

DELAWARE UPDATE – 2006 LEGISLATION AMENDING CERTAIN ALTERNATIVE ENTITY LAWS

by

Norman M. Powell, Esquire*

In its legislative session ended June 30, 2006, the Delaware General Assembly enacted amendments to the Delaware Limited Liability Company Act, 6 Del. C. § 18-101 et seq. (the “DLLC Act”), the Delaware Revised Uniform Limited Partnership Act, 6 Del. C. § 17-101 et seq. (the “DLP Act”), and the Delaware Statutory Trust Act, 12 Del. C. § 3801 et seq. (the “DST Act”). These amendments generally take effect on August 1, 2006, with the exception of those related to registered agents under the DLLC Act and DLP Act, which take effect on January 1, 2007.

The amendments to the DLLC Act and the DLP Act are substantially similar. Most significant, perhaps, are those relating to registered agents. The amendments define as “commercial registered agents” those registered agents serving as such for more than fifty (50) entities, and subject them to special rules. An entity (as contrasted with an individual) commercial registered agent must (i) maintain a place of business in Delaware which is generally open during normal business hours to perform the functions of a registered agent, (ii) maintain a Delaware business license, (iii) have present at its Delaware office during normal business hours an officer, director or managing agent who is a natural person, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent. Limited liability companies and limited partnerships must provide their registered agents (and update as necessary) contact information for a natural person who is authorized to receive communications from the registered agent. Such persons are referred to as “communications contacts.” Registered agents must maintain such information for communications contacts, and are authorized to resign if they are not provided such information. The amendments establish a procedure by which the Delaware Secretary of State may apply to the Delaware Court of Chancery to enjoin any person from serving as a registered agent or as an officer, director, or managing agent of a registered agent. While the Court of Chancery has broad equitable powers, the statutory amendments explicitly provide that any person or entity convicted of a felony or any crime involving dishonesty, fraud, or moral turpitude, and any registered agent who, acting as such, has engaged in conduct intended or likely to deceive or defraud the public, may be enjoined from acting as a registered agent, or as an officer, director or managing agent of a registered agent. Certificates of formation and certificates of limited partnership may be cancelled if a limited liability company or limited partnership fails to timely obtain and designate a new registered agent following notice of an order by the Court of Chancery enjoining its registered agent from acting as such.

* Norman M. Powell is a partner in the Delaware law firm Young Conaway Stargatt & Taylor, LLP, where his practice includes service as Delaware counsel to bankruptcy-remote Delaware alternative entities, delivery of perfection, priority, and other security interest opinions, and representation of trusts and trustees in financing transactions. He can be reached via email at npowell@ycst.com. This article originally appeared as a link in the *Commercial Law Newsletter*, July 2006 edition (<http://www.abanet.org/buslaw/committees/CL190000pub/newsletter.shtml>).

Among the more salient amendments to the DST Act are those to Section 3806 clarifying that duties (including fiduciary duties) may be expanded, restricted, or eliminated by provisions in the governing instrument, and confirming that the implied contractual covenant of good faith and fair dealing may not be eliminated. Unless otherwise provided in the governing instrument, (i) persons acting in good faith reliance on provisions of the governing instrument are not liable to the statutory trust or to persons bound by its governing instrument, and (ii) meetings of beneficial owners and trustees, respectively, may be held by means of conference telephone or other communications equipment, so long as all participants in such meeting can hear each other. Persons managing the business and affairs of a statutory trust are fully protected in relying in good faith upon the records of the statutory trust and certain information reasonably believed to be within the professional or expert competence of the person offering the same, such as financial information and reports relevant to the statutory trust's ability to pay or make reasonable provision to pay claims and obligations. A new Section 3863 consists of a non-exhaustive list of twelve (12) things that, when done by foreign statutory trusts in the State of Delaware, do not constitute doing business in Delaware for purposes of the DST Act. They include maintaining, defending, or settling actions or proceedings, maintaining bank accounts, creating or acquiring indebtedness (whether as lender or borrower, whether secured or unsecured), collecting debts and foreclosing mortgages and other security interests, conducting isolated transactions not in the course of similar transactions, and doing business in interstate commerce.

This article summarizes these amendments to the DLLC Act (House Bill No. 414, 75 Del. Laws 317), the DLP Act (House Bill No. 415, 75 Del. Laws 414), and the DST Act (House Bill No. 445 75 Del. Laws 418).

DLLC ACT AMENDMENTS.

The DLLC Act was amended by House Bill No. 414, 75 Del. Laws 317, effective August 1, 2006 and, with respect to certain provisions relating to registered agents, January 1, 2007.

The amendment to Section 18-101(12) confirms that the term "person" is to be construed broadly, and includes governmental entities, subdivisions, agencies and instrumentalities, and various organizations and entities, including series thereof.

By far the largest of this year's changes relate to registered agents and, generally speaking, these changes are the same in both the LLC Act and the LP Act. Section 18-104(a) expands the types of entities that may serve as registered agents, clarifying that an LLC may be its own registered agent or may have a domestic or foreign partnership (whether general or limited, and including a limited liability limited partnership) act as its registered agent. New Section 18-104(e) prescribes the duties of a registered agent, including (in the case of entities) the maintenance of a business office located in Delaware and generally open or (in the case of individuals) being present at a designated location in Delaware at sufficiently frequent times to perform the functions of a registered agent. Foreign entities acting as registered agents must be authorized to transact business in Delaware. Of course, registered agents must accept service of process and other communications and forward them to the LLC to which such communications are directed, and similarly must forward statements for annual taxes due the State of Delaware.

New Section 18-104(f) provides that registered agents serving as such for more than fifty (50) entities (commercial registered agents) are subject to special rules. A natural person commercial resident agent must (i) maintain a principal residence or principal place of business in Delaware, (ii) maintain a Delaware business license, (iii) be generally present at a designated location in Delaware during normal business hours to perform the functions of a registered agent, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent. An entity commercial registered agent must (i) maintain a place of business in Delaware (note it need not be a principal place of business) which is generally open during normal business hours to perform the functions of a registered agent, (ii) maintain a Delaware business license, (iii) have present at its Delaware office during normal business hours an officer, director or managing agent who is a natural person, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent.

New Section 18-104(g) requires every LLC formed or qualified to do business in Delaware to provide its registered agent (and to update as necessary) the name, business address, and business telephone number of a natural person who is a member, manager, officer, employee or designated agent of the LLC and is authorized to receive communications from the registered agent. Such persons are referred to as “communications contacts.” Registered agents are obligated to maintain such information for communications contacts and authorized to resign if they are not provided such information with respect to communications contacts. New Section 18-104(h) authorizes the Secretary of State to issue rules and regulations to carry out the foregoing.

New Section 18-104(i) sets forth a procedure by which the Delaware Secretary of State may apply to the Delaware Court of Chancery to enjoin any person from serving as a registered agent or as an officer, director, or managing agent of a registered agent. While the Court of Chancery has broad equitable powers, the statutory amendments provide in particular that any person or entity convicted of a felony or any crime involving dishonesty, fraud, or moral turpitude, and any registered agent who, acting as such, has engaged in conduct intended or likely to deceive or defraud the public, may be enjoined from acting as a registered agent, or as an officer, director or managing agent of a registered agent. This new section provides for cancellation of a certificate of formation should an LLC fail to timely obtain and designate a new registered agent following notice of an order by the Court of Chancery enjoining its registered agent from acting as such, and new Section 104(j) authorizes the Secretary of State to make a list of registered agents available to the public.

Sections 18-203 and 18-206(b) have been amended to conform to new Section 18-104(i)(4) regarding cancellation of a certificate of formation.

Section 18-209(b) has been amended to correct certain words, clarifying that merger or consolidation results in a single, designated surviving or resulting entity.

Technical changes have been made to Section 18-212 regarding domestication of non-United States entities, clarifying that the term “non-United States entity” can include a statutory trust or any unincorporated business or entity. A new Section 18-212(c)(6) requires that domestication be approved in the manner provided for by the writing governing the internal affairs

of the non-United States entity and the conduct of its business, or by applicable non-Delaware law, as appropriate. New text in Section 18-212(h) provides that property of a domesticated non-United States entity remains vested not only in the domestic LLC, but also in the non-United States entity, if and for so long as the non-United States entity continues its existence in the foreign jurisdiction in which it was existing immediately prior to the domestication. Section 18-213 now contains provisions with respect to continuance paralleling nearly all provisions relating to transfer or domestication. Section 18-214, relating to conversion of certain entities to LLCs, now more clearly applies to any unincorporated entity. New text in Section 18-216(c) provides that conversion of a domestic LLC to another entity or business form doesn't constitute a dissolution of such LLC. Rather, the other entity or business form constitutes a continuation of existence of the LLC in the form of such other entity or business form.

Section 18-302(d) has been amended to clarify that meetings of members may be held by conference telephone or similar means by which all participants can hear each other, unless otherwise provided in the LLC agreement; likewise Section 18-404(d) with respect to meetings of managers.

Section 18-906 has been amended to conform to the provisions of new 18-104(i)(4) providing for cancellation of the registration of a foreign LLC in the circumstances provided therein.

Finally, Section 18-1109 has been amended to permit the revival of a certificate of formation of an LLC whose certificate of formation has been cancelled pursuant to new 18-104(i)(4).

DLP ACT AMENDMENTS.

The DLP Act was amended by House Bill No. 415, 75 Del. Laws 414, effective August 1, 2006 and, with respect to certain provisions relating to registered agents, January 1, 2007.

The amendment to Section 17-101(14) confirms that the term "person" is to be construed broadly, and includes governmental entities, subdivisions, agencies and instrumentalities, and various organizations and entities, including series thereof.

The amendment to Section 17-102 confirms that the name of a limited liability limited partnership must contain the designation required by Section 17-214(a) (e.g., LLLP), rather than that required by Section 17-102(a) (e.g., LP).

By far the largest of this year's changes relate to registered agents and, generally speaking, these changes are the same in both the LLC Act and the LP Act. Section 17-104(a) expands the types of entities that may serve as registered agents, clarifying that an LP may be its own registered agent or may have a domestic or foreign partnership (whether general or limited, and including a limited liability limited partnership) act as its registered agent. New Section 17-104(e) prescribes the duties of a registered agent, including (in the case of entities) the maintenance of a business office located in Delaware and generally open or (in the case of individuals) being present at a designated location in Delaware at sufficiently frequent times to perform the functions of a

registered agent. Foreign entities acting as registered agents must be authorized to transact business in Delaware. Of course, registered agents must accept service of process and other communications and forward them to the LP to which such communications are directed, and similarly must forward statements for annual taxes due the State of Delaware.

New Section 17-104(f) provides that registered agents serving as such for more than fifty (50) entities (commercial registered agents) are subject to special rules. A natural person commercial resident agent must (i) maintain a principal residence or principal place of business in Delaware, (ii) maintain a Delaware business license, (iii) be generally present at a designated location in Delaware during normal business hours to perform the functions of a registered agent, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent. An entity commercial registered agent must (i) maintain a place of business in Delaware (note it need not be a principal place of business) which is generally open during normal business hours to perform the functions of a registered agent, (ii) maintain a Delaware business license, (iii) have present at its Delaware office during normal business hours an officer, director or managing agent who is a natural person, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent.

New Section 17-104(g) requires every LP formed or qualified to do business in Delaware to provide its registered agent (and to update as necessary) the name, business address, and business telephone number of a natural person who is a partner, officer, employee or designated agent of the LP and is authorized to receive communications from the registered agent. Such persons are referred to as “communications contacts.” Registered agents are obligated to maintain such information for communications contacts and authorized to resign if they are not provided such information with respect to communications contacts. New Section 17-104(h) authorizes the Secretary of State to issue rules and regulations to carry out the foregoing.

New Section 17-104(i) sets forth a procedure by which the Delaware Secretary of State may apply to the Delaware Court of Chancery to enjoin any person from serving as a registered agent or as an officer, director, or managing agent of a registered agent. While the Court of Chancery has broad equitable powers, the statutory amendments provide in particular that any person or entity convicted of a felony or any crime involving dishonesty, fraud, or moral turpitude, and any registered agent who, acting as such, has engaged in conduct intended or likely to deceive or defraud the public, may be enjoined from acting as a registered agent, or as an officer, director or managing agent of a registered agent. This new section provides for cancellation of a certificate of limited partnership should an LP fail to timely obtain and designate a new registered agent following notice of an order by the Court of Chancery enjoining its registered agent from acting as such, and new Section 17-104(j) authorizes the Secretary of State to make a list of registered agents available to the public.

Sections 17-203 and 17-206(b) have been amended to conform to new Section 17-104(i)(4) regarding cancellation of a certificate of limited partnership.

Amendments to Section 17-214 confirm that a limited partnership may be formed from its inception as a limited liability limited partnership.

Technical changes have been made to Section 17-215 regarding domestication of non-United States entities, clarifying that the term “non-United States entity” can include a statutory trust or any unincorporated business or entity. A new Section 17-215(c)(6) requires that domestication be approved in the manner provided for by the writing governing the internal affairs of the non-United States entity and the conduct of its business, or by applicable non-Delaware law, as appropriate. New text in Section 17-215(h) provides that property of a domesticated non-United States entity remains vested not only in the domestic LP, but also in the non-United States entity, if and for so long as the non-United States entity continues its existence in the foreign jurisdiction in which it was existing immediately prior to the domestication. Section 17-216 now contains provisions with respect to continuance paralleling nearly all provisions relating to transfer or domestication. Section 17-217, relating to conversion of certain entities to LPs, now more clearly applies to any unincorporated entity. New text in Section 17-217(b) clarifies that an other entity may convert not only to a domestic limited partnership, but to a limited liability limited partnership as well. New text in Section 17-219(c) provides that conversion of a domestic LP to another entity or business form doesn’t constitute a dissolution of such LP. Rather, the other entity or business form constitutes a continuation of existence of the LP in the form of such other entity or business form.

Section 17-302(e) has been amended to clarify that meetings of limited partners may be held by conference telephone or similar means by which all participants can hear each other, unless otherwise provided in the partnership agreement; likewise Section 17-405(d) with respect to meetings of general partners.

Section 17-906 has been amended to conform to the provisions of new 17-104(i)(4) providing for cancellation of the registration of a foreign limited partnership in the circumstances provided therein.

Finally, Section 17-1111 has been amended to permit the revival of a certificate of limited partnership of a limited partnership whose certificate of limited partnership has been cancelled pursuant to new 17-104(i)(4).

DST ACT AMENDMENTS.

The DST Act was amended by House Bill No. 445, 75 Del. Laws 418, effective August 1, 2006.

Text inadvertently deleted by a prior amendment has been restored to Section 3801(a), which once again provides that a statutory trust may be organized to carry on any lawful business or activity, regardless of profit motive, including holding or otherwise taking title to property.

The amendment to Section 3801(d) confirms that the term “person” is to be construed broadly, and includes governmental entities, subdivisions, agencies and instrumentalities, and various organizations and entities, including series thereof.

Revisions to Section 3801(f) confirm that beneficial owners and trustees are bound by governing instruments regardless of whether or not they execute them.

Sections 3804(h) and 3852(b), relating to doing business in Delaware, have been deleted, such matters now being covered by new Section 3863 (discussed below).

Section 3806, relating to management, has been amended in several respects. Section 3806(c) clarifies that the duties (including fiduciary duties) of a trustee, beneficial owner, or other person party to or otherwise bound by a governing instrument may be expanded, restricted, or eliminated by provisions in the governing instrument, and confirms that the implied contractual covenant of good faith and fair dealing may not be eliminated thus. Section 3806(d) clarifies that unless the governing instrument provides otherwise, a trustee, beneficial owner, or other person acting in good faith reliance on the provisions of the governing instrument shall not be liable to the statutory trust or to another trustee, beneficial owner, or other person who is bound by such governing instrument. New Section 3806(e) permits a governing instrument to provide for limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a trustee, beneficial owner, or other person to a statutory trust or to another trustee, beneficial owner, or other person who is bound by such governing instrument, with the proviso that the governing instrument may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing. Former Sections 3806 (e) and (f) (now (f) and (g)) provide that, unless otherwise provided in the governing instrument, meetings of beneficial owners and trustees, respectively, may be held by means of conference telephone or other communications equipment, so long as all participants in such meeting can hear each other. New Section 3806(k) provides that any person designated in accordance with subsection (b)(7) (to manage the business and affairs of the statutory trust) shall be fully protected in relying in good faith upon the records of the statutory trust and certain information reasonably believed to be within the professional or expert competence of the person offering the same, and includes specifically information, opinions, reports or statements as to the value and amount of the assets, liabilities, profits or losses of the statutory trust and other matters relevant to its ability to pay or make reasonable provision to pay claims and obligations.

Section 3807(b)(2), which applies to certain statutory trusts that are or are to become registered investment companies, now permits limited partnerships, limited liability companies, and statutory trusts to act as registered agents for such statutory trusts.

Sections 3808 (c) and (e) and 3810(a)(2) now permit beneficial owners to vote to continue the existence of a statutory trust notwithstanding provisions of the governing instrument providing for dissolution, require that the winding up of a statutory trust include making reasonable provision to pay not only claims known to the trust but also for claims that, based on facts known to the statutory trust, are likely to arise or to become known to the statutory trust within ten years after the date of dissolution, and clarify that the existence of a statutory trust as a separate legal entity continues until cancellation of its certificate of trust.

Technical changes to Sections 3820 (a) and (f) and 3822(i) relate to conversion of an entity into a statutory trust and domestication of non-United States entities.

Changes to Section 3823(b) are intended to confirm the flexibility permitted under the DST Act with respect to transfer, domestication, and continuance of statutory trusts, setting forth a hierarchy of applicable rules. If a governing instrument specifies the manner of authorizing a transfer, domestication, or continuance, such manner shall be observed. If it does not, and does not prohibit such transfer, domestication, or continuance, the transfer, domestication, or continuance shall be authorized in the same manner as is specified in the governing instrument for authorizing a merger or consolidation. If the governing instrument does not specify the manner of authorizing a merger or consolidation and does not prohibit transfer, domestication, or continuance, the transfer, domestication, or continuance shall be authorized by approval of all beneficial owners and all trustees.

Section 3863 is new, and consists of a list (not purporting to be exhaustive) of twelve (12) things that, when done by foreign statutory trusts in the State of Delaware, do not constitute doing business in Delaware for purposes of the DST Act. They include maintaining, defending, or settling actions or proceedings, maintaining bank accounts, creating or acquiring indebtedness (whether as lender or borrower, whether secured or unsecured), collecting debts and foreclosing mortgages and other security interest, conducting isolated transactions not in the course of similar transactions, and doing business in interstate commerce.