the economic interest in the company and one nominal, noneconomic member would be a disregarded entity.
(2) Texas law does not permit a limited liability company with no members other than a noneconomic member. TBOC § 101.102(c).
(3) Even if a Series LLC has multiple economic members, if all of those members are associated with one or more Series and have no economic interest in the LLC apart from their interest in one or more Series, the Series LLC itself will be treated as having no economic members. For Federal tax purposes, the ownership of interests in a series and of the assets associated with a series is determined under general tax principles based on who is

entitled to the benefits and burdens of the series or assets. A series organization is not treated as the owner for Federal tax purposes of a series or of the assets associated with a series merely because the series organization holds legal title to the assets associated with the series. Proposed Reg. §30.7701-1(a)(5)(vi). As stated in the preamble to the Proposed Regulations:

> A series organization is not treated as the owner of a series or of the assets associated with a series merely because the series organization holds legal title to the assets associated with the series. For example, if a series organization holds legal title to assets associated with a series because the statute under which the series organization was organized does not expressly permit a series to hold assets in its own name, the series will be treated as the owner of the assets for Federal tax purposes if it bears the economic benefits and burdens of the assets under general Federal tax principles. Similarly, for Federal tax purposes, the obligor for the liability of a series is determined under general tax principles.
>
> In general, the same legal principles that apply to determine who owns interests in other types of entities apply to determine the ownership of interests in series and series organizations. These principles generally look to who bears the economic benefits and burdens of ownership. See, for example, Rev. Rul. 55-39 (1955-1 CB 403), (see §601.601(d)(2)(ii)(b)). Furthermore, common law principles apply to the determination of whether a person is a partner in a series that is classified as a partnership for Federal tax purposes under §301.7701-3. See, for example, *Commissioner v. Culbertson*, 337 U.S. 733 (1949); Commissioner v. Tower, 327 U.S.280 (1946).

2. The general default rule under the tax classification regulations is that a domestic entity formed under a non-corporate statute will be classified as a partnership if it has two or more owners and will be disregarded if it has only one owner. Such an entity may elect to be taxed as a corporation. Treas. Regs. §30.7701-2. An otherwise disregarded single-owner entity will be regarded for certain employment and excise tax matters, however. Treas. Regs. §30.7701-2(c)(2)(iv) and (v).

3. A special rule provides that an entity will be classified as a corporation if it is a state-chartered bank that is federally insured.

(a) Texas permits limited liability companies to be "limited banking associations." TEX FINANCE CODE § 31.002(53).

(b) The provisions governing the formation of "limited banking associations" do not contemplate Series LLCs. The TBOC applies to limited banking associations only to the extent consistent with the Finance Code for purposes of "the regulation of the internal affairs of the bank." TEX FINANCE CODE § 32.002(12).

(c) In a telephone conversation, Everette Jobe, Counsel, Bank & Trust Matters, Texas Department of Banking, stated that no one had ever applied to have a Series approved as a limited banking association, and he did not believe that the existing statute would permit that. He said any change would require the approval of the FDIC and the Federal Reserve as well as that of state banking officials. He did state that he was aware of banks that were forming Series LLCs for the purpose of holding loan participations.

4. The Proposed Regulations are only proposed; a Series LLC therefore could report now as single entity but would have to switch to separate reporting if the Proposed Regulations are finalized as written. This switch would be considered a conversion from a single entity to multiple entities for federal tax purposes. For a taxpayer who reports in accordance with the Proposed Regulations, however, they are "substantial authority." Treas. Regs. §1.6662-4(d)(3)(iii). Note,

however, as discussed below, the Proposed regulations do not apply for purposes of employment taxes or employee benefits and, therefore, would not be substantial authority for a taxpayer's treatment of those matters in a Series LLC.

5. The Proposed Regulations do not address foreign entities (except for insurance businesses), employment taxes or employee benefits.

(a) The preamble to the Proposed Regulations discusses several perceived problems that could arise if a series is treated as a separate entity for Employment tax purposes. The preamble's discussion is set forth below with the authors' comments in italics:

> The domestic statutes authorizing the creation of series contemplate that a series may operate a business. If the operating business has workers, it will be necessary to determine how the business satisfies any employment tax obligations, whether it has the ability to maintain any employee benefit plans and, if so, whether it complies with the rules applicable to those plans. Application of the employment tax requirements will depend principally on whether the workers are employees, and, if so, who is considered the employer for Federal income and employment tax purposes. In general, an employment relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. See §§31.3121(d)-1(c)(2), 31.3306(i)-1(b), and 31.3401(c)-1(b).
>
> An entity must be a person in order to be an employer for Federal employment tax purposes. See sections 3121(b), 3306(a)(1), 3306(c), and 3401(d) and §31.3121(d)-2(a). However, status as a person, by itself, is not enough to make an entity an employer for Federal employment tax purposes. The entity must also satisfy the criteria to be an employer under Federal employment tax statutes and regulations for purposes of the determination of the proper amount of employment taxes and the party liable for reporting and paying the taxes. Treatment of a series as a separate person for Federal employment tax purposes would create the possibility that the series could be an "employer" for Federal employment tax purposes, which would raise both substantive and administrative issues.

It is not clear what more the drafters of the Proposed Regulations thought might be necessary "to make an entity an employer for Federal employment tax purposes." The statutory provisions cited in the preamble do use the term "person" in referring to employers. Moreover, the cited employment tax provisions sometimes use additional terms to describe who can be an "employer." Thus, IRC section 3121(h) defines "American employer" as inter alia, an "employer which is…(3) a partnership, if two-thirds or more of the partners are residents of the United States or (5) a corporation organized under the laws of the United States or of any State." Unless a series is disregarded, under the Proposed Regulations, it will be either a partnership or an association taxable as a corporation for Federal tax purposes. Moreover, although Treas. Regs. §31.3121(d)-2(a) states that "every person is an employer if he employs one or more employees," §31.3121(d)-2(b) states that "an employer may be an individual, a corporation, a partnership, a trust, an estate, a joint stock company, an association, or a syndicate, group, pool, joint venture, or other unincorporated organization, group, or entity." It would appear difficult to fit a series within that definition.

> The series structure would make it difficult to determine whether the series or the series organization is the employer under the relevant criteria with respect to the services provided. For example, if workers perform all of their services under the direction and control of individuals who own the interests in a series, but the series has no legal authority to enter into contracts or to sue or be sued, could the series nonetheless be the employer of the workers? If

> workers perform services under the direction and control of the series, but they are paid by the series organization, would the series organization, as the nominal owner of all the series assets, have control over the payment of wages such that it would be liable as the employer under section 3401(d)?

These questions appear to be make-weights. Although there may be some circumstances in which it is not at first apparent who the employer is, an examination of the facts should almost always lead to a clear result, or at least as clear a result as is obtained in ambiguous employment situations outside of series entities. As noted above, at least for certain employment tax purposes, a "group" may be an employer. Treas. Regs. §31.3121(d)-2(b). It is not clear that a group would necessarily have the legal authority to enter into contracts or to sue and be sued, and it is not apparent why this factor should be a reason for not providing guidance in this area, at least for series organizations that do have such authority.

> The structure of a series organization could also affect the type of employment tax liability. For example, if a series were recognized as a distinct person for Federal employment tax purposes, a worker providing services as an employee of one series and as a member of another series or the series organization would be subject to FICA tax on the wages paid for services as an employee and self-employment tax on the member income. Note further that, if a domestic series were classified as a separate entity that is a business entity, then, under §301.7701-3, the series would be classified as either a partnership or a corporation. While a business entity with one owner is generally classified as a corporation or is disregarded for Federal tax purposes, such an entity cannot be disregarded for Federal employment tax purposes. See §301.7701-2(c)(2)(iv).

It is unclear how the fact that a worker might be considered to be the employee of more than one series is any different from the issues that arise if a worker is the employee of two or more separate juridical entities under some degree of common control.

> Once the employer is identified, additional issues arise, including but not limited to the following: How would the wage base be determined for employees, particularly if they work for more than one series in a common line of business? How would the common paymaster rules apply? Who would be authorized to designate an agent under section 3504 for reporting and payment of employment taxes, and how would the authorization be accomplished? How would the statutory exceptions from the definitions of employment and wages apply given that they may be based on the identity of the employer? Which entity would be eligible for tax credits that go to the employer such as the Work Opportunity Tax Credit under section 51 or the tip credit under section 45B? If a series organization handles payroll for a series and is also the nominal owner of the series assets, would the owners or the managers of the series organization be responsible persons for the Trust Fund Recovery Penalty under section 6672?

Once again, the authors believe the drafters of the Proposed Regulations protest too much. In particular, it strikes us as somewhat disingenuous to ask how the common paymaster rules would work. The common paymaster rules allow certain commonly controlled corporations to use one of the corporations to pay employees who work for more than one of the controlled corporations, applying one wage base, etc. Treas. Reg. §31.3121(s)-1. The common paymaster rules apply only to corporations. It seems likely to the authors that the great majority of series that are treated as separate entities for Federal tax purposes will either be disregarded entities or will be partnerships for tax purposes. The common paymaster rules as currently written would have no application to such series, except possibly to a series that, because disregarded, was treated as a division of a corporation. It would seem to be a *useful project for the Treasury department to revise the common paymaster regulations so that they would apply to all entities that are under common control as defined therein, whether or not incorporated.*

> Special administrative issues might arise if the series were to be treated as the employer for Federal employment tax purposes but not for state law purposes. For example, if the series were the employer for Federal employment tax purposes and filed a Form W-2, "Wage and Tax Statement," reporting wages and employment taxes withheld, but the series were not recognized as a juridical person for state law purposes, then administrative problems might ensue unless separate Forms W-2 were prepared for state and local tax purposes. Similarly, the IRS and the states might encounter challenges in awarding the FUTA credit under section 3302 to the appropriate entity and certifying the amount of state unemployment tax paid.

These perceived problems also appear not to justify the absence of guidance. The authors do not know how many states would present the possible need for separate W-2s, since many, if not most states, simply piggyback on the taxpayer's federal taxable income.

> In light of these issues, the proposed regulations do not currently provide how a series should be treated for Federal employment tax purposes.

(b) Employee benefit plans. The preamble to the Proposed Regulations state that to the extent a Series may maintain an employee benefit plan, the aggregation rules and employee leasing rules of Internal Revenue Code section 414 will apply. The authors do not see any reason why a series should not be able to maintain an employee benefit plan on its own. As the preamble to the Proposed Regulations states, the analysis whether the series is properly maintaining the plan should be the same analysis that is made when any entity that is under common control with a number of other entities maintains an employee benefit plan.

6. State tax issues are evolving.

(a) The Comptroller apparently intends to treat a Series LLC as a single entity for franchise tax purposes. The State Bar Tax Section has recommended that each series be treated as a separate entity for margin tax purposes to avoid causing the difference that would otherwise result with respect to aggregating entities for margin tax purposes. Separate entities that are under common control do not have to file as a combined group unless they are engaged in a unitary business. However, under the Comptroller's approach, all series created under the same Series LLC will in effect be combined for margin tax purposes even if the series are not engaged in a unitary business.

(b) The California Franchise Tax Board has announced it will treat each Series within a Series LLC as a separate LLC, thus subjecting each Series to minimum $800 annual franchise tax.

D. Current Cases.

The authors are aware of three published decisions in cases involving series LLCs, but none of these opinions shed light on any of the issues discussed above. In a bankruptcy case arising in Montana, an individual series of a series LLC filed for bankruptcy, but the opinion does not contain any discussion of the propriety of filing on that basis. *In re CANYON HOLDINGS, LLC SERIES 39* (U.S. Bank. Ct. D. Montana) 2011 WL 3679056 (August 23, 2011). A second bankruptcy case involved a fantastical series LLC that included an automobile series, a jewelry series, and a personal residence series. The series structure again was not in issue—the fraudulent transfer issues were so blatant that the court simply didn't need to consider the series structure. *In Re Master*, 2011 WL 4498834 (U.S. Bank. Ct. W. D. Wash., September 27, 2011). Finally, in another case in which the series structure was not at issue, the series structure may have clouded the court's consideration whether an arbitration clause in an LLC Agreement bound a non-party to the agreement. *Carr v. Main Carr Development, LLC,* 337 S. W. 3d 489 (2011), 2011 WL 1238390 (Tex. Civ. App.—Dallas, March 31, 2011).

XII. OTHER STATUTORY LIMITATIONS ON SERIES LLCS.

Series LLC have other statutory limits that must be thought through, besides debtor/creditor issues.

Most of these matters originate from the newness of the structure, and the lack of time to adjust other statutes that affect the operation of a Series LLC. Only a few states have legislation that authorizes the use of a Series LLC. Texas is one of only about ten jurisdictions so far to enact Series LLC provisions. This raises the question about whether a jurisdiction without Series LLC legislation would respect the Series within an LLC. While the general rule is that the law of the state of formation should govern the regulation of the internal affairs of an entity, it would appear to be a stretch for a jurisdiction without Series LLCs to recognize the liability limitation function of the Series within the LLC—the effect of the liability limitation function applies to third party creditors, not just to the internal affairs of the entity and its members *inter se*. Practically speaking, the issue of foreign qualification of the Series within the LLC or the LLC (Mothership) is quite daunting to think through. Major states that have legislation include Delaware and Illinois. Two states adjacent to Texas, Louisiana and New Mexico, conversely, do not have provisions concerning Series LLCs. Oklahoma does have series LLC legislation.

Even if you have a transaction that could go across state boundaries (a real estate developer that works in Texas and Chicago), state legislation is not uniform. The most extreme examples are Kansas, Illinois and Iowa, that permit the treatment of each Series within an LLC as a separate entity. Other differences exist, particularly with respect to Delaware, which was the first state, and upon which provisions other states have drafted "improvements." The bodies in charge of uniform laws, such as NCCUSL and the ABA, have only recently weighed in with uniform provisions, in the Uniform Statutory Trust Entity Act. While it is not entirely clear how the controversy over entity/nonentity status of the Series within the LLC will work out, we do believe that the "entity" status argument has the weaker position, since that would be the functional equivalent of wholly owned subsidiaries, which we may already form.

XIII. WHAT ARE CIRCUMSTANCES WHERE SERIES LLCS MAY BE HELPFUL?

Now that we know more about how to form and operate a Series LLC, the next question becomes when you would want to consider using one. The initial use for the Series LLC was in the context of regulated mutual funds, where the LLC (Mothership) contained all of the SEC compliance structures and management contracts and arrangements, and the Series within the LLC were used as different silos of managed assets under that management structure. Illinois adopted the rules on Series LLCs because the filing fees in Illinois for an LLC are quite high, and the Series LLC was a mechanism that avoided the filing fee expense of wholly owned subsidiaries (don't you wonder how long it will take the Illinois legislature to figure that one out).

With a little imagination, you may think of other businesses where there is a common management thread or other common business thread that makes separate subsidiaries cumbersome. A business that must have a license, similar to the investment company act rules, would also be a good candidate. Real estate transactions where separate, but contiguous parcels are put together for a project would be a great candidate, especially if there is a business reason (which there often is when parcels are assembled from separate owners) that the parcels cannot all be identically owned or identically managed. In any business with different operating business divisions, the Series LLC may be used to create a legal separation that is not as difficult to manage as wholly owned subsidiaries, but effective to isolate strategic or difficult assets, where the boundaries provided by the Series could provide a more effective solution than the black/white choice of wholly-owned subsidiary or division. In the oil and gas world, development transactions, where there are ongoing capital expenditure obligations and the risk of different ownership percentages, would be another ideal fact pattern for Series LLCs.

XIV. EXAMPLE – AN OIL AND GAS DEVELOPMENT AGREEMENT.

While many choose to enter into contracts to develop oil and gas properties, many also choose to enter into those arrangements through partnerships and LLCs. This is particularly true when those participating in the development are passive investors relying on the expertise of an entrepreneur. The ability to rely on concepts of fiduciary duties in this context is important to investors. A Series within an LLC works quite well for the business problems presented by the ongoing development plans of a typical oil and gas prospect. Currently, development transactions are approached through a development agreement or participation agreement, where the parties are newly formed LLCs or other partnership vehicles. A Series LLC could be a more user friendly device for this particular fact pattern, when compared to a simple LLC or a set of parent-subsidiary or brother-sister LLCs.

To begin, development agreements contain agreements about the rights and responsibilities for the initial drilling of the prospect, and commitments, including both financial and affirmative covenants about the conduct of operations. If that initial group of wells in the first set of drilling is placed into a Series within a Series LLC, the future decisions about the development would be easier to both finance and manage. Later drilling on a prospect is always under changed conditions, both technically and financially, and a Series LLC would facilitate the management of the development.

Inevitably during the period of initial drilling, which may last as long as two years, the parties that are participating in the front end cannot remain through the life of the project. Over the period for the development, it is not uncommon for the financial position of the parties to change significantly (think the recession of 2008), or other management issues may arise that will alter views or opinions about the project as it matures. Thus, the second and third phases of drilling often require significant adjustments in the original terms of the entity that is participating, and to date, the only tools are to create special allocations or new classes in the first partnership or LLC, or to create an entirely new entity. The Series structure more elegantly solves this problem because a Series LLC allows you to alter both financing and management within one entity. Much as a standard Joint Operating Agreement allows undivided interest owners to go non consent on a well, the Series LLC would allow members to similarly go non consent, through placing the next set of wells in a separate series with different members, and if necessary, managers, for the partnership equivalent of a non consent.

Another accommodating feature about using a Series LLC is that the LLC (Mothership) can act as operator, and hold the permits, seismic licenses, bonds and other regulatory requirements for all of the series, and there is still just one entity. Currently, if the next phase of the development is sufficiently different, a whole new entity is formed, and the existing operator must act as a contract operator since it will not likely have the requisite ownership under the Joint Operating Agreement. If all of the real property interests may be contained in one entity, the operatorship issue may be simplified. Similarly, the current custom of creating an operating subsidiary to hold all of the permits and bonds, and to actually conduct operations isolated from the entity that owns the properties is not needed. By placing the real property interests into a Series, the LLC (Mothership) may perform that function, and again obviate the need for contract operating agreements.

The Series LLC could also facilitate both equity and debt financing for the entire development. As development proceeds, the risk profile of the drilling operations must change. Later development drilling is always less risky than the initial wells to prove the prospect. The placement of the later wells into their own series would allow for both equity and debt providers to finance the specific risk profile, which would both make the financing easier, in being more focused, and faster. Properties that are acquired after the commencement of the development drilling through Area of Mutual Interest provisions could also be placed into a separate series, since the pricing terms of leases after the development has been successful have been known to be different from the original leasing rates. The ability to segregate properties acquired at different prices would also facilitate the financing of drilling that acreage. Similarly, required midstream projects to treat and transport the product could also be placed in a separate series, again separating the risks and the nature of the financing. A Series LLC, however, would permit you to establish one entity for an exit, where currently, there are several commonly controlled entities that must be tied together contractually through tag along and drag along agreements, and similar contractual provisions in Joint Operating Agreements. Finally, the segregation of different phases of the drilling of a development is a simple mechanism to isolate old fashioned drilling risks. The "silos" created by a Series should offer the same liability limitations as a separate LLC, without actually making a separate legal entity that must be dealt with through contracts. The Series LLC can hold all of the phases of the development agreement under one entity, while permitting both different economics and related financing and different management structures (mid-stream separated from upstream, for example), leaving the entire prospect in one entity. Thus, the authors believe that Series LLCs will prove quite useful as a structure for oil and gas exploration.

XV. CONCLUSION.

While the Series LLC is a new vehicle that has some unanswered questions, it is a solution to problems of management of assets that have common, but not identical features. The statute makes very clear the ability to deal with assets and the transactions surrounding assets that may be held by an entity. If you focus on the feature of asset management and commonality, but not identity, the confusion caused by the flexibility permitted in the TBOC provisions falls away, and you are able to focus on fact patterns that are truly facilitated by this structure. The single most "common" commonality is management, but the commonality may be the nature of the asset (such as the accumulation of one large asset from divided parts) or the development of an asset over time, where ownership may shift. We would like to encourage you to join the ranks of the optimists and urge you to study and think about this new vehicle. Consider embracing the good points of a Series LLC in transactions appropriate for the solutions that it provides.