

Secured Lending to Series of LLCs: Beware What You Do Not (And Cannot) Know

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Abstract

A “series LLC” is an LLC that has one or more “series.” A “series” is like, but not quite, a subsidiary. About a dozen states currently offer series LLCs. Most can have their own assets and liabilities. Internal liability shields provide that assets associated with a series are available only to creditors of that series, and not to creditors of other series or of the series LLC. Generally, series can conduct their affairs in their own names. But it’s unclear whether a given state will honor another state’s series or their internal liability shields, UCC Article 9 presents challenges and uncertainties with respect to series as debtors, and the Bankruptcy Code’s applicability to series is simply unknown. Even a status opinion implicates enforceability (and effectiveness) of the relevant LLC agreement or other governance document.

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I. Introduction.

A “series LLC” is a limited liability company that has one or more “series.” In some ways a “series” is like a subsidiary of its series LLC. But in other ways a series is unlike a subsidiary of its series LLC. Most series have their own assets and liabilities. Internal liability shields provide that assets associated with a given series are available only to creditors of that series, and not to creditors of other series or of the series LLC. Under the laws of most states that offer them, series can conduct their affairs in their own names. But many series might not be organizations or persons, and that has real consequences under the UCC and the Bankruptcy Code.¹

While a growing minority of states offer series LLCs,² the majority do not. There are significant differences among

¹References herein to the “Bankruptcy Code” are to Title 11 of the United States Code, 11 U.S.C.A. §§ 101 to 1532 (2014).

²Jurisdictions offering series LLCs include the following (with, in each case, citation to the statutory section or sections in which provisions dealing with the formation of LLC series are primarily to be found): Alabama (Ala. Code § 10A-5A-11.01 (2014) (effective Jan. 1, 2015)); Delaware (Del. Code Ann. tit. 6, § 18-215 (2014)); the District of Columbia (D.C. Code § 29-802.06 (2014)); Illinois (805 Ill. Comp. Stat. Ann. 180/37-40 (2014)); Iowa (Iowa Code § 489.1201 (2013)); Kansas (Kan. Stat. Ann. § 17-76,143 (2013)); Missouri (Mo. Rev. Stat. § 347.186 (2014)); Montana (Mont. Code Ann. § 35-8-202 (2013)); Nevada (Nev. Rev. Stat. § 86.161 (2014)); Oklahoma (Okla. Stat. tit. 18, § 2054.4 (2014)); Puerto Rico (P.R. Laws Ann. tit. 14, § 3967 (2011)); Tennessee (Tenn. Code Ann. § 48-249-

states offering series LLCs. It's unclear whether a given state will honor another state's series or their internal liability shields. Will a given series be respected in the jurisdiction(s) in which it operates? Will other series of the same series LLC be respected in the jurisdictions in which they operate? UCC Article 9 presents challenges and uncertainties with respect to series as debtors. The Bankruptcy Code's applicability to series is simply unknown.

II. What are Series?

A. Series Might Not Have Internal Shields.

Most statutes don't define the term "series" as such. Rather, they provide that an operating agreement may establish (or provide for the establishment of) one or more series of members, managers, assets, and economic rights. Note current laws do not require any publicly available notice of the mere existence of a series. But where additional preconditions (including public notice) are satisfied, the debts, obligations, and other liabilities of a given series are enforceable only against the assets of such series, not against the assets of any other series or the series LLC as a whole. This limitation is referred to as "internal shields." Presumably, internal shields are important to most, if not all, lenders to series. Preconditions to existence of internal shields differ, but generally include publicly available notice of series existence. Some statutes require general notice filing with the Secretary of State (e.g., Delaware—notice can simply indicate that the series LLC has or may in the future have one or more series, and need not reference any specific series by name or otherwise³). Some require specific notice filing with the Secretary of State (e.g., Illinois—notice must be filed with respect to and specifically referencing each series by name⁴). In addition, the statutes generally require that the records maintained for any series account for the assets associated with such series separately from the other assets of the series LLC or its other series. Finally, inasmuch as the establishment of series is facilitated by the enabling

309 (2014)); Texas (Tex. Bus. Orgs. Code Ann. §§ 101.601 to 101.622 (West 2013)); and Utah (Utah Code Ann. § 48-2c-606 (2014)).

³See § 18-215(c) of the Delaware Limited Liability Company Act, Del. Code Ann. tit. 6, §§ 18-101 to 18-1109 (2014). Unless otherwise indicated, all citations to § 18-___ are to the Delaware LLC Act.

⁴805 Ill. Comp. Stat. Ann. 180/37-40(b), (c) (2014).

statutes, but accomplished by or pursuant to provisions of the relevant limited liability company agreement, the LLC agreement must adequately provide for all relevant series. Thus, existence of internal shields requires satisfaction of both static requirements (e.g., the requisite filing and LLC agreement language), and ongoing requirements (e.g., maintaining the requisite separate records). Later failure to maintain the requisite separate records generally results in loss of internal shields. But the series continues to exist as a series despite the loss of internal shields.

B. Series Might Not Be Respected In Other States.

With only a minority of states offering series, one may well wonder whether internal shields will be respected in states that don't offer shielded series. Some say yes. They begin with a choice of law analysis under the law of the forum state, and look to the law of the state under which the series was formed. This approach implicitly assumes that shields are always and necessarily internal affairs under the internal-affairs conflict-of-laws doctrine.⁵ Others take a contrary view. A recent opinion offers compelling insights.

The dispute in *Alphonse v. Arch Bay Holdings, L.L.C.* arose in the context of a residential mortgage foreclosure.⁶ The mortgage was held by and foreclosed by a series of a Delaware series LLC. Alphonse, the homeowner, did not defend, but later brought an action against the series LLC contending the foreclosure was based on robo-signing and therefore fraudulent. The trial court dismissed Alphonse's suit, accepting the argument that the series and the series LLC were sufficiently separate from each other. The appeals court acknowledged that under Louisiana's choice of law statute, the law of the state of formation normally determines issues relating to the internal affairs of an LLC. But the court went on to note that different conflict-of-laws principles apply where the rights of third parties (i.e., strangers to the

⁵See, e.g., *Sagarra Inversiones, S.L. v. Cementos Portland Valderivas, S.A.*, 34 A.3d 1074, 1081–82 (Del. 2011) (defining internal affairs doctrine).

⁶*Alphonse v. Arch Bay Holdings, L.L.C.*, 548 Fed. Appx. 979 (5th Cir. 2013).

LLC agreement, such as Alphonse) are involved.⁷ In its decision, the court quoted a district court decision interpreting California's choice of law statute, to the effect that the internal affairs doctrine "does not apply to disputes that include people or entities that are not part of the LLC."⁸

C. Series Might Not Be Entities.

Though endowed with certain characteristics commonly found in separate legal entities, most series are statutorily prohibited from having other such characteristics. Given their many entity-like attributes, many assume series are separate entities. Some may even reason to that conclusion. But most statutes are silent (e.g., Delaware⁹). Some statutes state that an LLC's governance documents may provide that its series are to be treated as separate entities (e.g., District of Columbia¹⁰), with the consequence that entity status is a matter of contract construction. Others provide separate entity status only where internal liability shields are in place and to the extent provided in their governance documents (e.g., Illinois¹¹). Still others explicitly disclaim separate entity status (e.g., Texas¹²). Further complicating matters, a series may be an entity for some purposes, but not for others.¹³ For example, under the Treasury Department's proposed regulations regarding the classification of series for federal tax purposes, a series is treated as an entity formed under state law, regardless of whether the series is a juridical person for state law purposes.¹⁴ Series cannot exist other than during the existence of the series LLC. They can be formed after or concurrent with the formation of the series LLC. Series can

⁷*Alphonse v. Arch Bay Holdings, L.L.C.*, 548 Fed. Appx. at 986 (citing *First Nat. City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 621, 103 S. Ct. 2591, 77 L. Ed. 2d 46 (1983)).

⁸*Alphonse v. Arch Bay Holdings, L.L.C.*, 548 Fed. Appx. at 986 (quoting *Butler v. Adoption Media, LLC*, 2005 WL 2077484, *1 (N.D. Cal. 2005)).

⁹See Del. Code Ann. tit. 6, § 18-215 (2014).

¹⁰D.C. Code § 29-802.06(h) (2014).

¹¹805 Ill. Comp. Stat. Ann. 180/37-40(b) (2014).

¹²Tex. Bus. Orgs. Code Ann. § 101.622 (2013).

¹³"Sometimes words have two meanings." Robert Plant, *Stairway to Heaven*, on untitled album (Atlantic Records 1971).

¹⁴Prop. Reg. §§ 301.6011-6, 301.6071-2, 301.7701-1. Series LLCs & Cell Companies, 75 Fed. Reg. 55699, 55699 (proposed Sept. 14, 2010) (to be codified at 26 C.F.R. Pt. 301).

be terminated, or dissolved and wound up, without causing dissolution of the series LLC, but a series must be terminated or dissolved, and its affairs wound up, upon dissolution of the series LLC.

D. Series Can Have Unique Governance.

Generally speaking, the statutes provide a default rule of series governance by associated members in proportion to their economic interests, though most open-endedly permit such other governance as may be agreed. Thus, a series can have most any governance structure. Governance of a series, for example, can differ from that of the series LLC, and governance of one series can differ from that of another series.

E. Series Can Have Unique Purposes.

Most statutes generally provide that a series may have any lawful purpose. Some authorize series both for profit and not for profit, and many exclude certain traditionally regulated activities such as banking. Some explicitly provide that a series' purpose may differ from that of the series LLC, though it is generally less clear whether a series can have a purpose inconsistent with the purpose of the related series LLC. Statutes differ in explicitness with respect to such matters as holding title to real, personal, and intangible property, granting liens and security interests, and suing and being sued. Most statutes provide options for the holding of property. That is to say, while the statute tells us what's possible, the filings and agreements tell us what's in place. Alternatives generally include holding assets associated with a series (i) in the name of the series LLC, (ii) in the name of the series, and (iii) in the name of a nominee.

F. Key Differences Among Series Statutes.

As noted above, a growing minority of jurisdictions offer series LLCs, including Alabama (legislation takes effect 2015), Delaware, the District of Columbia, Illinois, Iowa, Kansas, Montana, Nevada, Oklahoma, Puerto Rico, Tennessee, Texas, and Utah. The chart appearing on the last page of this article highlights key differences among these currently-existing series LLC statutes. In 2012, the Uniform Law Commission established a committee tasked with draft-

ing a uniform or model act dealing with series of unincorporated business entities.¹⁵

III. Series LLCs and UCC Article 9.

Where series are not, or might not be, entities, they may fall outside the scope of UCC Article 9.¹⁶ When lending to series of an LLC, secured parties must be particularly careful in identifying the “debtor” and addressing each consideration that follows. By definition, the “debtor” is the person having an interest in the collateral at issue within the meaning of UCC RA9 § 102(a)(28). LLCs are generally acknowledged to be “registered organizations.” Thus LLCs are “located” in their formation jurisdictions under UCC RA9 § 9-307(e), and a financing statement on form UCC1 identifying an LLC as “debtor” must feature the LLC’s name (only) in box 1a and be filed in such jurisdiction. But things may be different for assets associated with a series. LLC acts permitting series generally provide choices for how assets associated with a series may be held. These choices include holding associated assets in the name of the limited liability company, through a nominee, or in the name of the series. Thus, when dealing with a security interest granted on behalf of a series of an LLC, secured parties must determine what, in fact, is the debtor within the meaning of UCC RA9.

A. Series LLC as Debtor.

If a series LLC is the debtor, UCC RA9 requires an ordinary filing against and naming the series LLC as debtor, in the series LLC’s location as determined under UCC RA9 § 9-307. Matters unique to the series might be addressed in the collateral description, or in box 17 (miscellaneous) of a financing statement addendum on form UCC1Ad, as appropriate.

¹⁵The Series of Unincorporated Business Entities Committee is chaired by Steven G. Frost, Partner, Chapman and Cutler, LLP, Chicago, Illinois; its reporter is Daniel S. Kleinberger, Professor, William Mitchell College of Law, St. Paul, Minnesota. The author participates in the SUBE Committee as an American Bar Association Business Law Section Advisor.

¹⁶References to UCC Article 9 (hereinafter, “UCC RA9”) are to the official text promulgated in 1998 by the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws) and the American Law Institute, as amended through the 2010 Amendments thereto, which generally took effect on July 1, 2013.

B. Nominee as Debtor.

If a nominee is the debtor, the secured party must determine whether the nominee is an organization, a registered organization, or an individual. An effective filing would be filed in the nominee's location¹⁷ and name the nominee in box 1a or 1b, as appropriate. Note that a nominee's location may differ from that of the series LLC or a given series (assuming that the series is an organization whose location can be determined under UCC RA9).

C. Series as Debtor.

If a series is the debtor, the secured party must determine whether it is sufficiently clear that the series is an organization within the meaning of the Uniform Commercial Code. UCC RA9 does not define the term "organization," but instead utilizes the definition appearing in Article 1 (2001 version) of the Uniform Commercial Code. Article 1 § 1-201(b)(25) defines "organization" as "a person other than an individual." Article 1 § 1-201(b)(27) of the 2001 version of Article 1 defines "person" as:

an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity.

(Emphasis added.) For the reasons discussed above,¹⁸ it may be unclear whether a given series is a legal or commercial entity at all, arguable that some series simply are not, and quite clear that a series of a Texas LLC is not. Equally clear, but widely misunderstood, is that no series is a registered organization, with the exception of a series of an Illinois LLC which satisfies each of the statutory prerequisites to internal liability shields.

UCC RA9 § 102(a)(71) defines a registered organization as:

an organization formed or organized solely under the law of a single state or the United States by the filing of a public organic record with, the issuance of a public organic record by,

¹⁷Generally, an organization is located at its place or business or, if it has more than one, at its chief executive office (UCC RA9 § 307(b)(2), (3)); a registered organization organized under the law of a state is located in that state (UCC RA9 § 307(e)); and an individual is located at his or her principal residence (UCC RA9 § 307(b)(1)). *See generally* UCC RA9 § 307.

¹⁸*See supra* section II.C ("Series Might Not Be Entities").

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or the enactment of legislation by the State or the United States.

This definition simply does not fit most currently available series. Under current series LLC statutes, the Secretaries of State need not receive, let alone maintain, any record showing a given series to have been *organized*. Nor will the Secretary of State in Alabama, Delaware, Iowa, Nevada, Oklahoma, Puerto Rico, Tennessee, Texas, or Utah necessarily have any record of the name, if any, associated with any given series. Even for series of LLCs established under the laws of the District of Columbia, Kansas, and Montana, the required series-specific filing is not a precondition to establishment of a series, but only a precondition to a series having internal shields. Thus, such series are not themselves registered organizations. They are analogous to limited liability partnerships. LLPs are a subset of general partnerships, formed without the need for any filing, but acquire limited liability features only by way of filing. LLPs are not registered organizations.¹⁹ For the same reasons, neither are most series of LLCs.

The Illinois statute speaks, variously, in terms of “series” and “series with limited liability,” suggesting either that (i) the latter is a subset of the former, or (ii) the two are completely distinct.²⁰ Under the Illinois statute, an operating agreement may “establish”²¹ or “create”²² a series. A series with limited liability is to be “treated as a separate entity,” and its existence begins upon the filing of a certificate of designation with the Secretary of State.²³ Thus, it appears such a series is intended to be a registered organization for purposes of UCC RA9.²⁴

¹⁹See Permanent Editorial Bd. for the Unif. Commercial Code, PEB Commentary No. 17: Limited Liability Partnerships Under the Choice of Law Rules of Article 9 (June 29, 2012), available at <http://www.ali.org/doc/PEB%20Commentary%20on%20LLPs-final.pdf>.

²⁰805 Ill. Comp. Stat. Ann. 180/37-40 (2014).

²¹805 Ill. Comp. Stat. Ann. 180/37-40(a) (2014).

²²805 Ill. Comp. Stat. Ann. 180-37-40(b).

²³*Id.* § 180-37-40(d).

²⁴Similarly, consider the Delaware statutory trust, which is “created” by a governing instrument (Del. Code Ann. tit. 12, § 3801(g)(1) (2014)), by definition must have a certificate of trust (Del. Code Ann. tit. 12,

D. A Suggested Approach.

Under current series LLC statutes, the surest way to facilitate perfection of security interests by filing is to vest title to collateral associated with a series of an LLC in the series LLC itself (or in the name of a registered organization nominee). The series LLC (or the nominee) is then the debtor. Its name can be determined from its certificate of formation (or other public organic record).²⁵ Its location will be its formation jurisdiction. The secured party will complete a UCC1 financing statement by specifying the series LLC's (or nominee's) name in box 1, and file in the series LLC's (or nominee's) location.

IV. Series LLCs and the Bankruptcy Code.

The interrelation between series LLCs and the Bankruptcy Code is still more uncertain. Because many series are not, or may not be, entities, they may be ineligible to become “debtors” under the Bankruptcy Code. Under the Bankruptcy Code, a debtor is “a *person* . . . concerning which a case . . . has been commenced.”²⁶ Person, in turn, is defined to include individuals, partnerships, and corporations.²⁷ It seems clear that a series of an LLC is not an individual, but whether it is a partnership or a corporation or both (for Bankruptcy Code purposes) is the more interesting question. The Bankruptcy Code does not define the term “partnership.”²⁸ The Bankruptcy Code defines “corporation” such that it “(A) *includes*—(i) [an] association having a power or privilege that a private corporation, but not an individual or a partnership, possesses; (ii) [a] partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association; (iii) [a] joint-stock company; (iv) [an] unincorporated company or association; or (v) [a] business trust; but (B) does not include [a] limited

§ 3801(g)(2)), and is “formed at the time of the filing of the initial certificate of trust” (Del. Code Ann. tit. 12, § 3810(a)(2)).

²⁵The 2010 Amendments to UCC RA9 provide improved guidance for determining a registered organization debtor's name for filing purposes, utilizing the new defined term “public organic record.” See UCC RA9 § 102(a)(68).

²⁶11 U.S.C.A. § 101(13) (emphasis added).

²⁷11 U.S.C.A. § 101(41).

²⁸See, e.g., *In re Shea & Gould*, 214 B.R. 739, 743, 38 Collier Bankr. Cas. 2d (MB) 1453 (Bankr. S.D. N.Y. 1997).

partnership.”²⁹ The enumeration is illustrative, not exclusive or exhaustive. Since the advent of LLCs, most have become comfortable with the conclusion that they will be characterized as corporations for Bankruptcy Code purposes.³⁰ Many series LLCs will fit the Bankruptcy Code’s definition of “corporation.” But it is far from certain whether any series of an LLC will fit the definition. Similarly, while there are arguments that internal shields should be respected in a bankruptcy proceeding, there is no basis on which to conclude that internal shields will be honored in the event a series of an LLC, or a series LLC itself, becomes a debtor in bankruptcy.

V. Closing Opinions for Series.

Presumably, lenders to series will have many of the same concerns as lenders to more traditional borrowers. These include opinion issues specific to the borrower, such as status, power, and action opinions; opinion issues specific to the transaction, such as enforceability of documents; and ancillary opinion issues, such as required consents and perfection of security interests. Lenders to series may have additional concerns unique to series. Since series are established by, or pursuant to provisions in, LLC agreements, even a status opinion would seem to implicate enforceability (and effectiveness) of the relevant LLC agreement, series supplement, or other governance document. It can be anticipated that the lender dealing with a series borrower will be particularly interested in the viability of internal liability shields. While assurances as to the borrower series’ internal liability shields will provide some comfort, such comfort is far from complete. Where a series LLC has one series, it will likely have additional series. If any series is amenable to suit in a jurisdiction that may not respect internal liability shields, a lender to any series may find its expectations frustrated. A closing opinion seems an unlikely and ill-suited way to address such issues. Perhaps in time borrowers and lenders will agree on certain jurisdictions in which internal liability shields are expected to be

²⁹11 U.S.C.A. § 101(9) (emphasis added; internal subsection breaks omitted).

³⁰*Cf.* In re DeLuca, 194 B.R. 79 (Bankr. E.D. Va. 1996) (determining rights of members in chapter 11 debtor entity, an LLC formed under Virginia law); In re DeLuca, 194 B.R. 65 (Bankr. E.D. Va. 1996) (same).

honored, and agree that neither the borrower series nor any other series of the same series LLC will conduct business or otherwise expose itself to suit in any other jurisdiction. Of course, a negative covenant by a given series is of limited value as a means to constrain conduct of a non-signatory series.

VI. Conclusion.

Series are somewhat like, and yet different from, subsidiaries. They are typically established, not formed, by or pursuant to provisions in a governing instrument, and may or may not be separate entities. Thus, even the establishment of series implicates contract law. No jurisdiction currently requires a filing or other notice of series, though all require some form of filing or notice as a prerequisite to series' internal liability shields. In some (e.g., Delaware), a general notice is sufficient. In others (e.g., Illinois), a specific notice filing with respect to each series is required. Where a series is intended to be a UCC RA9 debtor, complications can arise: where the series itself is the debtor, what and where to file to perfect security interests are unclear. Whether a series itself can be a debtor under the Bankruptcy Code is unclear, as is the question of how and to what extent assets of a series may be affected by the bankruptcy of a series LLC.

VII. Summary Points.

- A series is typically an associated set of assets and liabilities.
- There may or may not be a public record of the existence of a series.
- A series might not have, or might lose, internal shields.
- Some series either aren't entities or it's unclear, and of course the answer may differ by context.
- Series cannot exist independently of the related series LLC.
- Series governance is flexible and may differ from that of the related series LLC.
- Series assets can be held in a number of different ways, some of which interface better with UCC RA9 than others.
- It is unknown whether series can file for protection under the Bankruptcy Code, and unclear how they will be treated in a bankruptcy of the related series LLC.

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Juris- dic- tion	Entity?	General Notice Required for Series?	General Notice Required for Shields?	Specific Notice Required For Shields?	Good Stand- ing Concept?	Good Standing Cer- tificate Avail- able?
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Alabama	No state- ment	No	Yes	No	No	No
Delaware	No state- ment	No	Yes	No	No	No
District of Co- lumbia	“treated as” if shielded	No	No	Yes	Yes, if shielded ³¹	Yes, if shielded*
Illinois	“treated as” if shielded	No	No	Yes	Yes, if shielded*	Yes, if shielded*
Iowa	“treated as” if shielded	No	Yes	No	No	No
Kansas	“treated as” if shielded	No	No	Yes	Yes, if shielded*	Yes, if shielded*
Montana	No state- ment	No	No	Yes	Yes, if shielded*	Yes, if shielded*
Nevada	No state- ment	No	Yes	No	No	No
Okla- homa	No state- ment	No	Yes	No	No	No
Puerto Rico	No state- ment	No	Yes	No	No	No
Tennes- see	No state- ment	No	Yes	No	No	No
Texas	Not an entity or organiza- tion	No	Yes	No	No	No
Utah	“treated as” if shielded	No	Yes	No	No	No

³¹Series formed under the LLC Acts in the District of Columbia, Illinois, Kansas, and Montana are deemed to be in good standing so long as the related series LLC is in good standing.

