

TITLE ALERT

Title Alert 2016-04

April 1, 2016

Series LLCs

PA - STANDARD

Purpose: To provide guidance and establish requirements for transactions involving a series limited liability company.

Background: An increasing number of states have adopted legislation authorizing the formation of a business entity known as a series limited liability company (“Series LLC”). A Series LLC is similar to a traditional LLC, but differs in that it is permitted to segregate its assets, liabilities, and members into any number of separate cells within the Series LLC itself. Under the laws of most states that have passed legislation permitting Series LLCs, each cell is protected from the liabilities of other cells and the Series LLC by its own internal liability shield. Therefore, this Title Alert will refer to the cells of a Series LLC as “Protected Series” – though it is important to remember that some states may not provide a liability shield for each cell. State laws vary on other defining attributes as well. For example, some states treat each Protected Series as a separate entity capable of entering into contracts, suing or being sued, and holding title to real or personal property in its own name, whereas others do not. As will be evident from this Title Alert, Series LLCs remain a novel and developing concept for which few generalizations can safely be made.

The perceived advantage of utilizing a Series LLC structure is that it may carry lower costs (legal, regulatory, accounting, tax, or registration) than forming a new entity to hold certain assets or transferring assets between existing entities. However, unanswered questions and a lack of uniform state laws have limited their use in the business world. With regard to title insurance, such unanswered questions include:

- Can a Protected Series hold title in its own name, or must the Series LLC hold title for the benefit of the Protected Series?
- Do liens, judgments, or similar encumbrances against one Protected Series attach to the property of another Protected Series or the Series LLC itself?
- Can a Protected Series file for bankruptcy by itself, or must the Series LLC file for bankruptcy on its behalf? If the Series LLC files for bankruptcy, will the assets of the Protected Series be part of the Series LLC’s bankruptcy estate? If a Protected Series can file for bankruptcy, will the assets of another Protected Series or the Series LLC become part of the bankruptcy estate?
- How will jurisdictions that do not have Series LLC legislation treat property ownership by a Series LLC, or a Protected Series thereof, formed under a jurisdiction that does have Series LLC legislation? Will the “non-series jurisdiction” respect and uphold the liability shield of the Series LLC or its Protected Series?

- Is a Protected Series qualified to do business in jurisdictions other than the jurisdiction of its formation?
- Do transfer taxes apply to a direct or indirect transfer of property between a Series LLC and its Protected Series, or between two Protected Series within the Series LLC?

While some state statutes provide answers to these questions, others do not, and the courts have not provided much guidance. Because Series LLCs are unique and difficult concepts, even for attorneys knowledgeable in corporate law, Penn Attorneys/Ohio Bar Title Insurance Company (PA/OBT) considers Series LLCs to be an unusual risk.

Recognizing that you are dealing with a Series LLC or a Protected Series thereof is the first step to help us underwrite the issues associated with these entities. Note that a Series LLC or Protected Series will not always use the word "series" in its name. Relatedly, the mere fact that an entity uses the word "series" in its name does not automatically indicate that it is a Series LLC or Protected Series. Therefore, a review of the operating agreement (sometimes called a limited liability company agreement, or similar term) is often necessary to determine whether you are dealing with a Series LLC. By way of example, you may encounter the following naming conventions, among others:

- **Series LLC:**
 - o Business Entity, LLC, a Delaware series limited liability company
 - o Business Entity, Series LLC, a Delaware series limited liability company
- **Protected Series:**
 - o Business Entity, LLC - Series A, a series of Business Entity, LLC, a Delaware series limited liability company
 - o 123 Main Street, a series of Business Entity, LLC, a Delaware series limited liability company

Standard: Penn Attorneys/Ohio Bar Title Insurance Company (PA/OBT) will follow the protocol set forth below that best corresponds to the circumstances of your transaction.

A. The Proposed Insured under an owner's policy is a Series LLC or Protected Series

You must obtain approval from Penn Attorneys/Ohio Bar Title Insurance Company (PA/OBT) before we will issue an owner's policy naming a Series LLC or a Protected Series thereof as the Insured. Before seeking approval, you should be prepared to answer the following questions:

- Will title be vested in the Series LLC or a Protected Series thereof?
- Under what state's law was the Series LLC formed?
- Do the founding documents of the Series LLC contain any provisions required by the law of the state of its formation for keeping Protected Series' assets separated from one another and from the Series LLC?
- Is a Protected Series considered to be a full artificial person with its own independent corporate existence under the laws of the state where the Series LLC was formed?

- Is a Protected Series capable of holding title in its own behalf under the laws of the state where the Series LLC was formed?
- In what state is the property located? If it is not the same state where the Series LLC was formed, on what basis have you concluded that the state where the property is located will recognize and respect the foreign Series LLC concept?

B. The borrower in the Insured Mortgage under a loan policy is a Series LLC or Protected Series

You must obtain approval from PA/OBT before we will issue a loan policy to a lender whose borrower under the Insured Mortgage is a Series LLC or a Protected Series thereof. Before seeking approval, you should be prepared to answer the following questions, in addition to those set forth above for owner's policies:

- Who is the borrower under the loan agreement: the Series LLC, a Protected Series thereof, or both?
- Who will be executing the Insured Mortgage: the Series LLC, a Protected Series thereof, or both?

C. The Proposed Insured under a loan policy is a Series LLC or Protected Series

You must obtain approval from PA/OBT before we will issue a loan policy naming a Series LLC or a Protected Series thereof as the Insured. We will only name the actual lender (i.e., the source of the loan funds named in the promissory note) as an Insured under a loan policy. For example:

- If the Series LLC is the lender named in the promissory note, we will name the Series LLC as the Insured.
We will not name as additional insureds any Protected Series of the Series LLC.
- If a Protected Series is the lender named in the promissory note, we will name the Protected Series as the Insured. We will not name as additional insureds any other Protected Series, or the Series LLC itself.
- The issuance of any endorsements will require specific underwriting review and approval. You should be prepared to explain how you have concluded that the Series LLC or the Protected Series, as the case may be, has properly qualified to do business in the state where the property is located, or is exempt from qualification requirements.

Series LLCs are complex. Contact us for assistance, or if the customer requests a Schedule A listing of the Insured that differs from the instructions above.

D. The seller of the property to be insured is a Series LLC or Protected Series

You must pay careful attention to the authority documentation establishing the right of the Series LLC or a Protected Series thereof to convey the property. Series LLC authority can be complicated, and you should contact us if you need assistance.

E. Title Search, Examination, and Clearance Requirements for Series LLCs and Protected Series

i. Title Search and Examination

In all cases where a Protected Series purports to be in actual or beneficial title to the Land, you must search and report matters with regard to that Protected Series. Similarly, in all cases where a Series LLC purports to be in actual or beneficial title to the Land, you must search and report matters with regard to that Series LLC. These search and examination requirements are the same as those for other types of business entities, including traditional LLCs.

However, the following additional search and examination requirements also apply with regard to Series LLCs and Protected Series thereof: If a Protected Series purports to be in actual or beneficial title to the Land, then you must also search and report matters with regard to all other Protected Series of the Series LLC, as well as the Series LLC of which they are a part. In order to perform this search and examination, you should first obtain from the seller or borrower, as the case may be, a list of all Protected Series that are part of the Series LLC. Note that several states do not require a separate public filing for each Protected Series or a separate operating agreement for each Protected Series, and also note that the operating agreement for the Series LLC may not identify each Protected Series within the Series LLC. Therefore, obtaining a list from the seller or borrower is the most reliable evidence in regard to what Protected Series may be part of the Series LLC.

Of course, it may not always be possible to complete the additional search and examination discussed above. Therefore, in the alternative, if you are unable to perform the additional search and examination described above, then we will raise the following exception and/or requirement, as applicable:

EXCEPTION

“Any defect, lien, encumbrance, or other adverse matter on or affecting the Title that may arise by, through, or under [name of Series LLC], a(n) [name of state where Series LLC was formed] series limited liability company, or any series thereof other than [name of the Protected Series which you have searched and examined].”

REQUIREMENT

“Evidence satisfactory to the Company of the release or non-existence of any defect, lien, encumbrance, or other adverse matter on or affecting the Title that may arise by, through, or under [name of Series LLC], a(n) [name of state where Series LLC was formed] series limited liability company, or any series thereof other than [name of the Protected Series which you have searched and examined].”

In some circumstances, it may be permissible to limit the scope of your search and examination, and/or PA/OBT may modify or delete the exception or requirement. However, the analysis to do so may require considerable time and document review, and you should reach out to us as soon as practicable if you will be seeking to limit the scope of your search, or to modify or delete the exception. You should carefully manage customer and lender expectations in this regard.

ii. Title Clearance

If a customer or lender requests matters to be cleared as requirements or exceptions on the basis that the Series LLC and any Protected Series thereof are independent of one another, contact us. You should be prepared to answer the questions set forth above with regard to naming a Series LLC or a Protected Series thereof as a Proposed Insured under an owner's policy.

F. The lender from whom you are requesting a payoff is a Series LLC or Protected Series

You must pay careful attention to the authority documentation establishing the right of the lender to accept a payoff and provide a release of the mortgage. It is a best practice to obtain a copy of the note in advance and confirm whether it has been endorsed to (or endorsed in blank and in the possession of) the Series LLC or Protected Series that would be receiving the payoff and providing the release. Series LLC authority can be complicated, and you should contact us with the details.

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Series LLCs remain a unique and difficult concept, and PA/OBT will analyze each use of a Series LLC or Protected Series on its own particular facts for title insurance purposes. Feel free to reach out to us for support and assistance if you encounter a Series LLC or Protected Series.

If you have any questions, please feel free to contact us.

Note: Under the Approved Attorney system, the scope of our relationship is limited to the functions of underwriting and the issuance of title insurance policies on your behalf and does not include closing or escrow services. We sometimes provide information and recommendations with regard to your closing or escrow business as a courtesy to you. Moreover, some communications, depending on whether noncompliance could impact on liability under our policies or closing protection letters, should be considered directives. This Advisory is being provided to you with those considerations in mind.

WARNING: This Underwriting Communication is intended solely for the employees of Penn Attorneys/Ohio Bar Title Insurance Company and its Approved Attorneys, and is not to be distributed to third parties, and any reliance by any other person or entity is unauthorized. This Underwriting Communication is intended solely for the purpose of underwriting policies of Ohio Bar Title Insurance Company.

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