

VIRGINIA'S "NEW" ENTITY - THE PROTECTED SERIES LIMITED LIABILITY COMPANY

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This article is intended to introduce the reader to Virginia's newest legal entity and provide a brief overview of some of the more significant characteristics of the "protected series limited liability company" (the "SeLLC"). Virginia has very modern business entity statutes, all typically based heavily on the various uniform laws drafted by the Uniform Laws Commission, and the Virginia Uniform Protected Series Act¹ is no exception. This discussion is not intended to be a complete and comprehensive analysis, but rather to describe and explain some of the similar and unique provisions of the Act (compared to other Virginia entities) and also comment on some practical issues.² Hopefully it will provide enough information to enable readers to assess more readily the potential of the SeLLC with their own review and research of the Act and the SeLLC for asset holding structures that might be useful in particular situations. In particular, a basic discussion of the use of SeLLCs for real estate holdings in Virginia will be included.

A. Introduction to the SeLLC

A complex variant of the limited liability company form of entity is the relatively new "series" limited liability company ("SeLLC"), created by Virginia's 2019 enactment of its version of the Uniform Protected Series Act.³ In fact, the VUPSA is not a "stand-alone" Act, but is really a subset of the Virginia Limited Liability Company Act (Article 16 of Chapter 12 of Title 13.1; the "VLLCA"); it can better be understood in that context. If the VUPSA does not address an issue, the VLLCA controls.

SeLLCs began in Delaware over 20 years ago, but perhaps due to non-adoption elsewhere (along with unfavorable cases involving foreign recognition), they still only exist in approximately 15 states as of the date this was written. The main legal distinction of a SeLLC from a regular LLC is the presence of an internal liability shield that protects assets of the SeLLC and its various "series" from liabilities of each other and each other series (occasionally referred to as "horizontal" liability), as well as the protection of the members from liabilities of the entity and the entity from liabilities of its members as with a regular LLC (also referred to as "vertical" liability). In this sense, the SeLLC emulates the effect of having a tiered LLC structure – a "master" or "parent" LLC that itself owns any number of single member LLCs or "children" LLCs (much like wholly-owned subsidiaries), the form of compound asset holding using different "buckets" that has heretofore been utilized. However, the SeLLC also can take this somewhat common design one step further than the parent-child structure

¹ The Virginia Uniform Protected Series Act is based on the Uniform Act promulgated in 2017 by the National Conference of Commissioners on Uniform State Laws (NCCUSL) (aka the Uniform Laws Commission - <https://www.uniformlaws.org>), is effective as of July 1, 2020. See Va. Code § 13.1-1088 et seq.

² There are many other issues not covered in this article that should be considered when evaluating the use of an SeLLC—such as the rules regarding rights of members to information and compliance with entity transaction rules that are available, to name a few.

³ The provisions of the VUPSA, though enacted in 2019, have a delayed effective date of July 1, 2020.

by permitting different members of the different series, provided that all such members are also members of the SeLLC.⁴ This unique aspect of the SeLLC distinguishes it from all other Virginia entities (except the Business Trust, which also has the concept of different series⁵ and discussed some in this article), and also contributes to its relative complexity among entities.

B. General Characteristics of a SeLLC

As defined by the VUPSA,⁴ the SeLLC is characterized by the following:

1. an identifiable set of assets segregated within a limited liability company (“a series limited liability company”);
2. the assets:
 - a. comprise a protected series, which is empowered to conduct activities in its own name;
 - b. must be identified by thorough recordkeeping that distinguishes them from assets of the series limited liability company and assets of any other protected series of the company;
 - c. are obligated solely to persons asserting claims pertaining to activities related to the segregated assets; and
 - d. are not available to persons asserting claims arising from the activities of the series limited liability company or any other protected series of the company;
3. one or more members of the series limited liability company may be associated with the protected series, but not necessarily; and
4. distributions arising from the assets and activities go to:
 - a. the members associated with the protected series, if any; or
 - b. if the series has no associated members, the series limited liability company.

C. Organizational and Entity Issues

1. *SeLLC Operating Agreement.* A detailed operating agreement will be absolutely critical to a SeLLC, and except as otherwise specifically provided by the VUPSA, it will govern:

- a. The internal affairs of a protected series, including: relations among associated members, managers, assignees of the protected series and the protected series; rights and duties of any managers; governance decisions affecting and the conduct of the activities and affairs of the protected series; and procedures and conditions for becoming an associated member or protected series assignee;
- b. The relations among the protected series of a series limited liability company, the series limited liability company, and any other protected series of the series limited liability company; and
- c. Relations between any of the protected series, its manager, any associated member or assignee of the protected series; and a person who is not an associated member, manager or assignee of the protected series, or an assignee of the series limited liability company.⁶

2. *Limitations.* The SeLLC has more limitations for entity combinations than other Virginia entities, largely due to its unique multi-faceted nature.

- a. A series limited liability company may not: convert to a different type of entity; domesticate as a foreign limited liability company; or be a party to or the surviving company of a merger

⁴ Va. Code § 13.1-1099.3.A.

⁵ See Va. Code § 13.1-1219.B.1.

⁶ Va. Code § 13.1-1092.

(unless not created in the merger).⁷ However, an SeLLC may be party to a merger only if: each party to the merger is a limited liability company; and the surviving LLC is not created in the merger.⁸

b. To clarify: although a protected series is generally regarded “as if” it were a separate LLC,⁹ it cannot: be a party to a merger; convert to a different type of entity; domesticate as a protected series under the laws of a foreign jurisdiction; or be a party to or be formed, organized, established, or created in a transaction substantially like a merger, interest exchange, conversion, or domestication.¹⁰

D. Additional Characteristics and Limitations

The SeLLC concept can perhaps best be understood by looking at the entity from the perspective of the assets with those assets being separated into different series and identified as such— both by the SeLLC’s name and series name, and suffixed with either “protected series,” “PS,” or “P.S.” Each separate series of assets may, but need not, be effectively owned by different members of the SeLLC and associated with the assets of a protected series. Each PS will need to file a “statement of protected series designation”¹¹ with the SCC and pay its own filing fee and annual registration fee.¹² The PS must have a registered agent (as with other entities conducting business in Virginia), but it must be the same agent as its SeLLC.¹³ From a state law filing perspective, the SeLLC offers no cost or administrative advantage over a tiered structure of LLCs, and also will be at least as complicated from an organizational structure and document standpoint. The novelty of SeLLC’s governing law, the statutory provisions and terminology (overlaid on the existing LLC laws), and the interrelated nature of the SeLLC and its PSs almost certain to make the SeLLC a significantly more complicated organizational structure than the LLC. There are also many statutory provisions for SeLLCs that cannot be altered by the SeLLC’s operating agreement, such as the requirement that all SeLLC Members must agree to any amendments of a statement of a protected series designation.¹⁴ On the other hand, for very closely held SeLLCs, some operational and dissolution simplifications may exist due to the overlapping nature of the SeLLC and its PS— such as the dissolution of the SeLLC resulting in the dissolution of every PS within it.¹⁵

With respect to the SeLLC, confusion will likely arise from the unique terminology of the VUPSA itself. The VUPSA does not use familiar language such as the PS “owning” an asset; rather it uses the construct that an asset is either “associated” with a PS or the SeLLC (but not both). Also, confusion will arise from the fact that only the SeLLC can participate in certain entity-level transactions (like a merger with another LLC),¹⁶ and dissolution of the SeLLC also causes dissolution of its PS;¹⁷ but each

⁷ Va. Code § 13.1-1099.15.

⁸ Va. Code § 13.1-1099.16.

⁹ Va. Code § 13.1-1094.1.

¹⁰ Va. Code § 13.1-1099.14.

¹¹ Va. Code § 13.1-1095.

¹² Va. Code §§ 13.1-1099.1. and 13.1-1061.

¹³ Va. Code § 13.1-1097.

¹⁴ Va. Code § 13.1-1093.A.9. and 13.1-1095.D.

¹⁵ Va. Code § 13.1-1099.11.1.

¹⁶ Va. Code § 13.1-1099.14.

¹⁷ Va. Code § 13.1-1099.11.1.

PS is otherwise regarded as a separate “person,”¹⁸ having the power and authority to hold, own, manage and administer its own assets, as well as contract and conduct business in its own name, and sue and be sued in its own name,¹⁹ characteristics normally reserved for legal separate entities. A PS apparently can own interests in other legal entities, such as other LLCs and corporations, but cannot own an interest in its own SeLLC or another PS.²⁰ Further, the various Member and Manager interests in a SeLLC or PS are interconnected with the SeLLC and each PS in many ways, which further compounds the potential confusion.²¹ Specifically to this point of potential confusion, with respect to each PS, an associated member, assignee, membership interest, manager, asset, or creditor or other obligee of the PS is also “deemed to be” a member, assignee, membership interest, manager, asset, or creditor or other obligee of the SeLLC.

The image here is a comparatively flat one-tiered structure: with the members of the SeLLC as the owner level, the SeLLC as the consolidated entity level directly owned by its members, and each PS being owned only by those same members of the SeLLC (though potentially in differing proportions) as the series level. In contrast, partnerships and LLCs can have any number of tiers of members—sort of like the mythical story of the earth’s support being on the back of a turtle, which in turn rested on the back of another turtle, and so on *ad infinitum*.

For example, a simple SeLLC could have two series, A, PS and B, PS. This would involve three separate SCC filings: first one for the SeLLC Series, and then one each for the SeLLC Series A, PS, and SeLLC Series B, PS. Let’s assume three persons who would like to participate in a business venture, X, Y and Z, but X and Y only are to have rights in the asset associated with SeLLC Series A, PS, and only Y and Z are to have rights in the asset associated with SeLLC Series B, PS. All three of X, Y and Z must be members of the SeLLC. The income from the activities of SeLLC Series A, PS, is only distributable to X and Y, and the income from the activities of SeLLC Series B, PS, is only distributable to Y and Z. Obviously very detailed books and records for each PS will be required in this regime, and that is precisely the mandate of the VUPSA.²² If a member were to convey its transferrable interest,²³ it must convey both the associated member interest in the SeLLC and the member interest in the PS with which it is associated.²⁴

E. Liabilities

Somewhat unique to Virginia’s statutory requirements for entities,²⁵ recordkeeping for assets and members will need to be detailed and comprehensive and maintained meticulously on a continuous basis because much of the segregated liability protection afforded to the SeLLC and each of its separate protected series is based on the proper maintenance of such records. For instance, separate bank accounts for each PS would undoubtedly be essential. In short, if an asset is associated with SeLLC Series A, PS, and there is a creditor of that series or a particular asset of that series, and the proper identification and activity records are maintained, that creditor will not be able to pursue its claim against either SeLLC Series B, PS, the SeLLC, or any of their respective members. As noted, the Virginia Business Trust by its statutory terms has a similar horizontal liability shield,²⁶ but its

¹⁸ Va. Code §§ 13.1-1089 and 1094.1.

¹⁹ Va. Code § 13.1-1090.A.

²⁰ Va. Code § 13.1-1090.D.

²¹ Va. Code § 1094.

²² Va. Code § 13.1-1099.2.

²³ Va. Code § 13.1-1039.A.

²⁴ Va. Code § 13.1-1099.3.A.

²⁵ Except perhaps for Virginia Business Trusts, see Va. Code § 13.1-1219.B.

²⁶ Va. Code § 13.1-1231.D.

language for a separate series is more limited, now 20 years old, and judicially untested in Virginia. More on this comparison below.

1. *Exclusive Charging Order Remedy.* A significantly critical protective feature of the SeLLC is that the ultimate creditor remedy against a Member's interest in a SeLLC is a "charging order." As with Members of an LLC,²⁷ Virginia's exclusive remedy for a creditor against a Member's or assignee's interest in a SeLLC is a "charging order" on that interest²⁸ – a remedy arising out of the Uniform Partnership Act²⁹ and akin to a garnishment. A creditor holding a charging order collects the economic returns for the LLC interest until the lien is satisfied, but they cannot seize or sell that Member's interest in the LLC. This is substantial protection of a Member's ownership interest, and can result in a bargaining advantage in settlement of claims, because if there are no SeLLC distributions, the creditor gets nothing and has to sit and wait for the possibility there will be distributions in the future. In contrast, a shareholder's ownership of stock in a corporation does not have similar protection - the stock can be seized and sold through judicially ordered processes as with other personal assets. In closely held entities where the Member/owner has control or a significant voice over distributions, the practical benefits of this exclusive charging order are even more substantial.

2. *Comparison to the Virginia Business Trust.* Comparing this asset protection advantage of the SeLLC to the Virginia Business Trust, the only other Virginia entity that provides for separate series of asset ownership, the SeLLC is superior at its basic statutory level. A Virginia Business Trust does not have exclusive charging order protection under Virginia law. A creditor of a beneficial owner of an interest in a Virginia Business Trust can pursue all remedies available under law against that beneficiary's interest. This disadvantage can be remedied by interposing an LLC as the owner of the business trust interest, but that extra layer begs the question of the selection of the business trust as the entity of choice in the first place. However, if the business trust were already in place, this extra step might make sense (if a conversion of entity type or merger of the Virginia Business Trust were not possible or desired).

F. Taxation

The SeLLC will be subject to the same kinds of tax analysis as an LLC. It will be able to elect corporate tax treatment, or otherwise be classified under the default provisions depending on whether it has a sole owner or multiple owners.³⁰ If there are multiple members but all their respective SeLLC and PS interests are all the same, then one partnership tax return should be the logical answer. In an SeLLC with a more complicated structure, each protected series of an SeLLC will be subject to a similar analysis, so an SeLLC that has PSs with different associated members among those PSs could easily be treated as a partnership of partnerships (i.e., "tiered partnerships") for income tax purposes. If the SeLLC with such PSs with differing associated members desired to only file one partnership income tax return, it still should be able to do so for at least the time being,³¹ but will have to observe and its operating agreement reflect the detailed special allocation rules of IRC § 704 to accurately track the income from each PS, and of course meticulously maintain capital accounts to give economic

²⁷ Va. Code § 13.1-1041.1.

²⁸ Va. Code § 13.1-1099.9.

²⁹ Va. Code § § 50-73.108.

³⁰ 26 CFR § 301.7701-2. Federal tax regulations proposed in 2010 would treat each series within a SeLLC as a separate entity for federal income tax purposes. REG-119921-09, filed 9/13/10, published 9/14/10 (F.R. Doc. 2010-22793; 75 Fed. Reg. 55699 et seq.), adding Prop. Treas. Regs. §§301.6011-6, 301.6071-2, and 301.7701-1(a)(5), and amending §§301.7701-1(e) and (f). Each series would be classified as a partnership, disregarded, or as an association taxable as a corporation. To date, these have not been finalized.

substance to those PS allocations in liquidation. Thus, in complex SeLLCs, the tax treatment will be at least as complex as their organizational structures.

G. Observations on Adoption and Use of the SeLLC

The SeLLC will likely be accompanied by the perception of consolidation, simplification and economy in having one entity that has many component parts, but in matter of fact such thinking will largely be disappointing. While some consolidation simplification results from having a common registered agent³¹ and the possibility of a common manager for the SeLLC and all of its protected series, *each* protected series will need to be registered with and pay annual fees to the Virginia SCC (as if a separate entity), and will need to be the subject of detailed provisions in the SeLLC's operating agreement (though there will likely be occasion for replication of similar provisions by extrapolation and cross-reference). Separate accounts and accounting will be required in all cases. Of course, something can be said about having just one operating agreement despite it being more complex; it certainly should be able to be review and/or amended easier than multiple agreements of sibling LLCs, regardless of how similar they may be. Unless and until there is widespread adoption of the SeLLC across the United States to add more certainty to the issues caused by jurisdictions that do not recognize SeLLCs, SeLLCs will be best suited for assets and activities that are clearly subject only to Virginia law (or only the laws of a sister UPSA state). There are also other uncertainties resulting from the interaction with other laws, such as federal bankruptcy and securities laws to name just two. Additionally, there is the not insubstantial consideration that novelty invokes its own complexity and uncertainty that can only be addressed with gaining legal and operational familiarity over time. As such, at least for a while, the SeLLC will likely only be used by advanced practitioners for specific subsets of types of aggregated asset structures.

H. Observations for Use of the SeLLC for Real Estate Holdings

The SeLLC may prove to be a useful form of Virginia entity for certain assets that merit one-level tiered structures, such as for a real estate investor that owns and manages multiple rental or investment properties - they could form an SeLLC and put each separate property into a different PS. At the top of the list of advantages is the combined benefit of horizontal and vertical liability protections as well as the exclusive creditor remedy of the charging order. Especially for single owner or very closely held ownership of SeLLCs, an SeLLC may offer some simplification and cost savings over time, particularly as familiarity and acceptance become more commonplace. For multi-owner SeLLCs, there will be additional complications in design and drafting of SeLLC documentation, (presumably no less simple than a tiered LLC structure) particularly in the initial setup, but also perhaps in ongoing operational complexities, especially with changing assets and Members.

As for concerns and potential disadvantages of SeLLCs, novelty and unfamiliarity are likely to at least initially cause issues for SeLLCs and their PSs—particularly with title, borrowing and security. Title issues should be the easiest to resolve, as the separate entity provisions should be readily applied to the SeLLC and each PS. Authority in PS managers to contract for and convey real property should also be readily established, because they are simultaneously managers of the SeLLC.³² The SeLLC itself is deemed to be the manager of any PS without associated members.³³ Based on anecdotal experience, the novelty and complexity of the SeLLC and PS are likely to cause lenders to be more concerned about the SeLLC. The early adopter of the SeLLC is likely to face additional compliance issues with banks and financial institutions for lending either to the SeLLC or a PS, and in documenting authority for the securing of such loans, including UCC financing statement issues. Virginia has addressed this as much as possible in the relatively uncharted SeLLC environment, clarifying that a PS is a separate entity capable of acting as a separate juridical entity for almost all

³¹ Va. Code § 13.1-1097.

³² Va. Code § 13.1-1094.A.5.

³³ Va. Code § 13.1-10994.B.

transactions except for certain limited entity-level transactions. Perhaps the most likely result in the authority arena is that signoffs will be asked of both the SeLLC and the PS involved; time will tell.

I. Conclusion

Some have and will suggest the SeLLC is an entity that no one asked for and no one needed. They may be correct, as they have been for more than 20 years in the case of early-adopting jurisdictions, though a brighter future may in fact exist for the Virginia SeLLC. No new form of entity has been quick to be adopted, and the SeLLC is likely to be no different. Over time, however, the SeLLC will become more recognized and accepted, and will no doubt take its place in the tool chest of the planners that think, advise, and choose the best tools for the job at hand.