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July 31, 2006

## Legislative and Case Law Developments in Delaware's "Alternative Entities" – Limited Liability Companies, Limited Partnerships, Partnerships and Statutory Trusts

The Delaware legislature in its latest session enacted a number of amendments to Delaware's four "alternative entity" statutes – the Delaware Limited Liability Company Act ("DLLCA"), the Delaware Revised Uniform Limited Partnership Act ("DRULPA"), the Delaware Revised Uniform Partnership Act ("DRUPA") and the Delaware Statutory Trust Act ("DSTA"). The amendments, some of which become effective on August 1, 2006 and some on January 1, 2007, further enhance the utility and flexibility of Delaware law and respond to several issues raised by practitioners. Among other things, the amendments to each of the statutes: (i) expand the definition of "person" to include specifically governments and governmental subdivisions, councils, committees, groups and organizations as well as "series" and (ii) provide that meetings of managers, members, partners, trustees and beneficial owners may be held by conference telephone, except as otherwise provided in the constituent documents of the applicable entity. The amendments to the DSTA also (i) clarify that a beneficial owner or trustee is bound by the governing instrument whether or not such beneficial owner or trustee executes the governing instrument, (ii) provide that all duties (including fiduciary duties) other than the implied contractual covenant of good faith and fair dealing may be eliminated by the provisions of the governing instrument and (iii) provide that trustees, beneficial owners, officers, employees and managers may rely, and will be fully protected in relying, on the records of a statutory trust.

The utility of the Delaware alternative entity statutes as well as the other advantages of using Delaware entities (for example, the predictability of the Delaware courts and the customer friendly attitude of the Delaware Secretary of State's office) have resulted in significant use of Delaware alternative entities. According to the Delaware Secretary of State, 3,200 statutory trusts, 8,696 limited partnerships and 87,630 LLCs were formed in 2005, bringing the total number of each of these alternative entities existing at the end of 2005 to 14,164, 58,345 and 333,565 respectively. The continued formation and use of Delaware's alternative entities have predictably led to additional litigation, and we have again updated our survey of Delaware case law relating to alternative entities. The 2006 Cumulative Survey is now available on our website at [www.MNAT.com](http://www.MNAT.com).

The changes referenced above, together with other changes of particular interest, are summarized below.

## HIGHLIGHTS

### I. CERTAIN 2006 AMENDMENTS TO THE DELAWARE LIMITED LIABILITY COMPANY ACT, 6 DEL. C. §§ 18-101 ET SEQ..

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#### A. Definition of Person [Section 18-101(12)]

The amendment to Section 18-101(12) expands the definition of “person” to include a government (including a country, state, county or any other governmental subdivision, agency or instrumentality) and confirms that an association includes any group, organization, co-tenancy, plan, board, council or committee. The amendment also confirms that a “series” constitutes a person.

#### B. Registered Agent Provisions [Section 18-104]

Effective January 1, 2007, the amendments to Section 18-104 will set forth certain new provisions with respect to registered agents. Most relevant to Delaware limited liability companies and foreign limited liability companies qualified to do business in Delaware is the requirement that each such entity provide to its registered agent (and update from time to time 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 limited liability company and who is authorized to receive communications from the registered agent. If a limited liability company fails to provide its registered agent with such information, the registered agent may resign. The amendments also provide that the Court of Chancery, upon application by the Delaware Secretary of State, may enjoin any person or entity from serving as a registered agent under certain circumstances, including that the registered agent has engaged in conduct likely to deceive or defraud the public. Under such circumstances, the Secretary of State will send notice of the order to each affected limited liability company if it either has an address for the limited liability company or it can obtain an address from the limited liability company’s former registered agent. If an affected limited liability company does not designate a new registered agent within 30 days after such notice is given or, if no notice is given (because the Secretary of State does not have an address), within 60 days after entry of an order by the Court of Chancery, the certificate of formation of such limited liability company will be deemed cancelled.

#### C. Effect of Conversion of a Limited Liability Company [Section 18-216]

The amendments to Section 18-216 confirm that a conversion of a limited liability company to another entity or business form is not a dissolution of such limited liability company unless otherwise agreed and also provide that upon conversion of the limited liability company to another entity or business form, the converted entity or business form is deemed to be the same entity as the converting limited liability company and a continuation of the existence of the limited liability company in the form of such other entity or business form. The amendments also require that the name of the converted entity or business form be stated in the certificate of conversion filed with the Secretary of State.

#### D. Telephonic Meetings of Members and Managers [Sections 18-302 and 18-404]

Sections 18-302(d) and 18-404(d) were amended to provide that meetings of members and meetings of managers may be held by conference telephone or similar communications equipment provided that all persons participating in the meeting can hear each other, unless otherwise provided in the applicable limited liability company agreement.

**II. CERTAIN 2006 AMENDMENTS TO THE DELAWARE REVISED UNIFORM LIMITED PARTNERSHIP ACT, 6 DEL. C. §§ 17-101 ET SEQ.**

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**A. Definition of Person [Section 17-101(14)]**

The amendment to Section 17-101(14) expands the definition of “person” to include a government (including a country, state, county or any other governmental subdivision, agency or instrumentality) and confirms that an association includes any group, organization, co-tenancy, plan, board, council or committee. The amendment also confirms that a “series” constitutes a person.

**B. Registered Agent Provisions [Section 17-104]**

Effective January 1, 2007, the amendments to Section 17-104 will set forth certain new provisions with respect to registered agents. Most relevant to Delaware limited partnerships and foreign limited partnerships qualified to do business in Delaware is the requirement that each such entity provide to its registered agent (and update from time to time 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 limited partnership and who is authorized to receive communications from the registered agent. If a limited partnership fails to provide its registered agent with such information, the registered agent may resign. The amendments also provide that the Court of Chancery, upon application by the Delaware Secretary of State, may enjoin any person or entity from serving as a registered agent under certain circumstances, including that the registered agent has engaged in conduct likely to deceive or defraud the public. Under such circumstances, the Secretary of State will send notice of the order to each general partner of each affected limited partnership at the address of such general partner specified in the affected limited partnership’s certificate of limited partnership. If an affected limited partnership does not designate a new registered agent within 30 days after such notice is given, the certificate of limited partnership of such limited partnership will be deemed cancelled.

**C. Effect of Conversion of a Limited Partnership [Section 17-219]**

The amendments to Section 17-219 confirm that a conversion of a limited partnership to another entity or business form is not a dissolution of such limited partnership unless otherwise agreed and also provide that upon conversion of the limited partnership to another entity or business form, the converted entity or business form is deemed to be the same entity as the converting limited partnership and a continuation of the existence of the limited partnership in the form of such other entity or business form. The amendments also require that the name of the converted entity or business form be stated in the certificate of conversion filed with the Secretary of State.

**D. Telephonic Meetings of Limited Partners and General Partners [Sections 17-302 and 17-405]**

Sections 17-302(e) and 17-405(d) were amended to provide that meetings of limited partners and meetings of general partners may be held by conference telephone or similar communications equipment provided that all persons participating in the meeting can hear each other, unless otherwise provided in the applicable partnership agreement.

III. CERTAIN 2006 AMENDMENTS TO THE DELAWARE REVISED UNIFORM PARTNERSHIP ACT, 6 DEL. C. §§ 15-101 ET SEQ.

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A. Definition of Person [Section 15-101(16)]

The amendment to Section 15-101(16) expands the definition of “person” to include a government (including a country, state, county or any other governmental subdivision, agency or instrumentality) and confirms that an association includes any group, organization, co-tenancy, plan, board, council or committee. The amendment also confirms that a “series” constitutes a person.

B. Registered Agent Provisions [Section 15-111]

Effective January 1, 2007, the amendments to Section 15-111 will set forth certain new provisions with respect to registered agents. Most relevant to partnerships that have filed a statement of partnership existence or a statement of qualification or foreign qualification is the requirement that each such entity provide to its registered agent (and update from time to time 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 partnership and who is authorized to receive communications from the registered agent. If a partnership fails to provide its registered agent with such information, the registered agent may resign. The amendments also provide that the Court of Chancery, upon application by the Delaware Secretary of State, may enjoin any person or entity from serving as a registered agent under certain circumstances, including that the registered agent has engaged in conduct likely to deceive or defraud the public. Under such circumstances, the Secretary of State will send notice of the order to each affected partnership if it either has an address for the partnership or it can obtain an address from the partnership’s former registered agent. If an affected partnership does not designate a new registered agent within 30 days after such notice is given or, if no notice is given (because the Secretary of State does not have an address), within 60 days after entry of an order by the Court of Chancery, the statement of partnership existence and statement of qualification or foreign qualification of such partnership (in each case as applicable) will be deemed cancelled.

C. Effect of Conversion of a Partnership [Section 15-903]

The amendments to Section 15-903 confirm that a conversion of a partnership to another entity or business form is not a dissolution of such partnership unless otherwise agreed and also provide that upon conversion of the partnership to another entity or business form, the converted entity or business form is deemed to be the same entity as the converting partnership and a continuation of the existence of the partnership in the form of such other entity or business form. The amendments also require that the name of the converted entity or business form be stated in the certificate of conversion filed with the Secretary of State.

D. Telephonic Meetings of Partners [Section 15-407]

Section 15-407(d) was amended to provide that meetings of partners may be held by conference telephone or similar communications equipment provided that all persons participating in the meeting can hear each other, unless otherwise provided in the applicable partnership agreement.

E. Reinstatement of Statement of Qualification or Statement of Foreign Qualification [Section 15-1004]

Effective January 1, 2007, new Section 15-1004 will be added setting forth the procedure by which a partnership whose statement of qualification or statement of foreign qualification has been canceled pursuant to Section 15-111(d) or new Section 15-111(i)(4) may apply to the Secretary of State for reinstatement. Under new Section 15-1004(a), the application for reinstatement must state the name of the

partnership and the effective date of the cancellation. If such name is unavailable at the time of reinstatement, the application must state the name under which the statement of qualification or statement of foreign qualification is to be reinstated. The application must also state that the partnership has obtained and designated a new registered agent and the name and address of such new registered agent and the address of the partnership's registered office in the State of Delaware. New Section 15-1004(b) confirms that a cancellation of a partnership's statement of qualification or statement of foreign qualification pursuant to Section 15-111(d) or Section 15-111(i)(4) is not an event of dissolution of the partnership. New Section 15-1004(c) provides that a reinstatement relates back to and takes effect as of the effective date of the cancellation so that the partnership's status as a limited liability partnership or a foreign limited liability partnership continues as if the cancellation never occurred.

**IV. CERTAIN 2006 AMENDMENTS TO THE DELAWARE STATUTORY TRUST ACT, 12 DEL. C. §§ 3801 ET SEQ.**

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**A. Definition of Person [Section 3801(d)]**

The amendment to Section 3801(d) expands the definition of "person" to include a government (including a country, state, county or any other governmental subdivision, agency or instrumentality) and confirms that an association includes any group, organization, co-tenancy, plan, board, council or committee. The amendment also confirms that a "series" constitutes a person.

**B. Definition of Governing Instrument [Section 3801(f)]**

The definition of "governing instrument" has been amended to confirm that beneficial owners and trustees of a statutory trust are bound by the governing instrument whether or not they execute the governing instrument.

**C. Elimination of Fiduciary Duties and Fiduciary and Contract Based Liability [Section 3806]**

Consistent with the principle of freedom of contract that is the hallmark of Delaware's alternative entity statutes, Section 3806 of the DSTA has been amended to make clear that to the extent a trustee or beneficial owner or other person has duties (including fiduciary duties) to a statutory trust or to another trustee or beneficial owner or to another person that is a party to or is otherwise bound by a governing instrument, such trustee's or beneficial owner's or other person's duties may be eliminated (as well as expanded or restricted) in the governing instrument, except that the governing instrument may not eliminate the implied contractual covenant of good faith and fair dealing. Similarly, the amendment makes clear that a governing instrument may provide for the elimination of any and all liabilities for breach of contract and breach of duty (including fiduciary duties) by a trustee or beneficial owner or other person to a statutory trust or to another trustee or beneficial owner or to another person that is a party to, or bound by, the governing instrument, except 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. These amendments make clear that, subject to a specific, limited exception, the parties to a governing instrument may agree among themselves as to the extent of their duties, including whether or not they will have any duties, and the extent of their liability in connection with any breach of duty; the sole exception being the basic concept of contract law that every contract includes an implied covenant of good faith and fair dealing. Thus, this covenant, to the extent it constitutes a duty, may not be eliminated. With respect to the elimination of liability, the amendment recognizes that the implied contractual covenant of good faith and fair dealing includes essentially two different concepts: the concept of implied terms and the requirement that parties act in good faith. The amendment makes clear that just as the parties to a contract

are free to limit or eliminate any liability for breach of an express covenant, they are likewise free to limit or eliminate any liability for breach of an implied covenant. However, the amendment retains the concept that parties must always act in accordance with the good faith and fair dealing requirements of the implied covenant and therefore may not limit or eliminate liability for any breach of that aspect of the covenant, referred to by the amendment as a bad faith breach of the covenant. The amendment also makes clear that as a default rule, a trustee or beneficial owner or other person is not liable to a statutory trust or to another trustee or beneficial owner or another person that is party to, or bound by, the governing instrument for breach of fiduciary duty for the trustee's or beneficial owner's or other person's good faith reliance on the provisions of the governing instrument but that this default rule does not extend to, or protect against potential liability for, breach of contract.

**D. Meetings of Beneficial Owners and Meetings of Trustees [Section 3806]**

Sections 3806(f) and 3806(g) were amended to provide that meetings of beneficial owners and meetings of trustees may be held by conference telephone or similar communications equipment provided that all persons participating in the meeting can hear each other, unless otherwise provided in the applicable governing instrument.

**E. Reliance on Reports and Information [Section 3806]**

New subsection (k) has been added to Section 3806 of the DSTA to protect trustees, beneficial owners, officers, employees, managers and other agents of a statutory trust (collectively, "trust agents"). Under new subsection 3806(k), which is based on Section 18-406 of the DLLCA, trust agents are fully protected in relying on good faith upon the records of the statutory trust and upon information, opinions, reports or statements presented by other trust agents or by any other person with respect to matters that a trust agent reasonably believes are within such other person's professional or expert competence. New subsection 3806(k) makes clear that such protection includes a trust agent's reliance on information, opinions and reports or other statements as to the value and amount of the assets, liabilities, profits or losses of the statutory trust in connection with making distributions to beneficial owners or creditors.

**F. Revocation of Dissolution [Section 3808]**

Section 3808(c) has been amended to authorize the revocation of the dissolution of a statutory trust so long as the statutory trust's certificate of trust has not been cancelled by the filing of a certificate of cancellation. Revocation is effected by the vote or written consent to continue the statutory trust of all remaining beneficial owners and of any other person whom the governing instrument grants the right to approve a revocation of dissolution. However, if the dissolution was caused by a vote or written consent, each beneficial owner (or other person) who previously voted for or consented to such dissolution (or his or her respective personal representative) must vote or consent in writing to continue the statutory trust.

**G. Transfer or Continuance of Domestic Statutory Trusts [Section 3823]**

Prior to the amendments, the default rule for approval of a transfer or domestication or continuance of a domestic statutory trust required the approval in writing of all of the beneficial owners and all of the trustees of the statutory trust. The amendments eliminate this requirement and replace it with the structure currently used in connection with the approval of a conversion of a domestic statutory trust. Thus, under the amendments, if the governing instrument specifies the manner of authorizing a transfer or domestication or continuance, the transfer or domestication or continuance is authorized in the manner specified in the instrument. If the governing instrument does not specify the manner of authorizing a transfer

or domestication or continuance and does not prohibit a transfer or domestication or continuance, the transfer or domestication or continuance is authorized in the same manner as specified in the governing instrument for authorizing a merger or consolidation. If the governing instrument does not specify the manner of authorizing a transfer or domestication or continuance or a merger or consolidation and does not prohibit a transfer or domestication or continuance, the transfer or domestication or continuance is authorized by the approval of all of the beneficial owners and all of the trustees (which need no longer be in writing).

H. Activities Not Constituting Doing Business [Section 3863]

New Section 3863 has been added to the DSTA which identifies activities of a foreign statutory trust in Delaware that do not constitute doing business for purposes of the requirement that a foreign statutory trust register with the Delaware Secretary of State before doing business in Delaware. Section 3863 is based on Section 18-912 of the DLLCA. Activities that under new Section 3863 do not constitute doing business in Delaware include (i) holding meetings of beneficial owners or trustees or any other activity relating to the internal affairs of the statutory trust, (ii) maintaining bank accounts, (iii) doing business in Delaware as an insurance company, (iv) creating, as borrower or lender, or acquiring indebtedness with or without a mortgage or other security interest in property, (v) collecting debts or foreclosing mortgages or other security interests in property securing the debts, and holding, protecting and maintaining property so acquired and (vi) conducting an isolated transaction that is not one in the course of similar transactions.

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If you would like copies of the amendments or the 2006 Cumulative Survey or have any questions concerning either the amendments or the Survey, please contact Walt Tuthill 302-351-9204, Lou Hering 302-351-9213 or David Harris 302-351-9351.

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Morris, Nichols, Arsht & Tunnell LLP was founded in 1930 by former United States District Judge Hugh M. Morris. The firm combines a broad national practice of corporate, intellectual property, bankruptcy and commercial law and litigation with a general business, tax, estate planning and real estate practice within the State of Delaware. The firm's clients include Fortune 500 companies, smaller firms and partnerships, financial institutions, government agencies, law firms and not-for-profit organizations. The firm's partners are principal drafters of the modern Delaware General Corporation Law, Limited Partnership Act, Limited Liability Company Act, Statutory Trust Act and the Financial Center Development Act. The firm is regularly involved as lead counsel or co-counsel in matters of national and international significance, as well as those affecting our immediate community. Our advice is frequently sought by distinguished national and international law firms and corporate counsel.

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