LIMITED LIABILITY COMPANIES -
MANAGEMENT STRUCTURES AND SELECTED
ISSUES IN USING LLC’S

BY

JAMES A. WINKLER

FOLEY & LARDNER
CHICAGO, ILLINOIS

AND

GARY E. FLUHRER

FOSTER PEPPER & SHEFELMAN
SEATTLE, WASHINGTON

PRESENTED TO THE

AMERICAN COLLEGE OF REAL ESTATE LAWYERS

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James A. Wikler
Foley & Lardner
Chicago, Illinois

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Gary E. Fluhrer
Foster Pepper & Shefelman
Seattle, Washington

Within a fairly short time, i.e., since most of us graduated from law school, limited liability companies have become the preferred organizational vehicle for many types of start-up businesses, and specifically for the ownership, operation and financing of real estate. The LLC form combines the objectives of limited liability and “pass-through” tax effect for its members with a seemingly endless choice of management structures. The LLC can be “member-managed;” it can be “manager-managed;” it can have a “corporate-style” management structure, complete with a board of directors, president and secretary, etc.; by way of “single-purpose entity” covenants and a required “independent member” or “independent director” the entity can be made “bankruptcy-remote” to avoid consolidation of assets with those of its principal owner or member in the event of the principal’s bankruptcy; it can have many members, or a single member; it can have (if organized in certain jurisdictions) “non-economic” members, and its status as an independent entity can even survive the death or other departure of its sole member; and, under the Delaware “series LLC” model, it may be able to own and operate a theoretically infinite number of businesses and properties, with each “series” having a different ownership and management structure, and with each series being liable only for the liabilities of the particular series and not for the liabilities of the LLC generally or of the other “series” established within the LLC structure. The purpose of this paper is to discuss some of the issues raised by this versatility of structure and use, and to focus particularly on management structures and issues of “authority” and “apparent authority.” For purposes of this paper, we will refer most often to the Uniform Limited Liability Company Act (“the ULLCA”), on which a number of state LLC statutes are based, and the Limited Liability Company Act of Delaware, which has been generally in the vanguard in adopting such concepts as the “single member,” “non-economic member” and “series LLC” concepts.

1 See particularly the LLC statutes of Hawaii, Illinois, South Carolina, Vermont and West Virginia.
2 Del.C. Tit. 6, §18-101 et seq.
1. **Varieties of Management Structure**

(a) **Member-Managed.** Most LLC statutes permit, or provide for, management by members, in accordance with the provisions of an LLC operating agreement or, in the absence of an operating agreement, either on a per capita basis, or according to ownership percentage interests. For example, the Delaware statute, section 18-402, provides that “Unless otherwise provided in a limited liability company agreement, the management of a limited liability company shall be vested in the members in proportion to the then current percentage or other interest of members in the profits of the limited liability company owned by all the members, the decision of members owning more than 50 percent of the said percentage or other interest in the profits controlling . . . .”

The ULLCA is rather different. At section 404, it is stated that “(a) In a member-managed company: (1) each member has equal rights in the management and conduct of the company’s business; and (2) except as otherwise provided in subsection (c) or in Section 801(b)(3), any matter relating to the business of the company may be decided by a majority of the members.” The Comment to section 404 makes it clear that the ULLCA’s per capita rule may be varied by the terms of the operating agreement, just as the text of the Delaware statute provides that the Delaware Act’s “proportional ownership interest” can be modified by the applicable operating agreement (which is actually referred to in the Delaware statute as a “limited liability company agreement”). Thus, the members can provide for voting and management rights among themselves in the LLC operating agreement in virtually any manner they wish.

(b) **Manager-Managed.** Section 203 of the ULLCA requires that the Articles of Organization of the LLC must set forth “whether the company is to be manager-managed, and, if so, the name and address of each initial manager.” In the absence of a designation that the company is to be manager-managed, the company will be member-managed.

The Delaware statute does not require that the certificate of formation state whether the LLC is to be member-managed or manager-managed. Section 18-402 of the Delaware statute, quoted above, provides that management shall be by the members “(u)less otherwise provided in a limited liability company agreement.”

(c) **Corporate-Style Management.** The Minnesota Limited Liability Company Act is an example of an LLC statute that allows for corporate-style management. Section 322B.606 of the Minnesota Act provides that “(t)he business and affairs of a limited liability company is (sic) to be managed by or under the direction of a board of governors . . . .” Each LLC must have one or more governors, who must be natural persons. Section 322B.603 provides that “[a] limited liability company may, but need not, have bylaws, which may, but need not, be known as an operating agreement.” Section 322B.67 provides that “[a] limited liability company must have one or more natural persons exercising the functions of the offices, however designated, of chief manager and treasurer.” The chief manager, among other things, has the authority to “sign and deliver in the name of the limited liability company any deeds, mortgages,

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3 Minn. Stat., §322B et. seq.

4 The LLC statutes of North Dakota and Tennessee are other examples of corporate-style organization.
bonds, contracts or other instruments pertaining to the business of the limited liability company, except in cases in which the authority to sign and deliver is required by law to be exercised by another person or is expressly delegated by the articles, a member control agreement, or bylaws or the board of governors to some other manager or agent of the limited liability company . . . .”

The board of governors under the Minnesota statutes has the power to appoint other managers or agents, and a manager has the power to delegate authority to an agent.

Although the requirements for a board of managers and for a chief manager are mandatory, it seems clear that, within this framework, management functions can be tailored pretty much as the members wish through the means of a “member control agreement.” Section 322B.37 of the Minnesota statute provides that “a member control agreement relating to any phase or aspect of the business and affairs of a limited liability company is valid as provided in subdivision 2 and enforceable as provided in subdivision 3. A member control agreement valid under subdivision 2 may relate to, without limitation, the management of the limited liability company’s business, the declaration and payment of distributions, the sharing of profits and losses, the election of governors or managers, the employment of members and others by the limited liability company, the relations among members and persons who have signed contribution agreements (including the termination of continued membership), the dissolution, termination and liquidation of the limited liability company (including the continuation of the limited liability company’s business through a successor organization or individual), and the arbitration of disputes. Wherever this chapter provides that a particular result may or must be obtained through a provision in the articles of organization (other than a provision required by section 322B.115, subdivision 1, to be contained in the articles), in the by-laws, or by an act of the board, the same result can be accomplished through a member control agreement valid under this section or through a procedure established by a member control agreement valid under this section. A member control agreement may allocate to the members authority ordinarily exercised by the board of governors, allocate to the board of governors authority ordinarily exercised by the members, or structure the government of the limited liability company in any agreed fashion and may waive, in whole or in part, the member’s dissenting rights under Sections 322B.383 and 322B.386.” A member control agreement is valid if in writing and signed by all members of the LLC and all persons who are a party to contribution agreements as of the date of execution.

Some state statutes, such as Delaware, specifically authorize a manager or member to delegate its right to manage and control the LLC to others. These state statutes would expressly authorize the appointment of corporate “officers,” a “board of directors” or other governing body, and delegate specified powers and duties. However, even in the absence of a specific provision in the applicable state statute regarding delegation, traditional common law agency analysis should authorize the managers to delegate specific powers to officers or boards in the LLC operating agreement. Although common law rules would generally prohibit agents (such as managers) from delegating discretionary authority, such authority under common law

5 Minn. Stat., §322B.37.Sub.2.
6 Del. C. Titl. §18-407.
rules can be delegated with the consent of the principal. Thus, the managers (in a manager-
managed LLC) under traditional common laws rules could be authorized to delegate certain
specified powers to others, such as officers or boards, in the LLC operating agreement. By this
type of express delegation in the LLC operating agreement, virtually any desired management
structure could be created.

2. **Authority-Agency Issues.**

   (a) **Member-Managed LLC’s.** Section 301(a) of the ULLCA provides that, with respect to a member-
       managed company, “(e)ach member is an agent of the limited liability company for the purpose of its business, and an act of a member, including the signing of an instrument in the company’s name, for apparently carrying on in the ordinary course the company’s business or business of the kind carried on by the company binds the company, unless the member had no authority to act for the company in the particular matter and the person with whom the member was dealing knew or had notice that the member lacked authority.” Subsection (2) of section 301 provides that “(a)n act of a member which is not apparently for carrying on in the ordinary course the company’s business or business of the kind carried on by the company binds that company only if the act was authorized by the other members.”

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7 See generally Restatement (Second) of Agency §18(1958). The delegation must be expressly authorized. Hence the description of the authority to be delegated, and the individuals to exercise such authority, should be expressly stated.

8 The LLC operating agreement would not only establish the express consent of the principal, but also satisfy any statutes or fraud issues requiring that an agent’s authority be in writing.

9 On the subject of “knowledge” and “notice,” the ULLCA contains section 102, which reads as follows: §102. Knowledge and notice.

   (a) A person knows a fact if the person has actual knowledge of it.

   (b) A person has notice of a fact if the person:

       (1) knows the fact;

       (2) has received a notification of the fact; or

       (3) has reason to know the fact exists from all of the facts known to the person at the time in question.

   (c) A person notifies or gives a notification of a fact to another by taking steps reasonably required to inform the other person in ordinary course, whether or not the other person knows the fact.

   (d) A person receives a notification when the notification:

       (1) comes to the person’s attention; or

       (2) is duly delivered at the person’s place of business or at any other place held out by the person as a place for receiving communications.

   (e) An entity knows, has notice, or receives a notification of a fact for purposes of a particular transaction when the individual conducting the transaction for the entity knows, has notice, or receives a notification of the fact, or in any event when the fact would have been brought to the individual’s attention had the entity exercised reasonable diligence. An entity exercises reasonable diligence if it maintains reasonable routines for communicating significant information to the individual conducting the transaction for the entity and there is reasonable compliance with the...
The Delaware statute does not raise conditions for “ordinary course” or “knowledge” or “notice” of the other party. Section 18-402 says simply that “(u)less otherwise provided in a limited liability company agreement, each member and manager has the authority to bind the limited liability company.” Under section 18-407, a manager or member also has the power to delegate its right to manage and control the LLC to “1 or more other persons.”

(b) Manager-Managed LLC’s. Under the ULLCA, “in a manager-managed company: (1) A member is not an agent of the company for the purpose of its business solely by reason of being a member. Each manager is an agent of the company for the purpose of its business, and an act of a manager, including the signing of an instrument in the company’s name, for apparently carrying on in the ordinary course the company’s business or business of the kind carried on by the company binds the company, unless the manager had no authority to act for the company in the particular matter and the person with whom the manager was dealing knew or had notice that the manager lacked authority.”

For real estate practitioners, Section 301(c) of the ULLCA provides the comfort that “[u]less the articles of organization limit their authority, any member of a member-managed company or manager of a manager-managed company may sign and deliver any instrument transferring or affecting the company’s interest in real property.”

(c) “Corporate” LLC’s. With respect to the Minnesota LLC statute, section 322B.673 cited above is clear in stating that it is the function of the chief manager to “sign and deliver . . . any deeds, mortgages, bonds, contracts or other instruments pertaining to the business of the limited liability company . . . .” These functions can be modified, however, and delegated or assigned to other managers or agents through an express delegation set forth in the articles, or through a member contract agreement, or through the LLC by-laws, or by resolution of the board of governors. Section 322B.676 of the Minnesota statute provides for the election or appointment, either as stated in the article, or in a member control agreement, or in the by-laws, or by resolution, of “other managers or agents the board of governors considers necessary . . . .” Section 322B.689 further contemplates that any manager may “delegate some or all of the duties and powers of an office to other persons.”

(d) Issues of “Actual,” “Apparent,” and “Inherent” Authority; Estoppel. Common law issues of “actual,” “apparent” and “inherent” authority, and the routines. Reasonable diligence does not require an individual acting for the entity to communicate information unless the communication is part of the individual’s regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

Some state LLC statutes otherwise modeled on, or similar to, the ULLCA and containing language similar to that of section 301 of the ULLCA with respect to “knowledge” and “notice,” nevertheless do not include a provision analogous to ULLCA section 102, apparently preferring to rely on applicable case law. For example, the Illinois LLC statute, 805 ILCS 180/1-1 et seq., contains at section 13-5 provisions similar to section 301 of the ULLCA, but does not contain a counterpart to section 102 of the ULLCA.

10 ULLCA, section 301(b).

11 Minn. Statute, §322B.673, Subd. 2(f).
principles of equitable estoppel, should generally be kept in mind and often will be of critical
importance. In this area, state law and “choice-of-law” principles may be determinative. For a
general overview of these issues, see “Agency Authority in LLC Statutes” by Matthew J. Barnett
and Brian H. Blaney, in the Spring and Summer 1998 issues of Journal of Limited Liability
Companies.

3. Due Diligence Issues. It is apparent that, regardless of the state of
organization of an LLC or the form of its management structure, most LLC statutes provide for
evernomous leeway in the ways in which an individual LLC may operate, usually by providing that
the operating agreement (which may be, as indicated above, referred to in some states as a
“limited liability company agreement” or a “member control agreement”) of an LLC may provide
for the management of an individual LLC in pretty much any way the members wish, subject
only to certain general rules.

More often than not, the provisions and even the existence of any such operating
agreement need not be disclosed in the filed articles of organization. (And, of course, in many
states the operating agreement need not be in written form.) This flexibility offered through the
governing statute makes it imperative that in entering into at least any major transaction with an
LLC (for example, a mortgage financing or a purchase of property), the lender or buyer should
review not only the filed articles of organization and certificates of authority, but the operating
agreement, the by-laws, and appropriate resolutions (in the case of a corporate-type LLC), and
should require standard “authority” and “enforceability” legal opinions. Of equal importance is
familiarity with the applicable LLC statute (and, for that matter, a determination of what is the
applicable statute -- the state of the LLC’s organization, the state where the property is located, or
another state which has ties to the transaction) and its provisions. Does the state law refer to
“ordinary course of business,” or to “actual” or “constructive” notice? Must deeds and
mortgages, etc. be signed by the LLC’s “president” or “chief manager,” or is there a default rule
that will afford some degree of safety to a party dealing with the LLC? If the applicable statute
or the operating agreement requires unanimous or some specified percentage of membership
approval for a particular transaction, then appropriate resolutions or member certifications will be
necessary. Where title insurance is involved, the title insurer will request the same
documentation, but review by the lender’s or buyer’s attorney is also essential because in a
typical transaction not every agreement will be suitable for title insurance protection.

12 For example, section 107 of the ULLCA provides that an operating agreement may not override certain
rights and limitations otherwise set forth in the statute, such as members’ rights to receive information, certain duties
of loyalty and fair dealing (though providing that the operating agreement may contain provisions setting standards
or defining activities that do not violate such duties), and requirements concerning the winding up of the LLC’s
business. The Delaware statute contains no such restrictions.

13 In the case of a securitization transaction, as described in Part 4. Below, “true sale” and “non-
consolidation” opinions may also be required.

14 In this connection, the California statute, for example, provides that if at least 2 managers sign an
instrument, the LLC is estopped from denying such managers’ authority unless the other contracting party had actual
knowledge that such managers lacked authority. Cal. Limited Liability Company Act, section 17157.
Attached as Exhibit A hereto are sample “due diligence” checklists for use in a transaction involving a seller or borrower LLC. Other state-specific checklists may be found on the ACREL web site.

4. Varieties of Use of LLC. The flexibility of use of the LLC form is noteworthy. Even more impressive than the varieties of management structure may be the scope of use of the entity form. In this regard, the extremes may be the use of a “special purpose bankruptcy-remote entity” (“SPE”) in structured finance transactions on the one hand, and the “series LLC” on the other.

(a) Use of an LLC in Structured Real Estate Finance Transactions. With benefit of hindsight, rumors of the death of securitized lending (i.e., mortgage on the borrower’s property is used as collateral for rated securities) were greatly exaggerated in late 1998. Not only has securitized lending returned in force, but the requirements imposed by the lenders and rating agencies in securitized lending have been adopted by real estate lenders generally who wish to preserve the ability to sell portions of their portfolio for securitization, even if they do not have a present intention to do so.

The focus of this section is to discuss several selected issues from the perspective of the borrower and borrower’s counsel relating to the use of limited liability companies (“LLCs”) as the special-purpose bankruptcy remote entity (“SPE”) to be used as the borrower in securitization transactions. This use may arise in circumstances where the borrower is already an LLC but the operating agreement must be amended to incorporate the SPE requirements or where the property is owned by an owner/user that engages in a variety of business activities and the property must be contributed to an SPE (usually a single member LLC is convenient) to meet the lender’s requirements. The borrower’s overall objective for engaging in these transactions is to borrow funds at a lower overall cost than what might be available from banks, life insurance companies, and other traditional sources. To meet this objective, the borrower will wish to keep the borrower structure as simple as possible (e.g., minimize or eliminate the need to form and maintain entities other than the borrower) and to control closing costs, particularly multiple legal opinions from different firms.

The purpose of the SPE and the related covenants from the lender’s perspective is to (a) place restrictions on the ability of the borrower to incur liabilities in excess of the mortgage debt, (b) insulate the borrower from liabilities of third parties and those arising from activities unrelated to the property; (c) reduce the risk of dissolution or other termination of the borrower;

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16 The Rating Guidelines define an SPE as follows: An SPE is an entity which is unlikely to become insolvent as a result of its own activities and which is adequately insulated from the consequences of any related party’s insolvency.

17 For an excellent discussion of single member LLCs in this context, see Steven Horowitz, ACREL Seminar on Single Member Limited Liability Companies in Real Estate Finance Transactions (Spring 1999).
and (d) provide some protection from use of bankruptcy proceedings by the borrower as a means to restructure the mortgage debt. The first, second and third objectives are generally accomplished by covenants in the loan documents, covenants in the LLC operating agreement (and sometimes in the LLC certificate of formation), and the single asset nature of the SPE. The fourth objective is accomplished by the requirement that the SPE have an independent director (or manager) whose consent is required to file a bankruptcy or insolvency petition, dissolve, merge or liquidate the borrower, engage in any business activity other than the property, and amend the LLC operating agreement (“Restricted Activities”).

An independent director (the term director will be used even though the “director” will be a member or manager in the case of an LLC) is generally required by the lender and rating agencies for the SPE except in certain limited cases where the ownership is dispersed among a number of nonaffiliated members or the loan(s) from the borrower are a small percentage of a pool. This discussion will focus primarily on the requirement for this independent director and how it may be structured in loan transactions with LLC SPEs to meet the borrower’s objectives of simplicity and cost. Although this discussion supports the use of LLCs as the SPE, it suggests that some advance thought by the borrower and the borrower’s counsel is appropriate in counseling the borrower on structuring the LLC and closing the loan to meet the borrower’s objectives. In some limited circumstances, the borrower may wish to consider a limited partnership SPE structure.

(i) The Independent Director as Non-Member Manager.

(A) LLC Structure. One of the simplest structures for injecting the independent director into the SPE LLC is to establish the independent director as a non-member manager (usually as a co-manager with the borrower’s manager who will perform general management functions) whose consent is required to approve the Restricted Activities. Most state LLC acts permit non-member managers, and the appropriate provisions can be added by amendment to the existing LLC operating agreement or included in the operating agreement if an LLC must be created. Exhibit B includes sample amendment provisions defining the scope of the authority of the independent manager. If the property owned by the LLC requires a liquor license, healthcare license, or other special state permit or entitlement, it will be helpful to provide that the independent director’s authority be limited to the Restricted Activities, and the independent director not have any authority over operating decisions or general management of the LLC, particularly those activities for which the state permit or license is required.

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18 See the discussion of the role of independent directors in Chapter Four of Rating Guidelines I. In some (so far, rare) cases, the rating agencies have imposed a requirement for two independent directors for the borrower SPE. The current version of S&P’s SPE requirements states that, in pool transactions, an independent director will be required only if the loan(s) to a borrower and its affiliates comprise more than 15% of the entire pool.

19 Id.
(B) **Opinions Required.** The rating agencies and the lender will generally require at least the following opinions from borrower’s counsel in connection with the loan and the LLC SPE:

1. the due organization, valid legal existence and good standing of borrower and any entity that is a controlling member of borrower;

2. a bankruptcy court would hold that the laws of the jurisdiction of formation of the borrower govern the question of whether the person or entity filing the bankruptcy petition on behalf of the borrower was authorized to do so;

3. the provision in the borrower’s operating agreement that requires the consent of the independent director to file a voluntary bankruptcy petition on behalf of the borrower is enforceable and is not subject to the effect on the borrower’s operating agreement of bankruptcy, insolvency, fraudulent transfer, fraudulent conveyance, moratorium, receivership, reorganization, liquidation and other similar laws relating to or affecting the rights and remedies of creditors generally;

4. under the limited liability statute applicable to borrower and the borrower’s operating agreement, the bankruptcy of any member will not, by itself, cause the borrower to be dissolved or its affairs to be wound up;

5. the loan documents are duly authorized, executed and delivered and constitute the valid, binding and enforceable obligations of the borrower;

6. that the assets of borrower (and its members and, if applicable, any affiliated manager) will not be substantively consolidated with the assets of any other affiliated person or entity, including, without limitation, any member or manager, in the event of a bankruptcy or insolvency proceeding of any such person or entity (generally this opinion will only be required if a member and its affiliates own more than 49% of the equity of the borrower).20

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20 Generally speaking, nonconsolidation opinions tend to be lengthy “reasoned” opinions that rely heavily on, and that assume adherence to, the SPE or “separateness” covenants of the loan documents and the LLC documents. Because of the “fact-specific” nature of bankruptcy courts’ decisions in the area of substantive consolidation, the rating agencies will generally accept a “should” opinion. This is to be distinguished from required “True sale” opinion, where a “would” opinion generally is required. Non-consolidation opinions generally will not be required in pool transactions for any borrower and affiliates whose loans comprise less than 15% of the pool. See the Rating Guidelines I, Chapter Four.
that the property and its use by borrower comply in all material respects with applicable requirements of governmental authorities having jurisdiction over the property;

that the loan does not violate applicable usury laws; and

that the loan documents and the execution thereof and the performance of the obligations thereunder do not conflict with or violate any applicable laws, agreements or restrictions by which borrower is bound (usually borrower’s counsel will not be required to address the borrower’s actual compliance with such obligations).

Opinions (1) - (4) relate directly to the LLC operating agreement and will of course be determined under the law governing the LLC operating agreement. To render these opinions, it will be most convenient and cost effective to have the LLC formed in and governed by the law of the state where borrower’s regular counsel is licensed to practice law. This should generally not be a problem because most state LLC Acts permit non-member managers with broad authority and, therefore, the LLC Act of the state where borrower’s counsel is licensed can accommodate this structure.

(ii) The Independent Director as Member.

(A) LLC Structure. If the above structure cannot be accommodated because the lender requires that the independent director act as or through a member of the LLC rather than as a non-member manager, the LLC will need to be structured either with an SPE corporation as a member (and the independent director as a director) or with the independent director as an individual non-economic member. In either case the consent of the SPE corporation as Member (and the independent director as a director of the corporation) or the independent director as an individual non-economic member will be required to approve any Restricted Activities. The borrower would clearly prefer the latter alternative, i.e., the independent director as an individual non-economic member, because the former structure requires the formation and ongoing maintenance of another corporation owned by a member of the LLC (with associated opinions) while the latter structure involves no

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21 Generally, in a pool transaction an independent director will not be required if the loan(s) to a borrower and its affiliates comprise less than 15% of the pool. If such loan(s) comprise less than 10% of the pool, a borrower LLC will be required to be a SPE, but, generally, the requirement for a SPE member will be dropped. See Rating Guidelines I, Chapter Four.
additional entities, ongoing maintenance or opinions. Some issues arise, however, from structuring the independent director as an individual non-economic member. Because the independent director cannot by definition be a beneficial owner of the borrower, it will be necessary that the state LLC Act permit a non-economic member, i.e., a member without an interest in profits, losses, capital, or cash distributions. Without conducting a survey, the only state LLC Act that comes readily to mind that permits a non-economic member is Delaware. Therefore, borrower’s counsel will need to consider several alternatives if the state LLC Act of the state where he or she is licensed will not permit a non-economic individual member.

(B) Use the law of the state where borrower’s counsel is licensed to govern the LLC but include a corporate SPE as a member of the LLC with an economic interest, with one or more of the members of borrower as the shareholders, and with the independent director as a director of the corporate SPE.

(C) Form the LLC under Delaware law with the independent director as an individual non-economic member, and then qualify the LLC as a foreign LLC in the state where the property is located.

(D) Use a limited partnership structure with a corporation SPE as a general partner formed under the laws of the state where borrower’s counsel is licensed.

Consideration of these alternatives will necessitate a dialogue with the lender because ultimately it must approve the structure.

(E) Opinions. To render the opinions noted in paragraph 4(a)(i)(B) above for a member structure, borrower’s counsel will need to consider the following:

(1) Is Borrower’s counsel comfortable rendering an opinion on Delaware law (if not licensed there) and will the lender’s counsel accept such opinion? If so, then forming the LLC under Delaware law is perhaps the simplest solution. If not, retaining special Delaware counsel for purposes of forming and rendering the opinions is certainly an option.

(2) If use of Delaware law or counsel is not acceptable to the borrower for cost or other reasons, then the borrower should consider alternatives (A) and (C) in 4(a)(ii) above.

22 Del. C. Tit. 6, §18-301(d).
(F) Finding the Independent Director. Although not directly related to the topic, some consideration will need to be given to finding an independent director. The independence requirements of the rating agency rules will preclude most of the usual candidates, e.g., relatives or business associates of the members of the borrower.23

(b) The Series LLC.

(i) What is it? In some respects, the series LLC is the antithesis of the SPE described in paragraph 4(a) above. As set forth in section 18-215(a) of the Delaware LLC statute, an LLC agreement “may establish or provide for the establishment of designated series of members, managers or limited liability company interests having separate rights, powers or duties with respect to specified property or obligations of the limited liability company or profits and losses associated with specified property or obligations, and, to the extent provided in the limited liability company agreement, any such series may have a separate business purpose or investment objective.” If established in accordance with the requirements of section 18-215, a series LLC can effectively partition its assets; for each series or project it can have a different ownership and management structure; and each series or project can operate independently of each other series. Each such series will be responsible only for its own liabilities and not for liabilities of other series or of the LLC itself. In many respects, each established series is treated as though it were a separate LLC.

(ii) How is it created? The Delaware statute sets forth the following requirements:

(A) The LLC agreement must create one or more series and must provide that liabilities will be isolated among the separate series;

(B) Notice of the limitation on liabilities of a series must be stated in the certificate of formation filed with the Secretary of State;

(C) Separate and distinct records must be established for each series; and

23 The Rating Guidelines II generally define a “independent director” as “a duly appointed member of the board of directors of the relevant entity who shall not have been, at the time of such appointment or at any time in the preceding five years, (a) a direct or indirect legal or beneficial owner in such entity or any of its affiliates (excluding deminimus ownership interests), (b) a creditor, supplier, employee, officer, director, family member, manager, or contractor of such entity or any of its affiliates, or (c) a person who controls (whether directly, indirectly or otherwise) such entity or its affiliates or any creditor, supplier, employee, officer, director, manager, or contractor of such entity or its affiliates.”
(D) The “assets associated with any . . . series” must be “held and accounted for separately from the other assets of the limited liability company, or any other series thereof . . . .”

If the foregoing steps are followed, then “the duties, liabilities and obligations incurred, contracted 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 limited liability company agreement, none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the limited liability company generally or any other series thereof shall be enforceable against the assets of such series.”

(iii) Questions Presented.

(A) How are the assets of separate series “held” separately? If the XYZ LLC is set up in Delaware as a series LLC, how does it, for example, hold title to real estate? Must it somehow take title in the name of the series, or is it sufficient if separate books and records are kept? The statute offers no guidance.

(B) What is a series LLC for tax purposes – is it a single tax entity, or is each series a separate entity? The answer to this question becomes particularly important when one recalls that each series may have separate ownership provisions. A member may be a 50% owner of one series, a 10% owner of another and may have no interest in a third.

(C) For real estate purposes, at least, why use a series LLC at all? What can be accomplished (other than perhaps avoidance of filing fees) by using a series LLC that could not better (or at least more clearly) be accomplished by using a number of separate LLC’s?

(D) What are the bankruptcy implications? Can the creditors of a series file an involuntary petition which may affect the LLC generally, along with the other series?

So far, the use of the series LLC seems to be limited and many practitioners will not even have heard of it. To the authors’ knowledge, the series LLC has not yet been used in real estate transactions, the title and tax issues so far apparently being insurmountable. Given the flexibility and usefulness of the LLC

24 Delaware C Tit. 6, §18-215(b).
form, however, it can be expected that the real estate business will find other uses for it.

25 A further discussion of the series LLC and of questions surrounding its use can be found in an article by Terence Floyd Cuff entitled “Series LLC’s and the Abolition of the Tax System” in the January/February 2000 issue of Business Entities.
EXHIBIT A

DUE DILIGENCE CHECKLIST-ILLINOIS

Limited Liability Companies

I. ORGANIZATION AND GOOD STANDING

A. Governing Law

Illinois Limited Liability Company Act. 805 ILCS 180/1-1 et seq.

B. Illinois LLC

1. Articles of Organization must be filed with Illinois Secretary of State. LLC exists from time of filing (or any later time, not more than 60 days after filing, specified in articles of organization) 805 ILCS 180/5-5(b). At present, there is a backlog in the Illinois Secretary of State’s office, and Articles are not filed until at least three and one-half (3-1/2) weeks after submission to the Secretary of State.

2. If LLC is organized for the practice of medicine, each organizer must be a licensed physician. 805 ILCS 180/5-1(a).

3. If LLC is organized for the practice of law, it must obtain a Certificate of Registration from Supreme Court of Illinois.

4. LLC may have one or more numbers. 805 ILCS 180/5-1(b).

5. Obtain Certificate of Good Standing from Illinois Secretary of State.

6. LLC must file annual reports, and pay $200 fee with each filing.

7. Review Operating Agreement.

8. Require legal opinion re due organization and good standing from LLC counsel.

C. Foreign LLC

1. Foreign LLC must obtain Certificate of Authority from Illinois Secretary of State. 805 ILCS 180/45-5. Foreign LLC is not authorized to transact business in Illinois until Certificate of Authority is issued. Because of backlog in office of Illinois Secretary of State, there is approximately a 3-1/2 weeks delay in obtaining a Certificate of Authority after application therefor has been filed.
2. Foreign LLC may not file suit in Illinois courts until Certificate of Authority is issued. Foreign LLC may be sued, however, and validity of contracts is not affected. 805 ILCS 180/45-45.

3. If entering into transaction with foreign LLC after application for admission to transact business is filed but before Certificate of Authority is issued, consider accepting (a) copy of Application for Admission to Transact Business in Illinois and (b) legal opinion from LLC’s counsel re (i) Application for Admission to Transaction Business has been filed, and (ii) validity, enforceability and priority of liens of contracts and other transactional documents and actions not adversely affected by delay in issuance of Certificate of Authority.

4. Obtain certified copies of Articles of Organization from Secretary of State of state of organization.

5. Obtain Certificate of Good Standing from state of organization.

6. Require legal opinion re due organization and good standing from LLC counsel.

D. Organization and Good Standing of Member(s) or Manager

1. Member(s) or managers may be individuals, corporations, general or limited partnerships or one or more other LLC’s. The organization and good standing of any such members or managers must also be established.

2. Where transaction requires that LLC be a “single-purpose, bankruptcy-remote entity,” with a “independent member” or “independent managing member” whose consent is necessary for any bankruptcy filing, the organization and good standing of any such “independent” party must also be reviewed. Further, a “non-consolidation” opinion of the LLC’s counsel may be required.

II. POWER AND AUTHORITY

A. Member-Managed LLC

1. Review Articles of Organization and Operating Agreement.

2. Unless provided to the contrary in the organizational documents, each member has equal rights in management and conduct of the business. Any matter relating to the business of the LLC may be decided by a majority of the members. 805 ILCS 180/15-1.
3. Unless authority is limited by the Articles of Organization, each member is an agent of the LLC with apparent authority, for all matters in the usual course of business. 805 ILCS 180/13-5.

B. Manager-Managed LLC

1. Review Articles of Organization and Operating Agreement.

2. If a matter involves “the sale, lease, exchange, or other disposal of all, or substantially all, of the company’s property with or without goodwill,” the consent of all members is necessary, unless Articles or Operating Agreement provides otherwise. 805 ILCS 180/15-1.

3. Unless authority is limited by Articles of Organization or Operating Agreement, each manager is an agent of the LLC with apparent authority. 805 ILCS 180/13-5.

III. DUE AUTHORIZATION, EXECUTION AND DELIVERY

1. See discussion under “Power and Authority.”

2. Review Articles of Organization and Operating Agreement.

3. Unless the operating agreement provides otherwise, in a member-managed LLC, each member has equal rights in the management and conduct of the company’s business. Except for actions referred to in 805 ILCS 180/15-1(c), any matter relating to the business of the LLC may be decided by a majority of its members. 805 ILCS 180/15-1.

4. Unless the operating agreement provides otherwise, in a manager-managed LLC, each manager has equal rights in the management and conduct of the company’s business. Except for matters referred to in 805 ILCS 180/15-1(c), any matter relating to the business of the LLC may be decided exclusively by the manager or, if there is more than one manager, by a majority of the managers. 805 ILCS 180/15-1.

5. The following matters require the consent of all members (whether LLC is managed by members or managers), unless the Operating Agreement provides otherwise:

   a. amendment of the Operating Agreement;
   b. amendment of the Articles of Incorporation;
   c. compromise of obligations to make a contribution;
d. compromise, as among members, of a member’s obligations to make a contribution or return money or other property paid or distributed in violation of the Act;

e. making of certain interim distributions;

f. admission of a new member;

g. use of company’s property to redeem an interest subject to a charging order;

h. consent to dissolve the company;

i. waiver of the right to have the company’s business wound up and the company terminated;

j. consent to merge with another entity; and

k. the sale, lease, exchange or other disposal of all, or substantially all, of the company’s property with or without goodwill. 805 ILCS 180/15-1(c).

All actions may be taken without a meeting

IV. SPECIFIED TRANSACTIONS

The following is true unless the operating agreement provides otherwise:

A. Purchase by LLC

Requires actions by a majority of members (if member-managed) or managers (if manager-managed).

B. Sale or Lease

1. If all or substantially all of LLC’s property, consent of all members is required.

2. If less than all or substantially all of LLC’s property, consent by a majority of members (if member-managed) or majority of managers (if manager-managed) is required.

C. Mortgage

Same as for sale or lease.

D. Guaranty
If in the ordinary course of business, requires consent of a majority of members (if member-managed) or managers (if manager-managed).

E. Conversions and Mergers

1. The Illinois LLC Act does not provide for conversion of an LLC to another form (corporation, partnership, etc.).

2. A partnership or limited partnership may convert to an LLC. 805 ILCS 180/37-10.

3. An LLC may merge with or into almost anything – another LLC, foreign or domestic corporation, foreign or domestic partnership, etc. 805 ILCS 180/37-20. Merger requires the consent of all members, or such lesser number or percentage as may be stated in the Operating Agreement. 805 ILCS 180/37-20(c).

4. Articles of Merger must be filed with Illinois Secretary of State.
SPE PROVISIONS FOR BORROWER’S OPERATING AGREEMENT

LIMITED LIABILITY COMPANY

ARTICLE ONE: PURPOSE.

The Limited Liability Company’s (the “Company’s”) business and purpose shall consist solely of the acquisition, ownership, operation and management of the real estate project known as _____________________________, located in _____________________ (the “Property”) and such activities as are necessary, incidental or appropriate in connection therewith.

ARTICLE TWO: POWER AND DUTIES.

So long as any obligations secured by the Mortgage (as defined below) remain outstanding and not discharged in full, without the consent of all Members, the Manager shall have no authority to:

(i) borrow money or incur indebtedness on behalf of the Company other than normal trade accounts payable and lease obligations in the ordinary course of business, or grant consensual liens on the Company’s property; except, however, that the Manager is hereby authorized to secure financing for the Company pursuant to the terms of the Mortgage with [Lender] (the “Mortgage”) and other indebtedness expressly permitted therein or in the documents related to the Mortgage, and to grant a mortgage, lien or liens on the Company’s Property to secure such Mortgage;

(ii) dissolve or liquidate the Company;

(iii) sell or lease, or otherwise dispose of all or substantially all of the assets of the Company;

(iv) file a voluntary petition or otherwise initiate proceedings to have the Company adjudicated bankrupt or insolvent, or consent to the institution of bankruptcy or insolvency proceedings against the Company, or file a petition seeking or consenting to reorganization or relief of the Company as debtor under any applicable federal or state law relating to bankruptcy, insolvency, or other relief for debtors with respect to the Company; or
seek or consent to the appointment of any trustee, receiver, conservator, assignee, sequestrator, custodian, liquidator (or other similar official) of the Company or of all or any substantial part of the properties and assets of the Company, or make any general assignment for the benefit of creditors of the Company, or admit in writing the inability of the Company to pay its debts generally as they become due or declare or effect a moratorium on the Company debt or take any action in furtherance of any action;

(v) amend, modify or alter Articles [One, Two, Three, Four or Five] of these Articles [Note: cross reference to actual sections addressed in this form]; or

(vi) merge or consolidate with any other entity.

Notwithstanding the foregoing and so long as any obligation secured by the Mortgage remains outstanding and not discharged in full, neither the Manager nor the Members shall have any authority (1) to take any action in items (i) through (vi) above unless such action has been approved by the Independent Director (hereafter defined), or (2) to take any action in items (i) through (iii) and (v) and (vi) without the written consent of the holder of the Mortgage. Except for the items set forth in the preceding sentence, the Independent Director shall not have any obligation or responsibility to approve or otherwise manage the affairs and business of the Company.

At all times until such time as all obligations secured by the Mortgage have been paid in full, there shall be at least one Independent Director. “Independent Director” shall mean an individual who is a manager of the Company, and who is not and has not been at any time during the preceding five (5) years: (i) a stockholder, member, director, officer, employee or partner of the Company or any of its affiliates; (ii) a customer, supplier or other person who delivers more than 10% of its purchases or revenues from its activities with the Company or any of its affiliates; (iii) a person controlling any such stockholder, partner, member, customer, supplier or other person; or (iv) a member of the immediate family of any such stockholder, member, director, officer, employee, partner, customer, supplier or other person. (As used herein, the term “control” means the possession, directly or indirectly, of the power to direct or cause the direction of management, policies or activities of a person or entity, whether through ownership of voting securities or member interests, by contract or otherwise.)

With the consent of the Members of the Company, which consent the Members believe to be in the best interest of the Members and the Company, no Independent Director shall, with regard to any action to be taken under or in connection with this ARTICLE, owe a fiduciary duty or other obligation to the Members (except as may specifically be required by the statutory law of any applicable jurisdiction), and every Member, including each successor member, shall consent to the foregoing by virtue of becoming a member of the Company, no further act or deed of any member being required to evidence such consent. Instead, such Independent Director’s fiduciary duty and other obligations with regard to such action under or in connection with this ARTICLE shall be owed to the Company (including its creditors). In addition, no Independent Director may be removed unless his or her successor has been elected.
Upon the death, disability, disassociation or withdrawal of the Independent Director, the Company shall appoint a new Independent Director.

[Add Independent Director to “manager” provisions of operating agreement and to indemnification provisions.]

ARTICLE THREE: TITLE TO COMPANY PROPERTY.

All property owned by the Company shall be owned by the Company as an entity and, insofar as permitted by applicable law, no Member shall have any ownership interest in any Company property in its individual name or right, and each Member’s interest in the Company shall be personal property for all purposes.

ARTICLE FOUR: SEPARATENESS/OPERATIONS MATTERS.

The Company shall conduct its business and operations in accordance with the following provisions:

(a) maintain books and records and bank accounts separate from those of any other person;

(b) maintain its bank accounts and all its other assets separate from those of any other person or entity;

(c) hold regular meetings, as appropriate to conduct the business of the Company, and observe all customary organizational and operational formalities;

(d) hold itself out to creditors and the public as a legal entity separate and distinct from any other entity;

(e) prepare separate tax returns and financial statements, or if part of a consolidated group, then it will be shown as a separate member of such group;

(f) allocate and charge fairly and reasonably any common employee or overhead shared with affiliates;

(g) transact all business with affiliates on an arm’s-length basis and to enter into transactional with affiliates on a commercially reasonable basis;

(h) conduct business in its own name, and use separate stationery invoices and checks;

(i) not commingle its assets or finds with those of any other person;

(j) not assume, guarantee or pay the debts or obligations of any other person;
(k) pay its own liabilities and expenses only out of its own funds;
(l) pay salaries of its own employees from its own funds;
(m) maintain sufficient number of employees in light of its contemplated business operations;
(n) not hold out its credit as being available to satisfy the obligations of any other person or entity;
(o) not acquire the obligations or securities of its affiliates or owners, including partners, members or shareholders, as appropriate;
(p) not make loans to any other person or entity nor buy or hold evidence of indebtedness issued by any other person or entity (other than cash and investment grade securities);
(q) not pledge its assets for the benefit of any other person or entity other than the holder of the Mortgage;
(r) correct any known misunderstanding regarding its separate identity;
(s) not identity itself as a division of any other person or entity; and
(t) maintain adequate capital in light of its contemplated business operations.

ARTICLE FIVE: EFFECT OF BANKRUPTCY, DEATH OR INCOMPETENCY OF A MEMBER

The bankruptcy, death, dissolution, liquidation, termination or adjudication of incompetency of a Member shall not cause the termination or dissolution of the Company and the business of the Company shall continue. Upon any such occurrence, the trustee, receiver, executor, administrator, committee, guardian or conservator of such Member shall have all the rights of such Member for the purpose of settling or managing its estate or property, subject to satisfying conditions precedent to the admission of such assignee as a substitute Member. The transfer by such trustee, receiver, executor, administrator, committee, guardian or conservator of any Company interest shall be subject to all of the restrictions hereunder to which such transfer would have been subject if such transfer had been made by such bankrupt, deceased, dissolved, liquidated, terminated or incompetent Member. [The foregoing shall apply to the extent permitted by applicable law.]

ARTICLE SIX: TRANSFER OF OWNERSHIP INTERESTS IN THE COMPANY
No transfer of any direct or indirect ownership interest in the Company such that the transferee owns more than a 49% interest in the Company (or such other interest as specified in the Mortgage or by a rating agency) may be made unless such transfer as conditioned upon the delivery of an acceptable non-consolidation opinion to the holder of the Mortgage and to any applicable rating agency concerning, as applicable, the Company, the new transferee and/or their respective owners.