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Code to Code

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Series LLCs: Can a Series File for Bankruptcy, and What if It Does?

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A series limited liability company (SLLC) is a limited liability company within which separate units (called "series") might be organized, each possessing many of the attributes of independent legal entities. Twelve states, the District of Colombia and Puerto Rico authorize the formation of SLLCs.[1] Series within an SLLC can hold property in their own names separate from the property of the SLLC and other series. A series may incur liabilities independently of other series or the SLLC itself, and, if appropriate corporate formalities are observed,[2] creditors may look only to the series incurring the liability in order to collect their debts.

The series within an SLLC are not subsidiaries of the SLLC, as they have no existence independent of the SLLC and will dissolve upon the dissolution of the SLLC under which they are organized.[3] In addition, the membership interests in each series need not be owned by the SLLC itself and may be owned by any combination of persons or entities irrespective of whether they are the holders of membership interests in other series or the SLLC.[4] Commentators have likened SLLCs and their constituent series to cells within a honeycomb or fish within a school. A series is both part of and independent of the SLLC and the other series within it.

The SLLC structure was initially authorized in Delaware in 1996 and has since been employed to minimize the cost and administrative burden of separate corporate filings, and to limit liabilities associated with separate asset holdings or lines of business.[5] Despite the proliferation of the SLLC structure, however, fundamental questions concerning SLLCs and bankruptcy remain almost entirely unanswered. First, can a series of an SLLC file for bankruptcy?[6] If a series can, what assets are included within its estate? Finally, will the claims against the estate be limited to creditors of the debtor series? For now, there is a complete lack of decisional law on the subject, and definitive answers will have to wait until these issues are adjudicated.

Eligibility under the Code

Section 109 of the Bankruptcy Code[7] provides that "only a *person* … may be a debtor under this title,"[8] and a "person" is defined to include an "individual, partnership, and corporation."[9] A "corporation" includes an "association having a power or privilege that a private corporation, but not an individual or partnership, possesses."[10] Therefore, whether the Bankruptcy Code permits a series of an SLLC to be a debtor depends on whether a series possesses a "power or privilege" that is unique to corporations.

1 These jurisdictions are Alabama (Ala. Code § 10A-5A-11.01, *et seq.*), Delaware (6 Del. Code § 18-215), District of Columbia (D.C. Code § 29-802.06), Illinois (805 Ill. Comp. Stat. 180/37-40), Iowa (Iowa Code § 489.1201), Kansas (Kan. Stat. Ann. § 17-76,143), Missouri (Mo. Rev. Stat. § 347.186), Montana (Mont. Code Ann. § 35-8-304), Nevada (Nev. Rev. Stat. § 86.296), Oklahoma (Okla. Stat. tit. 18, § 2054.4), Tennessee (Tenn. Code Ann. § 48-249-309), Texas (Tex. Bus. Org. Code § 101.610, *et seq.*), Utah (Utah Code Ann. § 48-3a-1201) and Puerto Rico (14 P.R. Laws Ann. § 3967). Several other jurisdictions authorize the establishment of separate series-of-membership interests within an LLC, but the resulting series do not have the attributes of separate entities that give rise to the bankruptcy questions addressed in this article.

2 As an example, in order to maintain limited liability between series and the SLLC, Delaware requires the series to account for assets separately from other series and to give notice of inter-series liability limitations in the SLLC's certificate of formation. *See* 6 Del. Code § 18-215(b). Since many states' SLLC laws closely follow Delaware's, this article focuses primarily on Delaware law.

3 *See* 6 Del. Code § 18-215(k).

4 *See* 6 Del. Code § 18-215(j).

5 *See* Shannon L. Dawson, "Series LLC and Bankruptcy: When the Series Finds Itself in Trouble, Will It Need Its Parent to Bail It Out?," 35 *Del. J. Corp. Law* 515, 516-17 (2010).

6 Other than the chapter 11 cases of three related series (*In re Crush Real Estate Series LLC, sole beneficiary of 427 E. Sixth St. Realty Trust*, 15-bk-10237 (Bankr. D. Mass. 2015), *In re Crush Real Estate Series LLC, sole beneficiary of 917 E. Broadway Realty Trust*, 15-bk-12105 (Bankr. D. Mass 2015), and *In re Crush Real Estate Series LLC, sole beneficiary of 305 K St. Realty Trust*, 15-bk-12106 (Bankr. D. Mass 2015)), where the issue of eligibility was neither litigated nor decided, the author has been unable to locate any bankruptcy cases in which a single series of an SLLC was the debtor.

7 11 U.S.C. § 101, *et seq.*

8 11 U.S.C. § 109(a) (emphasis added).

9 11 U.S.C. § 101(41).

10 11 U.S.C. § 101(9)(A)(i).

While federal law controls the meaning of the term "corporation" as used in § 101(9), the powers and privileges of an association are granted by state law.[11] Therefore, the determination of whether a series of an SLLC is eligible to be a debtor depends on the powers and privileges afforded to the series under the law of the state of its organization.[12] For example, a series of an SLLC under Delaware law "may carry on any lawful business, purpose or activity, whether or not for profit, with the exception of the business of banking ... [and] shall have 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."[13] Like members of ordinary LLCs, members of a series are not personally liable for the debts of the series by virtue of their membership interests.[14]

Several bankruptcy courts have agreed that ordinary LLCs fit within the Bankruptcy Code's definition of "corporation" due to the "powers and privileges" enjoyed by LLCs that are not enjoyed by partnerships or individuals.[15] In these decisions, the limited liability of members seems to be central to the classification of an LLC as a corporation.[16] Since members of SLLCs series generally enjoy the same limited liability as members of an ordinary LLC, it is reasonable to conclude that a series would similarly fit within the definition of "corporation" set forth in § 101(9)(A)(i) of the Bankruptcy Code.[17] Therefore, a series of an SLLC is seemingly eligible to be a debtor under the Code.

Property of a Series' Estate

Assuming that a single series of an SLLC is eligible to be a debtor, a threshold question remains: What property is included within the series' bankruptcy estate? The estate generally includes all "legal and equitable interests of the debtor in property as of the commencement of the case," and the question of whether a debtor holds an interest in property is determined by reference to state law.[18] Series of an SLLC are expressly granted the power to hold property in their own names under Delaware law, but the assets associated with an individual series may also be held in the name of the SLLC of which it is a part, by a nominee or otherwise.[19] Irrespective of the nominal state of title, Delaware law permits assets associated with an individual series to be insulated from the liabilities of other series, and the SLLC of which it is a part, if three conditions are satisfied: (1) an LLC agreement must provide for the insulation of the series' assets from such liabilities; (2) the limitation on inter-series liability must be noted in the SLLC's certificate of formation; and (3) the assets must be accounted for separately from the assets of other series and the SLLC.[20] The separate-accounting requirement might be satisfied by any means that would make the identity of the series' assets "objectively determinable," including "computational or allocational formula or procedure (including percentage or share of any asset or assets)."[21]

In those instances where a series holds a title to assets in its own name, identifying property of a series' estate should be no more complicated than it would be had the debtor been a more-common type of entity. However, in light of *Butner* and Delaware's approach to inter-series limited liability, a debtor-series' assets may be no more than intra-SLLC book entries allocating to multiple series shares of assets nominally owned by the SLLC itself. Assuming that accurate and consistent accountings are maintained by each series holding an interest in an asset, the process of allocation should therefore be noncontroversial. However, experience teaches us that a debtor's books and records are not always properly maintained. In the event of inter-series inconsistencies and creditor overlap between series, it is easy to envision creditors of one series making claims to the assets of another, or a nondebtor series contesting the validity of a debtor series' accounting of assets.

Claims Against the Estate

The failure of a series to accurately account for its assets not only casts uncertainty over what property is included within a series-debtor's estate, it also exposes a series' bankruptcy estate to claims of creditors of other series. This results from the fact that a series' limited liability depends on, among other things, the separate accounting of its assets.[22] The failure to properly maintain such an accounting can lead to the dilution of claims against a series-debtor or the substantive consolidation of estates should the SLLC or more than one series become a debtor.

For example, in the pending bankruptcy of one Delaware SLLC, Dominion Ventures LLC, the appointed trustee reported that the debtor's principals treated the SLLC and each of its five series as a single enterprise despite provisions in the relevant LLC and series agreements that the assets and liabilities of each series would be maintained separately.[23] The separate series had raised an aggregate of $6 million in investments of outside nonvoting members, presumably on the premise that the series in which they invested would be operated independently for their benefit. Instead, through a number of inter-series loans and apparent comingling of assets, the formerly separate series effectively forfeited their separate status, which resulted in the *de facto* substantive consolidation of the series in the bankruptcy of their "parent" SLLC without a formal action by the trustee or decision of the court consolidating the series. Following the conversion to chapter 7, the trustee abandoned assets that were formerly owned by some series and sold the assets that were formerly owned by another. While the claims-reconciliation process has not been completed, the register of claims reflects that credi-

11 *See Sherron Assocs. Loan Fund XXI (Lacey) LLC v. Thomas (In re Parks)*, 503 B.R. 820, 828 (Bankr. W.D. Wash. 2013) ("[F]ederal law controls the interpretation of the definitional statutes [11 U.S.C. § 101] at issue...."); *In re Prism Props. Inc.*, 200 B.R. 43, 45 (Bankr. D. Ariz. 1996) ("Whether a debtor has such a power or privilege and therefore a debtor's status as a corporation, is a matter of state law.").
12 *See In re Prism Props. Inc.*, 200 B.R. at 45.
13 6 Del. Code § 18-215(c).
14 6 Del. Code §§ 18-303(a) and 18-215(k).
15 *See* 11 U.S.C. § 101(9)(A)(i); *Redmond v. CJD & Assocs. LLC (In re Brooke Corp.)*, 506 B.R. 560, 567 (Bankr. D. Kan. 2014); *In re Parks*, 503 B.R. at 829.
16 *See In re Brooke Corp.*, 506 B.R. at 567; *In re Parks*, 503 B.R. at 829.
17 While this conclusion seems supportable based on judicial interpretation of the definition of "corporation," one commentator has fairly questioned whether a single series of a Delaware SLLC can be a debtor given the fact that it cannot exist separately from the SLLC within which it is organized and lacks other attributes of a separate entity. *See* Norman M. Powell, "Series LLCs, the UCC and the Bankruptcy Code: A Series of Unfortunate Events," 41 *U.C.C. Law J.* 103, 108 (2008).
18 11 U.S.C. § 541(a)(1); *Butner v. United States*, 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979).
19 6 Del. Code § 18-215(b) and (c).
20 6 Del. Code § 18-215(b).
21 *Id.*
22 *Id.*
23 *In re Dominion Ventures LLC*, 11-bk-12282-CSS (Bankr. D. Del.), ECF Doc. 168, p. 5.

tors whose claims were explicitly limited to a single series of the SLLC are now seeking payment from the bankruptcy estate of the SLLC itself.

Conclusion

There is a complete lack of decisional law concerning SLLCs in bankruptcy. Accordingly, issues concerning eligibility, estate property and administration, and allowance of claims remain unresolved. While there is nothing inherent in the structure of SLLCs that would prevent the effective use of the Bankruptcy Code, certain characteristics of SLLCs may present challenges for parties-in-interest in SLLC bankruptcies. With the proliferation of laws allowing the formation SLLCs, courts may soon be asked to answer fundamental questions about SLLCs and bankruptcy. abi

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