

TITLE ISSUES

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A SERIES OF LIMITED LIABILITY COMPANY INTERESTS: A NEW TOOL TO FURTHER ISOLATE LIABILITY

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Introduction

Effective August 16, 2005, Illinois followed the lead of Delaware, Iowa, Wisconsin and Oklahoma by enacting legislation authorizing the creation of a new business entity, or at the very least, a new variation of the limited liability company. The name of this “new kid on the block” is “a series of members, managers or limited liability company interests” popularly known as “a series of limited liability company interests” or “a series LLC” (“series”). New section 37-40 of the Limited Liability Company Act, 805 ILCS 180/37-40, authorizes and defines a series. This article explores the real estate aspects of a series from a title company’s perspective.

Illinois limited liability companies have been in existence for over a decade. In the years following their inception, real estate investors and their attorneys have embraced limited liability companies as a preferred vehicle for holding title to a particular parcel of real estate. What makes the limited liability company so popular? The limited liability company isolates liability from other assets of the

investors that are not included within that specific limited liability company. It is common to create a limited liability company solely for holding title to a particular piece of real estate (single purpose entity). The name of the limited liability company itself often includes the address of the real estate for which it holds, or will hold, title. When the limited liability company later sells the real estate, the purpose for the limited liability company no longer exists, and the investors dissolve it.

It is generally not prudent for one limited liability company to hold title to more than one real estate project, especially if any site is high risk from a liability perspective. A high-risk example is real estate that has environmental problems. If the same limited liability company holds title to an environmentally challenged parcel and also owns residential real estate, liability arising from the high-risk site could affect the safer, residential property as well. This scenario is not conducive to encouraging investment in real estate because the risks can be so high. Until



the series came along, the only option was to create a separate limited liability company for each site.

Statutory Components of a Series

To create a series, the limited liability company itself must be properly created. See the Illinois Secretary of State's filing form LLC-5.5 (S) at the end of this article. (series contemplated). Compare form LLC 5.5 (series not contemplated). The filings with the Secretary of State must give notice of the creation or future creation of a series. (Form LLC-5.5 (S) only).

Then, the members or organizers of the limited liability company must draft specific language in the operating agreement of an existing or prospective limited liability company that either establishes a series or makes provision for a series in the future. 37-40(a). A series is not restricted to a particular business purpose. For example, a builder constructs residential housing as well as shopping centers. A separate series may be created for each site.

Item 7 on form 5.5 (S) defines the key characteristics of a series:

7. The operating agreement provides for the establishment of one or more series. When the company has filed a certificate of designation for each series, which is to have limited liability pursuant to 37-40 of the Illinois Limited Liability Company Act, the debts, liability and obligations incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only, and not against the assets of the limited liability

company generally or any other series thereof, and unless otherwise provided in the operating agreement, none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to this company generally or any other series thereof shall be enforceable against the assets of such series. (Emphasis added) See also 37-40(b).

Section 37-40(b) of the Act describes the steps necessary to insulate the liability of a particular series from the limited liability company and others in the series:

- (1) The series must maintain its records distinct from the limited liability company and any other series.
- (2) The series must establish separate accounting procedures and hold its assets separate from other assets of the limited liability company.
- (3) The limited liability company must file a form called "Certificate of Designation" with the Illinois Secretary of State for each series. (Form LLC-37-40). The form appears as an exhibit at the end of this article.

What's in a name? Plenty, according to the statute. Section 37-40(c) states that the entire name of the limited liability company must appear in the name of the series, and the series must be distinguishable from others in the series. The statute does not provide further details or suggestions. For example, assume that the name of the limited liability company is XYZ LLC, an Illinois Limited Liability Company. Permitted names for one in the series

might be “XYZ LLC, an Illinois Limited Liability Company- Blackacre Series” or “Blackacre, a Series of XYZ LLC, an Illinois Limited Liability Company”. Both versions follow the language of the statute. This author recommends including the word "Series" in the name. Only time will tell what will be a typical style for the naming of a series.

Section 37-40(d) of the Act states a series begins its existence when the Secretary of State’s office approves the certificate of designation application form (LLC-37-40) and stamps “Filed” on each of the duplicate copies.

The statute provides that the limited liability company, or any manager, person or entity designated in the operating agreement, may file a certificate of designation.

Item 4 of the form states the registered agent and registered office for the limited liability company in Illinois shall serve as the agent and office for service of process in Illinois for each series. 37-40(f).

Items 5(a) and (b) inquire whether the series is member or manager-managed. Section 37-40(h) allows the series to choose what type of management will prevail for that particular series. Unless otherwise provided in the operating agreement, the management of a series is member-managed. Items 5(a) and (b) need only be filled out if management of the series is different or changed from management of the limited liability company. Any noted changes from the limited liability company’s operating agreement must also include the names and business addresses of the series managers and the

names and addresses of the series members. For example, the limited liability company has 5 members. Not all 5 need to be members of each series created. The operating agreement may provide for future new members of a subsequent series. Form LLC-37-40 also includes a box to check in item 3 when there is a series name change or when dissolving the series.

A series of a limited liability company is in good standing as long as the limited liability company is in good standing. 37-40(e). Unless stated otherwise in the operating agreement, the dissolution of a series does not dissolve the limited liability company, or any other in the series. However, the dissolution of the limited liability company dissolves the series. 37-40(m).

Filing Costs

For investors holding numerous real estate assets, the creation of multiple limited liability companies can get expensive when you consider the filing costs and annual fees payable to the Illinois Secretary of State’s office due from each limited liability company (805 ILCS 180/50-10). Investors and their attorneys now have the option of either creating a separate limited liability company for each real estate site or creating one limited liability company with a series for each site. The series version might save the investor some money in the long run. The pertinent fees are:

- 1) articles of organization (domestic), \$500.
- 2) restated articles of organization (domestic) in connection with a

- limited liability company with a series, \$750.
- 3) certificate of designation for each series, \$50.
 - 4) annual report by a limited liability company without a series, \$250.
 - 5) annual report by a limited liability company with a series, \$250 plus \$50 for each filed series.

Title Insurance Requirements

A commitment for title insurance shows title vested in XYZ LLC, an Illinois Limited Liability Company Series X. You represent the seller. What type of title clearance will the title company require?

- 1) A certificate of good standing for an Illinois limited liability company from the Illinois Secretary of State establishing that the limited liability company was properly created to allow for a series, and evidence that the limited liability company is not dissolved subsequent to the date of certificate of good standing. If the limited liability company was formed under the law of another state, the certificate of good standing from the appropriate officer of that other state. The Limited Liability Company Act permits a foreign limited liability company to register with the Illinois Secretary of State. 805 ILCS 180/45-5(a).
- 2) A full copy of the limited liability company's current operating agreement containing language that it has or will establish a series, along with pertinent procedures necessary for the establishment of a series.
- 3) Documentation that the limited liability company did establish the series in question. Typical examples are language in the operating agreement or in subsequent resolutions. There should be clear language as to whether the series is to be manager managed or member managed.
- 4) A copy of the certificate of designation form for the series filed with the Illinois Secretary of State, and evidence that the series was not dissolved subsequent to the date of the certificate of designation. The form may provide information as to whether the series in question is manager managed or member managed, along with the names and addresses of members or managers. The statute permits a foreign limited liability company or its series to file for admission as a foreign limited liability company, or series, and a certificate of designation shall be filed for each series being registered to do business in Illinois. 37-40(o).
- 5) A copy of all authority documents for the series, including a resolution from all appropriate parties approving the contemplated transaction.

Conclusion

There are more choices than ever regarding how to vest title in Illinois real estate. There is no caselaw to report at this time that might shed some light on possible pitfalls to consider when

choosing between a series and a separate limited liability company for each real estate site. The series may offer significant filing fee savings for the same investor or investors dealing with multiple parcels of real estate each year. However, a series may not be the best choice in situations that require customized operating agreements for

each site or if each new series draws in new members. Time will tell whether attorneys and investors adopt the series as a popular and useful form of ownership.

Examples of these forms are attached to this email. The forms can also be found at <http://cdsprod.ilsos.net/corp.html>

We welcome your topic suggestions for future Title Issues. If you are interested in submitting your ideas, please e-mail us at: Patrick.quist@ctt.com or complete this form and mail to:



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TOPIC: _____
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