

Memo to the Floor
5-28-14

To: Committee of the Whole

From: Steven G. Frost, Chair
Daniel S. Kleinberger, Reporter

Subject: An act to provide for protected Series of Unincorporated Business Entities within unincorporated business organizations

Date: May 28, 2014

The Concept of a Protected Series

The Prefatory Note to the annual meeting draft explains the protected series concept in some detail as involving:

- an identifiable set of assets segregated within an unincorporated entity;
- with those assets:
 - comprising a protected series;
 - being associated with specified activities;
 - being solely responsible to persons asserting claims pertaining to those assets or arising from those activities; and
 - not being responsible to persons asserting claims arising from the assets or activities of the unincorporated entity or any other set of assets segregated within that entity; and
- with the profits of the protected series inuring to the benefit of:
 - the unincorporated entity (and thereby indirectly to all the owners of that entity); or
 - only specified owners of the unincorporated entity.

Although state statutes enacted to date refer simply to “series,” to avoid confusion the Drafting Committee has tentatively decided to use “protected series” as the term of art.¹

Import of this Project

The protected series:

- is one of the most significant developments in the law of business organizations since the advent of the limited liability company;

¹ For an explanation of the confusion, see the annual meeting draft, Reporter’s Introductory Note, Drafting Premises, What’s in a Name?

- pushes the conceptual envelop of entity law by providing for a quasi-distinct “legal person” existing *within* another, overarching entity;
- establishes a new type of liability shield – rather than protecting the owners of an enterprise from vicarious liability for the enterprise’s debts, the “internal shields” of a protected series protect the assets of one protected series from the creditors of the overarching entity and any other protected series of that entity;²
- is increasingly popular, with enactments in more than ten states and major commercial states waiting for an act from the Conference;³ and yet
- is a structure for which neither the Study Committee that recommended this drafting project nor the Drafting Committee has been able to identify any clear, specific, and unmet need.

Two Fundamental Drafting Issues

Stand-alone or “add on” – This project is entitled Series of Unincorporated Business Entities Act, which suggests a stand-alone act. In order to make policy decisions and explore conceptual and drafting complexities, the Drafting Committee decided to first draft an “add on” series article for one act. The Committee chose the Uniform Limited Liability Company Act (“ULLCA”) (2006) (Last Amended 2013).

Applying many provisions of the LLC act to protected series – A protected series has most of the characteristics and is subject to most of the same rules (default and mandatory) as apply to a limited liability company. The Drafting Committee has discussed two different methods for applying the main provisions of ULLCA (2006) (Last Amended 2013) to protected series:

- Separate article only –the annual meeting draft takes this approach.
 - o This approach necessarily involves “incorporation with substitution.” For example:

SECTION 1114. SUBSTITUTED MEANINGS; RELATIONSHIP BETWEEN THIS ARTICLE AND OTHERS.

(a) For the purposes of Sections 1115 to 1131, the following words and phrases are applied as follows.

(1) “certificate of formation” as if the phrase referred to “protected series designation”;

SECTION 1120. CONTRIBUTIONS AND DISTRIBUTIONS.

(a) Except as stated in subsections (b) and (c), Sections 402 through 406 apply to a protected series.

² This construct has long existed in the context of investment trusts, but in that context cross series liability claims do not arise. In 2009, the Conference adopted the Uniform Statutory Trust Entity Act, which provides a uniform vehicle for investment trusts.

³ For example, when a Florida bar association committee was working to enact the Uniform Limited Liability Company Act, that committee expressly decided to refrain from including provisions for protected series, pending the Conference’s work on the subject.

- The Committee on Style found this approach problematic. Although the approach has the virtue of brevity (relatively speaking), “incorporation with substitution” produces a dehydrated act, not useable “off the rack.”
- Separate article for series-specific provisions with tag-along provisions throughout the act
 - Appendix A illustrates this approach.
 - This approach:
 - does not ask the user to “re-hydrate” the protected series provisions; but
 - cannot be used in a stand-alone statute and will require detailed amendments in states that have adopted any version of the uniform LLC acts.

We look forward to your questions, comments, and guidance.